



Università degli Studi di Ferrara

DOTTORATO DI RICERCA IN
DIRITTO DELL'UNIONE EUROPEA

CICLO XXV

COORDINATORE Prof. Paolo BORGHI

The European Union's Generalised System of Preferences
"Il sistema di preferenze generalizzate dell'Unione europea"

Settore Scientifico Disciplinare IUS/14

Dottorando

Dott. Putranti Ika Riswanti

Tutore

Prof. Borghi Paolo

Anni 2012/2013



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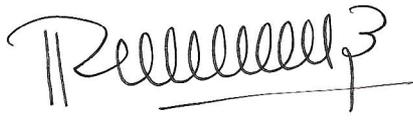
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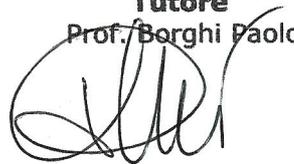
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Acknowledgement

Emphasizing that legal research should not merely provide advantage for the academic sphere but also delivering wider benefits for the “common” society, therefore, this research attempted to strip utilization of the unilateral preference from the two sides, that is, preference granting country and the beneficiary country proportionally. A shifting of pattern relationship between developed countries and developing countries has changed the features of the unilateral preferences, for instances the application of non-trade conditionality based on some international standards in the GSP scheme. The European Union is the largest group of developed countries that granting unilateral preferences by emphasizing the application of good governance on their scheme modalities. The idea of this research is based on the contribution of the GSP scheme in driving implementation of good governance in developing countries, especially on trade services. This research has been conducted through so many enhancements along with the legal framework development and dynamicization of the related policies.

During three years of the research journey with all the hard works and dedications, finally the end is near to start the new beginning. This doctoral dissertation would not have been able to be finished without help and support of the wonderful people around me, to only some of whom it is possible to give particular mention here.

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Abbreviations

GSP	Generalized System of Preferences
EU	European Union
US	United States
AB	Appellate Body
WTO	World Trade Organization
MFN	Most Favoured Nation
GATT	General Agreement on Tariffs and Trade
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UNCTAD	United Nations Conference on Trade and Development
LDC	Least Developing Countries
ITO	International Trade Organization
RTA	Regional Trade Agreement
FTA	Free Trade Agreement
OTC	Organization for Trade Cooperation
OEEC	Organization for European Economic Cooperation
USSR	Union of Soviet Socialist Republics
CCT	Common Customs Tariff
CCP	Common Commercial Policy
CAP	Common Agricultural Policy
EEC	European Economic Community
IMF	International Monetary Fund
DSU	Dispute Settlement Understanding
DSB	Dispute Settlement Body
MTS	Multilateral Trading System
S&D	Special and Differential Treatment
MTAs	Multilateral Trade Agreements
FCN Treaties	Friendship, Commerce and Navigation Treaties
RTAA	Reciprocity Trade Agreements Act
OECD	Organisation for Economic Co-operation and Development
GATS	General Agreement on Trade in Services
EC	European Community
ILC	International Law Commission
ICJ	International Court of Justice
GSTP	Global System of Trade Preferences among Developing Countries.
ASEAN	Association of Southeast Asian Nations
AEM-EU	ASEAN Economic Ministers
EBA	Everything But Arms
ECSC	European Coal and Steel Community
EEC	Treaty establishing European Economic Community
EURATOM	Treaty establishing European Atomic Energy Community
TEC	Treaty establishing the European Community
VAT	Value Added Taxes
SEA	Single European Act
IGC	Intergovernmental Conference
CFSP	Common Foreign and Security Policy

CEECs	Central and Eastern Europe Countries
CU	Custom Unions
EMU	Economic and Monetary Union
EMS	European Monetary System
CET	Common External Tariff
ECJ	European Court of Justice
CSDP	Common Security and Defense Policy
IP	Intellectual Property
FDI	Foreign Direct Investment
RPS	Regulatory Procedure with Scrutiny
PRAC	Procédure de Réglementation avec Contrôle
EPA	Economic Partnership Agreement
QMV	Qualified Majority Vote
WCO	World Customs Organization
EEA	European Economic Area
ACP	African, Caribbean and Pacific
UN	United Nation
CN	Combined Nomenclature
HS	Harmonized System
EDCNRP	Environmental Data Centre on Natural Resources and Products
COMEXT	Community External Trade Statistics
GDP	Gross Domestic Product
GNP	Gross National Product
ILO	International Labour Organization
NGO	Non Governmental Organization
CCC	Customs Co-operation Council
CTC	Change of Tariff Classification
CTH	Change in Tariff Heading
PTA	Preferential Trade Agreement
TNC	Trans National Corporation
MNC	Multi National Corporation
UNECE	United Nations Economic Commission for Europe
APEC	Asia – Pacific Economic Cooperation
ICT	Information and Communication Technology
ECOSOC	Economic and Social Council
CIS	Commonwealth of Independent States
UN/CEFACT	United Nation / Centre for Trade Facilitation and Electronic Business
UNCITRAL	United Nations Commission on International Trade Law
ISO	International Organization for Standardization
IEC	International Electrotechnical Commission
ITU	International Telecommunication Union
UNeDocs	United Nations electronic Trade Documents
EDIFACT	Electronic Data Interchange for Administration, Commerce, and Transport
CTG	Council on Trade in Goods
NAMA	Non-Agricultural Market Access
DDA	Doha Development Agenda
NGTF	Negotiating Group on Trade Facilitation
TA/CB	Technical Assistance/Capacity Building

SME's	Small and Medium Enterprises
TTCs	Trade Transaction Costs
CARIS	Centre for the Analysis of Regional Integration at Sussex
TARIC	Tarif Intégré de la Communauté (Integrated Tariff of the European Community)
AFTA	ASEAN Free Trade Area
NAFTA	North American Free Trade Agreement
APRIS	ASEAN Programme for Regional Integration Support
CEPTS	Common Effective Preferential Tariff Scheme
AIA	ASEAN Investment Area
ACT	ASEAN Consultation to Solve Trade and Investment Issues
AEC	ASEAN Economic Community
EAS	East Asia Summit
NTBs	Non-Tariff Barriers
ASW	ASEAN Single Window
INSW	Indonesian National Single Window
RoO	Rule of Origin
CoO	Certificate of Origin
ASTP	ASEAN Strategic Transport Plan
ICTMP	Information Communications Technology Master Plan
ATSP	ASEAN Tourism Strategic Plan
ARF	ASEAN Regional Forum
NSA	Non-State Actors
VOC	Vereenigde Oostindische Compagnie
MTN	Multilateral Trade Negotiations
AEMMs	ASEAN-EU Ministerial Meetings
AMM	ASEAN Foreign Ministers Meeting
JCC	Joint Cooperation Committee
ACP	African, Caribbean & Pacific
READI	Regional EC-ASEAN Dialogue Instrument
TREATI	Trans Regional EU-ASEAN Trade Initiative
AEM	ASEAN Economic Ministers Meeting
CRO	Cumulative Rules of Origin
ECU	European Currency Unit
ASEM	Asia-Europe Meeting
AANZFTA	ASEAN-Australian-New Zealand
ACFTA	ASEAN-China
TIG	Agreement on Trade in Goods
APT	ASEAN Plus Three
OGA	Other Government Agencies
AEISP	ASEAN Economic Integration Support Programme
ACTS	ASEAN Customs Transit System
RKC	Revised Kyoto Convention
CPI	Corruption Perceptions Index
GNI	Gross National Income
GSTP	Global System of Trade Preferences among Developing Countries
PTN	Protocol on Trade Negotiations
APTA	Asia Pacific Trade Agreement
VC	Value Content
RVC	Regional Value Content

FOB	Free On Board
ATIGA	ASEAN Trade in Goods Agreement
VCLT	Vienna Convention on the Law of Treaties
MRA	Mutual Recognition Agreement
AEUFTA	ASEAN EU Free Trade Agreement
SPS	Sanitary and Phytosanitary
IPR	Intellectual Property Rights
TBT	Technical Barriers to Trade
CMLV	Cambodia, Myanmar, Laos, and Vietnam
CML	Cambodia, Myanmar, and Laos
PCA	Partnership and Cooperation Agreement
CEPA	Comprehensive Economic Partnership Agreement
APEC	Asia-Pacific Economic Cooperation
EUROMED	Euro-Mediterranean Partnership
BRIC	Brazil, Russia, India and China
SITC	Standard International Trade Classification
CACM	Central American Common Market
CIS	Commonwealth of Independent States
MEDA	Euro - Mediterranean Partnership
MERCOSUR	Mercado Común del Sur
NIE	Newly Industrialising Economy
HPAEs	High Performing Asian Economies
IBRD	International Bank for Reconstruction and Development
ALA	Asia and Latin America
CSP	Country Strategy Paper
DCI	Development Cooperation Instrument
TSP	Trade Support Programme
NIP	National Indicative Program
TRTA	Trade Related Technical Assistance
EAL	Economic analysis of law
NAFED	National Agency for Export Development
ITPC	Indonesian Trade Promotion Centre
BRD	Buyer Reception Desk
ICC	Industrial Craft Certification
AKFTA	ASEAN Korea FTA
AIFTA	ASEAN India FTA
IJ-EPA	Indonesia Japan Economic Partnership Agreement
EGDI	E-Government Readiness Index
SLA	Service Level Arrangement
AANZFTA	ASEAN Australia New Zealand FTA
LIC	Low-Income Country
LMIC	Lower-Middle-Income Country
SIDS	Small Island Developing States
CDDC	Commodity-Dependent Developing Country
VA	Value Added

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The European Union's Generalised System of Preferences

Abstract

The Generalised System of Preferences, known as GSP, is defined as “a formal system of exemption from the more general rules applied by the European Union on its trade relationship with third countries”. Specifically, it is a system of exemption from the GATT MFN clause that obligates WTO member countries to treat the imports of all other WTO member countries not worse than they treat the imports of their "most favoured" trading partner. The objective of GSP is to assist developing countries on poverty reduction, by helping them to generate revenue through international trade. In EU law, the GSP traditionally comes under the Common Commercial Policy, Article 133 of the EC Treaty as amended by Article 188C of the Treaty of Lisbon. Implementation and utilisation of GSP should not solely be a duty of the preference-granting country but of the beneficiary country as well. Strengthening trade facilitation between the preference-granting country and the beneficiary country is deemed as an important factor to achieve the purpose of the GSP. Implementation of the GSP is considered as a multi complex task, associated with international trade law, international taxation law (tariffs, custom duties and administrative procedures), trade facilitations, capacity building of trade institutions, import export procedures, good governance and information technology (e-governance, e-trade, and e-statistics). All these factors are interrelated and mutually supported to optimise the utilisation of GSP by the beneficiary country.

Il sistema di preferenze generalizzate, conosciuto come GSP, è definito come "un sistema formale di esenzione dalle regole più generali applicate dall'Unione Europea sulle sue relazioni commerciali con i Paesi terzi". In particolare, si tratta di un regime di esenzione dalla clausola MFN GATT, che obbliga i Paesi membri del WTO a trattare le importazioni di tutti gli altri Paesi membri del WTO in maniera non peggiore di quella in cui trattano le importazioni dei loro partner commerciali "preferiti". L'obiettivo del GSP è quello di assistere i Paesi in via di sviluppo nella riduzione della povertà, aiutandoli a generare reddito attraverso il commercio internazionale. Nel diritto dell'Unione Europea, il GSP proviene tradizionalmente dall'ambito della politica commerciale comune, l'articolo 133 del trattato EC, come modificato dall'articolo 188C del Trattato di Lisbona. L'attuazione e l'utilizzo di GSP non devono essere intesi esclusivamente come un dovere per il Paese che concede la preferenza, ma anche (come dovere) del Paese beneficiario. La facilitazione degli scambi e la cooperazione tra il Paese che concede la preferenza e il Paese beneficiario è stato identificato come un fattore importante per raggiungere lo scopo del GSP. L'attuazione del GSP è considerata come un compito più complesso, associato al diritto commerciale internazionale, al diritto tributario interno (tariffe, dazi doganali e procedure amministrative), alle agevolazioni commerciali, al potenziamento delle capacità di istituzione del commercio, alle procedure di import export, alla good governance e ai sistemi di tecnologia dell'informazione (e-governance, e-trade, and e-statistics). Inoltre, l'esistenza di accordi commerciali regionali e organizzazione regionale, per esempio l'ASEAN, ha contribuito allo sviluppo del diritto nel settore del commercio internazionale. Tutti questi fattori sono correlati tra loro e si sostengono a vicenda al fine di ottimizzare l'utilizzo del GSP da parte del Paese beneficiario.

Keywords : *GSP, Trade, Governance, EU, Law.*

CHAPTER I

Introduction

I. Context of Study

The Generalised System of Preferences (GSP) has multidimensional aspects, covering national policy, regional policy and international policy. These multidimensional aspects involve many sectors and stakeholders. Along with the dynamic change of international economic development, the GSP has undergone many improvements in order to cope with the development needs of beneficiary countries. The GSP is established under the legal framework of the Enabling Clause, which was incorporated into Part IV of the GATT on November 1979. It is stipulated that developed countries might accord preferential tariff treatment to products originating from developing countries under the GSP system.¹ According to the Appellate Body decision on the *EC Preferences Case*, only preferential tariff treatment that complies with the principles "generalised, non-reciprocal, and non-discriminatory" treatment is justified under Paragraph 2(a). The Enabling Clause explicitly permits the states exempted from MFN obligation to provide more favourable treatment to developing countries.

The embryo of such preferences was created in the first United Nations Conference on Trade and Development (UNCTAD) in 1964. The negotiation process in the second session of UNCTAD in 1968 led to Resolution 21(II)², through acknowledgement of "unanimous agreement" to provide preferential arrangements. The preferential arrangement contains tariff discrimination, which departs from the basic principles of MFN. Implementation of the preferential tariff schemes was first authorised by waiver 1971. This waiver was only effective for 10 years or was about to expire after 10 years. Therefore, on 28 November 1979 the GATT contracting parties established "*differential and more favourable treatment, reciprocity and fuller participation of developing countries*", known as the "*Enabling Clause*". Later, the Marrakesh Agreement "*Enabling Clause*" was incorporated into the law of the WTO, as Part V of the GATT Agreement.³

From the legal perspective, Part IV of the GATT leaves space for interpretation, for instance, its provisions apply the word "shall" rather than "should". According to Hudec, the wording "shall" has no precise meaning. In other words, the GATT does not impose binding legal obligation to developed countries. Part IV of the GATT is "a non-binding text that imposed greater commitment", and "contained no definable legal

¹ See Article 2 paragraph (a) of Enabling Clause 1979 (L/4903) and the Decision of the Contracting Parties of 25 June 1971 regarding Waiver : *Generalized System of Preferences, relating to the establishment of "generalized, non-reciprocal and non discriminatory preferences beneficial to the developing countries"* (BISD 18S/24) :

"[...] in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries in order to increase the export earnings, to promote the industrialization, and to accelerate the rates of economic growth of these countries [...]"

"[...] that mutually acceptable arrangements have been drawn up in the UNCTAD concerning the establishment of generalized, non-discriminatory, non-reciprocal preferential tariff treatment in the markets of developed countries for products originating in developing countries [...]"

² However, as stated by the Panel Report on EC-Preferences Case paragraph 7.82 : "...the Resolution 21(II) itself did not set up the details of the GSP arrangements although it did set out its objectives and principles. The Resolution established a Special Committee on Preferences as a subsidiary organ of the Trade and Development Board, with the express mandate to settle the details of the GSP arrangements..."

³ See Grossman, Gene M., & Sykes, Alan O. (2004). *A Preference for Development: The Law and Economics of GSP*. UC Berkeley: International Legal Studies Program, pp. 1-2, available at : <http://escholarship.org/uc/item/6jn6q6gj>, last accessed : on 16 August 2010.

obligations". Principally, Part IV of the GATT is considered as an "agreed statement" between developing countries and developed countries.⁴

The objectives of the UNCTAD to establish a system of generalised, non-reciprocal and non-discriminatory preferences is explained in the UNCTAD research memorandum as follows:

"[...] in the relationship between developed and developing countries the most-favoured-nation clause is subject to important qualifications. These qualifications follow from the principle of a generalised, non-reciprocal, and non-discriminatory system of preferences. Developed market-economy countries are to accord preferential treatment in their markets to exports of manufactures and semi-manufactures from developing countries. Only the developing suppliers of these products should enjoy this preferential treatment. At the same time, developing countries are required to grant developed countries reciprocal concessions [...]"⁵

According to Resolution 21 of UNCTAD II 1968, it was agreed that the objectives of the GSP in favouring developing countries, should be dedicated to increase export earnings, to promote industrialisation, and to accelerate economic growth.⁶ The Enabling Clause 1979 was designed to facilitate trade of developing countries but not to raise barriers to the trade of other contracting parties.⁷ The non-reciprocal principle is stipulated in Article 5 of the Enabling Clause 1979:

"[...] the developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries [...]".

The GSP is established based on the unequal relationship of economic development between developing and developed countries.⁸ The world's economic development disparities become obstacles to obtain the same concessions. Therefore, it is difficult to apply the reciprocity principle in the unequal level. Beginning in the 1960s, developing countries expressed a demand for exceptional treatment, known as "special and differential treatment".⁹

The philosophy of the UNCTAD establishment was rooted from the assumption that the trade needs of a developing economic are substantially different from those that have developed. Consequently, those unequal economic situations should not be subject to equal rules. Applying the MFN clause to all countries regardless of their level of development only complies with the formal conditions of legal equality but not with the essence of equality itself. The MFN principle constitutes an "implicit" discrimination against countries that lack economic capacity. The opening sentence of

⁴ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 55-56.

⁵ See United Nation, *The Yearbook of the International Law Commission: Report of the International Law Commission on the work of its twenty-seventh session*, Document: vol. II, 5, May - 25 July 1975, Official Records of the General Assembly, Thirtieth session, Supplement, No. 10, A/10010/Rev.1, 1975, available at : www.un.org/law/ilc/index.htm, last accessed : September 2010.

⁶ See Commentaries on the ILC's Draft Articles, see Report of the International Law Commission on the Work of its Thirtieth session , 8 May - 28 July 1978, Official Records of the General Assembly, Thirty-third session, Supplement No. 10, Doc. A/33/10 ILC Report), 2 Yearbook of the International Law Commission (1978), p. 59, available at : http://untreaty.un.org/ilc/documentation/english/A_33_10.pdf, last accessed : 28 October 2010. See also Grossman, Gene M., & Sykes, Alan O. (2004).

⁷ See Paragraph (a) The Decision of the Contracting Parties of 25 June 1971 regarding Waiver: Generalized System of Preferences.

⁸ See Commentaries *Draft Articles on most-favoured-nation clauses 1978*, p. 59, available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/1_3_1978.pdf, last accessed : 28 October 2010.

⁹ See Yanai, Akiko, *The Function of the MFN Clause in the Global Trading System*, Working Paper Series 01/02-No. 03, APEC Study Center, Economic Cooperation Studies Departement Institutes of Developing Economies, JETRO, March, 2002, available at : <http://202.244.105.129 / English / Publish / Download / Apec/ 1863ra0000006alga-att /1863ra0000006cgb.pdf>, last accessed : 15 September 2010.

the General Principle Eight states that international trade should be conducted to mutual advantage based on the MFN treatment. The recognition of the “development needs of developing countries” requires that, for a certain period, the MFN should be excluded in certain types of international trade relations to help the beneficiary countries at least to have the capacity to pay the same concession.

Article 23 of the Draft Articles on MFN clauses 1978¹⁰ regulates *the MFN clause in relation to the treatment under GSP regime*, where it is stated that:

“[...] a beneficiary state is not entitled, under an MFN clause, to treatment extended by a developed granting state to a developing third state on a non-reciprocal basis within a scheme of generalised preferences, established by that granting state, which conforms with a GSP recognised by the international community of states as a whole or, for the state members of a competent international organisation, adopted in accordance with its relevant rules and procedures [...]”.¹¹

Tariff Preferences are designed “to respond positively” to the “development, financial and trade needs” of developing countries.¹² The wording “to respond positively” is interpreted by the Appellate Body on *EC Preferences Case*, based on the assumption that developing countries have different economic and trade needs from developed countries. Such special needs are met by developed countries through tariff and other preferential treatment allowed under the Enabling Clause.¹³

The current EU¹⁴ GSP is embodied in Council Regulation (EC) Number 732/2008, which was applicable from 1 January 2009 to 31 December 2011. This scheme consisted of a general arrangement and two special arrangements. The special arrangements were designed based on “the various development needs of countries” in “similar economic situations”. The general arrangement was granted to all beneficiary countries that were not classified by the World Bank as high-income countries and had not sufficiently diversified their exports.¹⁵

¹⁰ See Text adopted by the International Law Commission at its thirtieth session, in 1978, and submitted to the General Assembly as a part of the Commission’s report covering the work of that session (at para. 74). The report, which also contains commentaries on the draft articles, appears in Yearbook of the International Law Commission, 1978, vol. II, Part Two, available at : http://untreaty.un.org/ilc/texts/instruments/english/commentaries/1_3_1978.pdf, last accessed : in 17 September 2010.

¹¹ See Commentaries on the ILC’s Draft Articles, see Report of the International Law Commission on the Work of its Thirtieth session , 8 May – 28 July 1978, Official Records of the General Assembly, Thirty-third session, Supplement No. 10, Doc. A/33/10 ILC Report), 2 Yearbook of the International Law Commission (1978), available at : http://untreaty.un.org/ilc/documentation/english/A_33_10.pdf, last accessed : 28 October 2010. See also Grossman, Gene M., & Sykes, Alan O. (2004).

¹² See Article 3 paragraph (3) of Enabling Clause 1979 (L/4903).

¹³ See Julia Ya Qin, *Defining Nondiscrimination Under The Law Of The World Trade Organization*, available at <http://www.worldtradelaw.net/articles/qinnondiscrimination.pdf>, last accessed: 27 August 2010.

¹⁴ Since 1 December 2009, “[...] European Union has been the official name in the WTO as well as in the outside world. Before that, “European Communities” was the official name in WTO business for legal reasons, and that name continues to appear in older material. The EU is a WTO member in its own right as are each of its 27 member states making 28 WTO members altogether. While the member states coordinate their position in Brussels and Geneva, the European Commission — the EU’s executive arm alone speaks for the EU and its members at almost all WTO meetings and in almost all WTO affairs. For this reason, in most issues, WTO materials refer to the “EU” (or previously the legally official “EC”). However, sometimes references made to the specific member states, particularly where their laws differ. This is the case in some disputes when an EU member’s law or measure is cited, or in notifications of EU member countries’ laws, such as in intellectual property (TRIPS). Individual EU members speak in committee meetings or sponsor papers, particularly in the Budget, Finance and Administration Committee. Sometimes individuals’ nationalities are identified, for example the nationalities of WTO committee chairpersons [...]”, available at : http://www.wto.org/english/thewto_e/countries_e/european_communities_e.htm, last accessed in 13 November 2010.

¹⁵ See Recitals 7 Council Regulation (EC) Number 732/2008. “[...] Such instrument for instance such as the 1986 UN Declaration on the Right to Development, the 1992 Rio Declaration on Environment and Development, the 1998 ILO Declaration on Fundamental Principles and Rights at Work, the 2000 UN Millennium Declaration, and the 2002 Johannesburg Declaration on Sustainable Development [...]”.

As noted in Public Consultation, the EU GSP is essentially aimed to contribute to alleviating global poverty, promoting sustainable development, and encouraging the implementation of good governance in developing countries. It is reiterated in Recitals 2 of Council Regulation (EC) Number 732/2008, that the primary objective of the GSP¹⁶ is to contribute to the reduction of poverty and the promotion of sustainable development and good governance.¹⁷ It is widely accepted by economists that economic growth generally reduces poverty. It creates the resources to increase incomes and delivers benefits to the poor. When income increases, the prosperity of people increases and poverty is eliminated.¹⁸

Globalisation creates interdependency between states, especially in trade and development.¹⁹ It shifts the pattern of the trade relationships between developed and developing countries, where in the past their relationship was established as donor and recipient countries. Developing countries see themselves in an unequal situation and impose higher protectionism policies, obviously this impedes their full integration into the global trading system. The EU's GSP plus is aimed to encourage developing countries to fully participate in international trade and increase their export revenue. This policy is established to support the implementation of sustainable development and alleviate poverty in developing countries.²⁰ The GSP is expected to reduce the dependency of developing countries on exports of primary products and to promote industrialisation.²¹

Naturally, the GSP is not an obligation for developed countries. It is a voluntary obligation which they can choose to adopt or not to adopt. Developed countries design their GSP scheme individually under their national laws. Practically, preference-granting countries impose various limitations on the product coverage and eligibility criteria for beneficiary countries. For instance, the eligibility criteria in the general arrangement of EU GSP are based on economic criteria, in this regard, the income classification of the countries.

Generally, preference-granting countries, grant greater benefits or “more favourable treatment” to the LDCs due to political and national interest considerations. In fact, the establishment of eligibility criteria for beneficiary countries brings implication of different tariff treatment. This raises the question whether the GSP programme is truly “non-reciprocal” and “non-discriminatory”.²² According to Lorand

¹⁶ See Waiver of Generalized System of Preferences, Decision of 25 June 1971, BISD 18S/24 : “[...] Recalling that at the Second UNCTAD, unanimous agreement was reached in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries in order to increase the export earnings, to promote the industrialization, and to accelerate the rates of economic growth of these countries [...]”.

¹⁷ See Recitals 2 of Council Regulation (EC) Number 732/2008, “[...] The Community’s common commercial policy is to be consistent with and to consolidate the objectives of development policy, in particular the eradication of poverty and the promotion of sustainable development and good governance in the developing countries. It is to comply with WTO requirements, and in particular with the GATT ‘enabling clause’ of 1979 according to which WTO Members may accord differential and more favourable treatment to developing countries [...]”.

¹⁸ See Winter, L. Alan., McCulloch, Neil., and McKay, Andrew., *Trade Liberalization and Poverty: The Evidence So Far*, Journal of Economic Literature, Vol. XLII (March 2004) pp. 72-115. Winters, L. Alan., *Critical Perspective on the Global Trading System and the WTO : The WTO and Poverty and Inequality*, Volume I, An Elgar Reference Collection, UK, 2007.

¹⁹ See Public Consultation exercise on the revision and updating of the European Union's scheme of Generalised System of Preferences (the GSP scheme), available at : http://trade.ec.europa.eu/doclib/docs/2010/march/tradoc_145972.pdf, last accessed : 27 September 2010.

²⁰ See Factsheet, *EC Generalised Scheme of Tariff Preferences (GSP) 2009-2011*, Available at : http://trade.ec.europa.eu/doclib/docs/2008/july/tradoc_139988.pdf, last accessed: 07 May 2010.

²¹ See Grossman, Gene M and Sykes, Alan O, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries (WT/DS246/AB/R)*, American Law Institute, 2005.

²² See Julia Ya Qin, *Op.cit.*

Bartels, the EU GSP scheme was ambiguous. The GSP principle is legally binding under the Enabling Clause, despite the fact the nature of GSP is “voluntary”.²³

Along with the development on international trade, some preference-granting countries have started to apply conditions²⁴ in their GSP scheme. These conditions are politically used as a tool to compel developing countries complying with international standards in order to accelerate their integration in the global trading system. The compliance of such conditions would be rewarded by greater preferences. While, non compliance towards such conditions would lead to punishment, such as suspension or withdrawal.

The origin of GSP as a “non-reciprocal” programme resulted from developing country demands.²⁵ The main issue raised in the *EU Preferences case* concerned the “condition of non-discriminatory preferences”. In the submission, India argued that the Enabling Clause imposed a non-discrimination obligation on preference granting countries, which prohibited them from differentiating between beneficiary countries. Differentiation was only allowed subject to the exceptions set out in the Enabling Clause (more favourable treatment to LDCs).²⁶

In the *EC Preferences Case*, the Appellate Body reversed the panel’s findings of Paragraph 2(a) of the Enabling Clause and Footnote 3. The Appellate Body decision on the *EC Preferences Case* stated that the preference-granting country shall grant preferential tariffs to all similarly situated beneficiary countries based on the “non-discriminatory” principle.²⁷ Yet, for different reasons the Appellate Body upheld the panel’s conclusion that the EU failed to demonstrate the measure challenged justified under Paragraph 2(a) of the Enabling Clause.²⁸

The simplification of the EU’s GSP is aimed to respond positively to special development needs of developing countries consistently with the Enabling Clause. The dynamic concepts of economic development influence the conception of GSP beyond economic criteria. Trade preferences are not merely about trade, but it should also consider social values such as human rights and environmental protection. For

²³ See Bartels, Lorand, *The Appellate Body Report In European Communities – Conditions For The Granting Of Tariff Preferences To Developing Countries*, WT/DS246/AB/R and Its Implications For Conditionality In GSP Programs, available at : <http://www.worldtradelaw.net/articles/bartelsgsp.pdf>, last accessed : 2 March 2011.

²⁴ See Mason, Amy M, *The Degeneralization of the Generalized System of Preferences (GSP): Questioning the Legitimacy of The US GSP*, available at : www.law.duke.edu/shell/cite.pl?54+Duke+L.+J.+513+pdf, last accessed : January 2011. “[...] All GSP schemes condition preferences to some degree in the form of either “positive” or “negative” conditionality. Positive conditionality is the practice of granting additional concessions to developing countries that fulfil prescribed criteria; positive conditionality affects preferences offered to countries that are already GSP beneficiaries. For instance, the EU provides additional reductions in GSP tariffs to countries that take prescribed legislative steps to protect fundamental labour rights. In contrast, negative conditionality more commonly used in GSP schemes denotes the withdrawal of concessions from countries that fail to comply with prescribed criteria, or the refusal to grant concessions to such countries from the outset. As such, negative conditionality affects the designation of beneficiary status. Virtually all conditions in the U.S. GSP scheme are origin neutral: that is, the conditions, such as those conditioning GSP benefits on compliance with labour standards, apply to all potential beneficiaries. Consequently, the conditions violate Article I:1 only if they are de facto discriminatory. However, the precise meaning of de facto discrimination remains unclear. Developed countries might argue that a measure is not de facto discriminatory if it merely imposes conditions that all countries are equally capable of fulfilling or are even required to fulfil [...]”.

²⁵ See Grossman, Gene M., & Sykes, Alan O. (2004), *Op.cit.*

²⁶ See *Ibid* : “[...] According to India, when a nation grants a preference on a particular product, it must extend that preference to all developing countries, subject only to the proviso that least-developed nations can receive greater preferences. Because the drug-related preferences in the European scheme afford special benefits to twelve enumerated beneficiaries that are not co-extensive with the set of least-developed nations, India contended, the preferences failed the requirement of non-discrimination under the Enabling Clause and in turn violated GATT Article I [...]”.

²⁷ See Appellate Body Decision on EC — Tariff Preferences, para 173, 190 (e), (g).

²⁸ See European Communities — *Conditions for the Granting of Tariff Preferences to Developing Countries*, available at : http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds246_e.htm, last accessed : 27 Octobre 2010.

instance, nowadays development is associated with terms of environment, improved social conditions, anti-corruption measures, and good governance practices. Moreover, development and poverty eradication are major agenda items of the United Nations Millennium Declaration. This declaration emphasises the importance of creating a favourable and conducive environment at the national and global level to support economic development and eliminate poverty. A practical example of a favourable environment is clean bureaucracy and environmentally sound policies.²⁹

The development needs of developing countries grow more complex along with globalisation. Among those various development needs, the EU as the GSP preference-granting country considers the demand of sustainable development and good governance as crucial and urgent for developing countries to guarantee that welfare is delivered properly and the common needs of the people are fulfilled.

The basic concept of GSP is to reduce tariffs for developing countries to boost their exports and improve their economic development. Yet, it is debatable by some experts that the design of the GSP scheme delivers significant improvement for the export earnings of developing countries. The obstacles of GSP utilisation do not only come from the preferences-granting country but also from beneficiary countries. Indeed, the GSP is the unilateral preference where all its policies are decided by the preference-granting country, yet the beneficiary country also has the important role of ensuring these preferences are properly utilised by its traders or any business actors. It has to be noted that GSP is a kind of favour providing opportunities for beneficiary countries to participate in the EU market. The benefits of the GSP are prominently dedicated for the improvement of the economic growth of the beneficiary countries, therefore, it needs the support and cooperation from the grantor and the grantee of preferences to ensure this policy is utilised properly.

Some problems of the beneficiary country have been identified as factors that impede GSP utilisation. It has been written in many references that corruption, excessive formalities and procedures on export procedures, bureaucracy complexities, insufficient infrastructures and lack of human resource availabilities aggravate the problems faced by developing countries in economic development. The GSP should be designed appropriately to address such problems.

Therefore, the EU as a preference-granting country is considering to revise the GSP scheme to be more open and responsive towards such situation. The design of the special arrangement is based on the incentive concept to encourage developing countries to implement international standards of sustainable development and good governance. Inherently, the special incentive arrangement is open to all developing countries fulfilling certain criteria set out in the regulation.³⁰

Underlining the main objective of the GSP schemes is to assist developing countries to benefit from trade and globalisation, in this regard, the scheme must be compatible with the Doha Development Agenda programmes.³¹ Particularly, the contribution of trade to sustain development and increase people's quality of life.

²⁹ See United Nations Millennium Declaration, Resolution adopted by the General Assembly, 18 September 2000, available at : <http://www.gtz.de/de/dokumente/Millenniumsdeklaration.pdf>, last accessed : on 14 September 2010.

³⁰ See Communication from The Commission to the Council, The European Parliament and the European Economic and Social Committee Developing countries, international trade and sustainable development: the function of the Community's generalised system of preferences (GSP) for the ten-year period from 2006 to 2015.

³¹ See United Nations Millennium Declaration, Resolution adopted by the General Assembly, 18 September 2000, available at : <http://www.gtz.de/de/dokumente/Millenniumsdeklaration.pdf>, last accessed : on 14 September 2010.

The establishment of the GSP departing from the MFN principles should not create new discriminatory measures by taking into consideration similarly situated conditions and development needs. The GSP should not be used as a tool to raise barriers to trade or create indirect concessions of the beneficiary country. Therefore, Article 3 Paragraph (a) of the Enabling Clause stipulates “*any differential and more favourable treatment provided under this clause shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties*”.

There are some economic studies about utilisation of the GSP by developing countries. In 2007, Janaka conducted a research in the Utilisation of the GSP in Sri Lanka by comparing the utilisation of this preference under two schemes, i.e. US and EU. His research uses qualitative analysis of utilisation rates across sectors and across schemes (US and EU). Data collected is based on discussions made with stakeholders (government officials of various departments/institutions, chambers/associations and top exporters) in order to obtain their opinions on Sri Lanka’s performance under both schemes. Janaka was assessing Sri Lanka’s performance under both schemes using a number of variables rules of origin, product coverage, and awareness knowledge among exporters, administration, and issuance of certificates. His study compares the GSP scheme between the EU and US, and highlights the main features of both schemes. The UNCTAD identifies some factors that affect utilisation of non-reciprocal preferences, which include lack of security of access (unpredictable scheme), insufficient coverage of products, lack of understanding/awareness of the preferences available and conditions, lack of capacity to supply and non-trade related conditionality.³² In his research, Janaka used *utilisation rate and utility rate*. *Utilisation rate* is the ratio between imports that actually receive preferential treatment and those that are covered by the scheme. *Utility rate* is the ratio of the value of imports that receive preferences to all dutiable imports (covered or not). Since the research conducted by Janaka is focused on non-GSP related problems affecting exports in general and relating to supply side capacities of a country, therefore, he concludes that awareness of GSP schemes, and administration and issuance of certificates are not a significant problem in the utilisation of preferences.³³

In 2006, Candau *et al.* conducted economic studies on trade-preference utilisation. According to their research, the EU preferences are not fully utilised by developing countries, especially in Sub-Saharan Africa. To benefit from a preferential scheme, the beneficiary countries need to comply with several technical and administrative requirements, such as providing a certificate of the origin of the products. The benefits of preferential agreements are not granted automatically, costless nor unconditional. They found significant dependency on the EU preferences by a limited number of African and Caribbean countries and improved utilisation of tariff preferences facilities. They also address issues of under-utilisation in the EBA initiative by South-Asian LDCs. They argue that the main reason for under-utilisation is the constraint imposed by the rules of origin on textile and clothing exports (the foremost export specialisation of South-Asian LDCs).

³² See UNCTAD (2001); See also Wijayasiri, Janaka, *Utilization of Preferential Trade Arrangements: Sri Lanka’s Experience with the EU and US GSP Schemes, Asia-Pacific Research and Training Network on Trade*, Working Paper Series, No. 29, January 2007, Published in International Economic Series No.8, IPS, Colombo, 2007, Presented in “Third ARTNeT Consultative Meeting of Policy Makers and Research Institutions” Macao, China 1-2 November, 2006, available at : <http://www.unescap.org/tid/artnet/pub/wp2907.pdf>, last accessed : 1 February 2011.

³³ See Wijayasiri, Janaka, (2007), *Op.Cit.*

As a contractual non-reciprocal preference, the Cotonou Agreement has played a significant role for Sub-Saharan African countries. The strongest dependency on the EU preferences is found in non-LDC Caribbean and Sub-Saharan African countries.³⁴ In addition, Candau et al. previously studied *the utilisation rate of preferences in the EU* from an economic perspective. They analysed how effective the EU's preferential agreements were to improve market access of the beneficiary countries. Candau et al. conclude that utilisation appears weak under the GSP for textile and clothing, and most of all for EBAs for the same products. In addition, restrictive rules of origin are considered as the major constraint that undermines such utilisation of preferences.³⁵ Under the EU GSP Scheme, Indonesia is included as a beneficiary country of general arrangement. Indonesia is entitled to the facility as regulated under Section 1 Article 6³⁶. Indonesia received sector graduation on Section IX" Wood and articles of wood; wood charcoal; cork and articles of cork"³⁷. Pursuant to Article 13 of the current GSP Scheme Indonesia also granted section graduation³⁸ on Section III,³⁹ which covered "animal or vegetable fats and oils and their cleavage products, prepared edible fats, animal or vegetable waxes" have been removed. It has to be noted that approximately 40% of EU imports come from developing countries. In this regard, the EU has absorbed one fifth of developing country exports.⁴⁰

According to the mid-term evaluation of the EU's GSP, about 45.50 % of Indonesia's exports enter into the EU under the duty free of the MFN tariffs; 20.93% pay a positive MFN tariff; 11.54% under duty free of the GSP scheme; and 17.18 pay a positive tariff under the GSP Scheme. Total imports from Indonesia are 11,183.20 million euros.⁴¹ In 2005, Indonesia was included in the big three countries that have a large amount of exports under the GSP scheme. It approximately covered an amount of 5% of EU imports under the GSP scheme after India with 11.8% and China with 35.8%, respectively.⁴² According to statistical data from 2008, of the twenty top importer countries under the GSP Scheme, Indonesia was placed in sixth position.⁴³ In 2008, the utilisation rates of GSP by Indonesia reached 60.8%.⁴⁴

³⁴ See Candau, Fabien, Jean, Sébastien, *What Are EU Trade Preferences Worth for Sub-Saharan Africa and Other Developing Countries?*, May 3, 2006, JEL Codes: F13, N77, available at : http://www.hubrural.org/pdf/candau_jean_eu_preferences.pdf, last accessed : 23 March 2011.

³⁵ See *Ibid.*

³⁶ Available at : http://trade.ec.europa.eu/doclib/docs/2008/july/tradoc_139963.pdf, last accessed : 12th March 2011.

³⁷ See Factsheet EC Generalised Scheme of Tariff Preferences (GSP) 2009-2011, available at : http://trade.ec.europa.eu/doclib/docs/2008/july/tradoc_139988.pdf, last accessed : 12 Octobre 2010.

³⁸ See Annex I : *Beneficiary countries and territories of the Community's scheme of generalised tariff preferences of Council Regulation (EC) Number 1236/2009*, available at : <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:332:0038:0045:EN:PDF>, last accessed : 12 March 2011. See also http://trade.ec.europa.eu/doclib/docs/2009/april/tradoc_143050.pdf.

³⁹ See Table of list rules applicable to products (following the classification in the CN), available at : http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/nonpreferential/article_1622_en.htm. See also <http://www.eds-destatis.de/en/method/download/cnen03.pdf>.

⁴⁰ See GSP: The new EU preferential terms of trade for developing countries, MEMO/05/43, Brussels, 10 February 2005, available at : http://www.subel.be/myDocuments/01/001/004/gsp_eu_com_memo-06-43_050210_e1.pdf, last accessed : 23 December 2010.

⁴¹ See Center for the Analysis of Regional Intergartion at Sussex, Mid-term Evaluation of the EU's Generalised System of Preferences: Appendices to the Final Report, Table A.3: Share of Each Regime in Total Country Exports (2008), p. 17, available at : http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146195.pdf, last accessed : 12 March 2011.

⁴² See GSP: The new EU preferential terms of trade for developing countries, MEMO/05/43, Brussels, 10 February 2005, available at : http://www.subel.be/myDocuments/01/001/004/gsp_eu_com_memo-06-43_050210_e1.pdf, last accessed : 23 December 2010.

⁴³ See http://trade.ec.europa.eu/doclib/docs/2010/march/tradoc_145946.pdf, last accessed : 12 March 2011.

⁴⁴ See Addendum, Notification by the European Communities, Generalized System of Preference, available at : http://trade.ec.europa.eu/doclib/docs/2009/april/tradoc_143051.pdf, last accessed : 12 March 2011.

In 2002, Indonesia was the most important beneficiary among ASEAN members, with preferential imports in the EU of approximately €3 billion Euros.⁴⁵ According to Cuyvers and Verherstraeten, the utilisation rate is a significant indicator to measure the success of a preferential scheme. They define utilisation as the imports receiving preferential treatment as a share of imports eligible for receiving such preferences under the GSP in a certain year. Therefore, the utilisation rate indicates how well the potential benefits of the GSP scheme are fully “utilised” by beneficiary countries.⁴⁶ Wulf and Sokol define the utilisation rate as a ratio of imports receiving preferences to eligible imports.⁴⁷ According to the Delegation of the European Union to Indonesia, almost 40% (around €4.9 billion Euros) from the total imports from Indonesia (€13 billion Euros in 2007) are qualified under the GSP scheme.

The GSP exists on behalf of demands from developing countries to obtain “fair” treatment based on economic development disparities. The EU GSP was established under exemption of international trade principles of MFN and derogation of common customs tariffs. It reflects how this system has been given a prominent place within international trade relations. In the Report of the International Law Commission on the work of its thirtieth session the measures to increase the utilisation of preferences are mentioned⁴⁸:

“[...] Efforts should be made by all preference-giving countries and beneficiary countries to increase, as much as possible, the degree of utilisation of the different schemes of generalised preferences by all appropriate means. In this connection, developed countries should make efforts to give technical assistance to countries benefiting from generalised preferences, particularly to the least advanced countries, to enable them to draw maximum advantage from preferences [...]”.

Many scholars characterise GSP as a “grant, gift, autonomous right, unilateral action, non-obligatory policy, or optional policy”, which is provided by developed countries for developing countries. Scholars identify these terms as the weakness of GSP. Preference-granting countries can change or review their policies on such system. Therefore, GSP is considered as an unstable and unpredictable system.

Nowadays, the EU is developing its GSP based on the stability principle, predictability, objectivity, and simplicity. The EU argues that its GSP reform is aimed to improve its system for it to be more effective, efficient, and to give more benefit to development in developing countries. This is justified under Paragraph 3 (c) of the Enabling Clause “to respond positively” to development needs of developing country. Development needs of developing country must be taken into account as a dynamic variable.

Preference-granting countries set out some requirements to be fulfilled by traders from developing countries in order to get benefits. Most of these requirements relate to trade facilitation, rules of origin, export-import formalities, custom and duties regulations and others non-tariffs barrier.

Based on EU data from 2008, Indonesia only has a 60.8% utilisation rate of GSP. It has shown that Indonesia cannot fully utilise the GSP benefits. This research takes a different perspective about how developing countries, in this term Indonesia, utilise

⁴⁵ See Cuyvers, Ludo and Verherstraeten, Stijn, *The EU's Generalized System of Preferences and its ASEAN beneficiaries: a success story?*, CAS Discussion paper No 47, December 2005, available at : <http://webh01.ua.ac.be/cas/PDF/CAS%2047.pdf>, last accessed : 12 March 2011.

⁴⁶ See *Ibid.*

⁴⁷ See Wulf, Luc De., Sokol, Jose B., *Customs Modernization Handbook*, The World Bank, Washington, 2005.

⁴⁸ See Commentaries on the ILC's Draft Articles, see Report of the International Law Commission on the Work of its Thirtieth session , 8 May – 28 July 1978, Official Records of the General Assembly, Thirty-third session, Supplement No. 10, Doc. A/33/10 ILC Report), 2 Yearbook of the International Law Commission (1978), p. 64.

the “gift” from the EU. Since, GSP has some weakness for instance the unstable scheme that might be changed or reviewed periodically. It will be examined how Indonesia prepared its trade system and policies to cope with this matter. Hence, this research is focused on how government trade institutions in Indonesia established its trade policy to support Indonesian traders to maximise EU GSP utilisation. According to the context of the study presented above, we have raised three questions in this research, as follows:

1. *How does the Association of Southeast Asian Nations (ASEAN) trade facilitations policies support the utilisation of the European Union's Generalised System of Preferences in Indonesia?*
2. *What are the trade policies of the Indonesian Government in maximising utilisation of the European Union's Generalised System of Preferences scheme?*
3. *Does the European Union's Generalised System of Preferences affect implementation of good governance in the bureaucracy of Indonesia's foreign trade policies?*

The research methodology has a juridical normative approach. Data used in this research is secondary data in the form of related documents and archives. The research will identify data systematically in order to answer the problems. Secondary data will be divided into primary legal material, secondary legal material, and tertiary legal material. The primary legal material of research uses relevant references of EU law and regulations, Indonesian law and government regulations in trade policies, relevant international law, DSB decisions, other WTO legal texts, jurist doctrines and other legal documents. The secondary legal material of research uses textbooks, law journals, articles, working papers, papers presented at conferences, seminars, workshops, news, public hearings, press releases, other relevant documents, interviews with Indonesian Government Institutions related to trade and online research. Tertiary legal material covers news, articles from magazines or newspapers. Interviews with some stakeholders in the institution trade in Indonesia were conducted as primary data. The method to analyse the data is a qualitative descriptive in order to answer the problem statement of the research.

CHAPTER II

Principle of most favoured nation

This chapter will focus on the non-discrimination principle in the World Trade Organization. The non-discrimination principle is the core principle in establishing liberalisation of the trading system. The objectives of the Marrakech Agreement are to direct the substantial reduction of tariffs and other barriers to trade and to eliminate discriminatory treatment in international trade relations. The non-discrimination principle of the General Agreement on Tariffs and Trade (GATT) 1947 is divided into two treatments, which are the Most Favoured Nation Treatment and National Treatment. The non-discrimination principle was embodied in Article I:1 of the GATT 1947. The National Treatment was embodied in Article III of the GATT 1947 and aimed to reduce trade barriers and the practice of protectionism by member states. Under the National Treatment clause, member states are obliged to treat the “like products” from any other contracting parties in the same way as its own “like product”. These principles of non-discrimination become the main spirit in promoting free and fair trade in the multilateral trading system. However, there are still some issues regarding the implementation and interpretation of the non-discrimination principle by the WTO member states on their national regulations.

I. General overview of the basic principles of WTO.

The existence of the economic development gap among WTO member states cannot be abandoned by forcing equal rules and equal treatment. The integration of the global trading system should be deemed as a need for global understanding and global cooperation between rich and poor countries. Peter Sutherland, former WTO Director General, highlights the WTO as a tool “to achieve greater measure of equity” and to assist “marginalised country” efforts to participate in the global trading system.¹ The importance of achieving “*a greater measure of international equity*” was deemed as recognition of inequality in international trade relations. Taken from the words of Henri-Dominique Lacordaire “*entre le fort et le faible, entre le riche et le pauvre, entre le maître et le serviteur, c’est la liberté qui opprime et la loi qui affranchit*”,² to take those differences into “equity” it is necessary to enforce a set of rules that recognises the existence of a gap between two different conditions. These rules must make it possible to facilitate inferior parties to afford the same opportunities in the global trading system with “positive discriminatory treatment” according to their special needs.

International trade policy started being designed after Second World War through international negotiations from 1946 to 1948. Starting with the Atlantic Charter that was concluded between the US and United Kingdom in 1941, which laid down post-war economic order. The Atlantic Charter led to the enactment of the United States-United Kingdom Lend-Lease Agreement of February 1942 and the US “Proposed Charter” of December 1945. It should be noted that within those agreements there was no clue that the “provisions of special and differential treatment” should be granted to the developing country in the sphere of international trade policy.³ The objective of the Atlantic Charter was to carry out “the enjoyment by

¹ See Peter Sutherland, 1997; Van den Bossche, Peter., *The Law and Policy of the World Trade Organization, Text, Cases and Materials*, Cambridge University Press, United Kingdom, 2005, p. 35.

² See Henri-Dominique Lacordaire, 1835 Conferences at the Notre Dame in Paris; Van den Bossche, Peter., 2005, *Op. Cit.*, p. 37.

³ See United States considers that the special treatment of developing countries would be included in the Economic Development Sub-Commission of the United Nations and Social Council and by institutions such as the World Bank, not in the area of trade policy.

all states, great and small, victors and vanquished, of access, on equal terms, to the trade and raw materials of the world which are needed for their prosperity". In this regard, it seems that the early drafting of international trade policy in the post-war period was based on one-package rules applied for all countries without considering the various development stages and economic needs in every country.⁴

The history of GATT can be traced back to after Second World War. The GATT was not an organisation but only an international treaty in trade. After Second World War, the States intended to establish a new economic order aimed to eliminate the tension between states in international trade. From 1 to 22 July 1944, a conference was held by the United Nations Monetary and Financial Conference, known as the Bretton Woods conference. This conference was held at the Mount Washington Hotel, located in Bretton Woods, New Hampshire in the US, and was attended by the 44 nations. The conference mainly established the new order of world economics on monetary and financial issues. Although trade was not included as the main agenda, the conference recognised the need to establish an institution to govern international trade.⁵ The Bretton Woods conference also established modern institutions for international commerce including the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade (GATT) and the International Bank for Reconstruction and Development (IBRD).

The GATT was signed as the foundation of establishing the international organisation of trade. Therefore, in 1947 the United Nations Conference on Trade and Employment, held in Havana, Cuba, known as the Havana Charter, established the International Trade Organization as a multilateral trade organisation. Eighteen countries joined the preparatory committee that held four meetings to draft the Havana Charter from October 1946 to March 1948.⁶ The United Nations Conference on Trade and Employment or the Havana Charter consists of 106 Articles and 16 annexes. It contains employment and economic activity, economic development and reconstruction, commercial policy⁷, an inter-governmental commodity agreement, and International Trade Organization.⁸ The establishment of the Havana Charter is in accordance with the objectives of the United Nations as set forth in Article 55⁹ of its Charter, particularly the attainment of higher standards of living, full employment and conditions of economic and social progress and development.¹⁰ A majority in the

⁴ See Hudec, Robert E., *Developing Countries in the GATT/WTO Legal System*, Rowman & Littlefield, Cordell Hull Institute, Washington, DC, Gower Publishing Company Limited, UK, 1987, p. 20, available at : <http://lawweb3.law.umn.edu/uploads/hy/jz/hy/jzgliHRF7Q3VUx-XRBZQ/wto-trachtman.pdf>, last accessed : 17 April 2011.

⁵ See Van den Bossche, Peter., 2005, *Op. Cit.*, p. 37.

⁶ See World Trade Organization, *World Trade Report 2007: Sixty Years of The Multilateral Trading System: Achievements And Challenges*, p. 180, para. 4, Available at : http://www.wto.org/english/res_e/booksp_e/anrep_e/wtr07-2d_e.pdf, last accessed : October 2010.

⁷ It covers tariffs, preferences, and internal taxation and regulation, quantitative restrictions and related exchange matters, subsidies, states trading and related matters, general commercial provisions, special provisions, restrictive business practices.

⁸ See The United Nations Conference on Trade and Employment, known as Havana Charter, held At Havana, Cuba From 21 November 1947, to 24 March 1948, Final Act and Related Documents, Available at : http://www.wto.org/english/docs_e/legal_e/havana_e.pdf, last accessed : October 2010.

⁹ See Article 55 Charter of United Nation, Available at <http://www.un.org/en/documents/charter/chapter9.shtml>. With a view to the creation of conditions of stability and well-being which are necessary for peaceful and friendly relations among nations based on respect for the principle of equal rights and self-determination of peoples, the United Nations shall promote: a) higher standards of living, full employment, and conditions of economic and social progress and development; b) solutions of international economic, social, health, and related problems; and international cultural and educational cooperation; and b) universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion.

¹⁰ See Chapter I Article 1 Purpose and Objective of the United Nations Conference On Trade and Employment, Available at http://www.wto.org/english/docs_e/legal_e/havana_e.pdf, last accessed : October 2010.

United States Congress rejected the Charter. Further, several business groups in the US judged the Charter as not being part of the topic. This judgment was based on the contents of the Charter, which covers some matters indirectly related to trade, such as employment and antitrust. Others were concerned that foreign investment was insufficiently protected under the Charter.¹¹

The Havana Charter was the standpoint to facilitate the birth of the ITO as an international trade organisation with a legal personality. As noted by Hajnal, ITO has an organisational infrastructure to administer, apply, develop, and enforce the detailed and extensive substantive obligations contained in the Havana Charter. The substantive contents of the Havana Charter are related to employment, economic development and reconstruction, commercial policy, restrictive business practices, investment and intergovernmental commodity agreements.¹²

The organisational organ of ITO as stipulated in the Havana Charter, is similar to the WTO, which consists of governance, decision-making, and dispute settlement. As noted by Hudec, "the ITO represented a new idea in international economic affairs, the idea that the governments of the world, by acting together in concerted rule-making activity, could shape the international trade environment in which their economies would operate".¹³ Decision making in ITO was performed by the plenary Conference and the eighteen members Executive Board by simple majority vote including amendments to the Charter. The dispute settlement in the Havana Charter aimed to settle disputes between states. Based on the dispute mechanism, any complaint from the member states was submitted to the political organs of the organisation for investigation. In the dispute mechanism, ITO only concluded the final word on economic and financial questions. While concerning pure questions of law, an advisory opinion can be requested from the International Court of Justice (ICJ). The enforcement of dispute settlements in ITO is carried out based on the authorisation of sanctions on a limited and compensatory basis.¹⁴

There are six objectives of the Havana Charter as stated in Article 1 of the charter. The first objective is to assure a large and steadily growing volume of real income and effective demand, to increase the production, consumption and exchange of goods, and thus to contribute to a balanced and expanding world economy. The aims are related to international trade flows and international economic balance. The second objective is to foster and assist industrial and general economic development, particularly of those countries, which are still in the early stages of industrial development, and to encourage the international flow of capital for productive investment.¹⁵

The third objective is related to equality for all countries on access to the markets, products, and productive facilities, which are needed for their economic prosperity and development. This implies reducing trade barriers between states and contains the principle of non-discrimination. The fourth objective is to promote, on a reciprocal and mutually advantageous basis, the reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international commerce.¹⁶

The fifth objective is to increase trade and economic development opportunities, to abstain from measures, which would disrupt world commerce, to reduce productive

¹¹See World Trade Organization, World Trade Report 2007, *Op. Cit.*, p. 180.

¹² See Hajnal, Peter I, *International Information : Documents, Publications and Electronic Information of International Organizations*, Volume 2, Second Edition, Libraries Unlimited, Inc, USA, 2001, p. 74.

¹³ See Hudec, Robert E., 1987, *Op. Cit.*, p. 23.

¹⁴ See Hajnal, Peter I, 2001, *Op. Cit.*, p. 74.

¹⁵ See Havana Charter, 1948.

¹⁶ See *Ibid.*

employment, or retard economic progress. The sixth objective is to promote mutual understanding, consultation, and co-operation in the solutions of problems relating to international trade in the fields of employment, economic development, commercial policy, business practices, and commodity policy.¹⁷

Related to trade and economic development, the ITO negotiations are split into two major factions, developing countries and the US that was supported by some developed countries. Developing countries struggled to get recognition of “legitimate reasons” to depart from the general principle due to the inequality of economic development. In order to limit the scope and application of the exception or special treatment granted to developing countries, the US and developed countries proposed “additional substantive criteria”. For instance the graduation system, preferential rules of origin, withdrawal system and other conditions of preferences refer to trade policy objective of the preference-granting country. As noted by Hudec, GATT included Article 13 of ITO concerning “infant-industry exceptions for tariffs and quantitative import restrictions”, on the other hand, the US did not agree to include Article 15 of ITO which permitted new preferences for developing countries. The US argued that this provision was one of its major concessions. In this regard, the US was unwilling to grant the concession without any reciprocal concession. However, due to the failure of the ITO, the negotiations held during the establishment of ITO did not produce any agreement relating to specific policies for developing countries.¹⁸

After the Havana Charter completed in March 1948, the signatories had to ratify the Charter by the approval of their legislative body. To be in effect, the charter required approval from the majority of the signatory nations. However, most signatories decided to wait for the United States Congress to ratify the charter before sending it to their legislative bodies for approval.¹⁹ The Havana Charter was signed by 53 countries on 24 March 1948, but for various reasons, the charter never came into force.²⁰ As noted by Hajnal, the domestic political situation, which occurred in the United States and Great Britain at that time, had caused ratification in their national legislatures to fail.²¹ The differences concerning the substantive of the charter, the Cold War, and increasing socialism in Western Europe, were also allegedly the cause of the ITO failing to come into force.²²

From the beginning of its establishment, the GATT was not intended to be an organisation because the GATT was established as a provisional agreement until the ratification of the ITO Charter.²³ The GATT 1947 only served as a trade agreement until the ITO came into force.²⁴ In other words, when the ITO came into effect the GATT would not prevail.²⁵ The United States Congress assigned the United States negotiators during 1947 to “tentatively agree to draft GATT clauses”, which seemed to

¹⁷ See *Ibid.*

¹⁸ Hudec, Robert E., 1987, *Op. Cit.*, pp. 23-24.

¹⁹ See Kaplan, Edward. S, *American Trade Policy, 1923-1995*, Greenwood Press, Unites States, 1996, p. 53.

²⁰ See Havana Charter for an International Trade Organization, Havana, 24 March 1948, Available at http://www.wto.org/english/docs_e/legal_e/havana_e.pdf. The conditions for the entry into force of the Havana Charter, set forth in its article 103, were not fulfilled within the prescribed time-limit. No instrument of acceptance was deposited with the Secretary-General. For the text of the Havana Charter, see United Nations Conference on Trade and Employment, Final Act and Related Documents, E/CONF.2/78, United Nations publication, Sales No. 1948.II.D.4. Available at <http://treaties.un.org/doc/Publication/MTDSG/Volume%20I/Chapter%20X/X-1-b.en.pdf>

²¹ See Hajnal, Peter I, 2001, *Op. Cit.*, p. 74.

²² See Alzamora, Cecilia, “*The Question of Non-trade Issues in the WTO from a Developing Country Perspective*” (2004). LLM Theses and Essays. Paper 3, pp. 12-17, Retrieved on September 2010 from http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1002&context=stu_llm

²³ See World Trade Organization, *World Trade Report 2007*, *Op.Cit.* 180.

²⁴ See Hudec, Robert E., 1987, *Op. Cit.*, P. 24.

²⁵ See World Trade Organization, *World Trade Report 2007*, *Op.Cit.* 180.

imply an organisation. To ratify the Havana Charter it was necessary to get approval from the Congress, but according to the 1945 Act, the President does not have any authorisation to enter into agreement for an international organisation. The President only has authorisation to enter into agreement to reduce tariffs and other restriction trade. Therefore, the United States Congress disagreed with the organisational clauses in the GATT because it would exceed the authority of the President in conformity with the Act or, in other words, it would be included as executive infringement on the congressional domain because of the authority given to the President over tariff policies under the Regional Trade Agreement (RTA) programme.²⁶ The United States Congress declared that the GATT was an organisation that came under the Congress's authority, and that the president had exceeded his constitutional authority.²⁷ This was one of the main reasons why the United States negotiators redrafted the general GATT clauses to eliminate the suggestion of an organisation.²⁸

Finally, in April 1949 the charter was sent to the House Committee on Foreign Affairs. In this regard, numerous hearings were held, but unfortunately, Truman's request for a joint resolution permitting US participation in the ITO failed in the committee. This is one of the reasons why the charter did not get any approval from the Congress, because it never had the opportunity to be voted by the entire House.²⁹

In addition, the other reason behind the absence of approval from Congress of the ITO Charter was the domestic political situation. In 1948, the US Congress returned to be dominated by the Republicans, while the Presidency remained a Democratic Party. The US Congress rejected the ITO Charter as the Charter would threaten its national sovereignty in trade policy. Under this political pressure where the opposition had a very strong position in the Congress, President Truman, did not send the proposal to Congress.³⁰ Therefore, by the end of 1950 President Truman announced that "he would not resubmit the proposal of ITO to the Congress to get approval". This statement terminated the chance of ITO to come into existence.³¹ According to Jackson, the irony of the situation was that the United States was the initiator to develop the Havana Charter.³² With the United States, the decision not to ratify the ITO caused a domino effect where other states also re-considered ratifying it. As noted after Second World War, the US held a strong economic position and an international trade organisation without US participation was considered as nonsense.³³ After the ITO never came into existence, the GATT became the founding document for an international institution.³⁴ The GATT had its function as a *de facto* international organisation of international trade.³⁵ Hudec notes, after the failure of ITO, the GATT 1947 tended to approach the perspective of the US.³⁶

During ITO negotiations, the US submitted a draft resolution to the Economic and Social Council, which did not include any particular provisions, related to the developing country. The Economic and Social Council made a very significant recommendation that it is important to "take into account the special conditions which

²⁶ See Kaplan, Edward. S, 1996, *Op. Cit.*, p. 53.

²⁷ See *Ibid*,

²⁸ See Jackson, John Howard, *The World Trading System : Law and Policy of International Economic Relations*, Second Edition, Massachusetts Institute of Technology, USA, 1997, pp. 37-38.

²⁹ See Kaplan, Edward. S, 1996, *Loc. Cit.*, p. 53.

³⁰ See Mshomba, Richard E., *Africa and the World Trade Organization*, La Salle University, Philadelphia, 2009.

³¹ See Kaplan, Edward. S, 1996, *Loc. Cit.*, p. 53.

³² See Jackson, John Howard, 1997, *Op. Cit.*, pp. 37-38.

³³ See Choi, Byung- il and Howe, Brendan M, *International Negotiations : Theory and Practice, Jang-Hee Yoo Series on International Studies*, Volume 5, Ewha Womans Press, Seoul, Korea, 2007, p. 106.

³⁴ See Kaplan, Edward. S, 1996, *Loc. Cit.*, p. 53.

³⁵ See Yong-Shik Lee, *Reclaiming Development in the World Trading System*, Cambridge University Press, USA, 2006, p. 15

³⁶ See Hudec, Robert E., 1987, *Op. Cit.*, p. 25.

prevail in countries whose manufacturing industry is still in the initial stages of development".³⁷ However, the US abandoned the recommendations by proposing the "Suggested Charter" without accommodating particular provisions for developing countries.³⁸ The US argued that special treatment for developing countries under legal exception would not give them any extra "favour" or "assistance", in this regard, legal exception to distort the market was not an advantage.³⁹ The US approach was based on the global economic and political policy, in order to reduce trade protection generally and to eliminate discrimination. Concerning the elimination of discrimination, the US had an agenda to eradicate trade preferences based on colonial ties. Furthermore, the US had most advantages from export under international globalisation.⁴⁰

According to Hajnal, during the review session in 1954–1955, the contracting parties of the GATT attempted to create the Organization for Trade Cooperation or "OTC" aimed to administer the GATT 1947. The contracting parties realised that GATT needed an institutional structure to support its operation. The OTC was designed as an international organisation with a legal personality, so it had the legal capacity to enter into agreement with other intergovernmental organisations. The OTC agreement was a separate legal instrument, which exclusively contained institutional and procedural provisions. In the OTC agreement there were provisions on the organisational structure consisting of the secretariat, and executive and administrative organs which would be able to carry out many functions of the GATT.⁴¹ In the area of decision making, it was exercised by seventeen members of the Executive Committee. The Plenary Assembly with a two third majority vote elected the member of the Executive Committee. The Eisenhower administration supported⁴² the OTC, which was designed as a substitute for the ITO. Principally, the OTC had no authority to amend the GATT 1947 or to create any decision that would have the effect of imposing a new obligation on a Member.⁴³ However, once again, Congress refused to give approval.⁴⁴ Therefore, OTC also ended and never came into existence⁴⁵ and the GATT became the only multilateral instrument governing international trade from 1948 until the WTO was established in 1995.⁴⁶

³⁷ See *Ibid.*, p. 20.

³⁸ See *Ibid.*, p. 21.

³⁹ See *Ibid.*, p. 25

⁴⁰ See *Ibid.*, p. 21.

⁴¹ See Kaplan, Edward S, 1996, *Op. Cit.*, p. 54. See also Hudec, Robert E., 1987, *Op. Cit.*, p. 33.

⁴² At President Eisenhower's direction, Assistant Secretary of State Samuel Waugh, a Nebraska banker, signed the OTC agreement for the U.S. Though legally it was probably unnecessary for Eisenhower to submit OTC to Congress, he did it, as Secretary of State John Foster Dulles said, as a matter of courtesy. Moreover, the President knew that congressional blessing for OTC would have a psychological effect throughout the world, i.e., it would prove that not only the U.S. President but the U.S. Congress wanted a permanent policy of free world trade. Eisenhower said: "Failure to assume membership in the Organization for Trade Cooperation would strike a severe blow at the development of cooperative arrangements in defence of the free world." At the moment, OTC is stalled in House and Senate committees, and neither Democrats nor Republicans are pushing it. The high-tariff bloc and the protectionists are leagued with a group with a vague fear that the U.S. could eventually lose part of its sovereignty through OTC. Some opponents have incorrectly likened OTC to the sweeping International Trade Organization, or "World New Deal," which President Truman proposed to Congress in 1949 but withdrew in the face of opposition. OTC has also been denounced as "socialism," even though (by lowering trade barriers) it would not increase, but actually reduce, Government intervention in trade. Another charge is that the U.S. is handing over to foreign countries the power to set U.S. tariffs. To this, President Charles P. Taft of the businessmen's Committee for a National Trade Policy retorted: "Outright misrepresentation and dangerous nonsense.", Available at The Fight Over GATT, <http://www.time.com/time/magazine/article/0,9171,807211,00.html>.

⁴³ See Hajnal, Peter I, *Op. Cit.*, 2001, p. 76.

⁴⁴ See Kaplan, Edward S, *Op. Cit.*, 1996, p. 54.

⁴⁵ See Hajnal, Peter I, *Loc. Cit.*, 2001, p. 76.

⁴⁶ See The GATT years: from Havana to Marrakesh Available at : http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm#rounds, last accessed : November 2010.

Although the establishment of an international organisation of trade met a failure once again, the contracting parties did not give up and continued trying to make reforms. In the GATT reviews session, the participating governments made three basic changes whereas one of these basic changes had significant meaning for the developing countries. The first basic change was the agreement to re-write Article XVIII that contained the infant-industry exceptions. This provision supported the opportunity of infant industries to grow especially in developing countries. The second major change concerned the use of quantitative restrictions by developing countries in times of balance-of-payments difficulties. The Contracting Parties agreed on provisions that were more flexible in order to help developing countries face a balance-of-payments crisis. The third modification was a further attempt to accommodate the special needs of developing countries.⁴⁷

According to Hoekman, the WTO has some differences with GATT, where the WTO as an international organisation has a legal personality and has its own organisational structure where all of its members bind to dispute settlement procedures. In addition, the WTO also provides a mechanism for accession of new members, in this regard, the WTO can develop and play an important role in the international trading system.⁴⁸

The objectives of GATT are to reduce barriers to trade, to bind tariffs, and to limit the use of certain trade barriers, such as quotas. The negotiating parties agreed that substantial tariff cuts could only be achieved if certain exceptions were included in the structure of trade rules, in order to embody this arrangement, therefore GATT provisions provided several exemption clauses.⁴⁹

The GATT has a long negotiating history due to the dynamic changes of world economics and the continued increase in members from developing countries that acceded to the GATT. The history of GATT can be traced back to the successive rounds of negotiations, which led to new schedules of tariff concessions and new commitments towards greater liberalisation. Since the establishment of the GATT until the Marrakech Agreement, eight negotiating rounds have taken place. The first six rounds of negotiations focused on reducing tariffs. These six negotiating rounds are the Geneva Round (1947), the Annecy Round (1948), the Torquay Round (1950), the Geneva Round (1956), the Dillon Round (1960-1961) and the Kennedy Round (1964-1967). The seventh round held in Tokyo, known as the Tokyo Round (1973-1979), addressed the various non-tariff barriers to trade.⁵⁰ The eighth round of negotiations, known as the Uruguay Round, which was probably the most important round in the history of the GATT, not only because it lasted the longest (1986-1993), but also because the International Organisation of Trade, known as the World Trade Organization, was established during this round.⁵¹

The first round of the GATT, known as the Geneva Round, was held from April to October 1947. The participants completed 123 negotiations and established 20 schedules containing the tariff reductions, which became an integral part of GATT. The first round noted some successful histories where the US agreed to cut its tariffs on imports from Europe and did not put pressure to remove Europe tariff restriction. The

⁴⁷ See World Trade Organization, World Trade Report 2007, *Op.Cit.* 180.

⁴⁸ See Hoekman, Bernard, et. al, *A Handbook : Development, Trade, and The WTO*, The World Bank, Washington, D.C, 2002, p. 41.

⁴⁹ See World Trade Organization, World Trade Report 2007, *Op.cit.*

⁵⁰ See *Understanding The WTO: Basics, The GATT years: from Havana to Marrakesh*, Available at : http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm, last accessed : July 2010.

⁵¹ See *General Agreement on Tariffs and Trade (GATT)/WTO History*, Available at : <http://www.adb.org/documents/others/ogc-toolkits/wto/wto0100b.asp>, last accessed : July 2010.

first round successfully covered 45,000 tariff concessions and about \$10 billion USD in trade. The Protocol of Provisional Application regarding tariff concessions came into effect on 30 June 1948, as the new General Tariff and Trade Agreement.⁵²

The second round of GATT, known as the Annecy Round, was held from April to August 1949 in Annecy, France. Member states negotiated an additional 13,000 tariff reductions. In the second round there were 10 new accessions of member states. It should be noted that accession of a new member country does not require unanimity, but only a two-third majority of all existing member countries (23 countries). In the case of members voting against the accession of a new member, these members do not need to extend their trade policy concessions to the new member. During the second round, the 23 original members only negotiated with the acceding countries; consequently, the negotiation only covered 5000 items.⁵³ While in 1948, the Organisation for European Economic Cooperation, known as OEEC, had been founded as a tool to administer the Marshall Plan for the recovery of Europe after Second World War. The members of OEEC agreed to reduce the trade barriers in Europe, which included licenses, quotas, and exchange restrictions. As noted by Irwin, the elimination of quotas in 1949-1950 led to strong recovery of intra-European trade volumes and became the foundation of the establishment of a Common Market some years later.⁵⁴

The third round of trade negotiations was held in Torquay, England, from September 1950 to April 1951. It was known as the Torquay Round. The Torquay Round brought a significant result because the contracting parties agreed to leave most of the commitments agreed upon during the Geneva and Annecy Rounds. The Contracting Parties also decided to add another 8700 tariff items to the agreement.⁵⁵ However, some points were not adequate; some European countries could not bargain further because they could not afford to offer any more concessions.⁵⁶

Within the context that gave rise to the Cold War, meanwhile, the developed countries tried to minimise the tensions among the contracting parties of the GATT after the failure of ITO. The USSR insisted on encouraging the creation of an international organisation of trade under the United Nations. Related to this background, in 1956, 22 contracting parties held a meeting in Geneva, Switzerland, to engage in the fourth round, which was then known as the Geneva Round.⁵⁷ During the Cold War, the US began implementing protectionism while Europe started reducing its trade barriers.⁵⁸

Beside the difficult question of how better to integrate developing countries into the world trading system, the GATT faced another mounting challenge. Since the beginning of the 1950s, six European countries (Belgium, Luxembourg, France, the Federal Republic of Germany, Italy and the Netherlands,) had made considerable efforts to achieve deeper economic integration. After the successful creation of a common market for coal and steel in 1951, the six countries adopted the Treaty of Rome in 1957, which established the European Economic Community. For the GATT,

⁵²See *Understanding The WTO: Basics, The GATT years: from Havana to Marrakesh*, Available at : http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm, last accessed : July 2010.

⁵³ See Interim Commission for the International Trade Organization (ICITO) (1952) *Liberating World Trade*, (1957) *International Trade 1956*; World Trade Organization, *World Trade Report 2007, Six Decades of Multilateral Trade Cooperation : What We Have We Learnt?*, World Trade Publications, World Trade Organization, ISBN 978-92-870-3401-4, Switzerland, 2007, p. 181, Available at : http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report07_e.pdf.

⁵⁴ See World Trade Organization, *World Trade Report 2007*, *Op. Cit.* 180.

⁵⁵ See *Ibid.*

⁵⁶ See *Ibid.*

⁵⁷ See *Ibid.*

⁵⁸ The GATT Membership was stagnated from 1952 to 1957, GATT membership increased by only one country on net, with the withdrawal of Liberia being balanced by the accession of Japan and Uruguay

the question was how to manage trade relations between the members of this upcoming customs union and the other Contracting Parties. The fear was that an unsatisfactory adjustment would undermine the multilateral trading system.⁵⁹

The fifth round was held once more in Geneva and lasted from 1 September 1960 to July 1962. The negotiations were named the Dillon Round in honour of C. Douglas Dillon, US secretary of state under President Eisenhower. Dillon was also formerly Treasury Secretary under President Kennedy (during the round in January 1961) and the man who proposed the negotiations. The essential aim of this round was to change the tariffs of the six EEC members into a common schedule applied by all six towards non-member countries. In accordance with Article XXIV of the GATT, the new common external tariff was not allowed to be higher on average than the separate tariffs of the six countries, but if the EEC members wanted to depart from this rule, they were obliged to offer tariff concessions on other items such as compensation. Positive progress was made in the overall negotiations, but not in the field of agriculture.⁶⁰

The establishment of market integration in Europe was one of the factors of the opening of the fifth round in September 1960. There were 26 contracting parties involved in the negotiation. The fifth round consisted of two stages. First, related to the negotiations with EEC member states for the creation of a single schedule of concessions for the EEC based on its Common External Tariff (CET). At the same time, the establishment of the EEC had to compete with the influence of economic power of the US. The second stage was dedicated further to general tariff negotiations.

Most trade negotiations, which were carried out until the Dillon Round, concerned industrial products. Unfortunately, the US and the EEC, as the strong economic powers among the GATT members, were unwilling to join negotiations in the agriculture field. This was due to the fact that both of these countries were designing their agriculture policies for their domestic prices not to be included in the global market mechanism. Related to the Common Agricultural Policy (CAP), in the Dillon Round negotiations, the EEC refused to agree to new bindings on several agricultural products because it needed under determined rates for policy design in the future.⁶¹

The Dillon Round concluded in July 1962; about 4000-tariff concession had been made by the Contracting Parties covering \$4.9 billion USD of trade. The major result of the negotiations was the Arrangement on Cotton Textiles, which was agreed upon by the negotiating parties agreed as an exception to the GATT rules and permitted negotiations of quota restrictions with cotton exporting countries. Principally, the Dillon Round gave a foundation for the future rounds concerning agriculture and the integration of developing countries into the world trade system.⁶²

The sixth round was held from 1964-1967, in Geneva, Switzerland. The GATT trade rounds took more time and were more complicated. In the sixth round participation surged to more than 60 countries and 66 nations attended the opening ceremony.

In the 1960s, President Kennedy conveyed to the congress, on behalf of political and economic reasoning, that it was necessary to start a new round of negotiations.⁶³

⁵⁹ See Interim Commission for the International Trade Organization (ICITO) (1957); World Trade Organization, World Trade Report 2007, Six Decades of Multilateral Trade Cooperation : What We Have We Learnt?, World Trade Publications, World Trade Organization, ISBN 978-92-870-3401-4, Switzerland, 2007, p. 182, Available at : http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report07_e.pdf.

⁶⁰ See *Ibid.*

⁶¹ See Curtis and Vastine, (1971); World Trade Organization, World Trade Report 2007 *Op. Cit.* p. 180.

⁶² See World Trade Organization, World Trade Report 2007, *Op.Cit.*

⁶³ See *Ibid.*

Then the sixth round was held in May 1963 during the Ministerial Meeting of the GATT. Nevertheless, the negotiations officially began one year after this ministerial meeting. Therefore, the sixth round was known as the Kennedy Round, after the US President J. F. Kennedy.⁶⁴

The Kennedy Round ended in 1967⁶⁵, it recorded some achievements, including significant reductions of tariff protection in manufacturing in the late 1960s and early 1970s. That reduction influenced almost 75 per cent of world trade because industrial countries estimated a reduction in their tariffs of around 36-39 per cent.⁶⁶ The Kennedy Round was the first round to discuss some areas of trade beyond tariffs and related to certain non-tariff measures. In addition, in 1967, the International Anti-Dumping Code was enacted to regulate the complex problem of dumping. The Basic Code provided a valuable model for the next negotiation on similar problem areas. Another achievement of this round was a separate protocol agreement embodying several non-tariff measures.⁶⁷

There were some issues brought onto the negotiation table during the Kennedy Round. These issues covered liberalisation of agricultural commodities, the insertion of non-tariff measures, and the special treatment of developing countries. The other significant progress that was achieved related to bargaining, when countries started to negotiate with the EEC on its common external tariff. Therefore, contracting parties no longer made bargaining negotiations with individual countries. By the 1950s, the EEC had grown as a major economic power.⁶⁸

Disparity and deficit in trade were one of the reasons why the United States was eager to start a new round of negotiations. Another reason was the expansion of the EEC by the accession of new members, in addition, the Common Agricultural Policy (CAP) applied by the EEC, was considered by the US administration as a new barrier towards US exports of agricultural. Another issue, which emerged between the GATT Contracting Parties, was non-tariff measures, which played an important role when industrial tariffs decreased. These backgrounds encouraged the establishment of the new round of negotiations after the Kennedy Round.⁶⁹

From 12-14 September 1973, during the ministerial meeting held in Tokyo, Japan, the seventh round of negotiations was launched. Hence the name Tokyo Round. At that time, Japan had become one of the economic powers because its exports had covered most shares of world trading.⁷⁰ On the other hand, some other Asian economies also began to make positive progress in undertaking participation in world trading.⁷¹ There were 102 countries taking part in the negotiation, which meant that the number of participants had increased significantly. Most of these participants were developing countries.⁷² The decreasing of tariff duties was the essential part of the tariff negotiations, thus, the agreement also resulted in some kinds of agreements about non-tariff barriers.⁷³ This agreement was known as the plurilateral agreement

⁶⁴ See *Ibid.*

⁶⁵ See Kock, 1969; UNCTAD, 1968; World Trade Organization, World Trade Report 2007, *Op. Cit.*, p. 180.

⁶⁶ See The Multilateral Trading System : 50 Years of Achievement, Available at : http://www.wto.org/english/thewto_e/minist_e/min98_e/slide_e/slide_list.htm

⁶⁷ See World Trade Organization, World Trade Report 2007, *Op. Cit.*

⁶⁸ See Preeg, 1970; Curtis and Vastine, 1971; World Trade Organization, World Trade Report 2007, *Op. Cit.*, p. 180.

⁶⁹ See World Trade Organization, World Trade Report 2007, *Op. Cit.*, p. 186.

⁷⁰ See *Ibid.*, p. 186.

⁷¹ See *Ibid.*, p. 186.

⁷² See The Multilateral Trading System : 50 Years of Achievement, Available at : http://www.wto.org/english/thewto_e/minist_e/min98_e/slide_e/slide_list.htm

⁷³ See Tokyo Round Codes consists of : Subsidies and countervailing measures - interpreting Articles 6, 16 and 23 of the GATT, Technical barriers to trade sometimes called the Standards Code, Import licensing procedures, Government

because only a few state participants signed it. The plurilateral agreement did not bind all the states but only the states who signed the agreement.⁷⁴ In addition, this type of agreement was known as the Tokyo Round "codes".⁷⁵

In the Tokyo Round, developing countries insisted on embodying some rules accommodating their special needs which were different from the developed countries. As noted by Abdulqawi, developing countries participated in the trade negotiations and proposed specific measures in the Group on Tariffs for the improvement of GSP and for the safeguarding of preferential tariff margins from erosion, which may result from MFN tariff reductions, as well as for the securing of compensation in the case of such erosion. The negotiations also succeeded on the elaboration of an enabling clause that would permanently insert the preferences in the general body of GATT law.⁷⁶ In the Declaration of Ministers approved in Tokyo on 14 September 1973, the Contracting Parties to the GATT recognised the importance of maintaining and improving the Generalised System of Preferences. As a result, the GATT Contracting Parties approved the "enabling clause" which provides a permanent legal basis within the GATT for the preferential treatment of developing states.⁷⁷ Thus, one of the outcomes of the Tokyo Round was the declaration, which concerned "the need for special measures to be taken in the negotiations to assist the developing countries in their efforts to increase their export earnings and to promote economic development".⁷⁸

The focal point of the first five negotiation rounds of GATT was on the reduction of tariffs. However, starting from the Kennedy Round (1964-7) the topic of negotiation was broadened and shifted to non-tariff barriers, it was noticed that its non-tariff barriers had become a more serious barrier to trade than tariffs. The Tokyo Round (1973-1979) resulted in more agreements in the area of non-tariff barriers than the Kennedy Round. Nevertheless, the agreements were made mostly in the plurilateral context; in this regard, difficulties were created in its implementation because it did not bind many state parties. The GATT was not very successful in reducing non-tariff barriers compared to tariff reductions. In the regard of negotiations of non-tariff

procurement, Customs valuation - interpreting Article 7, Anti-dumping - interpreting Article 6, replacing the Kennedy Round code, Bovine Meat Arrangement, International Dairy Arrangement, and Trade in Civil Aircraft.

⁷⁴ See Van den Bossche, Peter., , Cambridge University Press, United Kingdom, 2005, p. 82; J. Jackson *The Law and Policy of the World Trade Organization, Text, Cases and Materials*, The World Trade Organization : Constitution and Jurisprudence (Royal Institute of International Affair, 1998). 24.

⁷⁵ The codes covered the following :

1. The Customs Valuation Agreement provided greater uniformity in the methods of calculating the value of goods on which ad valorem duties were based. It therefore limited the arbitrary valuation of imported goods which in many cases restricted trade.
2. The Agreement on Import Licensing Procedures was designed to simplify the administration of import licensing and to prevent licensing from becoming an import barrier in its own right.
3. The Agreement on Government Procurement aimed at promoting greater competition in the government procurement market by opening it up to foreign firms.
4. The Agreement on Subsidies and Countervailing Measures sought to control the use of subsidies and ensure they were not an unwarranted distortion of trade. Countervailing duties should not impede trade in an unjustifiable way.
5. The Agreement on Technical Barriers to Trade (Product Standards) aimed to prevent governments from establishing standards that created unnecessary obstacles to international trade. Furthermore, countries were encouraged to use existing international standards and to be transparent in establishing and applying national standards.

The Antidumping Agreement regulated the use of anti-dumping duties and associated procedures when governments decided to impose such duties in situations where exports were sold at less than their normal value.

⁷⁶See Yusuf, Abdulqawi, *Legal Aspects of Trade Preferences for Developing States: A Study in the Influence of Development Needs on the Evolution of International Law*, Martinus Nijhoff Publishers, The Hague, Netherland 1982., p.149.

⁷⁷ See *Ibid.*, p.160.

⁷⁸ See World Trade Organization, World Trade Report 2007, *Op.Cit.*, p. 186.

barriers, which were more complex, more than simply commitment was needed, and thus urged the establishment of an international organisation of trade. The United States and a few other countries brought a new issue in the area of Intellectual Property Rights onto the negotiations table.⁷⁹ As noted by Jackson “the world was becoming increasingly complex and interdependent”, in this context, the GATT rules were needed to regulate the measures carried out by the states in international trade.⁸⁰ Hence the establishment of a new round of trade negotiations in the early 1980s was extremely urgent because international trade was dealing with more extensive and complex problems.⁸¹

The next Ministerial Meeting took place in Punta del Este, Uruguay, on 14 September 1986. Two main important topics were brought onto the negotiations table. The first topic concerned “greater liberalisation” (in agriculture), as demanded by developing countries, and certainty for “more discipline and predictability”, considering the EC position. The second topic was related to a new subject, i.e. intellectual property rights, services, and investment. The Punta del Este meeting was completed⁸² in one week, on 20 September 1986, thus the new round, known as the Uruguay Round, eventually commenced.⁸³

The Final Agreement of the Uruguay Round was concluded on 15 April 1994 in Marrakesh, Morocco and was signed by 120 contracting parties. However, the results of the final agreement were not satisfying for all of the participating states because the scope of agreement was very limited and far from the outset of the Punta del Este Declaration.⁸⁴ Even so, the Uruguay Round was noted as the greatest achievement in history on the multilateral trading system. Fundamental progress in the international trading system had been born in the form of the World Trade Organization.⁸⁵ The fundamental basis for establishing the international trade organization is stipulated in the Preamble of the WTO Agreement.

“[...] Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development [...]”

⁷⁹ See Van den Bossche, Peter., 2005, *Op. Cit.*, p. 82; J. Jackson, *The World Trade Organization : Constitution and Jurisprudence* (Royal Institute of International Affair, 1998), *Op. Cit.*, p. 24.

⁸⁰ See *Ibid.*

⁸¹ See Van den Bossche, Peter., 2005, *Op. Cit.*, p. 82.

⁸² The Declaration of Punta del Este covered many important issues for negotiations on tariffs, non-tariff measures, tropical products, natural resource-based products, textiles and clothing, agriculture, GATT Articles, safeguards, the codes of the Tokyo Round, subsidies and countervailing measures, dispute settlement, trade-related aspects of intellectual property rights, trade-related investment measures, the functioning of the GATT system and trade in services. The scope of topic covered by Uruguay Round was the most ambitious trade negotiation ever undertaken. There were 15 negotiating groups established and started their work in February 1987. World Trade Organization, *World Trade Report 2007, Six Decades of Multilateral Trade Cooperation : What We Have We Learnt?*, World Trade Publications, World Trade Organization, ISBN 978-92-870-3401-4, Switzerland, 2007, p. 190.

⁸⁴ The Punta del Este Declaration set the goal of “bringing all measures affecting import duties and export competition under strengthened and more operationally effective GATT rules and disciplines”. See Ministerial Declaration on the Uruguay Round, GATT Doc. MIN. DEC (Sept. 20 1986), at 6, reprinted in GATT, BISD 33d Supp. At 19, 24 (1987) [Punta del Este Declaration].

⁸⁵ See Stewart, Terence P., *The GATT Uruguay Round : Negotiating History (1986-1994)*, Volume IV: The End Game (Part I), ISBN 9041192921, Kluwer Law International, The Hague, The Netherland, 1999, p. 3.

“[...] Recognizing further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development [...]”

In conclusion, the critical objectives of the World Trade Organization are to increase standards of living, the attainment of full employment, the growth of real income and effective demand, and the expansion of production, and trade in goods and services. In order to achieve these objectives, the WTO has to consider the “needs” of protecting the environment and “development needs” of developing countries.⁸⁶ The urgency of sustainable economic development and integration of developing countries, especially LDCs, in the multilateral trading system was emphasised in the preamble of the agreement. While, both those features were not covered by GATT 1947.⁸⁷

The key function of the WTO is providing the common institutional framework for conducting trade relations among its members under legal instruments incorporated in the Agreement.⁸⁸ The WTO constitutes codes of conduct for member states to establish international cooperation on trade-related policies. These codes enacted through negotiations among member states.⁸⁹ Explicitly, Article III of the WTO Agreement stipulates its main function’s in the international trade:

1. *The WTO shall facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements.*
2. *The WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to this Agreement.*
3. *The WTO may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.*
4. *The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter referred to as the "Dispute Settlement Understanding" or "DSU") in Annex 2 to this Agreement.*
5. *The WTO shall administer the Trade Policy Review Mechanism (hereinafter referred to as the "TPRM") provided for in Annex 3 to this Agreement.*
6. *With a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies.*

⁸⁶ See Van den Bossche, Peter., 2005, *Op. Cit.*, p. 87.

⁸⁷ In the *US-Shrimp cases* para. 153, the Appellate Body states : [The language to the Preamble to the WTO Agreement] demonstrates a recognition by WTO negotiators that optimal use of the world’s resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add colour, texture and shading to our interpretation of the agreement annexed to the WTO Agreement, in this case, the GATT 1994. We have already observed that Article XX (g) of the GATT 1994 is appropriately read with the perspective embodied in the above preamble.

⁸⁸ Agreement Establishing The World Trade Organization article II paragraph 1; in terms to provide a legal framework for incorporating the result of negotiation directed toward “reciprocal and mutually advantageous exchange of market access commitments on a non-discriminatory basis”. Typically, such an outcome is obtained through reduction of tariffs and other barriers to trade.

⁸⁹ See Hoekman, Bernard, et. al, 2002, *Op.Cit.*, pg. 46. The WTO can be seen as a market in the sense that countries come together to exchange market access commitments on a reciprocal basis. It is, in fact, a barter market. In contrast to the markets one finds in city squares, countries do not have access to a medium of exchange: they do not have money with which to buy, and against which to sell, trade policies. Instead they have to exchange apples for oranges: for example, tariff reductions on iron for foreign market access commitments regarding cloth. This makes the trade policy market less efficient than one in which money can be used, and it is one of the reasons that WTO negotiations can be a tortuous process. One result of the market exchange is the development of codes of conduct. The WTO contains a set of specific legal obligations regulating trade policies of member states, and these are embodied in the GATT, the GATS, and the TRIPS agreement.

The Agreement Establishing the WTO basically adopted the traditional concept theory of state in the matter of “functions of public authority”. According to this theory, with regards to the “state’s inner sphere”, there are three public functions, consisting of legislative, executive and adjudicative functions.⁹⁰ These three functions are set forth in Article III of the WTO Agreement with regard to Functions of the WTO. The executive function is laid down in Article III:1⁹¹, the legislative function is laid down in Article III:2⁹² and the adjudicative function is laid down in Article III:3⁹³. While Article III:5⁹⁴ of the WTO Agreement puts concern on international relations. Article IV of the WTO Agreement combines executive and adjudicative aspects. In this regard, the WTO followed the separation powers theory.⁹⁵

Concerning the exercising of the legislative function, the agreement stipulates that the WTO “shall provide the forum for negotiations”⁹⁶. The executive function is exercised by “facilitating the implementation, administration, and operation” of the Agreement. According to the negotiation process the WTO is not intended to “institutionalise any autonomous political process”. Therefore, its objective emphasises the “serving” function to its members, considering itself as a “member-driven institution”⁹⁷. In this context, contrast with the function of another institution, for example IMF which equipped a “greater operational autonomy” of the IMF Executive Board. On the other hand, the function of the WTO Director General is only regarded as “institution driven”.⁹⁸

The adjudicative function, as laid down in Article III:3, referred to the Dispute Settlement of Understanding or DSU. This mechanism of dispute settlement substantively has an autonomous function. With respect to the fairness principle, referring to Article 6.1 of the DSU, the adjudicative procedure “does not depend on the consent of the respondent member”. Articles 8.6 and 8.7 of the DSU embody the independency principle of the adjudicative process of “the nomination of the panellists” by the Secretariat and the Director-General. The adoption of the adjudicative decision is stipulated in Articles 16.4 and 17.14 of the DSU, respectively.⁹⁹

The WTO is considered as the means of globalisation, and has given a great contribution to international trade relations and the development of world economy for more than 50 years. The multilateral trading system (MTS) catalyses the rapid liberalisation of trade based on “stability, predictability, and transparency”. The achievement of the WTO has been proved by enlargement of membership, as noted, in

⁹⁰ See G. Jellinek, *Allgemeine Staatslehre*, 3rd edition, 1928, 609 et seq.; G. Zimmer, *Funktion – Kompetenz – Legitimation: Gewaltenteilung in der Ordnung des Grundgesetzes*, 1979, 33 et seq.

⁹¹ The WTO shall facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements.

⁹² The WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to this Agreement. The WTO may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.

⁹³ The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes.

⁹⁴ With a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies.

⁹⁵ See Von Bogdandy, Armin., p. 609 ; Frowein, Jochen A, et. al, 2001, *Op. Cit.*, p. 614.

⁹⁶ In WTO Negotiation Rules Governments negotiate only if they want and what they want based on general rule of consensus between states members.

⁹⁷ Available at :http://www.wto.org/english/thewto_e/whatis_e/10mis_e/10m01e.htm “In fact . it’s governments who dictate to the WTO”.

⁹⁸ See Von Bogdandy, Armin., p. 609 ; Frowein, Jochen A, et. al, 2001, *Op. Cit.*, p. 615.

⁹⁹ See Von Bogdandy, Armin., p. 609 ; Frowein, Jochen A, et. al, 2001, *Loc. Cit.*, p. 615.

23 July 2008, the WTO had 153 members¹⁰⁰, and with more than 30 countries in the process of accession. Consequently, the WTO has covered 97% of world trade volume.¹⁰¹

The member states of the WTO have the opportunity to take part in the decision-making of essential aspects of international trade and to design their development policies to be more predictable and stable.¹⁰² However, the insufficiency of understanding about the WTO could slow down the implementation of national ratification. As noted by Jackson, “the implications of the Uruguay Round Agreement are undoubtedly not fully understood yet by any government that has accepted them”, this is particularly critical since the agreement “has such potentially profound effects on the economic well-being and activity of billions of citizens”.¹⁰³

Currently, the accession issues of WTO have become very important for developing countries and non-market economies because most industrialised countries had joined GATT from the early negotiation rounds. As noted, the demand of developing countries with respect to Special and Differential (S&D) Treatment is accommodated in pragmatism and compromise during the negotiation rounds.¹⁰⁴

Most developing countries joined WTO by succession rather than accession, because most were former colonies, such as countries in the Caribbean and Africa and in some parts of Asia. For instance, Ghana and Malaysia both joined in 1957 under a succession mechanism that allowed newly independent territories to succeed to the rights and obligations of their “parent states”.¹⁰⁵ Former colonies entered the WTO under the exceptional condition as set forth in Article XXVI:5(c). Under this provision former colonies received the ease of joining by acquiring *de facto* GATT status on achieving independence, later the states could then convert *de facto* status into full GATT contracting party status by succession. The mechanism of succession was not so difficult and had fewer new commitments than the accession process under Article XXXIII of GATT. Nevertheless, several countries of former colonies preferred to wait several years and joined WTO using the accession mechanism, which is more difficult and more complicated. However, it should be noted that half of the developing countries joined WTO using the accession mechanism. On the other hand, some former colonies refused to use the succession mechanism on the grounds of ideological issues, considering both the institution and the rule as neo-colonialism.¹⁰⁶

The mechanisms of accession provided by the WTO are more difficult compared to accession to GATT 1947 based on various reasons.¹⁰⁷ In the accession mechanism,

¹⁰⁰ See *Understanding The WTO: The Organization: Members and Observers*, available at : http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm, last accessed : 2 March 2011.

¹⁰¹ See Naray, Peter, *Integration of countries into the multilateral trading system: The role of institutions and the human factor, Aspects of economic and institutional integration into the WTO*, Former Permanent Representative of Hungary to the UN Office in Geneva, , United Nations Conference On Trade And Development, WTO Accessions and Development Policies, United Nations, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11, p. 96, Available at : http://www.unctad.org/en/docs/ditctncd11_en.pdf, last accessed : September 2010.

¹⁰² See Ricupero, Rubens, Secretary-General of UNCTAD, *United Nations Conference On Trade And Development, WTO Accessions and Development Policies, United Nations*, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11, available at : http://www.unctad.org/en/docs/ditctncd11_en.pdf, last accessed : September 2010.

¹⁰³ See Von Bogdandy, Armin., p. 609 ; Frowein, Jochen A, et. al, 2001, *Loc. Cit.*, p. 615.

¹⁰⁴ See VanGrasstek, Craig, *Why demands on acceding countries increase over time: A three-dimensional analysis of multilateral trade diplomacy*, President, Washington Trade Reports, USA, United Nations Conference On Trade And Development, WTO Accessions and Development Policies, United Nations, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11, p. 84, available at : http://www.unctad.org/en/docs/ditctncd11_en.pdf, last accessed : November 2010.

¹⁰⁵ See Hudec, Robert E., 1987, *Op. Cit.*, p. 31.

¹⁰⁶ See VanGrasstek, Craig, 2001, *Loc. Cit.*, p. 84.

¹⁰⁷ Accession to the WTO involves a considerably more complex and difficult process than that for accession to the GATT 1947. First, the WTO Multilateral Trade Agreements (MTAs) involve more stringent and detailed rules and disciplines covering trade in goods, and the scope of these rules and disciplines has been expanded to cover trade

recognised as a unilateral procedure¹⁰⁸, the trade regime of the acceding country must comply with all the rules and disciplines as set out in the Multilateral Trade Agreements (MTAs). Further, it includes policies in the area of trade, service, agriculture, investment, communications, and transportation, aspects of immigration laws and other related areas¹⁰⁹. Consequently, it openly affects their trade policies and practices¹¹⁰. In addition, the acceding country has an obligation and has to pay a “membership fee”, “in conditions of specific concessions on tariff rates, commitments on agricultural subsidies and commitments on trade in services”. They are then granted rights to enjoy the profits from the liberalisation achieved during the previous multilateral negotiations under the WTO on an equal basis, in compliance with the principle of reciprocity and mutual benefit.¹¹¹

As noted by Ognivtsev et al., accession to the WTO, as before the GATT 1947, is shown as the organisation’s institutional specificity as an “umbrella” organisation for the administration, implementation and negotiation of intergovernmental contractual obligations with regard to multilateral trade relations.¹¹² Throughout the accession process, the acceding country has to accept rules and disciplines to be adopted in its strategic sector such as its economic, legislative, judicial and administrative systems in order to participate effectively in negotiations and afterwards to implement its obligations as a WTO member. The mechanism process of accession actually gives a lot of contribution “to building the country’s institutional capacity”, such as the implementation of good governance (transparency, accountability, rules of law, and fairness), sustainable development and efficiency in economic and trade regimes. This building foundation is very important to enhancing its capacity to defend its rights in future negotiations at all levels.¹¹³

According to Gibbs, the backdrop of accession negotiations is disparities in the WTO rights and obligations itself. In several cases, demands for commitments have departed from the scope of the WTO Agreements. For example, countries required to accept plurilateral agreements, which are an optional Agreement under Annex 4 of the WTO Agreements, with respect to privatisation and economic reform, elimination of

in services (which could cover investment, transport, communication, the movement of persons, etc.) as well as the protection of intellectual property rights. These new rules and disciplines intrude further into areas traditionally perceived as belonging to domestic policy. In addition to bringing their trade regime into conformity with the multilateral disciplines, acceding countries are required to negotiate concessions on reduction and bindings of tariffs, commitments on agricultural subsidies, and specific commitments on trade in various services sectors. Second, the attitude of the major trading countries vis-à-vis acceding countries has become more demanding, thus effectively increasing the “standard of accession”. Some have taken the position that acceding countries should accept a level of obligations higher than that accepted by the original members of the WTO. In practice, this has meant that acceding countries have had to accept a degree of tariff bindings and commitments on services comparable to that of the most advanced countries, and that they have not been able to benefit from all the relevant special and differential (S&D) provisions in favour of developing countries and economies in transition, and have been required to accept some of the “plurilateral” agreements. (Ognivtsev, Victor, et. al, 2001, p. 116.)

¹⁰⁸ See Ognivtsev, Victor., et. al, *Accession to the WTO: The process and selected issues*, United Nations Conference On Trade And Development, *WTO Accessions and Development Policies*, United Nations, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11, p. 122, available at : http://www.unctad.org/en/docs/ditctn11_en.pdf. *In the sense that all requests and demands are placed by WTO members on the acceding country, while the acceding country cannot submit requests to WTO members.*

¹⁰⁹ See Gibbs, Murray, Senior Advisor to the Secretary-General of UNCTAD, *United Nations Conference On Trade And Development, WTO Accessions and Development Policies*, United Nations, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11, available at : http://www.unctad.org/en/docs/ditctn11_en.pdf.

¹¹⁰ See Ognivtsev, Victor, et. al, 2001, Loc. Cit, p. 122.

¹¹¹ *Ibid.*, p. 122. *In the sense that all requests and demands are placed by WTO members on the acceding country, while the acceding country cannot submit requests to WTO members.*

¹¹² See *Ibid.*

¹¹³ See Ricupero, Rubens, Secretary-General of UNCTAD, *United Nations Conference On Trade And Development, WTO Accessions and Development Policies*, United Nations, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11, available at : http://www.unctad.org/en/docs/ditctn11_en.pdf.

price and profit controls, and the binding of export duties. The provisions for special and differential treatment (S&D) in the Multilateral Trade Agreements are considered inadequate by developing countries. For example, with respect to the transitional periods, it has been demonstrated very difficult for acceding developing countries to get benefit from such provisions. The other result is that the acceding developing countries become subject to a set of obligations and commitments that may not be able to be implemented. In other words, developing countries lack infrastructure and resources to implement all WTO commitments.¹¹⁴

To sum up, there are two main obligations of WTO members. First, the Members of WTO have to ensure the conformity of their laws, regulations, and administrative procedures with the agreements. Second, the Members of WTO have to participate actively in trade liberalisation rounds. As derived from the emergence of the GATT/WTO system, both obligations constitute difficulties for all developing countries, though in different forms and degrees, depending on the level of economic and institutional development.¹¹⁵

There are five essential principles which have importance in understanding both the pre-1994 GATT and the WTO, consisting of the non-discrimination principle, security and predictability of market access, fair trade, transparency and increasing the participation of developing countries in the multilateral trading system.¹¹⁶

The principle of non-discrimination has two main components: the Most Favoured Nation (hereinafter MFN) rule, and the national treatment principle. Both of these two principles are assembled across the WTO rules on goods, services, and intellectual property. However, those rules have different essence. The WTO applied the unconditional MFN. The background of applying the MFN system was for economic reason, if the policy does not discriminate between foreign suppliers, importers and consumers there will be an incentive to use the lowest cost foreign supplier. MFN also provides given specific countries preferential treatment for foreign policy reasons through an exemption system.¹¹⁷ The national treatment obliges each WTO Member to treat nationals of other Members at least as well as it treats its own nationals as stated by Article III of GATT 1994. The GATT addresses trade in goods, and in that context, national treatment requires non-discriminatory treatment of “like products” or tangible¹¹⁸ things. The national treatment applies only when the product or service has entered the market in which it should be treated equally. Subsequently, imposing customs duty on an import is not considered as a violation of national treatment even though locally produced products are not charged an equivalent tax.¹¹⁹ The national treatment principle has often invoked dispute settlement cases brought to the GATT. What matters is the existence of discrimination, not its effects.¹²⁰

The second principle of the WTO is security and predictability of market access with respect to the tariffs binding commitment and lowering trade barriers. The stability and certainty of tariffs policies play a crucial role in international trade. For

¹¹⁴ See Gibbs, Murray, 2001, *Op.Cit.*

¹¹⁵ See Naray, Peter, Integration of countries into the multilateral trading system: The role of institutions and the human factor, Aspects of economic and institutional integration into the WTO, Former Permanent Representative of Hungary to the UN Office in Geneva, United Nations Conference On Trade And Development, WTO Accessions and Development Policies, United Nations, New York and Geneva, 2001, UNCTAD/DITC/TNCD/11 p. 98, available at : http://www.unctad.org/en/docs/ditctn11_en.pdf.

¹¹⁶ See Hoekman, Bernard, et. al, 2002, *Op.cit.* ; Understanding The WTO: Basics Principles of the trading system, available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm.

¹¹⁷ See Hoekman, Bernard, et. al, 2002, *Op. Cit.*, p. 42.

¹¹⁸ Available at : http://www.iprsonline.org/unctadictsd/docs/RB_Part1_Nov_1.3Update.pdf

¹¹⁹ See Understanding The WTO: Basics Principles of the trading system, available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm.

¹²⁰ See Hoekman, Bernard, et. al, 2002, *Op. Cit.*, p. 43.

example, once a state has entered into agreement of tariff binding at a certain level in GATT, this means that the state has committed itself not to raise the tariff above that level except by negotiation with compensation for affected trading partners. In other words this means that it is prohibited for a state that has signed an agreement on tariff binding to increase the tariff level “unilaterally” above the tariffs boundary.¹²¹ Signing consent into agreement whether to increase or to lower trade barriers is crucial in trade, since, the agreement provides assurance and security for the trader and investors.¹²² According to Hoekman, “once tariff commitments are bound, it is important that there be no resort to other, non-tariff, measures that have the effect of nullifying or impairing the value of the tariff concession”.¹²³ In this regard, the WTO regime requires governments to open their policies and practices to the public and to notify the WTO. Stability and predictability encourage investment growth, which generates employment and creates fair competition, so that consumers can enjoy competitive prices and the best quality of trade and services. In short, the purpose of the multilateral trading system is to establish stability and predictability in the business environment.¹²⁴ Once countries have signed the agreement under the WTO regime, they are required to open their markets for goods or services, and are “bound” to their commitments. However, such countries, as explained above, may re-negotiate their commitment with the trading partners in order to agree on compensation for the loss of trade. The Uruguay round has increased the number of tariff binding agreements, for example, 100% of agriculture products now have bound tariffs.¹²⁵

The third principle of the WTO is to promote fair trade in the multilateral trading system.¹²⁶ Fair Trade is considered as a strategy for alleviating poverty and implementing sustainable development. Fair trade or fair business competition complies with the objectives of the WTO to raise standards of living, whereas it opens equal opportunities to the producers, traders, investors or other business actors who have been economically deprived or marginalised by the unfair conventional system. Fair trade is defined as equal trading partnership. Fair trade must be done based on fair negotiation, transparency, and must take into consideration the equity in international trade relations. Offering better trading conditions and securing the rights of marginalised producers and workers, especially in developing countries, contributes to sustainable development. Fair Trade Organisations, as organisations backed by consumers, are involved actively in supporting producers, awareness raising and in campaigning for changes in the rules and practice of conventional international trade.¹²⁷

Fair trade under the WTO regime is embodied in Article VI of the GATT on Anti-dumping, Countervailing Duties,¹²⁸ and Article XXVI on Subsidies. Both of these articles

¹²¹ See *Ibid*, p. 43.

¹²² See *Ibid*, p. 43.

¹²³ See *Ibid*, p. 43.

¹²⁴ See *Ibid*, p. 43.

¹²⁵ See *Ibid*, p. 43.

¹²⁶ Non-tariff barriers are the most frequent targets of complaint, followed closely by a large number of cases dealing with “unfair” trade practices or the measures taken to offset them (subsidies, antidumping/countervailing duties). (World Trade Report 2007, p. 34).

¹²⁷ Definition as agreed by FINE : In 1998, four key international organizations, based in Europe, created a widely accepted definition of Fair Trade. Fairtrade Labeling Organization (FLO), International Fair Trade Association (now World Fair Trade Organization, WFTO), the Network of European Worldshops (NEWS) and the European Fair Trade Association (EFTA) created a workgroup known as FINE, an acronym of their names, available at : <http://www.fairtraderesource.org/wp/wp-content/uploads/2010/02/what-is-fair-trade.pdf>.

¹²⁸ GATT (Article 6) allows countries to take action against dumping. The Anti-Dumping Agreement clarifies and expands Article 6, and the two operate together. They allow countries to act in a way that would normally break the GATT principles of binding a tariff and not discriminating between trading partners typically anti-dumping action means charging extra import duty on the particular product from the particular exporting country in order to bring its

provide provisions on unfair trade conduct, particularly on dumping and subsidies.¹²⁹ The measures of anti-dumping and countervailing are only invoked if the presence of domestic injury by unfair trade practices of imports is proven.¹³⁰ There are some foreign anti-competitive practices that come from outside their jurisdiction but could injure competition in the domestic market, such as international cartels or some mergers.¹³¹ Under the GATT regime on non-discrimination, MFN and national treatment are aimed to protect fair conditions of trade.¹³²

The fourth principle of the WTO is transparency¹³³, as the primary principle of the WTO, and it is a legal obligation, embedded in Article 10¹³⁴ of the GATT. Provisions

price closer to the “normal value” or to remove the injury to domestic industry in the importing country. Anti-dumping measures can only be applied if the dumping is hurting the industry in the importing country. Therefore, a detailed investigation has to be conducted according to specified rules first. The investigation must evaluate all relevant economic factors that have a bearing on the state of the industry in question. If the investigation shows dumping is taking place and domestic industry is being hurt, the exporting company can undertake to raise its price to an agreed level in order to avoid anti-dumping import duty, available at : http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm.

¹²⁹ See Hoekman, et. al, 2002 : Articles aimed at ensuring “fair competition” include the right to impose countervailing duties on imports that have been subsidized and antidumping duties on imports that have been dumped (sold at a price below that charged in the home market).

¹³⁰ Differentiation of application anti-dumping and countervailing duties with safeguard measures: dumping or subsidization may be supplier- or country-specific, anti-dumping and countervailing measures are imposed only on those suppliers whose products are found to be dumped or subsidized, i.e., the measures are not applied on an MFN basis. Safeguard measures are in principle applied on an MFN basis, i.e., are meant to apply to all sources of imports, although developing countries can be excluded from their application if those countries account for a small share of imports. Finally, since anti-dumping and countervailing measures are applied in response to specified trade practices (dumping or subsidization), there is no requirement to offer compensation to the affected trade partner. In contrast, a country applying a safeguard measure – which is in response to an import surge that has harmed its domestic industry, rather than in response to the effects of a particular trading practice – has to offer compensation for the adverse effects of the measure on trade partners

¹³¹ See Bilal, Sanoussi, *Trade and Competition Policy: Perspectives for Developing Countries*, Overseas Development Institute, London, available at : <http://www.odi.org.uk/resources/download/3598.pdf>.

¹³² Trade agreements define rules for the conduct of trade policy. These rules must strike a balance between commitments and flexibility. Too much flexibility may undermine the value of commitments, but too little flexibility may render the rules politically unsustainable. This tension between credible commitments and flexibility is often close to the surface during trade negotiations. Many of the kinds of flexibilities associated with trade agreements are generally referred to as escape clauses, contingency measures, trade remedies or safety valves. These terms will often be used interchangeably. The fundamental reason for incorporating escape clauses of various kinds into trade agreements is for governments to manage circumstances that cannot be anticipated prior to their occurrence. These may involve unexpected increases in imports from foreign suppliers or “unfair” trade practices, such as dumping and subsidies or the political desire to modify existing policy commitments. A trade agreement that offers such possibilities without unduly weakening existing contractual commitments has a better chance of remaining robust than an agreement that results in regular non-compliance by World Trade Organization (WTO) members in response to such circumstances. In addition, these measures allow governments to undertake deeper commitments, while reducing the political costs of signing the agreement. (See World Trade Report, 2009).

¹³³ Internal and external transparency have less to do about clarification of the provisions in multilateral agreements as with laying bare the process of decision-making in the institution or organization itself. The objective of internal transparency is to make decision-making in the WTO transparent and genuinely inclusive. It includes the outreach by the WTO to the smallest and poorest WTO Members, particularly to those without WTO missions in Geneva (non-resident delegations). External transparency refers to the WTO’s efforts to engage with civil society groups and the public at large. Much of this involves making available official WTO documents, reports, submissions by WTO Members and trade-related statistics. Other activities related to external transparency involve giving civil society groups access to relevant WTO meetings, including the Ministerial Conferences, and the holding of public forums to better explain the institution and WTO Agreements. (See World Trade Report 2007, p. 207).

¹³⁴ See Article X of the GATT requires Members to “publish promptly in such a manner as to enable governments and traders to become acquainted with them” all information related to the administration of trade regulations. The essential idea behind the publication obligation is that other WTO Members that are likely to be affected by governmental measures should have a reasonable opportunity to acquire information about such measures and either to adjust their activities or to seek modification of such measures. Notification provisions are, in terms of count, the most commonly found transparency mechanism in the WTO Agreements. Notifications are required to inform other Members about the enactment of legislation, or the adoption of new measures, or the progress made in the implementation of commitments (World Trade Report 2007, p. 207).

on transparency are spread across the range of WTO Agreements.¹³⁵ Transparency gives many advantages to trade. The WTO members are required to publish their trade laws and regulations, to establish and maintain institutions allowing for the review of administrative decisions affecting trade, to respond to requests for information by other members, and to notify changes in trade policies to the WTO. The Trade Policy Review is a periodic country specific report, prepared by the secretariat and discussed by the WTO General Council, as a tool to enhance internal transparency which is supplemented by multilateral surveillance of the trade policies of WTO members. External surveillance¹³⁶ also promotes transparency, both for public society inside the country and for foreign business actors. It is also considered as a tool to reduce the scope for countries to breach their obligations and minimise uncertainty with respect to the prevailing policy measures. Trade policy reviews are used by public access general trade policies taken by their government as a source of information. In order to encourage public participation in the mechanism of public policy planning of trade. As viewed from an economic perspective, transparency can also help reduce uncertainty related to trade policies.¹³⁷ The Trade Policy Review Mechanism is an effective tool to encourage transparency both domestically and at the multilateral level.¹³⁸ Information transparency is crucial for business actors such as traders and investors, because it is also used for the appraisal of feasibility of the business prospectus. The government and other authorities are required to publish all laws, regulations, and practices that can have an effect on trade or investment under WTO rules and regulations.¹³⁹

¹³⁵ See Article X of the GATT, Article III of the GATS, and Article 63 of the TRIPS agreement all require that relevant laws, regulations, judicial decisions, and administrative rulings be made public. More than 200 notification requirements are embodied in the various WTO agreements and mandated by ministerial and council decisions

¹³⁶ Surveillance in the WTO, takes place principally through the various committees or WTO bodies that have been established by the WTO Agreements. The raw material of this surveillance comes from the notifications, complaints and requests for consultations by Members as well as reports prepared by the Secretariat. Thus there is an important link between the observance of transparency by Members, their ability to provide timely and accurate notifications to various WTO organs and the quality of the surveillance function of the WTO. (See World Trade Report 2007, p. 207).

¹³⁷ See Hoekman, Bernard, et. al, 2002, *Op. Cit*, p. 44.

¹³⁸ The Trade Policy Review Mechanism (TPRM) established under Annex 3 of the Marrakech Agreement. Its purpose is: "to contribute to improved adherence by all Members to rules, disciplines and commitments made under the Multilateral Trade Agreements and, where applicable, the Plurilateral Trade Agreements, and hence to the smoother functioning of the multilateral trading system, by achieving greater transparency in, and understanding of, the trade policies and practices of Members. Accordingly, the review mechanism enables the regular collective appreciation and evaluation of the full range of individual Members' trade policies and practices and their impact on the functioning of the multilateral trading system. It is not, however, intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures, or to impose new policy commitments on Members." This objective is to be realized through regular reviews of a Member's trade policies and practices. Before this, a peer review mechanism of a Member's trade policy had been provisionally established in 1988, (World Trade Report 2007, p. 206). The TPRM was originally motivated in part by concerns stemming from the fact that the only available review of global trade policies at the time was produced by the United States (Keesing 1998). The TPRM is an important element of the WTO because it fosters transparency and enhances communication, thereby strengthening the multilateral trading system. Country specific reviews are conducted on a rotational basis, and the frequency of review is a function of a member's share in world trade. The four largest players the European Union, the United States, Japan, and Canada are subject to review by the WTO General Council every two years. In principle, the next 16 largest traders are subject to reviews every four years, and the remaining members are reviewed every six years. A longer periodicity may be established for least-developed countries. The trade policy review (TPR) for a country is based on a report prepared by the government concerned and on a report by the WTO Trade Policies Review Division. TPRs are supplemented by an annual report by the Director General of the WTO that provides an overview of developments in the international trading environment (Hoekman, et.al, 2002).

¹³⁹ See WTO Origin and Principles, p. 13, available at : [http://www.ifc.org/ifcext/mekongpsdf.nsf/attachmentsbytitle/wto-eng-chapter4/\\$file/wto-eng-chapter4.pdf](http://www.ifc.org/ifcext/mekongpsdf.nsf/attachmentsbytitle/wto-eng-chapter4/$file/wto-eng-chapter4.pdf), last accessed : November 2010.

In the 1950s, the major change in the relationships between poor and rich countries began. According to Karin Kock¹⁴⁰, the critical issue that influenced GATT affairs between developed countries and developing countries is when “the large number of British and French colonies” achieved their independency.¹⁴¹ This situation changed the legal relationship between parent countries and its former colonies became equal trading partners with the inequalities of economic development stages.¹⁴²

The original contracting of the GATT 1947 consisted of twenty-three states of which ten were developing countries.¹⁴³ Afterwards in the Annecy Round 1949, four developing countries joined GATT.¹⁴⁴ Indonesia as a new independent state, became a contracting party of GATT in 1950, five years after it had declared its independence on 17 August 1945. The developing countries that joined GATT increased as the period of colonialism came to an end. During the Torquay Round 1951, Peru and Turkey negotiated their memberships. As noted by Hudec, by the end of the decade, the total membership of developing countries in the GATT stood at only 37 and developed countries still held a 21-16 majority.¹⁴⁵ By the mid-1970s, there were seventy-seven contracting parties in the GATT, consisting of 25 developed countries and 52 developing countries.¹⁴⁶ Thus, after the Marrakech agreement, there was a significant increase in the membership of the WTO, whereas the developing countries dominated the majority¹⁴⁷ of membership. The principle embodied in the WTO, which recognised special needs of economic development, had attracted developing countries to participate in the multilateral trading system.¹⁴⁸

Hence, it was proven that trade liberalisation gave a positive impact to economic development especially in developing countries.¹⁴⁹ Fundamentally, the WTO regime aimed to contribute to the development. In addition, developing countries needed “leniency” to implement the agreements in their domestic policies. They needed to

¹⁴⁰ The Swedish expert on GATT affairs.

¹⁴¹ See Karin Kock, *International Trade Policy and the GATT 1947-1967*, *op. cit.*, p. 236; Hudec, Robert E., 1987, *Op. Cit.*, p. 42.

¹⁴² See Hudec, Robert E., 1987, *Op. Cit.*, p. 42.

¹⁴³ The Developing countries, which are the original Contracting Parties of GATT: Brazil, Burma, China, Ceylon, Chile, Cuba, India, Pakistan, Syria and Lebanon, however, within the first few years China (by then the Taiwan government), Lebanon and Syria withdrew from the memberships.

¹⁴⁴ The Developing countries, joined in Annecy round : The Dominican Republic, Haiti, Nicaragua and Uruguay.

¹⁴⁵ See Hudec, Robert E., 1987, *Op. Cit.*, p. 31.

¹⁴⁶ See *Ibid.*, p. 32.

¹⁴⁷ Over three quarters of WTO members are developing countries and countries in transition to market economies. During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberalization programmes autonomously. At the same time, developing countries and transition economies were much more active and influential in the Uruguay Round negotiations than in any previous round, and they are even more so in the current Doha Development Agenda. At the end of the Uruguay Round, developing countries were prepared to take on most of the obligations that are required of developed countries. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them. More recently, developed countries have started to allow duty-free and quota-free imports for almost all products from least-developed countries. On all of this, the WTO and its members are still going through a learning process. The current Doha Development Agenda includes developing countries' concerns about the difficulties they face in implementing the Uruguay Round agreements.

¹⁴⁸ See Who are the developing countries in the WTO?, Available at : http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm ; Hoekman, Bernard M., and Martin, Will., *Developing Countries and the WTO: A Pro-Active Agenda*, Blackwell Publishing Ltd., UK, 2001.

¹⁴⁹ See Thomas J., Schoenbaum., *The WTO and Developing Countries*, available at : http://subsite.icu.ac.jp/ssri/Publications/SummaryFolder/J54Summaries/016TJSchoenbaum_Eng.pdf; Michalopoulos, Constantine., *Developing Countries in the WTO*, Palgrave, New York, 2001 ; Commonwealth Business Council, *Developing countries and The WTO Trade Debate: A Compelling Case For Full Participation In The New Round* ; Hoekman, Bernard M., and Martin, Will., *Developing Countries and the WTO: A Pro-Active Agenda*, Blackwell Publishing Ltd., UK, 2001.

prepare and to build both macro and micro infrastructures including the institutional building in order to support the implementation of WTO agreements. As noted, GATT 1994 inherited the earliest provisions of GATT 1947 which allowed special assistance and treatment, and also trade concessions for developing countries. Nowadays, developing countries view trade as a vital tool to support their development. In the WTO, there are no exact definitions or criteria which clearly distinguish between “developed” and “developing” countries. As recognised by customary state practice, members declare for themselves whether they are “developed” or “developing” countries. However, other members can confront the declaration of a member to take advantages from provisions, which are provided for developing countries. Therefore, the WTO Member, which declares itself as a developing country, does not automatically get privileges from the unilateral preference schemes provided by some developed countries members such as the Generalised System of Preferences (GSP). In practice, the preference-granting country has the authority to arrange the scheme and criteria to decide the list of developing countries that will benefit from the preferences.¹⁵⁰

The status of developing country in the WTO brings certain rights. The WTO regime has provided some provisions with respect to the special needs of developing countries and provides developed countries the possibility to treat developing countries more favourably than other WTO Members. There are provisions in some WTO Agreements, which provide for developing countries. These special provisions¹⁵¹ include, for example, longer time periods for implementing agreements and commitments or measures to increase trading opportunities for developing countries and developing countries can receive technical assistance.¹⁵²

II. Non-discrimination principle in WTO: MFN treatment clause.

The history of the non-discrimination obligations concerning international economic matters can be traced back for centuries. However, in recent decades it has become increasingly complex. Although it has been argued that customary international law imposes a non-discrimination obligation on nations in the conduct of their international trading relationships, such an obligation only exists based on the agreement. Non-discrimination obligations are found in almost all sub-fields of international economic law, particularly in trade goods and services, investment security or the protection of intellectual property rights.¹⁵³

Over the centuries, various treaties have contained a variety of non-discrimination clauses. After the Second World War, the principal of non-discrimination norms were included in the GATT provisions. The non-discrimination

¹⁵⁰ See Who are the developing countries in the WTO?, Available at : http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm. ; Hoekman, Bernard M., and Martin, Will., *Developing Countries and the WTO: A Pro-Active Agenda*, Blackwell Publishing Ltd., UK, 2001.

¹⁵¹ These provisions are referred to as “special and differential treatment” provisions, which cover longer time periods for implementing Agreements and commitments, measures to increase trading opportunities for these countries, provisions requiring all WTO members to safeguard the trade interests of developing countries, support to help developing countries build the infrastructure for WTO work, handle disputes, and implement technical standards, and provisions related to Least-Developed country (LDC) Members.

¹⁵² See Work on special and differential provisions, http://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm.

¹⁵³ See Diebold, Nicolas F., *Non-Discrimination And The Pillars of International Economic Law*, Emerging Scholars Papers, A sub series of IILJ Working Papers, IILJ Emerging Scholars Paper 18, Institute for International Law and Justice, New York University School of Law, 2010, p. 3, available at : <http://www.iilj.org/publications/documents/ESP18-2010Diebold.pdf>, last accessed : 25 January 2011.

provisions concern these norms expressed in GATT.¹⁵⁴ The WTO contract essentially requires its members to ensure that they will not conduct discrimination treatment either *de jure* or *de facto* between domestic and foreign goods/services/suppliers of services.¹⁵⁵ The WTO agreement is not (or should not be interpreted as) an instrument for deregulation. Therefore, governments have the freedom to establish the regulation and take a measure whenever they consider it appropriate to intervene through regulatory means. The WTO members are free to enact any legislation they deem appropriate to achieve their stated goals provided, but they have to respect the non-discrimination principle.¹⁵⁶

With respect to the international economic behaviour, essentially, there are two types of non-discrimination¹⁵⁷ norms. The first norm is the “Most Favoured Nation” (MFN) treatment. The second norm is non-discrimination, which is called the “National Treatment” obligation. The National Treatment norm obliges a state to treat within its own borders, goods, services, persons, originating from outside its borders, in the equal manner it treats those of domestic origin.¹⁵⁸ These norms are embodied in GATT Articles I and III. The MFN rule also appears in several WTO Agreements.¹⁵⁹

The MFN principle stipulates that each member shall give equal treatment to the like products originating from all other members that it extends to its most favoured trading partner. This means that the WTO members are not allowed to discriminate among their trading partners. Subsequently, if a country improves the benefits that it gives to one trading partner, it has to give the equal “best” treatment to imports of like products from all other WTO Members so that they all enjoy “most-favoured”

¹⁵⁴ See Jackson, John H., *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations*, Cambridge University Press, UK, 2000/2007, p. 57.

¹⁵⁵ The MFN treatment was one of the core obligations of commercial policy under the Havana Charter where Members were to undertake the obligation “to give due regard to the desirability of avoiding discrimination between foreign investors”. The inclusion of MFN clauses became a general practice in the numerous bilateral, regional, and multilateral investment-related agreements which were concluded after the Charter failed to come into force in 1950. Its importance for international economic relations is underscored by the fact that the MFN treatment provisions of the GATT (Article I General Most-Favoured-Nation Treatment) and the GATS (Article II MFN Treatment) provide that this obligation shall be accorded “immediately and unconditionally” (although in the case of the GATS, a member may maintain a measure inconsistent with this obligation provided that such measure is listed in, and meets the conditions of, the Annex on Article II Exemptions). See J.H.H. Weiler, S. Cho & I. Feichtner, *International and Regional Trade Law: The Law of the World Trade Organization*, Unit IV: Tariffs and Customs Law/The Most-Favored Nation Principle, 2007.

¹⁵⁶ See Cottier, Thomas, Petros C. Mavroidis, and Blatter, Patrick, *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*, The World Trade Forum, Volume 2, The University Michigan Press, USA, 2002, p. 4.

¹⁵⁷ The notion of non-discrimination is a complex one. Its content is highly elastic and context-dependent. Recognizing the “infinite complexity” entailed by the concept, a WTO panel once warned: “Discrimination’ is a term to be avoided whenever more precise standards are available, and when employed, it is a term to be interpreted with caution, and with care to add no more precision than the concept contains.” Despite such perceived difficulties in defining the concept, the Appellate Body has recently interpreted the generic term “non-discriminatory” as a requirement of not treating similarly-situated countries differently. This interpretation is a significant development in WTO jurisprudence because it introduces a key for defining the general obligation of non-discrimination under WTO law. Under this interpretation, discrimination occurs only when differential treatment is accorded to “similarly situated” countries; thus, the central issue is to determine the basis for comparing similarity between WTO Members. See Julia Ya Qin, *Op.Cit.*, p. 218.

¹⁵⁸ See G. Schwarzenberg, “Equality and Discrimination in International Economic Law” in *The British Yearbook of World Affairs 1971* (London Institute of World Affairs, 1971), 163-181; J.N Hazard, “Editorial Comment; Commercial Discrimination and International Law” (1958) 52 *American Journal of International Law* 495; John H Jackson “Equality and Discrimination in International Economic Law : The General Agreement on Tariffs and Trade” in *The British Yearbook of World Affairs 1983* (London Institute of World Affairs, 1983), 224-239; ; Jackson, John H., 2000, *Op. Cit.*

¹⁵⁹ See Anderson, Kym and Hoekman, Bernard, *The WTO's Core Rules and Disciplines Volume 1 : Critical Perspectives on the Global Trading System and the WTO*, Edward Elgar Publishing, Inc, Massachusetts, USA, 2006. pp xvi ; Bernard Hoekman (2002), “ The WTO : Functions and Basic Principles”, in Bernard Hoekman, Aaditya Mattoo and Phillip English (eds), *Development, Trade, and the WTO : A Handbook*, Chapter 6, Washington, DC : The World Bank, 41-9, references.

treatment. The MFN is the dominance of the principle in multilateral trade negotiations; it is often referred to as one of the so-called “pillars” or “cornerstones” of the WTO.¹⁶⁰

As noted by Jackson, the use and scope of the MFN clauses have varied over time depending on the prevailing ideologies in international economic and political relations.¹⁶¹ MFN was originally used in trade-related agreements. Thus, MFN has a long history and has been used in commercial treaties since the 12th century.¹⁶² In the early 18th century, these clauses were developed and used broadly. They generally applied to “all privileges, liberties, immunities and concessions... already granted to foreigners or being granted in the future.”¹⁶³ According to Schill (2009), “the objective of these early treaties is to lay down the terms of equal treatment in trade between different nations on the basis of equal balance and equal competition”.¹⁶⁴ Regarding economics, MFN treatment has also broader implications for the structure of international relations in implementing equal treatment among nations.¹⁶⁵

Schill (2009) argues that the function of the MFN clauses changed under the influence of mercantilist ideology between the 17th and 18th centuries. Mercantilist economics assumed that the wealth of a nation depends upon its supply of capital. With respect to the volume of trade it further believed unchangeable. Protectionism policy and high tariffs could lead to the discouragement of imports among the instruments of choice of mercantilist politics. During the mercantilist era, MFN clauses were not the sole instruments of multilateralism, but also a form of bilateral and a protectionist view on international economic relations.¹⁶⁶

As mentioned above, discrimination in WTO jurisprudence consists of two types: *de jure* and *de facto*. *De jure* discrimination constitutes legal rules which distinguish in their express terms between foreign and local nationals. For instance, the distinctions are not justified by non-discriminatory purposes or on the basis of origin. The legal rules that use identical terms to address foreign and local nationals may appear neutral, but in fact produce discriminatory results through operation in practice. Therefore, when neutral legal rules are discriminatory in effect, this is referred to as *de facto* discrimination (discriminatory measures).¹⁶⁷

¹⁶⁰ See World Trade Organization, World Trade Report 2007, *Op. Cit.*, p. 132; See also Ukpe, Aniekan Iboro, 2009, *Op. Cit.* p. 2. The MFN principle is one of the oldest principles of international trade law, predating the 1947 GATT system. It is widely described that MFN in WTO circles as a ‘cornerstone’ of the GATT. The MFN clause which is the embodiment of this principle ensures that no trading partner is treated worse off than third partners in a subsequent Free Trade Agreement. No discrimination is allowed between trading partners.

¹⁶¹ See Generally Helmut Brandt, *Die Durchbrechung Der Meistbegünstigung* (1933) (*discussing the dialog between State-centered theories of foreign trade and liberal theories of foreign trade and their relation to and influence on the diffusion of MFN clauses*); Schill, Stephan W., *Multilateralizing Investment Treaties Through Most Favoured Nation clauses*, Cambridge University Press, 2009, Available at : http://www.boalt.org/bjil/docs/BJIL27.2_Schill.pdf, last accessed : 21st November 2010, p. 509.

¹⁶² See Georg Schwarzenberger, *The MFN Standard in British State Practice*, 22 BRIT. Y.B. INT’L L. 96, 97 (1945) [British MFN Standard]. Unilateral grants of MFN treatment can even be traced back to the Eleventh Century. See Endre Ustor, *First Report on the MFN Clause*, [1969] 2 Y.B. Int’l L. Comm’n 157, paras. 10-12, U.N. Doc. A/CN.4/SER.A/1969/Add. 1 [hereinafter First Report on the MFN Clause]; Schill, Stephan W., 2009, *Loc. Cit.*, p. 509.

¹⁶³ See, Baron Boris Noldé, *Droits et Technique des Traités de Commerce*, 3 RECUEIL DES COURS 295, 307-08 (1924 - II) (trans. by Author) (quoting the Latin text of an MFN provision in a 1679 treaty between the Netherlands and Sweden). Only during the course of the Eighteenth Century, treaties started differentiating more clearly between political and commercial aspects relating to the presence of foreign merchants. See Ustor, First Report on the MFN Clause, *supra* note 38, para. 17; Schill, 2009, *Op. Cit.*, p. 509.

¹⁶⁴ See Schill, 2009, *Loc. Cit.*, p. 509.

¹⁶⁵ See Schill, 2009, *Op. Cit.*, p. 508.

¹⁶⁶ See Schill, 2009, *Op. Cit.*, p. 510.

¹⁶⁷ See Diebold, Nicolas F., *Non-Discrimination And The Pillars of International Economic Law*, Emerging Scholars Papers, A sub series of IILJ Working Papers, IILJ Emerging Scholars Paper 18, Institute for International Law and Justice, New York University School of Law, 2010, p. 3, available at : <http://www.iilj.org/publications/documents/ESP18->

II. a. Historical and political perspective of multilateral MFN.

II. a. 1. Most Favoured Nation before GATT 1947.

The starting point of the MFN treatment can be found in the feudal age¹⁶⁸, from the 11th to 13th century, when Lords granted equal concessions to merchants of different foreign cities.¹⁶⁹ According to Hornbeck, Caplin, et al., the first appearance of an MFN clause in written treaties occurred on 8 November 1226, when the Emperor Frederick II extended the same trade privileges to Marseilles that had previously been granted to Pisa and Genoa.¹⁷⁰ The lords unilaterally granted privileges to the citizens outside of the territory. The favours granted were limited to those privileges already granted to others.¹⁷¹

According to Jackson and Cottier et al., the first use of the MFN clause can be traced back to the 11th century, where the town of Mantua in Italy obtained in its charter from the Holy Roman Emperor, Henry III, the guarantee that it would benefit from all privileges granted to "whatsoever other town".¹⁷² The term "most favoured nation" first appeared at the end of the 17th century.¹⁷³ Afterwards, the MFN clauses became more common features in commercial treaties.¹⁷⁴

After the 15th century, the concept of MFN treatment developed along with sovereign states and the ideals of equality that prevailed at the time. Along with the scope of commerce, which had increased among European nations, the use of MFN clauses in bilateral commercial treaties also increased. Until the second half of the 17th century, MFN clauses generally obliged the contracting parties to grant each other existing and future concessions given by either party to any nation.¹⁷⁵

In the 17th and 18th centuries the MFN clauses were commonly used in international commercial matters. The MFN clause in a treaty between two states

2010Diebold.pdf, last accessed : 25 January 2011; See also : http://www.iprsonline.org/unctadictsd/docs/RB_Part1_Nov_1.3Update.pdf

¹⁶⁸ See Traditionally, American and British historians have used the term "feudalism" to describe a political, military, and social system that bound together the warrior aristocracy of western Europe between ca. 1000 and ca. 1300. This "system," it is asserted, only gradually took shape, and differed in detail from region to region. The elements of this system were : 1) the personal bond of mutual loyalty and military service between nobles of different rank known as vassalage/lordship; 2) 'fiefs' (land or moveable wealth) held by vassals/men from their lords, whose property, in theory, the tenements remained, in return for specified service, which was usually a combination of military and social duties (e.g. attendance at the lord's court, hospitality to the lord and his men) and miscellaneous payments that reflected the lord's continued rights over the property; 3) jurisdictional and political power in the hands of 'private' individuals, that is, of nobles who held franchises, immunities or banal rights, which meant 4) decentralized rule under a weak king who was, nonetheless, defined (in theory) as the apex of this network of personal loyalty and land tenure (i.e. the lord of lords and the ultimate source of all rights over land). In this feudal paradigm the king possessed more authority than actual power. "Classical feudalism" (before the rise of strong feudal monarchies in which kings claimed the role of liege lords) is characterized by the fragmentation of political authority and the passage of public power into many different private hands. In this paradigm, "feudalism" is essentially a military recruitment system, in which land tenure is exchanged for knight service. See Richard Abels, *Feudalism*, available at : <http://www.usna.edu/Users/history/abels/hh315/Feudal.htm>, last accessed : 01 February 2011.

¹⁶⁹ See Akiko Yanai, (2002), *Op.Cit.* p. 3.

¹⁷⁰ See Caplin, Andrew, and Khrishna, Kala., *Tariffs and the Most-Favored-Nation Clause: A Game Theoretic Approach*, 1988, Seoul Journal of Economic, p. 267.

¹⁷¹ See Hornbeck, 1910, *Op. Cit.*, p. 11; Caplin, et al., 1988; Akiko Yanai, 2002, *Op. Cit.*, p. 3.

¹⁷² See Cottier, Thomas., Mavroidis, Petros C, 2002, *Op.Cit*; Davey, William J., Pauwelyn, Joost; *MFN Unconditionality : A Legal Analysis of the Concept in View of its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Product"*; The example is cited in Robert E. Hudec, Tiger, tiger in the House: *A Critical Evaluation of the Case against Discriminatory Trade Measures*, in *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems*, 165, 177 n.11; Ernst-Ulrich Petersmann & Meinhard Hilf eds. 1988.

¹⁷³ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost; John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* 158 (2d ed. 1997).

¹⁷⁴ See generally US Executive Branch GATT Studies, The MFN Provision, quoted in John H. Jackson, William J. Davey & Alan O. Sykes, *Legal Problems of International Economic Relations*.

¹⁷⁵ See Hornbeck, 1910, *Loc. Cit.*, p. 11; Akiko Yanai, 2002, *Loc. Cit.*, p. 3.

typically requires each state to accord to the other state any advantage of the type covered by the treaty that the state accords to a third state.¹⁷⁶

According to Murase and Akiko Yanai, the concept of MFN treatment in modern history differs from the feudal treatment in three respects. First, modern MFN treatment refers to exchanges between sovereigns (commonly state to state), whereas MFN treatment during the middle ages was unilaterally conducted by lords or kings. The new mutual form of the MFN agreement appeared for the first time in the treaty between England and Bourgogne, which was concluded on 1 August 1417.¹⁷⁷ Second, in the modern MFN clauses, the definition of third parties was extended from specified to unlimited nations. For example, the provision between England and the cities of Flanders and Brabant (4 August 1446) stated:

“[...] Item: *que les marchands d’Angleterre [...] seront traités aussi doucement et gracieusement comme les autres nations fréquentant ces pays et villes* (that the merchants of England would be treated as gently and graciously as the other nations visiting its country and cities) [...]”¹⁷⁸

Third, the concessions that would be granted in modern clauses went beyond privileges that existed at the time to include future privileges. A treaty between Great Britain and Sweden, dated 11 April 1654, stipulated:¹⁷⁹

“[...] The people, subjects and inhabitants of both confederates shall have, and enjoy in each other’s kingdoms, countries, lands, and dominions, as large and ample privileges, relations, liberties and immunities, as any other foreigner at present doth and hereafter shall enjoy [...]”¹⁸⁰

Such a clause only guaranteed treatment that was as good as other foreigners were to receive. It was not a guarantee of national treatment. Nationals may receive better or worse treatment than foreigners. Therefore, the MFN clause, which was established before the existence of GATT, was not a comprehensive non-discrimination provision.¹⁸¹

The aims of granting MFN treatment as shown in the Great Britain/Sweden agreement was for the benefit of the “people, subjects and inhabitants” of both states, thus commonly recognised as FCN (Friendship, Commerce and Navigation) treaties. Those MFN clauses were designed not exclusively on economic activities. However the advantage granted under those agreements was aimed to facilitate the economic activities of the subjects of each state within the territory of the other state. Indeed, the rational reason for granting MFN treatment was economic desire by the recipient of the MFN treatment to avoid its own subjects from being economically disadvantaged by comparison with the subjects of third states. Therefore, the reason the MFN clauses existed in the commercial agreement was not based on any notion of the equality of states.¹⁸²

The term MFN treatment in the agreement has various names. There are two examples which include the terms “*le peuple de n’importe quelle nation étrangère* (the people of any foreign nation)” as stipulated in the treaty between Great Britain and Denmark of 1660, and “all other strangers” as stipulated in the treaty between Great

¹⁷⁶ See J. H Jackson, 1969, *Op. Cit.*, p. 250.

¹⁷⁷ See Murase, 1974, *Op. Cit.*, pp. 58–9; Akiko Yanai, 2002, *Loc. Cit.*, p. 3.

¹⁷⁸ See Hornbeck, 1910, *Loc. Cit.*, p. 11; Murase, 1974, *Loc. Cit.*, pp. 58–59; Akiko Yanai, 2002, *Loc. Cit.*, p. 3.

¹⁷⁹ See Hornbeck, 1910, *Op. Cit.*, p. 12; Murase, 1974, *Loc. Cit.*, pp. 58–59; Akiko Yanai, 2002, *Op. Cit.*, p. 4.

¹⁸⁰ See Treaty of Peace and Commerce between Great Britain and Sweden, 11 April 1654, BSP 1/691

¹⁸¹ See International Law Commission, *MFN Clause, Report of the Working Group*, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, p. 4, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23rd November 2010,

¹⁸² See *Ibid.*

Britain and Spain of 1667.¹⁸³ The first usage term of “*la nation la plus favorisée* (most favoured nation)” appeared in the treaty between Denmark and the Hanse in 1692. In the early 17th century, most European countries insisted on mutual MFN status.¹⁸⁴

Article 18 of the preliminary Anglo-French peace treaty of 20 January 1783 provided for the appointment of ‘Commissioners to discuss new commercial arrangements of reciprocity’.¹⁸⁵ According to Henderson, the Anglo-French commercial treaty established in 1786, was one of the most important trade agreements of the 18th century. It reforms a commercial system that had long been accepted as the only method in regulating international trade. It also marketed a serious attempt to end the traditional rivalry between France and Britain.¹⁸⁶

Since 1713, Anglo-French commerce had been regulated by the Treaty of Utrecht. However, the reciprocal freedom of trade guaranteed by this agreement had never come into effect since Britain failed to ratify Articles 8 and 9.¹⁸⁷ Afterwards, France and Britain favoured the establishment of more liberal trade relationships between the two countries.¹⁸⁸

In the 1790s, the Treaty of Amity Commerce and Navigation was established, later known as the Jay Treaty, signed between His Britannic Majesty and The United States of America. The Jay Treaty specifically sought to guarantee reciprocal treatment in trade privileges enjoyed among partners. Effectively, this meant that ‘*the receiving nation is provided with a guarantee that it will receive all trade advantages, such as lower tariffs or easier access for its service suppliers, which its trading partner may grant to any third country in the future*’.¹⁸⁹

During the 1830s and 1840s, Great Britain unilaterally reduced tariffs on many kinds of goods. Moreover it revoked the Corn Act in 1846 and the Navigation Acts in 1849. This decision changed Britain’s policy from protectionism to liberalism which was afterwards followed by the French. These changes reflected the shift in the dominant trade theories of the time from mercantilism and protectionism to market economy and free trade.¹⁹⁰

According to Murase, while mercantilist ideas exercised significant influence on the development of MFN clauses, a more important factor that led to MFN clauses was the formation of the tariff system.¹⁹¹ During the middle ages, feudal domains imposed various kinds of duties and taxes. It was replaced by the establishment of one nation state, which integrated local duties into single tariff systems within their own territories. The sovereign had authority to establish and revise tariffs unilaterally depending on the circumstances. The sovereignty needed to protect industry and gain profits by imposing tariffs and regulations on imports. However, if tariffs were raised

¹⁸³ See Murase, 1974, *Loc. Cit.*, p. 59; Akiko Yanai, 2002, *Op. Cit.*, p. 2.

¹⁸⁴ See Caplin, Andrew, and Khrishna, Kala., *Tariffs and the Most-Favored-Nation Clause: A Game Theoretic Approach*, 1988, Seoul Journal of Economic, p. 267.

¹⁸⁵ See Henderson, W.O., *The Anglo-French Commercial Treaty of 1786*, The Economic History review, New Series, Vol. 10, No. 1 (1957), pp. 106, Blackwell Publishing on behalf of Economic History Society, available at : <http://www.jstor.org/stable/2600065?seq=1>, last accessed : 11 July 2010.

¹⁸⁶ See Henderson, W.O., 1957, *Op. Cit.*, p. 104.

¹⁸⁷ See *Ibid.*, p. 104. Article 8 was a most-favoured-national treaty clause, while Article 9 had abolished most of the increases in duties imposed by the two governments on Anglo-French trade since 1664. British opponents of clause 8 and 9 wanted to preserve intact the provisions of the Methuen Treaty (1703), by which Portugal admitted English woollens for ever ‘as was accustomed till they were prohibited by law’. Britain admitted Portuguese wines for ever on payment of an import duty which should be at least one third less than the duty levied upon French wines. See also Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nation* (1776), (Everyman Ed. 1910), II, 44.

¹⁸⁸ See Henderson, W.O., 1957, *Op. Cit.*, pp. 104 -105.

¹⁸⁹ See Ukpe, Aniekan Ibororo, 2009, *Op. Cit.*, p. 2.

¹⁹⁰ See Winham, 1992, *Op. Cit.*, p. 18; Akiko Yanai, 2002, *Op. Cit.*, p. 10.

¹⁹¹ See Murase, 1974, *Op. Cit.*, pp. 61–62; Akiko Yanai, 2002, *Op. Cit.*, p. 4.

by one nation, others retaliated, which led to tariff wars. The bilateral agreement could avoid and control the state to change rates unilaterally. This led to the creation of a conventional tariff system. This system meant that when a nation revised the tariff rates of a certain agreement it had to modify all other agreements with tariff rates. States also feared overlooking concessions when negotiating agreements. Consequently, alternative MFN clauses were devised that could avoid such repetitions and assure partner states the benefits of previous or subsequent concessions by providing MFN clauses for third states.¹⁹²

The other treaty which contains the MFN clause was the treaty between England and the town of Danzig in October 1706, which contained the following stipulation: '*for what remains, if any greater privileges, which any wise respect the persons, ships, or goods of foreigners at Danzig, shall be hereafter granted to any foreign nation, the British subjects shall in the like manner fully enjoy the same themselves, their ships and commerce*'. Since the second half of the 18th century, most European states included a MFN clause in their treaties.¹⁹³

Furthermore, the Anglo-French Treaty was followed by other similar treaties between France and many other countries. These treaties led to tariff 'disarmament' in continental Europe, mostly resulting from the MFN clause. Thereafter a treaty was signed between France and Belgium on May 1861. In August 1862, Germany (Prussia in the name of the Zollverein) ratified a treaty with France which led to a reduction in import duties of about 40-80 per cent on cotton goods, 25 per cent on crude iron, 80 per cent on manufactured iron goods, and 60-80 per cent on woollen clothes. Thus, between 1863 and 1866, by means of treaties with France, most European countries entered the free trade network, or what had been called the *network of Cobden-Chevalier treaties*. Italy joined in January 1863; followed by Switzerland in June 1864; Sweden and Norway in February 1865; the Hanseatic towns one month later; Spain in June 1865; The Netherlands in July of the same year; and, finally, Austria in December 1866. Portugal and Denmark were integrated into the free trade network by means of their commercial treaties with England.¹⁹⁴

The *network of Cobden treaties* played a critical role in the trade liberalisation of continental Europe. It influenced trade policies in most continental Europe countries between 1860 and 1877. The general tariff (that was applicable to countries not party to a treaty) had rather less impact when the network of treaties was as wide as that in force at the end of the 1860s.¹⁹⁵

The unification of *Italy* in 1861 led to the application of the whole country of the *Piedmontese* tariff liberalised by Count Camillo Cavour in 1851 and 1859. Moreover for certain states a dramatic reduction in duties was applied, especially in southern Italy, where it led to a drop of 80 per cent. This drop probably contributed to the industrial setback in this region.¹⁹⁶

The period free trade reached its climax in Europe lasted twelve years (around 1866-1877). In the middle of this period (around 1870-1872) the great depression of the European economy began.¹⁹⁷ The European depression ended in around 1892-

¹⁹² See United States Tariff Commission, 1919, p. 17; Akiko Yanai, 2002, *Op. Cit.*, p. 5.

¹⁹³ See Mathias, Peter and Pollard, Sidney, *The Cambridge Economic History of Europe : VIII The Industrial Economies: The Development of Economic and Social Policies*, Cambridge University Press, Great Britain, 1989, p. 39, <http://books.google.co.id/books?id=VZKkCLs3f90C&printsec=frontcover#v=snippet&q=Most%20favoured%20nation&f=false>.

¹⁹⁴ See Mathias, Peter and Pollard, Sidney, 1989, *Loc. Cit.*, p. 40

¹⁹⁵ See *Ibid.*, p. 40

¹⁹⁶ See Mathias, Peter and Pollard, Sidney, 1989, *Loc. Cit.*, p. 41.

¹⁹⁷ See *Ibid.*, pp. 41-45, This term has been used particularly in relations to Great Britain, since until recently the statistics for the growth of production and trade for the whole of Europe were not available. For these statistics,

1894, when the return to protectionism in continental Europe had become really effective. This policy created great problems which influenced tariff policies on economic development.¹⁹⁸

Following the 1870s, protectionism spread rapidly in Europe because of economic depression.¹⁹⁹ During the period of 1860-1913, world trade relations centred on a network of bilateral trade treaties containing the MFN clause. Each country was generally free to set and change its tariff code so long as it adhered to the MFN clause.²⁰⁰ Among the states that made use of the MFN clause in 18th century, Great Britain led in the number of MFN treaties, while the United States came second.²⁰¹

Free-trade was triggered by the increasing economic nationalism in power after First World War (around 1914–17) and the Great Depression in 1929. Throughout this period major countries such as Great Britain and France imposed high tariffs and other trade barriers to protect their own industries. They also built economic blocs with their autonomous territories and colonies. The establishment of the preferential treatment system encouraged countries to discriminate against non-allied states. The economic bloc trade system and currency devaluation, triggered a chain of events that resulted in a substantial reduction in world trade, and aggravated the Great Depression of the 1930s. This situation forced the US to change its attitude towards trade policy and started to conclude bilateral treaties that included unconditional MFN clauses.²⁰²

There are two variants of the MFN concept. The first variant is *the unconditional* MFN concept.²⁰³ The second variant is the *conditional* MFN concept.²⁰⁴

II. a. 1. a. Unconditional Most Favoured Nation.

According to Hornbeck, only about one fourth of the treaties established between 1826 and 1830 contained the unconditional MFN clause. However there were some treaties, constituting the conditional form of MFN, on the basis of reciprocity, for example treaties between: the US and Denmark on 26 April 1826; the Hanse Cities, on 27 November 1827; Prussia, on 1 May 1828; Brazil on 12 December 1828; Austria on 27 August 1829; Brazil and the Hanse Cities on 27 November 1827; Prussia on 18 April 1828; and Colombia and the Netherlands on 1 May 1829.²⁰⁵

As mentioned above, the *Cobden-Chevalier Treaty of 1860* was concluded by Great Britain and France, and substantially reduced tariffs on some goods and removed prohibitions on exports and imports between the two countries. According to

see Bairoch, Commerce extérieur et développement économique. As we shall see, in the period from 1871-1873 to 1889-1891, the great depression affected continental Europe much more than Great Britain.

¹⁹⁸ See *Ibid*, p. 45.

¹⁹⁹ See Akiko Yanai, 2002, *Op. Cit.*, p. 12.

²⁰⁰ See Irwin, 1995; Prempeh, Michanne Haynes, *The MFN Clause in the EPA: Supporting Multilateralism or Making Foes of Nations?*, Revised Draft, Paper presented at the 6th Garnet PhD School: "Global Governance & Regionalism: The Institutional Dimension", 12 June 2008, available at : http://www.garnet-eu.org/fileadmin/documents/phd_school/6th_phd_school/Students_papers/Haynes_Prempeh.pdf, last accessed : 3 May 2010.

²⁰¹ See Hornbeck, Stanley K., 1909, *Op. Cit.*, pp. 619-647.

²⁰² See Akiko Yanai, 2002, *Op. Cit.*, p. 12.

²⁰³ If state A has an MFN obligation in favor of states B, then any advantages of the type covered by the obligation in favor of that State A grants to State C must also be afforded by State A to State B. This obligation is unconditional. State B benefits from the advantage whether or not it grants a similar advantage to State A.

²⁰⁴ Where states A and B have entered into an agreement with a conditional MFN obligation, if state A grants an advantage of the type covered by the agreement to state C, then state A must offer the same advantage to state B. however, it is obligated to grant the advantage only if state B fulfil the conditions of the agreement, which would typically require state B fulfils the conditions of agreement, which would typically require the state B to offer states A a benefit similar to that offered by state C to state A. Thus, state B's MFN rights are conditional it obtains the advantage only if it is willing to "pay" for it by conceding an advantage to state A.

²⁰⁵ See Hornbeck, Stanley K., 1909, *Op. Cit.*, pp. 619-647.

Winham and Akiko Yanai, this treaty demonstrated that trade agreements could be effective tools of trade liberalisation.²⁰⁶ In Article XIX of the *Cobden-Chevalier Treaty*, Great Britain and France also secured MFN treatment without conditions. It stipulated:

“[...] Each of the two High Contracting Powers engages to confer on the other any favour, privilege, or reduction in the tariff of duties of importation on the articles mentioned in the present Treaty, where the said Power may concede to any third Power. They further engage not to enforce one against the other any prohibition of importation or exportation which shall not at the same time be applicable to all other nations [...].”²⁰⁷

According to Schill, this clause is different from the conditional MFN clause.²⁰⁸ The unconditional clause did not entail the beneficiary state to make the same concessions vis-à-vis the granting state as the MFN treatment.²⁰⁹ Both parties of the agreement regard the adoption of the unconditional MFN clause as aimed to mutual benefit. The reason of Great Britain to use unconditional MFN in the agreement was aimed to avoid a less favoured nation treatment. Because it had unilaterally reduced or eliminated its tariffs already on the basis of its free trade policy, it had nothing further to offer in return for a reduction of tariffs.²¹⁰ In this regard, if Great Britain had signed a commercial treaty containing the conditional MFN clause, it might have been unable to receive concessions granted to other nations. Therefore, Great Britain strongly insisted that an unconditional MFN clause should be included in the treaty. While in France, at that time, the industrial revolution had progressed, it had reached a certain level of manufacturing capability whereby it began to export its products aggressively. Therefore, France considered that excessively high tariffs as an obstacle to trade and began to prefer liberalism instead of protectionism.²¹¹

In its development the Cobden-Chevalier Treaty had a great impact on the European nations. Most of the European nations, which had commercial policies leaning towards free trade, discovered the advantage to participate in a free trade alliance between Great Britain and France. Afterwards, those nations expressed a preference for concluding commercial treaties that included an unconditional MFN clause. As a result, unconditional MFN clauses became common practice in European commerce. Therefore, in the 1860s, the major European powers concluded commercial treaties with unconditional MFN clauses. For example, Italy concluded twenty-four treaties, the German Custom Union had eighteen, Austria-Hungary had fourteen, France had nineteen and Belgium had twelve.²¹² Despite such circumstances, the US maintained a conditional MFN clause due to the tariff system of the US.²¹³

Belgium made treaties (between 1860 and 1870) with France, Great Britain, Switzerland, Italy, Lubeck, Holland, Hamburg, Denmark, Norway-Sweden, the Zollverein, Austria, and Spain. It was the most determined champion of the general and unconditional MFN treatment in all Europe. Italy was also enthusiastic making treaties in the decade after 1860 with Sweden, France, Great Britain, the Zollverein, Austria, Switzerland, and Spain. France made treaties with Belgium, Italy, the Zollverein, Spain, Austria, and Portugal.²¹⁴

²⁰⁶ See Winham, 1992, p. 18; Akiko Yanai, 2002, *Op. Cit.*, p. 10.

²⁰⁷ See Schill, 2009, *Op. Cit.*, p. 512.

²⁰⁸ See *Ibid.*, p. 512.

²⁰⁹ See *Ibid.*, p. 512.

²¹⁰ See Laughlin and Willis, 1903, pp. 13-14; Akiko Yanai, 2002, *Op. Cit.*, p. 11.

²¹¹ See Akiko Yanai, 2002, *Loc. Cit.*, p. 11.

²¹² See Murase, 1974, p. 84; Akiko Yanai, 2002, *Loc. Cit.*, p. 11.

²¹³ See United States Tariff Commission, 1919, p. 19; Akiko Yanai, 2002, *Loc. Cit.*, p. 11.

²¹⁴ See Hornbeck, Stanley K, 1909, *Op. Cit.*, p. 624.

The unconditional form of the MFN obligation was used exclusively until the late 18th century.²¹⁵ Much credit has been given to the use of the unconditional MFN clause in a number of European bilateral treaties in the latter half of the 18th century to promote a multilateral trading system.²¹⁶ European countries still held in their treaties *inter se* to the unconditional form of the clause until about 1830.²¹⁷

The unconditional clause had evolved to become “*the almost universal basis of a vast system of commercial treaties*” and developed into the “*cornerstone*” of international commercial relations until the era of First World War.²¹⁸ Furthermore, the US abandoned its support for conditional MFN clauses after First World War and henceforth based its commercial treaties on unconditional MFN treatment.²¹⁹ According to Schill, the abandonment of the conditional clause was closely connected to the free trade movement in the 19th and early 20th centuries. Ideologically, this reflected liberal ideas about the equality of states and the contribution of clause to liberalising international trade by fostering equal competition.²²⁰

As stipulated in Article 22 of the League of Nations Covenant regarding former colonies “equal opportunities for the trade and commerce of other Members of the League” were to be secured.²²¹ Similarly, there were other international treaty regimes that endorsed equality of opportunities as an ordering principle before and after First World War.²²²

In 1934 the US enacted the Reciprocity Trade Agreements Act (RTAA)²²³, which was based on the recognition that flourishing international trade was vital in domestic

²¹⁵ See Cottier, Thomas, Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost., p. 14.

²¹⁶ See Prempeh, Michanne Haynes, 2008.

²¹⁷ See Hornbeck, Stanley K, 1909, *Op. Cit.*, p. 621.

²¹⁸ In 1922, the International Economic Conference recommended that “commercial relations should be resumed upon the basis of commercial treaties, resting on the one hand upon the system of reciprocity adapted to special circumstances, and containing on the other hand, so far as possible, the MFN clause.” In 1927, the Conference reiterated its position that it “considers that the mutual grant of unconditional MFN treatment as regards custom duties and conditions of trading is an essential condition of the free and healthy development of commerce between States.” It went on to emphasize “that the scope and form of the MFN clause should be of the widest and most liberal character and that it should not be weakened or narrowed either by express provisions or by interpretation.” This position was upheld by the Committee of the League of Nations Assembly throughout the 1930s. In addition, various attempts were made to codify the law on MFN clauses at the time, thus illustrating the importance that was accorded to the concept of unconditional MFN treatment. These attempts encompassed one project under the auspices of the Economic Committee of the League of Nations in the 1930s, the work of the Committee of Experts for the Progressive Codification of International Law and a codification by the Institute of International Law. See Ustor, First Report on the MFN Clause, *supra* note 38, paras. 65-106.

²¹⁹ See Schill, 2009, *Op. Cit.*, p. 512.

²²⁰ See Schill, 2009, *Loc. Cit.*, p. 512. See also Hornbeck, Stanley K., 1909, *Op. Cit.*, p. 619.

²²¹ The Article 22 Covenant of the League of Nations : “Other peoples, especially those of Central Africa, are at such a stage that the Mandatory must be responsible for the administration of the territory under conditions which will guarantee freedom of conscience and religion, subject only to the maintenance of public order and morals, the prohibition of abuses such as the slave trade, the arms traffic, and the liquor traffic, and the prevention of the establishment of fortifications or military and naval bases and of military training of the natives for other than police purposes and the defence of territory, and will also secure equal opportunities for the trade and commerce of other Members of the League”. This Covenant forms Part I of the Treaties of Versailles, Saint-Germain-en-Laye, Neuilly, Trianon and Sèvres, signed in the Paris area between 28 June 1919 and 10 August 1920: it entered into force on 10 January 1920.

²²² See Schill, 2009, *Op. Cit.*, p. 513.

²²³ According to Gilligan, until 1934, protectionism was also dominant in the United States. It had developed its protectionist policies by means of so-called “reciprocity provisions” in the Tariff Acts and conditional MFN clauses in bilateral trade agreements. Most of the Tariff Acts from 1890 to 1930 contained reciprocity provisions, which gave the president the authority to impose duties on certain products when foreign governments were “reciprocally unjust or unreasonable,” or in other words when they discriminated against US products. These provisions emphasized a retaliatory aspect of reciprocity that “bad is returned for bad.” The Smoot-Hawley Tariff of 1930 was regarded as a typical Act based not on “reciprocity but retaliation”. See Gilligan, 1997, p. 68; Akiko Yanai, 2002, *Op. Cit.*, p.12. The Smoot-Hawley Tariff regarded as the highest tariff levels in the nation’s history. The bill was signed by President Herbert Hoover. The Smoot-Hawley Tariff imposed tariff rates reached nearly 100 percent of the cost of the goods, which followed retaliation action by other states. Economic activity declined precipitously. It is generally accepted today that these high tariffs worldwide exacerbated the Great Depression of

prosperity²²⁴, and endorsed the adoption of unconditional MFN clauses. In accordance with the RTAA, the United States concluded bilateral trade agreements²²⁵ with twenty-seven countries from 1934 to 1945²²⁶. Each agreement contained a reciprocal exchange of tariff reductions and an unconditional MFN clause.²²⁷

Multilateralism has been recognised as an instrument in governing international relations either politically or economically. After the re-emergence of multilateralism, the MFN reappeared and became the basis for ordering international trade relations. After First World War, the MFN treatment proved to play a crucial role in keeping world peace. MFN held a function to prevent international conflicts by prohibiting bilateral alliances and bloc building in economic context prone to spilling over military conflicts.²²⁸

As noted by Cottier and Mavroidis, several reasons may be cited to support the application of the unconditional MFN principle. According to GATT economists, the application of the MFN treatment brought five significant advantages. First, in economic terms, applications of the MFN rule enhance economic efficiency because the country's imports will be supplied by the most efficient international suppliers. Moreover, under this circumstance, the monopoly of business practices will be avoided and a fair competition environment will be created. When tariffs are varied according to the source of goods, new tension on trade and unfair competition of goods are created. Second, for trade policy purposes, the application of the MFN rule protects bilateral concessions and generalises them as the basis for the multilateral trading system. In this sense, the MFN principle serves as a positive force for liberalisation in the system, in particular, it protects the interests of small trading countries, whether rich or poor, weak or strong. Moreover, small trading companies can benefit from concessions without necessarily making concessions themselves. To sum up, applications of the MFN rule in trade policies have given equal opportunities and enhanced the economic growth of all member states in the multilateral trading system. Third, application of the MFN principle promotes better international relations since it avoids the unfair trade competition and tensions that may result from discriminatory policies that can lead to new conflict between states. Fourth, it has the advantage of administration simplification. The domestic producers benefited from administration simplification of tariffs and other forms of protection (no origin rules are needed) and

the 1930s. See Schaffer, Richard., Agusti, Filiberto., and Earle, Beverly., *International Business Law and Its Environment*, Seventh Edition, South Western Legal Studies in Business, Academic Series, USA, 2009, p. 272.

²²⁴ See Tasca, 1938, p. 39; Akiko Yanai, 2002, *Op. Cit.*, p. 12.

²²⁵ Prior to 1934, the president had little or no discretion in setting tariff rates. The Reciprocal Trade Agreement Act of 1934 provided the president with a mechanism not only for lowering U.S. tariffs, but for encouraging the other countries to lower their rate as well. This act granted the president far more flexible powers to adjust tariffs than under any prior legislation. The president was granted the authority to negotiate tariff reductions on a product by product basis with other countries on the basis of reciprocity. The United States would reduce a tariff on a foreign product if the foreign country would reciprocate by lowering its tariffs. An Agreement to reduce a tariff to a specified level is known as a tariff concession. The 1934 Law also introduced what is known as unconditional most-favored-nation (MFN) trade, now commonly referred to as normal trade relations (NTR). It provided that a lower tariff rate negotiated with one nation would automatically be granted to like products imported from all other nations that had signed an MFN agreement with the United States, without any requested from those nations in return. See Schaffer, Richard., et.al, 2009, *Loc. Cit.*, p. 272.

²²⁶ The contracting partner of the bilateral agreements were: Argentina, Brazil, the Belgo-Luxemburg Economic Union, Canada, Colombia, Costa Rica, Cuba, Ecuador, El Salvador, Finland, France, Great Britain and Northern Ireland, Guatemala, Haiti, Honduras, Iceland, Mexico, Netherlands, Nicaragua, Peru, Sweden, Switzerland, Turkey, Uruguay, and Venezuela.

²²⁷ See Akiko Yanai, 2002, *Op. Cit.*, p. 13.

²²⁸ In fact, national protectionism and bilateral isolation of markets in the inter-War period was viewed as a supporting factor, if not one of the reasons, for the economic depression in the 1930s and subsequently World War II. See Verbit, supra note 61, at 25-31; see also Gerald Curzon, *Multilateral Commercial Diplomacy* 20-33 (1965). Some States already regarded economic discrimination to be among the factors having caused World War I. See Verbit, supra note 61, at 19, 26; Schill, 2009, *Op. Cit.*, p. 514.

it promotes more transparent policies. Finally, it serves as a constraint on the ability of special interests to obtain discriminatory trade measures.²²⁹

As noted by Yanai, in the GATT 1947 based multilateral trade system, non-discrimination was adopted as a fundamental principle. Unconditional MFN clauses were considered to be an effective measure for applying this principle to actual trade practices. The unconditional MFN clause embodied in the GATT 1947 is different from the unconditional clause that was applied by the US in its bilateral trade agreements in the pre-war period.²³⁰ At that time, the US utilised an unconditional MFN clause as a tool to enter into its trade partners' markets so that it could expand its exports. Thus, the US has used the clause as a countermeasure against the other major nations, who had tended to enclose their economies within the walls of preferential or imperial trading blocs. In other words the US has used the unconditional MFN clause as a penetrating-tool into the trading blocs.²³¹

The GATT principle, non-discrimination and reciprocity, have contradicted one another because trade policy is aimed to pursue national interests. On the other hand trade liberalisation is conducted through both unilateral action and reciprocal bargaining in order to gain maximum benefits. If one state has lowered or removed its trade barriers, the expectation is that the other states will make a consequent and equivalent response. It is argued that contingency and equivalence are necessary aspects of reciprocity conduct. However, in the GATT system, such reciprocal concessions should be automatically multilateralised through unconditional MFN clauses.²³²

As noted by Yanai, when bilateral relations governed the world trade system, an MFN clause (even the unconditional form), could be compatible with reciprocity. This was because the decision of whether to grant unconditional MFN treatment to some nations could be made case-by-case.²³³ The concept of reciprocity is typically used to convince domestic interests that trade liberalisation is in their interest. The unconditional MFN principle is, of course, the antithesis of reciprocity, and the lack of reciprocity could create difficulties for governments to undertake trade liberalisation. This concern is closely related to the foregoing issue and the problem of critical mass.²³⁴ However, it has become problematic to pursue MFN treatment and trade liberalisation through reciprocal bargaining in the framework of the multilateral trade system.²³⁵

It is true that the application of the MFN rule not only promotes multilateralism but also results in the so-called "free rider" problem.²³⁶ There are two aspects of this problem. On the one hand, countries benefit automatically from the liberalisation measures of others, whether or not they undertake such measures on their own. This enables smaller trading nations, in particular, to free ride on the concessions made by others. Thus, they may make fewer concessions themselves. On the other hand,

²²⁹ See Cottier, Thomas, Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p. 15.

²³⁰ The 1934 Law also introduced what is known as unconditional most-favored-nation (MFN) trade, now commonly referred to as normal trade relations (NTR). It provided that a lower tariff rate negotiated with one nation would automatically be granted to like products imported from all other nations that had signed an MFN agreement with the United States, without any requested from those nations in return. See Schaffer, Richard., et.al, 2009, *Loc. Cit.*, p. 272.

²³¹ See Akiko Yanai, 2002, *Op. Cit.*, p. 20.

²³² See Akiko Yanai, 2002, *Op. Cit.*, p. 20.

²³³ See *Ibid*, p. 21.

²³⁴ Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p 16.

²³⁵ See Akiko Yanai, 2002, *Op. Cit.*, p. 21.

²³⁶ See Ludema, Rodney D., Mayda, Anna Maria, The Free-Riding Effect of the MFN Clause: Evidence Across Commodities and Countries, Georgetown University, 2007; Ludema and Mayda (2006), which provides the first theory-based empirical assessment, finding evidence of a significant free-rider effect of the MFN clause for US tariffs.

excessive free riding may cause major trading nations to agree to less liberalisation than they would if reciprocity were required. Again, the result may be fewer concessions if unconditional MFN treatment is required. It is not clear that this fear of free riding has significantly slowed down the process of multilateral trade liberalisation, but it is clear that it is a factor in negotiations. Unless a so-called “critical mass” is willing to make liberalisation commitments, some major trading nations may not make commitments.²³⁷ In this respect, it could be argued that it would be better to make progress towards freer trade with smaller groups of countries willing to do so immediately on a reciprocal basis, rather than to wait for the “critical mass” to emerge.²³⁸

Generally, it appears that unconditional MFN treatment is the most desirable policy for the world as a whole. While the problems of free riders and the need for perceived reciprocity are significant, they do not counteract the argument in favour of unconditional MFN.²³⁹ The unconditional MFN clauses still play an important role in bringing about multilateral trade liberalisation.²⁴⁰

II. a. 1. b. Conditional Most Favoured Nation.

As noted, in the Report of the Working Group of the *MFN Clause* by the International Law Commission, between the 19th and early 20th centuries, MFN was often granted conditionally in the economic field. During that period a state would only grant MFN treatment in exchange for a benefit provided by the other state. Therefore, the grant of MFN treatment had to be paid for. The practice of this treatment was known as “conditional MFN”. By the time the granting of conditional MFN declined, there was greater realisation that there were economic benefits to the granting state from granting MFN unconditionally. The practice of conditional MFN has little significance today.²⁴¹

As mentioned above, it was the US who brought reciprocity into trade policy. After gaining independence, the US signed the first commercial treaty in 1778 with France, which contained provisions for reciprocal trade concessions in order to secure a free flow of goods and ships.²⁴² Afterwards, the US entered the arena of world commerce with the principle of opening their ports and guaranteeing equal treatment to all comers upon a basis of reciprocity.²⁴³ The MFN treatment in the treaty was made conditional on providing the same compensation as had been provided by the third party that obtained the advantage.²⁴⁴

Starting with the Treaty of Amity and Commerce, conditional MFN clauses were introduced and subsequently became dominant in international treaty practice. According to Schill, conditional MFN treatment required that rights and privileges be

²³⁷ The first WTO financial service negotiations are an example. The United States declined to accept the result of the negotiations because of its view that the offers of others were insufficient for it to make an MFN-based offer (see, for example, US statement at the 21 June 1995 Meeting of the Committee on Trade in Financial Services, S/FIN/M/5/rev.1). Later in the financial services negotiation, the United States did accept the results of the negotiations, although it conditioned its offer, notably in the insurance sector where it reserved the right to discriminate against any WTO Member which compels US nationals to divest from its market (See the US List of Article II (MFN) exemption, GATS/EL/90/Supp.3.2.).

²³⁸ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p 16.

²³⁹ See Ludema, Rodney D., Mayda; 2007, Bagwell and Staiger (2006) finds no evidence of MFN free riding in the tariffs of countries recently acceding to the WTO.

²⁴⁰ See Akiko Yanai, 2002, *Op. Cit.*, p. 3.

²⁴¹ See International Law Commission, Most Favoured Nation Clause, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, p. 5, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010.

²⁴² See Ishikawa, 1985, p. 11; Akiko Yanai, 2002, *Op. Cit.*, p. 7.

²⁴³ See Hornbeck, Stanley K., 1909, *Op. Cit.*, p. 619.

²⁴⁴ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p 14.

extended to the beneficiary state under the condition that the beneficiary state grant the same concessions offered by the MFN in return for the more favourable rights in question. The conditional form of MFN clauses ensured that the beneficiary state could not benefit from more favourable treatment accorded to third parties without concurrently assuming potential disadvantages incumbent upon the third state. The purpose of the conditional MFN clause was ultimately to arrive at lower tariffs.²⁴⁵

As stated in the preamble of the treaty, emphasis was placed on the significance of reciprocity with the phrase that a fair and permanent commercial relationship between the two countries could not be attained without the most perfect equality and reciprocity based on the agreement.²⁴⁶ This principle of reciprocity embodied in the MFN clause of Article II reads as follows:

“[...] The Most Christian King and the US engage mutually not to grant any particular favour to other nations in respect of commerce and navigation, which shall not immediately become common to the other party, who shall enjoy the same favour, *freely, if the concession was freely made, or on allowing the same compensation, if the concession was conditional [...]*”.²⁴⁷

Under this provision, if the US made new concessions to any third party, France could receive these concessions only when it provided the US compensation which would be equivalent to that offered to the US by the third party. However, the second party (France) may have the right to require the favour on allowing the same concessions.²⁴⁸

In other words, it was explicitly stipulated that the favours granted to any third party could not be automatically extended between the two initial parties to the MFN clause. The idea of a conditional MFN clause is that MFN treatment at the time of concluding an agreement would be secured, while future discrimination would not necessarily be denied. The US insisted that a conditional MFN clause would not discriminate because it did not exchange MFN treatment without a conditional MFN clause and did not conclude any exclusive arrangements with specified nations. In this sense, the US treated every nation equally. Hornbeck, in describing this US attitude, suggests that “the opportunity was to be given for each country to purchase for itself such favours as might be granted to others for compensation”.²⁴⁹

The incorporation of a reciprocal principle in the MFN treatment by the US divided MFN clauses into two types: an unconditional MFN clause that extended favours freely and a conditional or “American” clause that required equivalent compensation.²⁵⁰ Prior to 1923, the US had used a conditional form of MFN. The conditional²⁵¹ MFN form was used by the US in nearly all commercial treaties until 1923, when President Harding approved the adoption of the unconditional form in US trade treaties. During the same period, most European countries used the unconditional form.²⁵² Under the conditional MFN, if a country grants a preferential tariff rate to another country, then it must extend the same rate to its MFN partners

²⁴⁵ See Schill, 2009, *Op. Cit.*, p. 510.

²⁴⁶ See Ishikawa, 1985, p. 11; Akiko Yanai, 2002, *Op. Cit.*, p. 7.

²⁴⁷ See Hornbeck, 1910, *Op. Cit.*, p. 14; Akiko Yanai, 2002, *Loc. Cit.*, p. 7.

²⁴⁸ See Hornbeck, 1910, *Op. Cit.*, p. 14; Akiko Yanai, 2002, *Op. Cit.*, p. 8.

²⁴⁹ See Hornbeck 1910, *Loc. Cit.*, p. 14; Akiko Yanai, 2002, *Loc. Cit.*, p. 7.

²⁵⁰ See Akiko Yanai, 2002, *Loc. Cit.*, p. 9.

²⁵¹ If a State A extends to State C all concessions granted by treaty to States B, only if State C matches the concessions made by State B to State A.

²⁵² See Caplin, Andrew, and Khrishna, Kala., 1988, *Op. Cit.* p. 271.

only if they “pay” for it with reciprocal tariff cuts. In the unconditional MFN form used under the GATT regime, no such reciprocity is required.²⁵³

As noted by Yanai, conditional MFN clauses applied by the US in the second half of the 18th century were a *point d'entre* into world trade securely and equally. At that time, Great Britain and Europe as large economic powers implemented preferential trade arrangements with their colonial tie. As a result, Great Britain and Europe discriminated other countries by imposing high tariffs. The US approach of conditional MFN clauses was plainly described in a US Tariff Commission report:

“[...] By the means of reciprocity treaties, the United States has granted various concessions to certain countries, for compensation, and has accepted concessions from them. This has involved in each case particular reductions from the rates established in the general tariff. In most cases the determination to enter into such agreement has come as a result of unusual circumstances, such as a peculiar geographical factor or peculiar political relations. Having made concessions under special circumstances, or for special compensation, the US has not considered it obligatory or even just to extend the same favours to third states “freely” [...].”²⁵⁴

On the 3 March 1815 the US enacted the Reciprocity Act. This act allowed the president to promote and establish duties on foreign ships entering US ports on the same terms that a foreign nation charged US ships entering their ports.²⁵⁵ This Act stipulated a clause which eliminated US discriminatory tariffs in accordance with the principle of reciprocity. The Act was followed by an agreement with Great Britain in the same year to eliminate discriminatory tariffs reciprocally. In the 1830s, the United States had also concluded bilateral commercial agreements that contained conditional MFN clauses with most Latin American countries. Furthermore, the conditional MFN clause was gradually accepted by the European states, where only the unconditional form had been used previously. Great Britain, for instance, enacted the Reciprocity of Duties Act in 1823, under which it entered into bilateral treaties to provide conditional MFN treatment for the exports of both signatories. Subsequently, the French government also followed the British trade policy of free trade based on reciprocity.²⁵⁶ In the period from 1825 to 1860, conditional MFN clauses were commonly adopted in the commercial treaties of the European states, which had dominated the unconditional MFN clause. Three-quarters of the important treaties made between 1826 and 1830 contained a conditional MFN clause. Conditional clauses accounted for more than 90 per cent of all MFN clauses in treaties until 1860.²⁵⁷

Starting from that period the conditional form of MFN became the majority practice by states in the commercial agreement. In the treaty between Great Britain and Portugal, on 19 February 1810, Article II, stipulated:²⁵⁸

“[...] gratuitously if the concession in favour of that other state shall have been gratuitous, and on giving, *quam proxime*, the same compensation or equivalent, in case the concession shall have been conditional [...].”

²⁵³ See Cebi, Pinar., and Ludema, Rodney., The Rise and Fall of the Most-Favored-Nation Clause, Office of Economics Working Paper, No. 2002-06-B, U.S. International Trade Commission, June 2002, p. 2, available at : http://www.usitc.gov/publications/332/working_papers/ec0206b.pdf, last accessed : 15th Octobre 2010,

²⁵⁴ This view reflected the principle in the US's commercial treaty-making policy that attached much importance to “bargaining between individual nations on the basis of reciprocal and progressive giving of favor for favor and concessions for concessions”. (United States Tariff Commission 1919: 19-20).

²⁵⁵ See Brune, Lester H., Burns, Richard Dean., Chronological History of U.S Foreign Relations, Volume I (1607-1932), Second Edition, Routledge, Great Britain, 2003, p. 86.

²⁵⁶ See Winham, 1992, p. 18; Akiko Yanai, 2002, *Op. Cit.*, p. 9.

²⁵⁷ See Hornbeck, 1910, p. 49; Murase, 1974, p. 71; Akiko Yanai, 2002, *Op. Cit.*, p. 9.

²⁵⁸ See Hornbeck, Stanley K., 1909, *Op. Cit.*, p. 620.

As noted by Yanai, the basis had been laid for conditional MFN treatment to spread in Europe. The conditional MFN clause was used by most European countries as a reasonable instrument of protectionism from foreign products.²⁵⁹

According to Hornbeck, the period from 1830 to 1859 was outspokenly a reciprocity period. The unconditional form of the MFN clause appeared more and more rarely in treaties. Great Britain still held the practice of the unconditional MFN clause. Instead of using the unconditional MFN clause Great Britain also used the conditional one. In 1810 Great Britain concluded a treaty with Portugal. To this treaty, that of 3 July 1838 may be added, with Austria, in which, Article XI, stipulates:

"[...] et leurs majestés s'engagent réciproquement a n'accorder aucunes faveurs, privilèges [etc. to a third state] qui ne soient en même temps accordés [to the co-contractant] gratuitement, si la concession ... a été gratuite, ou en donnant, en autant qu'il sera possible, le même équivalent, dans le cas où la concession aura conditionnelle [...]".²⁶⁰

In January 1843, Great Britain made a treaty with Russia containing the same formula. The treaty with Liberia on 21 November 1948 contained the conditional form, and the same appeared in treaties which Great Britain made between 1849 and 1853 with Costa Rica, Dominica, Peru, Hawaii, Sardinia, Ecuador, and Paraguay.²⁶¹

According to Hornbeck, an examination of the treaties made in this period by Austria, Belgium, France, The Netherlands, Portugal, Sardinia, Sicily, Spain, and the Zollverein, as well as those already mentioned, indicated the large use of the conditional MFN clause in the agreement. The agreement contains definite provision that compensation must be made for the privileges demanded. Moreover, an examination of commercial and tariff history, between 1825 and 1860, shows most western nations in conducting commercial relations based on the reciprocity principle.²⁶²

The use of conditional MFN clauses became more widespread in the early 19th century, but the unconditional form regained its dominance in the second half of the 19th century. However, the US only began to pursue unconditional MFN agreements in the 1920s.²⁶³ The GATT generally enshrines the unconditional MFN concept, although there are significant general exceptions to the MFN requirement.²⁶⁴ The purpose of conditional MFN clauses to gain a more liberal system of international trade is based on equality of treatment and non-discrimination coupled with increasingly lower tariffs. As noted above, the conditional MFN treatment was a tool to participate more actively in international trade. It formed part of US foreign economic policy until 1923, but also appeared in Europe until 1860.²⁶⁵

The treaty concluded between the US and Columbia had introduced conditional MFN clause practice to South America. Thus, a similar treaty in 1825 was established between the US and Central American Confederation. Henceforth for 35 years South and Central America included the conditional form in their treaties.²⁶⁶

In many cases, governments used a conditional MFN clause, by which concessions granted to one country would be granted to another on a MFN basis only if the other country granted compensatory or reciprocal concessions. Gradually governments moved towards an unconditional MFN. Starting with the Tariff Act of

²⁵⁹ See Akiko Yanai. 2002, *Op. Cit.*, p. 10.

²⁶⁰ See Hornbeck, Stanley K., 1909, *Op. Cit.*, p. 621.

²⁶¹ See *Ibid.*, p. 621.

²⁶² See *Ibid.*, p. 621.

²⁶³ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p. 15.

²⁶⁴ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p. 15.

²⁶⁵ See Schill, 2009, *Op. Cit.*, p. 511.

²⁶⁶ See Hornbeck, Stanley K., 1909, *Op. Cit.*, p. 620.

1922²⁶⁷, the US pursued a policy of granting MFN treatment on such an unconditional basis.²⁶⁸ According to Polley, the conditional MFN clause, if used by a country with an MFN Clause with any other country, cannot be truly conditional. Furthermore, if used as the basis of negotiations with all countries, it can be empty of content.²⁶⁹

The policy of conditional MFN treatment was ultimately abandoned, because it was too complicated and economically inefficient. The Secretary of State Hughes, for example, explained the reason why the US abandoned the conditional MFN treatment:

“[...] The ascertaining of what might constitute equivalent compensation in the applications of the conditional most-favored-nation principle was found to be difficult or impracticable. Reciprocal commercial arrangements were but temporary makeshifts; they caused constant negotiation and created uncertainty. Under present conditions, the expanding foreign commerce of the US needs a guarantee of equality of treatment which cannot be furnished by the conditional form of the most-favored-nation clause[...].”²⁷⁰

The conditional MFN clause had been used to protect national interests.²⁷¹ In other words, the conditional MFN clauses were an effective tool to obtain foreign market access while protecting domestic industries. On the other hand, unconditional clauses were potentially useful for maintaining an open and free world trading system. Interestingly, the dominant nations in world trade tended to prefer unconditional MFN clauses: the two most obvious examples being Great Britain during its Pax Britannica²⁷² period and the US during Pax Americana.^{273 274}

As noted by Hornbeck, while European practice changed in the manner indicated, first from the unconditional to the conditional, and then turned to the uniform use of the unconditional, the US maintained throughout the form and construction of the conditional. South and Central American practice varied. In some of the early South American treaties the unconditional form was used. After 1860, South American practice represented a tendency to waver between the two forms, in the way characteristic of European practice in the preceding period. Numerous treaties of Venezuela, Argentina, Paraguay, Uruguay, and Peru with European countries contained the unconditional form. This may be readily accounted for the policies of the latter. Mexico mainly used the unconditional form of the clause. The practice of reciprocity had, however, held firmly in the treaties of American states *inter se*, and in a majority of those made with European, Asiatic, and African states.²⁷⁵ Only the

²⁶⁷ The 1922 tariff act, known as The Fordney – McCumber Tariff, permitting the President to negotiate reciprocity. See Brune, Lester H., Burns, Richard Dean., *Chronological History of U.S Foreign Relations, Volume I (1607-1932)*, Second Edition, Routledge, Great Britain, 2003, p. 443. See also The Fordney-McCumber Tariff of 1922, available at : <http://eh.net/encyclopedia/article/kaplan.fordney>.

²⁶⁸ See Executive Branch GATT Studies, No. 9, “The Most Favoured Nation Provision”, Committee on Finance, United States Senate, Subcommittee on International Trade, 93rd Cong., 2nd Sess., 134 (compilation of 1973 studies prepared by the Executive Branch, Committee Print, March 1974); Jackson, John H., 2000/2007, *Op. Cit.*, p. 58.

²⁶⁹ For example, if France has conditional MFN clause with the US and Unconditional MFN clause with Britain. It exchanges concession with Spain; these are automatically extended without compensation to Britain. But if Britain received the concession gratuitously, then the US is also entitled to receive them free, by virtue of her Conditional MFN status. By this means the US apparently was granted all concessions negotiated between Europeans before 1914, without give anything in return. See Polley, William J, “*The Most Favored Nations Clause: What Can Trade Theory Tell Us?*”, Department of Economics, Bradley University, 1 October, 2004, p. 3, available at : <http://www.williampolley.com/webpapers/mfn.pdf>, last accessed : 15 May 2010.

²⁷⁰ See Richard Hackworth, 5 *Digest Of International Law* 273 (1943); Schill, 2009, *Loc. Cit.*, p. 511.

²⁷¹ See Akiko Yanai, 2002, *Op. Cit.*, p. 10.

²⁷² It refers to a period of British imperialism after the 1815 Battle of Waterloo, which led to a period of overseas British expansionism. Britain dominated overseas markets and managed to dominate Chinese markets after the Opium Wars.

²⁷³ Pax Americana is primarily used in its modern connotations concerning the peace established after the end of World War II in 1945.

²⁷⁴ See Akiko Yanai, 2002, *Op. Cit.*, 20.

²⁷⁵ See Hornbeck, Stanley K., 1909, *Op. Cit.*, pp. 625-627.

negative side of MFN treatment was specified in the treaties of Brazil and others before 1827. Treaties made by the US with Colombia in 1824, and with the Central American Confederation, Brazil, and Mexico in 1825, 1828, and 1832, contained the conditional form, and from then on the leading American states embraced this principle. Their treaties with the US regularly contained this form. In addition, between 1830 and 1860 they made no exception to this principle in their dealings with European states. Reciprocity was at the basis of their commercial policies. They guaranteed that " no higher or other duties " would be charged or applied, as had been done to the general tariff in US tariffs. For special concessions, equivalents were demanded in return.²⁷⁶

At the beginning of 1908, Great Britain had MFN agreements with forty-six countries. The MFN clause appeared in forty-five of the Italian Treaties. The US and Germany had MFN treaties with more than thirty countries. Then Spain, France, and Japan made twenty MFN agreements.²⁷⁷

III. The legal nature of the Most Favoured Nation treatment clause.

The MFN clause is an integral part of all multilateral trade agreements. For example, this clause constitutes the very first article of the GATT. Similarly, all the other major multilateral agreements of the WTO (such as the GATS or the Agreement on Trade Related Aspects of Intellectual Property Rights) also contain the MFN clause. As noted by Horn and Mavroidis and Hoekman and Kostecki, the MFN constitutes one of the pillars of the WTO system. At the core of MFN is the idea of non-discrimination.²⁷⁸

As mentioned above, non-discriminational conduct proved to alleviate the potential of tensions occurring from trade agreements.²⁷⁹ Indeed Pomfret notes that frequent controversies involving the US and nations excluded from its discriminatory trade agreements was one of the reason why the US embraced the notion of the unconditional MFN after the First World War.²⁸⁰ Furthermore, Ghosh et al., argued that the origin of advocacy of the MFN clause by the OECD countries stemmed from a desire to prevent newly independent developing countries from being drawn into adopting a communist regime.²⁸¹ Thus, MFN can be viewed as a strategic tool in international relations.²⁸² There is widespread belief among policy makers that a strong economic rationale for the MFN provision was based on the presumption that discrimination is inherently undesirable.²⁸³

The MFN principle became the core of the principle of non-discrimination under GATT, and this has continued under the WTO. Under the WTO regime MFN has been further used in the specific area of services and the protection of intellectual property rights. For example, Article II of the GATS provides for a very broad application of MFN in respect of "any measure covered by this Agreement".²⁸⁴

²⁷⁶ See *Ibid*, pp. 625-627.

²⁷⁷ See *Ibid*, p. 627.

²⁷⁸ Horn and Mavroidis (2000); Hoekman and Kostecki (2001); Saggi, Kamal, *Tariffs and the MFN Clause*, Journal of International Economics 63 (2004) 341- 368, 2003, Available at : <http://faculty.smu.edu/ksaggi/MFNJIE.pdf>, last accessed : 07th Octobre 2010, p. 341.

²⁷⁹ See Jackson (1997); Pomfret (1997) ; World Trade Organization, World Trade Report 2007, 2007, *Op. Cit*, p. 133.

²⁸⁰ Pomfret, 1997.

²⁸¹ Ghosh et al., 2003.

²⁸² Horn and Mavroidis, 2001; World Trade Organization, World Trade Report 2007, 2007, *Op. Cit*, p. 133.

²⁸³ See *Ibid*, p. 133.

²⁸⁴ See International Law Commission, *MFN Clause*, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, p. 5, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010.

Notwithstanding the centrality of the MFN treatment under GATT Article I, the GATT and the WTO also provide important exceptions to MFN treatment. The major exception provided by Article 1 of the GATT is regional arrangements, customs unions and free trade areas, which grant preferences to the members of those agreements and hence do not provide MFN treatment to all GATT contracting parties. In accordance with GATT Article XXIV, these benefits need not be extended to other GATT Contracting Parties or WTO Members.²⁸⁵

As noted by Folsom, GATT 1947 was never about free trade, merely freer trade. This was achieved over decades through tariff-reducing multilateral trade negotiations (known as “negotiating rounds”) and an ever-expanding membership. The essential contents of GATT 1947 and its successor GATT 1994 cover the principle of general MFN trading. This principle is essentially one of non-discrimination, that is to say a rejection of discriminatory tariff and trade preferences.²⁸⁶

Jacob Viner describes the use of the principle going back to the American Revolution. The MFN has been coded in the world trade system since the signing of the General Agreement on Tariffs and Trade (GATT) in 1947. The GATT obliges the contracting parties to leave off discrimination rates. The principle is stipulated clearly in the very first article of the agreement.²⁸⁷

The MFN clause embodied in Article I of the GATT was the defining principle for a system that emerged in the post Second World War era as a response to protectionism and preferential trading arrangements. As noted by Hoekman et al., both policies had contributed to the global economic depression of the 1930s.²⁸⁸

The League of Nations Covenant included a reference to the goal of “equitable treatment for the commerce of all members”. The League of Nations 1936, with respect to the standard of the MFN clause, established the basis for the MFN clause embedded in an early draft of the ITO charter, and had an important influence on the MFN clause that was incorporated into the GATT.²⁸⁹

Schill notes that the MFN Clause was not a rule of general international law that is universally applied among all States. It is a conventional norm that is widely included in the regulation of trade relations among States. However, since its conclusion in the GATT, to which eighty-five governments accounting for over four-fifths of world trade have joined, it has to be considered as a cornerstone of international trade relations.²⁹⁰ According to Abdulqawi, MFN treatment has a constitutional function, because it locks states into a multilateral framework and makes abandoning previously adopted standards of protection more difficult. Therefore MFN clauses in this regard are considered as an instrument to push towards

²⁸⁵ *Ibid.*, p. 5.

²⁸⁶ See Folsom, Ralph H., *Bilateral Free Trade Agreements: A Critical Assessment And WTO Regulatory Reform Proposal*, Legal Studies Research Paper Series, Research Paper No. 08-070, September 2008, p. 4, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1262872, last accessed: 11 September 2010.

²⁸⁷ See Polley, William J, 2004, *Op. Cit.*, p. 2.

²⁸⁸ See Hoekman, Bernard., Martin, William J. and Braga, Carlos A. Primo, *Preference Erosion: The Terms Of The Debate*, World Bank, May 2006, p. 1. Presented at the International Symposium on “Preference Erosion: Impacts and Policy Responses” in Geneva, June 13-14, 2005, organized by The World Bank with support from the Canadian International Development Agency and the UK Department for International Development. We are grateful to all the authors for having subsequently revised their papers, and to C. Tully for helpful comments and assistance. The views expressed are personal and should not be attributed to the World Bank Group, its Executive Directors, or the countries they represent, available at : http://siteresources.worldbank.org/INTRANETTRADE/Resources/Preferences_Intro_Terms_of_the_Debate.pdf, last accessed : 17 April 2010.

²⁸⁹ See League of Nation Economic Committee, Report on the MFN Clause, LN Doc. C. 379, M.250, 1936 II.B (Sales no. 1936 II. B. 9).

²⁹⁰ See Yusuf, Abdulqawi, *Legal Aspects of Trade Preferences for Developing States: A Study in the Influence of Development Needs on the Evolution of International Law*, Martinus Nijhoff Publishers, The Hague, Netherland 1982, p.xix.

an order that is multilateral in substance even though it is based on bilateral treaties.²⁹¹

III. a. Structure and Interpretation of Article I :1 of the GATT 1994.

As noted by Cottier and Mavroidis, the MFN that prevails now is different from the MFN that existed in European policy from 1825 to 1860.²⁹² The demand to deal with the complexity of modern treaty systems requires the old form of MFN to be modified by the mechanism of modern tariff policies.²⁹³

Since, MFN clauses have been adopted into the world trading system; many disputes have occurred within its application and interpretation.²⁹⁴ According to Cottier and Mavroidis, several of the issues which often appear, concern the scope of the coverage of Article I:1, interpretation of any “advantage, favour, privileged or immunity”, “originating”, “accorded... unconditionally” and the concept of “like product”.²⁹⁵

The scope of Article I:1 of the GATT is defined in its primary clauses. Basically, it covers duties and charges levied on goods or related payment transfers; the methods of levying such duties and charges; all rules and formalities related to importation and exportation; and internal regulations of the type covered by Article III:4. Importantly, sometimes forgotten, Article I:1 applies to exportation as well as importation.²⁹⁶ The phrases “methods of levying such duties and charges” and “all rules and formalities” have been interpreted to include the application of antidumping rules and countervailing duty rules. It has also been suggested that the phrases include such matters as customs valuation rules and more generally “improved sets of rules”, such as those entered in respect of some GATT provisions in the Tokyo Round.²⁹⁷

Referring to Article III, Paragraphs 2 and 4, the Chairman of the Contracting Parties ruled in 1948 that with respect to rebates of excise taxes, Article I:1 would be applicable to any advantage, granted with respect to internal taxes. In 1955 it was proposed to amend Article I:1 to specify that it applied “with respect to the application of internal taxes to exported goods”, but the amendment had not been ratified by all Contracting Parties at the time it was abandoned in 1967.²⁹⁸ As a general proposition, it can be said that the scope of Article I:1 had been interpreted broadly in WTO/GATT practice.²⁹⁹ Article I:1 covers advantages, favours, privileges, and immunities granted by a WTO member to any country, including countries which are not WTO members. Any such advantage, etc., needs to be extended immediately and unconditionally to all WTO members. As noted, countries which are not WTO members cannot claim such extension.³⁰⁰

One may also note that only those advantages, favours, privileges, and immunities, “granted [...] to any *product*” are subject to the MFN obligation in Article I:1. Advantages, favours, privileges, and immunities are not linked to the import, export or internal taxation, sale, distribution or use of products but, for example, exclusively linked to producers or service suppliers (without direct or indirect repercussions on the related products), would not seem to be subject to the MFN

²⁹¹ See Schill, 2009, *Op. Cit.*, p. 509.

²⁹² Cottier and Mavroidis, 2002.

²⁹³ See Hornbeck, Stanley K., 1909, *Op. Cit.*, p. 619.

²⁹⁴ See Schill, 2009, *Op. Cit.*, p. 504.

²⁹⁵ See Cottier, Thomas., Mavroidis, Petros C, 2002, *Op. Cit.*, p. 17.

²⁹⁶ See *Ibid.*, p. 17.

²⁹⁷ See *Ibid.*, p. 17.

²⁹⁸ See *Ibid.*, p. 17.

²⁹⁹ See *Ibid.*, p. 17..

³⁰⁰ See Cottier, Thomas., Mavroidis, Petros C, 2002, *Op. Cit.*, p. 18.

requirement.³⁰¹ In the panel report on *EC-Bananas*, a number of aspects of the EC import regime for bananas was considered to be advantageous and found to violate Article I:1 because they were not accorded to all WTO members.³⁰²

It is generally agreed that under existing WTO/GATT rules, members have considerable freedom to set their own rules of origin. However, as a result of the Uruguay round negotiations, the WTO complex of agreements include an Agreement on Rules of Origin. That agreement established a work-programme which will set standard rules of origin for non-preferential purposes. For the moment, the agreement requires several general principles to be followed in the application of the rule of origin, such as that rules of origin shall not be used to pursue trade objectives; shall not create restriction and disruptive effects on international trade: and shall be transparent. Disciplines to be observed once the harmonisation programme has been implemented include the principle that the country of origin of a good needs to be either the country where the good has been wholly obtained or, for instance, where more than one country is concerned in the production of goods, the country where the last substantial transformation was carried out.³⁰³ Article I:1 establishes an unconditional MFN obligation.³⁰⁴

Recently, a WTO panel concluded that the grant by Indonesia of customs and tax advantages to cars produced by one company in Korea violated Article I:1 because those advantages were conditional, *inter alia*, on the existence of a contractual relationship between an Indonesian company and the Korean company. According to the panel, advantages granted by a WTO member cannot be made conditional on, nor even be affected by, the existence of contractual obligations, such as the existence of a deal between a domestic company designated by the government and foreign company. Advantages accorded to products of one country in that case, to Korean cars and parts and components need to be granted to import like products from all other WTO members “immediately and unconditionally”. In reaching its conclusion, the panel noted that in 1973, the working party on the concession of Hungary where the GATT Secretariat had expressed the view that the prerequisite of having a co-operation contract in order to benefit from certain tariff treatment appeared to imply conditional MFN treatment and would therefore not be compatible with GATT rules.³⁰⁵

The concept of “like product” is a fundamental issue in the application of the MFN obligation in GATT Article I:1. The advantage afforded to one product (originating in or destined for any country) must be afforded to another product (originating in or destined for all other WTO Members) only if the other product is a like product.³⁰⁶

Article I:1 deals with differences in treatment between products which result from the regulatory distinction made by the governments. If such distinctions are made exclusively on the basis of the origin of the product rather than on the basis of factors affecting the properties, nature, qualities or end use of the product itself, no doubt Article I:1 would be violated. Such a violation could be referred to as *de jure* discrimination contrary to Article I:1. Origin-based discrimination between products is one extreme. The other extreme consists of regulatory distinctions made between products that manifest differently.³⁰⁷

³⁰¹ See *Ibid.*, p. 18

³⁰² See *Ibid.*, p. 18.

³⁰³ See Cottier, Thomas., Mavroidis, Petros C, 2002, *Op. Cit.*, p. 19.

³⁰⁴ See Cottier, Thomas., Mavroidis, Petros C, 2002, *Op. Cit.*, p. 20.

³⁰⁵ See *Ibid.*, p. 20.

³⁰⁶ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, *Op. Cit.*, p. 25.

³⁰⁷ See *Ibid.*, p. 25.

The concept of “like product” is incorporated in not less than nine articles of the GATT. It has long been accepted in GATT thinking that the concept might have a different meaning in the different provisions in which it is used. This view has been explicitly adopted by the Appellate Body, which states that:³⁰⁸

“[...] the concept of “likeness” is relative to one that evokes the image of an accordion. The accordion of “likeness” stretches and squeezes in different places as different provisions of WTO agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term “like” is encountered as well as by the context and circumstances that prevail in any given case to which that provisions may apply [...]”

WTO law generally uses the concept of ‘likeness’, such as ‘like products’ in GATT or ‘like service and service suppliers’ in GATS. In addition, one GATT non-discrimination provision also uses the concept of ‘directly competitive or substitutable products’ instead of ‘likeness’. The TFEU³⁰⁹ refers to ‘similar products’ and ‘other products’ in Article 110. In spite of the different terminologies, all comparator clauses share the identical fundamental problem of identifying the relevant *tertium comparationis*, i.e. the quality or element which two ‘situations’ or ‘objects’ must have in common in order to conclude that they are ‘alike’ for the purpose of the comparison.³¹⁰

III. b. Codification of Most Favoured Nation clause by the International Law Commission.

According to the International Law Commission, outside the economic field, MFN was a principle of non-discrimination suited to circumstances where relations between states were regulated through bilateral arrangements. However, as noted over history, most multilateral agreements in the economic field have included the MFN clause. This indicates that the MFN has engaged its pre-eminence in the economic field.³¹¹

The MFN clause has become such a typical clause in treaties that the International Law Commission (ILC) has drawn up draft articles on MFN clauses (hereinafter The ILC’s draft articles on MFN clauses).³¹² Notwithstanding, the ILC’s draft articles never came as a treaty and are non-binding. Nevertheless, the ILC’s draft Articles did codify the definition and the rules governing the operation of the MFN clause.³¹³ However, in 1978, the ILC adopted draft articles on the topic of the MFN

³⁰⁸ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, *Op. Cit.*, p. 26.

³⁰⁹ See Treaty on the Functioning of the European Union ‘TFEU’ (Consolidated version, as amended by the Treaty of Lisbon), OJ 2008 C 115, at 47-199; formerly Treaty establishing the European Community ‘TEC’ (Consolidated version, as amended by the Treaty of Amsterdam), OJ 2002 C 325, at 33-184.

³¹⁰ See Diebold, Nicolas F., *Non-Discrimination And The Pillars of International Economic Law*, Emerging Scholars Papers, A sub series of IILJ Working Papers, IILJ Emerging Scholars Paper 18, Institute for International Law and Justice, New York University School of Law, 2010, pp. 4-5, available at : <http://www.iilj.org/publications/documents/ESP18-2010Diebold.pdf>, last accessed : 25 January 2011.

³¹¹ See International Law Commission, MFN Clause, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July -10 August 2007, Distr. Limited A/CN.4/L.719, p. 4, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010.

³¹² See International Law Commission, *Draft Article on Most Favoured Nation clauses (ILC Draft Arts.)*, text adopted by the International Law Commission at its 30th session (1978), available at http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/1_3_1978.pdf . For commentaries on the ILC’s Draft Articles, see Report of the International Law Commission on the Work of its Thirtieth session , 8 May – 28 July 1978, Official Records of the General Assembly, Thirty-third session, Supplement No. 10, Doc. A/33/10 ILC Report), 2 Yearbook of the International Law Commission (1978) 8, available at: http://untreaty.un.org/ilc/documentation/english/A_33_10.pdf, , last accessed : 26 November 2010.

³¹³ See Radi, Yannick., *The Application of the MFN Clause to the Dispute Settlement Provisions of Bilateral Investment Treaties: Domesticating the ‘ Trojan Horse’*, EJIL (2007), Vol. 18 No. 4, 757–774, The European Journal of International Law Vol. 18 no. 4 © EJIL 2007, available at : <http://www.ejil.org/pdfs/18/4/232.pdf>, last accessed : 26 November 2010.

clause, but no conclusion was drawn up by the General Assembly.³¹⁴ The Commission justified the provisions by arguing that the agreement of both the GATT and UNCTAD to this principle had established its general observance. Although the United Nations had never adopted the model MFN clause itself, the Commission's recognition of the exception for preferences was regarded as a major step forward. This draft consisted of some 30 articles designed to clarify and elaborate the MFN concept. Among the provisions of the draft were two articles providing that the preferences given to developing countries should be exempt from the standard MFN obligation.³¹⁵

Provisions of the ILC's draft articles on the MFN clauses consisted of the definition of the MFN clause and MFN treatment (Draft Articles 4 and 5), its scope, the conventional rather than customary international law basis of MFN treatment (Draft Article 7), the scope of MFN treatment (Draft Articles 8, 9 and 10), the effect of conditional and unconditional MFN (Draft Articles 11, 12 and 13), the source of the treatment to be provided under an MFN clause (Draft Articles 14-19), the time that rights arise under an MFN clause (Draft Article 20), termination or suspension of an MFN clause (Draft Article 21), and the relationship of the MFN clause to a generalised system of preferences (Draft Articles 23 and 24), and the special cases of frontier traffic and transit rights of land-locked states.³¹⁶

Article 8 of the ILC's draft on the MFN Clause regulates the basic act (*acte regie*) as the agreement between the granting state and the beneficiary state. According to Schill, to apply MFN clauses in international law a relationship of at least three states is presupposed. The "Granting State" enters into an obligation vis-à-vis the "Beneficiary State". Extended rights and benefits are granted in a specific context to any "Third State". The existence of the MFN clause in the treaty between the "Granting State" and "Beneficiary State" can authorise the "Beneficiary State" to extend all benefits the "Granting State" grants vis-à-vis the "Third State", as long as the granted benefit is within the scope of application of the MFN clause in the relationship between the "Granting State" and the "Beneficiary State". The "basic treaty" is a treaty that contains the MFN clause between the "Granting State" and the "Beneficiary State".³¹⁷

The third-party treaty (between the "Granting State" and the "Third State") will not affect the parties of the basic treaty. In other words the third-party treaty does not have any legal effect to the basic treaty. Rather, the content of the third-party treaty becomes operative by means of the MFN clause of the treaty.³¹⁸ The decision of ICJ in *Anglo-Iranian Oil Company* stated:³¹⁹

"[...] It is this [*that is*, the basic] treaty which establishes the juridical link between the [beneficiary state] and a third-party treaty and confers upon that state the rights enjoyed by the third party. A third-party treaty, independent of and isolated from

³¹⁴ See International Law Commission, *MFN Clause*, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010, p. 3.

³¹⁵ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 88-89.

³¹⁶ See International Law Commission, *MFN Clause*, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010, p. 6; See also International Law Commission, Draft Articles on Most Favoured Nation clauses (ILC Draft Article.), text adopted by the International Law Commission at its 30th session (1978), available at http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/1_3_1978.pdf. For commentaries on the ILC's Draft Arts., see Report of the International Law Commission on the Work of its Thirtieth session , 8 May - 28 July 1978, Official Records of the General Assembly, Thirty-third session, Supplement No. 10, Doc. A/33/10 (hereinafter ILC Report), 2 Yearbook of the International Law Commission (1978) , available at: http://untreaty.un.org/ilc/documentation/english/A_33_10.pdf.

³¹⁷ See Schill, 2009, *Op. Cit.*, p. 506.

³¹⁸ See Schill, 2009, *Op. Cit.*, p. 507.

³¹⁹ See *Ibid.*, p. 507.

the basic treaty, cannot produce any legal effect as between the [beneficiary state] and [the granting state]: it is *res inter alios acta* [...]”.³²⁰

Referring to Article 8³²¹ of the ILC’s draft articles, Yannick notes that the indirect effect that exists between the parties in the basic treaty, is unintentional.³²² According to Article 36³²³ of the Vienna Convention on the Law of Treaties which deals with rights emerging from a treaty for a third state, it is stipulated that such a benefit granted to a third state can only derive from a clear intention expressed by the parties to the treaty.³²⁴

In order to define the scope of the MFN clause relating to dispute settlement provisions, it is necessary to interpret the intention of the contracting states in conformity with Articles 31 and 32 of the Vienna Convention on the Law of Treaties.³²⁵

The ILC’s draft on the MFN clause never came into existence³²⁶ because the Draft Articles did not exclude the customs unions and free trade areas, which became a significant issue of the EU. Since the EU (EEC) members did not want to extend the benefits under the Treaty of Rome to states that were not EU (EEC) members. The same reasons were also raised by developing countries that were entering into regional free trade.³²⁷ The development issue of the Draft Articles which includes the treatment of the generalised systems of preferences is also one of the reasons why the

³²⁰ See Commentaries on Article 8 ILC’s Draft on MFN Clause, p. 26.

³²¹ See Article 8 The source and scope of MFN treatment : 1. The right of the beneficiary State to most-favourednation treatment arises only from the MFNclause referred to in article 4, or from the clause on MFN treatment referred to in article 6, in force between the granting State and the beneficiary State; 2. The MFN treatment to which the beneficiary State, for itself or for the benefit of persons or things in a determined relationship with it, is entitled under a clause referred to in paragraph 1, is determined by the treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State. Draft Articles on MFN clauses, 1978, Text adopted by the International Law Commission at its thirtieth session, in 1978, and submitted to the General Assembly as a part of the Commission’s report covering the work of that session (at para. 74). The report, which also contains commentaries on the draft articles, appears in Yearbook of the International Law Commission, 1978, vol. II, Part Two, available at : http://untreaty.un.org/ilc/texts/instruments/english/commentaries/1_3_1978.pdf

³²² See Radi, Yannick., (2007), *Op. Cit.*, p. 759.

³²³ See Article 36 states: ‘ [t]reaties providing for rights for third States: 1. A right arises for a third State from a provision of a treaty if the parties to the treaty intend the provision to accord that right either to the third State, or to a group of States to which it belongs, or to all States, and the third State assents thereto. Its assents shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides. 2. A State exercising a right in accordance with paragraph 1 shall comply with the conditions for its exercise provided for in the treaty or established in conformity with the treaty ’ : Vienna Convention on the Law of Treaties (1969) (VCLT), 1155 UNTS (1980) 331, at 341, available at: http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf.

³²⁴ See Radi, Yannick., (2007), *Loc. Cit.*, p. 759.

³²⁵ See Article 31 states: ‘ General rule of interpretation: 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. 3. There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) any relevant rules of international law applicable in the relations between the parties. 4. A special meaning shall be given to a term if it is established that the parties so intended. ’ Art. 32 states: ‘ Supplementary means of interpretation: Recourse may be had to supplementary means of interpretation, including the preparatory work and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable ’ : Vienna Convention on the Law of Treaty, supra note 7, at 340. See Radi, Yannick., The Application of the MFN Clause to the Dispute Settlement Provisions of Bilateral Investment Treaties: Domesticating the ‘ Trojan Horse’, EJIL (2007), Vol. 18 No. 4, 757–774, The European Journal of International Law Vol. 18 no. 4 © EJIL 2007, available at : <http://www.ejil.org/pdfs/18/4/232.pdf>, last accessed : 26 November 2010, p. 760.

³²⁶ See Schill, 2009, *Op. Cit.*, p. 517.

³²⁷ See International Law Commission, *MFN Clause*, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010, p.7.

ILC's draft on the MFN clause is still a draft. Therefore, some states consider that the Draft Articles have been used as guidelines.³²⁸ Consequently, the ILC's draft on the MFN clause is used as guidelines³²⁹ of state practice and *opinio juris* on the general understanding and interpretation of the MFN clauses in international treaties.³³⁰

III. c. Interpretation of the Most Favoured Nation clauses under the Vienna Convention on the Law of Treaties.

According to Schill, "all agreements between member states of the WTO, in the form of derivation from an integral part of the WTO Agreement must comply with the principals of the WTO Agreement".³³¹ In this regard, all the member states of the WTO when they established the treaty under the "WTO umbrella norms" must not oppose the fundamental norms of the WTO. Their treaty should be able to reflect the spirit of WTO norms.

Referring to Article 31 of the Vienna Convention on the Law of Treaties, it is stipulated that a treaty 'shall be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and *in the light of its object and purpose*'. This provision is part of the customary rule of international law, which the WTO Dispute Settlement Body is obliged to take into consideration.³³² The Appellate Body itself has emphasised that WTO provisions must be interpreted in conformity with the preamble of the WTO Agreement.³³³ For example, the process of incorporating the Enabling Clause into the GATT Agreement should be in line with the Preamble of the WTO Agreement, which states "*commensurate with the needs of their economic development*", which is considered as a conscious 'positive effort' of WTO members.³³⁴ The Enabling Clause is exempted from Article I:1 of the GATT. The Appellate Body in the EC Preferences case upholds decisions of the panel, it stated that the Enabling Clause "does not exclude the applicability" to Article I:1 of the GATT 1994.³³⁵ The preservation of MFN in the WTO regime and its dispute settlement process has given a large contribution to the development of the world trading system. Finally, the MFN treatment as a basic principle must be interpreted in a consistent way.³³⁶

III. d. Exceptions and waivers of Most Favoured Nation clause under the GATT 1994.

As noted above, that MFN principle is one of the basic principles governing obligations under the WTO. However, the GATT Agreement itself contains a number of exceptions, to depart from MFN. During the development of the World Trading System

³²⁸ See *Ibid.*, p. 13.

³²⁹ See Schill, 2009, *Op. Cit.*, p. 518.

³³⁰ See *Ibid.*, p. 518.

³³¹ See Ukpe, 2009, *Op. Cit.*, p. 5.

³³² See Appellate Body Report on United States – Standards for Reformulated and Conventional Gasoline ("US – Gasoline"), WT/DS2/AB/R, p. 17. See also Article 3.2 of the WTO Understanding on Rules and Procedures governing the Settlement of Disputes (DSU); See also Ukpe, 2009, *Loc. Cit.*, p. 5.

³³³ See Appellate Body Report on United States – Import Prohibition of Certain Shrimp and Shrimp Products ("US – Shrimp"), WT/DS58/AB/R, para. 129; See also Ukpe, 2009, *Op. Cit.*, p. 5.

³³⁴ See Ukpe, 2009, *Op. Cit.*, p. 6.

³³⁵ See Appellate Body Report in *EC Preferences Case* para. 190.

³³⁶ See International Law Commission, *MFN Clause*, Report of the Working Group, Fifty-ninth session, Geneva, 7 May - 8 June and 9 July - 10 August 2007, Distr. Limited A/CN.4/L.719, p. 5, available at : http://untreaty.un.org/ilc/documentation/english/a_cn4_l719.pdf, last accessed : 23 November 2010.

the MFN eroded due to dynamic change in world economic development and different interests between member states.³³⁷

There are four major exceptions to the MFN obligations found in the WTO agreements; the general exceptions, the exceptions for customs unions and free trade areas, the security exception and for special and differential treatment of developing countries. Article I:2 of the GATT provides an exception for historical preferences.³³⁸ This Article allows exceptions for preferential arrangements listed in Annexes A to F of the GATT, many of which arose out of colonial ties. For example, the British Commonwealth preferences gave preferences to its former colonies from MFN under this exception. The formation and enlargement of the European Economic Community (European Union), a major “exception” itself, has further distorted the meaning of the historical preferences of GATT. However, the Yaoundé and Lomé conventions between the EEC and a number of developing countries, many of which were former colonies of EEC member states, in some cases might be able to be regarded as a form of continuation of these historical preferences.³³⁹ Such historical preferences have now been replaced by Economic Partnership Agreements with some revisions within their scheme.

Article XXV³⁴⁰ of the GATT contains a general power of “waiver” by a special (two-thirds) majority of the contracting parties. As noted by Jackson, this power should not be used to modify the effects of GATT Article I because amendments to that article require unanimity. Nevertheless, a number of waivers have been adopted to grant exemption from MFN obligations. The most important standpoint of MFN erosion was the 1971 waiver for the preference system for the trade of developing countries.³⁴¹ More generally the reason to depart from MFN could be argued that it is more understandable when discrimination would increase welfare in the basis of responding to the “special needs” of developing countries.³⁴²

III. d. 1. General exception of Article XX of the GATT 1994.

In general, non-discrimination provisions of the WTO agreements use the term “discrimination” *per se*, unfortunately, specific standards or criteria to define the obligation have not yet been provided. One of the articles, which permit a measure to depart from non-discrimination, is Article XX of the GATT. This article allows a member to adopt measures that are inconsistent with GATT obligations for particular policy reasons. Imposing an obligation on members not to apply such measures “in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail.”³⁴³

³³⁷ See United States Tariff Commission, Report to the Committee on Finance of the United States and its Subcommittee on International Trade, Part I, “Trade Barriers: An Overview”, TC Publ. 665 (1974), 110; J.H. Jackson, 1977, p. 544; John H. Jackson, 2000, *Op. Cit.*, p. 61.

³³⁸ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, p. 22

³³⁹ See John H. Jackson, 2000, *Op. Cit.*, pp. 61-62.

³⁴⁰ In exceptional circumstances not elsewhere provided for in this Agreement, the Contracting Parties may waive an obligation imposed upon a contracting party by this Agreement; Provided that any such decision shall be approved by a two-thirds majority of the votes cast and that such majority shall comprise more than half of the contracting parties. The Contracting Parties may also by such a vote :

(i) define certain categories of exceptional circumstances to which other voting requirements shall apply for the waiver of obligations, and

(ii) prescribe such criteria as may be necessary for the application of this paragraph.

³⁴¹ See Jackson, World Trade and the Law of GATT, p. 549; Jackson, World Trade and the Law of GATT, 100; John H. Jackson, 2000, p. 62.

³⁴² See World Trade Organization, World Trade Report 2007, , 2007, *Op. Cit.*, p. 133.

³⁴³ See Julia Ya Qin, *Op. Cit.*, p. 217.

III.d.1.a. The negotiating history of Article XX of the GATT 1994.

The history of the general exceptions, which are listed in Article XX of the GATT 1994, can be traced back to 1927 within the International Agreement for the Suppression of Import and Export Prohibitions and Restrictions.³⁴⁴ This Article contained an exception for trade restrictions applied for the protection of public health and the protection of animals and plants against diseases and against 'extinction',³⁴⁵ Subsequently, the drafters incorporated the same general exceptions³⁴⁶ during negotiations for the creation of the International Trade Organization ("ITO").³⁴⁷

The preparatory work of the General Exceptions provision, later becoming Article XX of the GATT 1947³⁴⁸, was notorious. The scope of the exceptions proposed under the article and the "divergence of national practices" became a debatable issue. The disagreement between the parties was explained in a report by the Preparatory Committee of the United Nations Conference on Trade and Employment in 1947:

"[...] A substantial degree of agreement among the members of the Preparatory Committee was reached on questions of the principle underlying these [General Exception] provisions. However, as was to be expected, there were numerous differences of opinion, and a number of reservations were made on account of national variations in the practice of detailed administration [...]"³⁴⁹

Eventually, the drafters of the ITO Charter included the General Exceptions provision which was proposed by the US and included as "Annexure II" of the London Draft Charter.³⁵⁰ The US draft contained the introductory language as follows: "Nothing

³⁴⁴ See International Convention for the Abolition of Import and Export Prohibitions and Restrictions, League of Nations Doc. C.559 M.201 1927.II[B] (1927). Article 4 provides an exception for, among other things, rules and regulations that are "issued on grounds of public health" or "imposed for moral or humanitarian reasons..." See Ala'i, Padideh, *Free Trade or Sustainable Development? An Analysis Of The WTO Appellate Body's Shift To A More Balanced Approach To Trade Liberalization*, p. 1132, available at : <http://www.auilr.org/pdf/14/14-4-5.pdf>, last accessed : 28 January 2011.

³⁴⁵ See Charnovitz, Steve., *Trade and The Environment In The WTO*, Journal of International Economic Law, Vol. 10, Public Law and Legal Theory Working Paper NO. 338, Legal Studies Research Paper NO. 338, 2007, p. 2, available at : <http://ssrn.com/abstract=1007028>, last accessed : 10 February 2011.

³⁴⁶ For the full drafting history of the ITO Charter general exceptions, see Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, U.N. ESCOR, 1st Sess., at 33, U.N. Doc. E/PC/T/33 (1946) [London Draft Charter] (illustrating that general exceptions were considered, but were not drafted); Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, U.N. ESCOR, 1st Sess., Annexure I, at 52, 60, U.N. Doc. EPCiT/33 (1946) [United States Draft Charter] (illustrating draft exceptions); Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment, U.N. ESCOR, 2d. Sess., at 31, 77, U.N. Doc. /PC/T/34/Rev. 1 (1947) [New York Draft Charter]; Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, U.N. ESCOR, 2d Sess., at 7-65, U.N. Doc. E/PCIT/186 [Geneva Draft Charter]; Final Act and Related Documents of the United Nations Conference on Trade and Development, U.S. ESCOR, at 33, U.N. Doc. E/Conf.2/78 (1948) [Havana Charter]; See Ala'i, Padideh, *Op. Cit.*, p. 1133.

³⁴⁷ At the Bretton Woods Conference in 1944, there was agreement among the participants that protectionism and restrictive trade policies had led to the worldwide recession, which had in turn caused World War II. As a result, partly to forestall history from repeating itself and partly to rebuild the economies of many parts of the world-specifically Europe and Japan-after the devastation of World War II, the Conference drafted outlines for three "Bretton Woods" institutions. Two of these institutions, the International Monetary Fund ("IMF") and the International Bank for Reconstruction and Development ("IBRD" or "World Bank"), began operating in Washington, D.C. in 1946. The third institution was the International Trade Organization ("ITO"). Negotiations for the creation of the ITO began in 1946 but the organization itself never came into existence, largely due to the fact that the United States Congress refused to ratify it. As a result, the General Agreement for Tariffs and Trade ("GATT"), which was originally envisioned to be a subsidiary agreement and part of the ITO, was concluded as an executive agreement and was left to fill the void that the failed ITO had left; See John H. Jackson, *The World Trading System: Law And Policy Of International Economic Relations* 35 (2d ed. 1997). See Ala'i, Padideh, *Loc. Cit.*, p. 1133.

³⁴⁸ The GATT was never contemplated to be an organization and it was implemented on a "provisional basis" for almost fifty years. Because the GATT was not an institution, signatory countries were referred to as Contracting Parties and not Members. Under the WTO, all signatory countries that have successfully joined and acceded to the organization are called Members. See Ala'i, Padideh, *Op. Cit.*, p. 1133.

³⁴⁹ See London Draft Charter ; See Ala'i, Padideh, *Loc. Cit.*, p. 1133.

³⁵⁰ See Ala'i, Padideh, *Loc. Cit.*, p. 1133.

in Chapter IV [on commercial policy] of this [ITO] Charter shall be construed to prevent the adoption of enforcement by any member of measures.”³⁵¹

The introductory language in the proposed draft suddenly provoked concerns about the possible abuse towards the enforcement of provisions. Therefore delegations from the Netherlands and Belgium-Luxembourg Economic Union concerned that “the stipulations” “to protect animal or plant life or health “would be abused as the new form of indirect protectionism.”³⁵² On that basis, in order to avoid further misuses of exceptions and, in this regard, to prohibit the use of the exceptions for protectionist objectives, the introductory language was amended as follows:³⁵³

“[...] *Subject to the requirement that such measures not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in Chapter V [General Commercial Policy] shall be construed to prevent the adoption or enforcement of any member of measures [...].*”³⁵⁴

This amendment prevented the abuse of Article XX in the regard of protection measures as an abuse by the member states. In conclusion, the drafting history of Article XX signifies the accommodation of the balance of trade liberalisation and national interest of each member state in the framework of the multilateral trading system.³⁵⁵

³⁵¹ See The full text of the General Exceptions provisions from the United States Draft Charter provided: Nothing in Chapter IV, article 32 [on commercial policy] of this [ITO] Charter shall be construed to prevent the adoption or enforcement by any Member of measures:

- a) necessary to protect public morals;
- b) necessary to protect human, animal, or plant life or health;
- c) relating to fusionable materials;
- d) relating to traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on for the purpose of supplying a military establishment;
- e) in time of war or other emergency in international relations, relating to the protection of the essential security interests of a Member;
- f) relating to the importation or exportation of gold and silver;
- g) necessary to induce compliance with laws or regulations which are not inconsistent with the provisions of Chapter IV, such as those relating to customs enforcement, deceptive practices, and the protection of patents, trade marks and copyrights;
- h) relating to prison-made goods;
- i) imposed for the protection of national treasures of artistic, historic or archeological value;
- j) relating to the conservation of exhaustible natural resources if such measures are taken pursuant to international agreements or are made effective in conjunction with restrictions on domestic production or consumption;
- k) undertaken in pursuance of obligations under the United Nations Charter for the maintenance or restoration of international peace and security; or
- l) imposed in accordance with a determination or recommendation of the Organization [ITO] formulated under paragraphs 2, 6, or 7 of Article 55 [Powers and Duties of the Conference].

³⁵² See GATT, Analytical Index: Guide To GATT Law And Practice 563 (1995) (citing U.N. Doc. E/PC/T/C.11/32 (1946) (note of the Netherlands and the Belgo-Luxembourg Economic Union). "Indirect protectionism is an undesirable and dangerous phenomenon. Many times stipulations to 'protect animal or plant life or health' are misused for indirect protection. It is recommended to insert a clause which prohibits expressly [the use of] such measures [to] constitute an indirect protection ...".

³⁵³ See Ala'i, Padideh, *Loc. Cit.*, p. 1133.

³⁵⁴ See New York Draft Charter.

³⁵⁵ See Ala'i, Padideh, *Loc. Cit.*, p. 1133.

III.d.1.b. Interpretation and application of Article XX of the General Exception of GATT 1994: Article XX (b) of GATT 1994 as a justification for the Drug Arrangements in the EC preferences case.

The interpretation of GATT Article XX has begun to play a significant role in defining the relationship between different areas of international law.³⁵⁶ As noted by Jackson, “this exception has a short limited freedom” which should not be misused against the basic principle of WTO. The sub provisions within articles give limitations and guidance of the measures, which can be taken by member states under the chapeau of Article XX of the GATT.³⁵⁷

The Article XX of General Exception of GATT 1994 provides:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

- a) *necessary to protect public morals;*
- b) *necessary to protect human, animal or plant life or health;*
- c) *relating to the importations or exportations of gold or silver;*
- d) *necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices;*
- e) *relating to the products of prison labour;*
- f) *imposed for the protection of national treasures of artistic, historic or archaeological value;*
- g) *relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;*
- h) *undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved;**
- i) *involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan; Provided that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination;*
- j) *essential to the acquisition or distribution of products in general or local short supply; Provided that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist.*

Article XX (b) and (g) of GATT 1994 authorise WTO Members to adopt trade-restrictive measures aimed at protecting the environment, thus, it is allowed to depart from basic norms, such as non-discrimination, however, this is subject to certain specified conditions.³⁵⁸

³⁵⁶ See Condon, Bradly J., *GATT Article XX and Proximity of Interest: Determining the Subject Matter of Paragraphs b and g*, p. 2, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=666984&http://papers.ssrn.com/sol3/papers.cfm?abstract_id=666984&re=1&srcabs=301404, last accessed : 15th Februari 2011.

³⁵⁷ See John H. Jackson, 2003, p. 791; Condon, Bradly J., *Op. Cit.*

³⁵⁸ See Gabiatti, Sonia., *Trade-Related Environmental Measures Under GATT Article XX (b) and (g)*, 2009, p. 24, available at : http://skemman.is/stream/get/1946/3044/10073/4/Sonia_Gabiatti_fixed.pdf, last accessed : 21 January 2011.

In US-Shrimp case, the Appellate Body interpreted the nature and purpose of Article XX as a balance of rights and duties:³⁵⁹

“[...] balance must struck between the right of a Member to invoke an exception under Article XX and the duty of that same Member to respect the treaty rights of the other Members. The task of interpreting and applying the chapeau is, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions (e.g., Article XI) of GATT 1994, so that neither the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves in that Agreement. The location of the line of equilibrium, as expressed in the chapeau, is not fixed and unchanging; the line moves as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ [...]”³⁶⁰

The Appellate Body linked the balance of rights and obligations under the chapeau of Article XX to the general principle of good faith:³⁶¹

“[...] The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state’s rights and enjoins that whenever the assertion of a right “impinges on the field covered by [a] treaty obligation, it must be exercised *bona fide*, that is to say, reasonably.”³⁶² An abusive exercise by a Member of its own treaty right thus results in a breach of the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting. Having said this, our task here is to interpret the language of the chapeau, seeking additional interpretative guidance, as appropriate, from the general principles of international law [...]”.

“[...] The task of interpreting and applying the chapeau is, hence, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions (e.g., Article XI) of the GATT 1994, so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves in that Agreement. The location of the line of equilibrium, as expressed in the chapeau, is

³⁵⁹ See World Trade Organization, *WTO Analytical Index : Guide to WTO Law and Practice, Second Edition, Volume I*, Cambridge University Press, 2007, Para. 575, available at : http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20, last accessed : 21 November 2011.

³⁶⁰ Appellate Body Report on US Shrimp case, paras. 156 and 159.

³⁶¹ See World Trade Organization, *WTO Analytical Index : Guide to WTO Law and Practice, Second Edition, Volume I*, Cambridge University Press, 2007, Para. 585, Available at : http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20, last accessed : 21 November 2011.

³⁶² See B. Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Stevens and Sons, Ltd., 1953), Chapter 4, in particular, p. 125 elaborates:

... A reasonable and *bona fide* exercise of a right in such a case is one which is appropriate and necessary for the purpose of the right (i.e., in furtherance of the interests which the right is intended to protect). It should at the same time be fair and equitable as between the parties and not one which is calculated to procure for one of them an unfair advantage in the light of the obligation assumed. A reasonable exercise of the right is regarded as compatible with the obligation. But the exercise of the right in such a manner as to prejudice the interests of the other contracting party arising out of the treaty is unreasonable and is considered as inconsistent with the *bona fide* execution of the treaty obligation, and a breach of the treaty. Also see, for example, Jennings and Watts (eds.), *Oppenheim’s International Law*, 9th ed, Vol. I (Longman’s, 1992), pp. 407–410, *Border and Transborder Armed Actions Case*, (1988) I.C.J. Rep. 105; *Rights of Nationals of the United States in Morocco Case*, (1952) I.C.J. Rep. 176; *Anglo-Norwegian Fisheries Case*, (1951) I.C.J. Rep. 142.

not fixed and unchanging; the line moves as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ [...].”³⁶³

Related to the analytical approach of discrimination under Article XX (g), in the regard of feasible similarities or differences in conditions from one country to another, which include social values or economic conditions, however, they burden responsibilities to the conservation purposes of the measure. The Rio Declaration as an international environmental policy stipulates the “differentiated responsibilities” of countries based on their developmental status.³⁶⁴ In the light of certain aspects of trade policy, it also authorises distinction between countries in terms of economic development.³⁶⁵

Environmental interests is covering the protection of human, animal and plant life or health and the conservation of exhaustible natural resources.³⁶⁶ The function of Article XX related to national measures taken for environmental protection is concluded by the Appellate Body in US-Gasoline case, as follows:³⁶⁷

“[...] It is of some importance that the Appellate Body point out what this does not mean. It does not mean, or imply, that the ability of any WTO Member to take measures to control air pollution or, more generally, to protect the environment, is at issue. That would be to ignore the fact that Article XX of the General Agreement contains provisions designed to permit important state interests including the protection of human health, as well as the conservation of exhaustible natural resources to find expression. The provisions of Article XX were not changed as a result of the Uruguay Round of Multilateral Trade Negotiations. Indeed, in the preamble to the WTO Agreement and in the Decision on Trade and Environment, there is specific acknowledgement to be found about the importance of coordinating policies on trade and the environment. WTO Members have a large measure of autonomy to determine their own policies on the environment (including its relationship with trade), their environmental objectives and the environmental legislation they enact and implement. So far as concerns the WTO, that autonomy is circumscribed only by the need to respect the requirements of the General Agreement and the other covered agreements [...].”³⁶⁸

The panel and Appellate Body discovered methods to implement Article XX to justify the inconsistent measures of the GATT. The justification of the inconsistent measure in GATT involves issues such as burden proof, the sequence of steps for the application of Article XX, the policy choice and fulfilment of the requirements of the paragraphs in Article XX as well as its introductory clause, known as the *chapeau*³⁶⁹. In order to interpret the chapeau of Article XX, the Appellate Body should refer back to the guidelines in the Preamble of the WTO Agreement, and consider the Uruguay Round Decision on Trade and Environment. In addition, the Appellate Body

³⁶³ See Appellate Body Report on US Shrimp case, paras. 158–159.

³⁶⁴ United Nations Conference on Environment and Development: Rio Declaration on Environment and Development, (“In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities.”).

³⁶⁵ One of the most well-known of such differentiations is the Generalized System of Preferences (“GSP”), allowing developed countries to grant preferential trade status to the poorer of the developing countries. For one of several ministerial decisions reached in conjunction with the Final Act of the Uruguay Round, see Decision on Measures in Favour of Least-Developed Countries (April 15, 1994) WTO Agreement, Part III, 33 I.L.M. 138 (1994) (reaffirming a 1979 decision to create the GSP); See Gaines, Sanford., The WTO’s Reading of the GATT Article XX Chapeau: A Disguised Restriction on Environmental Measures, p. 781, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=301404, last accessed : 13 January 2011.

³⁶⁶ See Gabiatti, Sonia., 2009, *Op. Cit.*, pg. 26.

³⁶⁷ See World Trade Organization, WTO Analytical Index : Guide to WTO Law and Practice, Second Edition, Volume I, Cambridge University Press, 2007, Para. 576, Available at : http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20, last accessed : 21 November 2011.

³⁶⁸ Appellate Body Report on US — Gasoline, pp. 30–31.

³⁶⁹ See Gabiatti, Sonia., 2009, *Op. Cit.*, p. 25.

surprisingly stated that to interpret the chapeau, it is possible to seek additional interpretation of the referral guidelines, which are appropriate from general principles of international law. The Appellate Body also explained that the remedy or measure of Article XX must be exercised 'reasonably' under general principles of law and international law.³⁷⁰

The Dispute Settlement Body of the WTO has evolved a two-step test based on these listed exceptions and the so-called 'chapeau' of Article XX to be used in the analysis to determine whether a particular environmental measure is consistent with the GATT/WTO obligations. First, the measure must fall under one of the listed exceptions stipulated in Article XX. Then the objectives of the measure must be examined to determine whether it falls under the scope of any of the listed exceptions or not. The second step of the test of the applicable measures aims to determine whether the application is discriminatory in specific ways. This subject of discrimination, at the second step, is determined by referring to the "chapeau" of Article XX. The chapeau disallows the application of a measure, which otherwise is compliant with the scope of Article XX (g), if it constitutes "arbitrary discrimination" (between countries where the same conditions prevail; "unjustifiable discrimination" (within the same qualifier); or "disguised restriction" on international trade. The above-mentioned three terms have-to be read "side-by-side," and "impart meaning to one another."³⁷¹

Concerning the burden of proof, it regulates that the party has to prove the affirmative of a particular claim or defence that it has submitted.³⁷² Affirmative defence imposes the obligation to the party who invoke Article XX of general exception to provide the burden of proof according to domestic law, international procedures and GATT/WTO practice.³⁷³ The burden of proof has to be provided by the party who invoke Article XX of general exception in order to justify a GATT inconsistent measure.³⁷⁴

Further, the party that is invoking an exception under Article XX has to prove that the inconsistent measure comes within the scope of one of the prescribed exceptions and also that the measure complies with the chapeau of Article XX.³⁷⁵ In the EC-Preferences Case, the panel held that the defending party had the responsibility to invoke it and the Appellate Body upheld this finding. Then, the question rose about the difference of the burden of proof in the Enabling Clause and General Exception Article XX. As noted by Matsushita, the developed country members are encouraged to use the Enabling Clause in order to participate in assisting the Developing Country and Less Developing Country in alleviating poverty and economic development. Hence, to "depart" from non-discrimination in tariffs is justified as long as this complies with the

³⁷⁰ See Charnovitz, Steve., *Trade and The Environment In The WTO*, Journal of International Economic Law, Vol. 10, Public Law and Legal Theory Working Paper NO. 338, Legal Studies Research Paper NO. 338, 2007, p. 24, available at : <http://ssrn.com/abstract=1007028>, last accessed : 10 February 2011.

³⁷¹ See Ghei, Nita., *Evaluating The WTO'S Two Step Test For Environmental Measures Under Article XX*, George Mason University Law And Economics Research Paper Series, 2006, pp. 19-20, available at : http://ssrn.com/abstract_id=946462, last accessed : 11 January 2011.

³⁷² See Gabiatti, Sonia., 2009, *Op. Cit.*, p. 26.

³⁷³ See Pauwelyn, Joost, Evidence, *Proof and Persuasion in WTO Dispute Settlement : Who Bears the Burden?*, Journal of International Economic Law 1, 1998, pp. 227-258, available at : http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2223&context=faculty_scholarship, last accessed : 27 February 2011.

³⁷⁴ See GATT Tuna I Report :

Article XX is a limited and conditional exception from obligations under other provisions of the General Agreement, and not a positive rule establishing obligations in itself. Therefore, the practice of panels has been to interpret Article XX narrowly, to place the burden on the party invoking Article XX to justify its invocation, and not to examine Article XX exceptions unless invoked.

³⁷⁵ See Gabiatti, Sonia., 2009, *Loc. Cit.*, p. 26.

standard as regulated in the Enabling Clause. While in Article XX of the GATT of the General Exception cases, members are not only encouraged to use exceptions as incorporated in Article XX of the GATT but are also recommended to refrain from invoking GATT General Exception measures. Further Matsushita argues that it might be inappropriate to classify the Enabling Clause as an exception since developed country members are encouraged to make exceptions. Thus, Matsushita concluded that it seems more natural to characterise the Enabling Clause as a provision establishing a special right for developed country members to deviate from the GATT obligations for promoting the purpose of the WTO regime, which is the economic development of developing countries.³⁷⁶

The harmonisation sequence of the applicability of Article XX agreed between the panel and the Appellate Body in the decision of the EC–Asbestos case. There are two steps established by the panel. During the first step, it is necessary to examine whether the measure falls within the scope of one of the listed exceptions in Article XX. Then, the second step considers whether the challenged measure satisfies the conditions of the chapeau of Article XX.³⁷⁷

Therefore, the correct order of steps in defence of a GATT inconsistent measure is to verify whether the challenged measure complies with the requirement of one of the Article XX exceptions. Afterwards, it is needed to examine whether it also fulfils the requirements of the chapeau of Article XX, the introductory clause. Since the role of the chapeau is to examine the method in which the measures are applied, this approach is justified. In order for a GATT inconsistent measure to fall under one of the exceptions of paragraphs (b), (d) or (g) of Article XX it must comply with the requirements contained in those provisions.³⁷⁸

As noted by Sanford, the chapeau of Article XX itself creates no independent “standards” or requirements. Further Sanford states that the chapeau is not a freestanding statement but a subordinate clause that takes its meaning from the rest of the sentence that follows the lettered paragraphs of Article XX. In other words, the chapeau contains a certain standard condition on the exercise of the rights granted in the separate paragraphs of the article. Essentially, it imposes a reasonableness standard for the possible trade discriminatory effects of national policy.³⁷⁹

The WTO has to set up a jurisprudence aimed to determine which “conditions” are relevant and when they can be deemed “similar.” In the matter of the “peculiarity” of each country in the world it is impossible that *all* conditions might be similar even in any two countries. In the trade perspective, it is argued according to the-premise that the “same conditions” never prevail between the states. An effective interpretation of the chapeau needs to be established, in order to decide the conditions to compare in justifying the application of a national measure.³⁸⁰

The applicability of Article XX emphasises that the purpose of the measure must be identified within the policies, which are described in GATT 1994. For example, the measure taken must be in compliance with the requirements that fall under Article XX (b), which means that the elements of necessity must be fulfilled.³⁸¹ The negotiating

³⁷⁶ See Matsushita, Mitsuo., *A Review of Major WTO Jurisprudence*, pp. 11-12, available at : <http://www.sipa.columbia.edu/wto/pdfs/MatsushitaWorkingPaper.pdf>, last accessed : 27 February 2011.

³⁷⁷ See Gabiatti, Sonia., 2009, *Op. Cit.*, p. 27.

³⁷⁸ See *Ibid.*, p. 27.

³⁷⁹ See Gaines, Sanford., *The WTO's Reading of the GATT Article XX Chapeau: A Disguised Restriction on Environmental Measures*, p. 777, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=301404, last accessed : 13 January 2011.

³⁸⁰ See *Ibid.*, p. 778.

³⁸¹ See Gabiatti, Sonia., 2009, *Op. Cit.*, p. 29.

history of Paragraph XX (b) provides support for the view that this paragraph is aimed at measures to protect internal health and life, in this regard this article is aimed to prevent the abuse of sanitary regulations.³⁸²

The *necessity test*³⁸³ defined as an approach which is developed to determine whether GATT-inconsistent measures may still be justified under the exception as prescribed in Article XX (b). This sort of method allows the necessity of the measures to be identified, which are otherwise inconsistent with the provisions of GATT 1994. The “necessity test” consists of two steps. The first step is that the policy objective pursued by the GATT-inconsistent measure must be the protection of life or health of humans, animals or plants. Thus the second step concerning the measure must be necessary to fulfil those policy objectives.³⁸⁴

The determination of whether the measure is “necessary”³⁸⁵ under Article XX (b) also involves a weighing and balancing process³⁸⁶. The considerations are based on a series of factors such as the contribution made by the measure, the importance of the common interests or values protected, and the impact of the measure on trade.³⁸⁷

In the EC-Preferences case, the European Communities claim that the Drug Arrangements are justified by Article XX (b) of GATT 1994. Three issues were raised by the European Union by invoking Article XX (b) of GATT 1994 as justification for its Drug Arrangements. First, the tariff preferences under the Drug Arrangements constitute a measure to protect human life or health in the European Communities. Second, the tariff preferences under the Drug Arrangements are “necessary” within the meaning of Article XX (b). Lastly, the Drug Arrangements are applied in a manner constituting arbitrary or unjustifiable discrimination in violation of the chapeau of Article XX.³⁸⁸

In the assessment of the necessity of the measure, the European Communities maintain that according to *Korea – Various Measures on Beef*, “the more vital the common interests or values pursued, the easier it would be to accept as necessary measures designed to achieve those ends”. It argues that the protection of human life

³⁸² See Condon, Bradley J., *Op. Cit.*, p. 21. It is important to note that paragraph XX(b) is not limited to sanitary regulations, however;

³⁸³ “When deciding whether or not an otherwise GATT inconsistent measure can be saved under an Article (a), (b) or (d) exception, panels must determine whether or not “necessary” to fulfil the legitimate objectives listed under the respective paragraphs. Several GATT and WTO panels have interpreted the term “necessity” within the context of relevant Article XX exceptions. However, the exact scope and meaning of the necessity test as interpreted by GATT and, later, by WTO tribunals remain unclear”. See Bernasconi-Osterwalder et al. 2006.149.

³⁸⁴ See Gabiatti, Sonia., 2009, *Op. Cit.*, p. 30.

³⁸⁵ A ‘necessary’ measure is significantly closer to the pole of being indispensable than to the opposite pole of merely contributing to the policy goal. For measures that are not indispensable to achieve the Article XX(b) objective, the ‘necessary’ standard is to be judged in every case through a process of weighing and balancing a series of factors. The factors are open ended, but should include: (1) the relative importance of the common interests or value pursued by the measure, (2) the contribution made by the measure to the realization of the ends pursued by it, and (3) the restrictive impact of the measure on international commerce. See Charnovitz, Steve., *Trade and The Environment In The WTO*, Journal of International Economic Law, Vol. 10, Public Law and Legal Theory Working Paper NO. 338, Legal Studies Research Paper NO. 338, 2007, available at : <http://ssrn.com/abstract=1007028>, last accessed : 10 February 2011.

³⁸⁶ “In relation to Korean – Beef : [...] The Appellate Body created a three factor balancing test for deciding whether or not a measure is necessary when it is not per se indispensable. The three factors to be considered are : (i) the contribution made by the (non-indispensable) measure to the legitimate objective; (ii) the importance of the common interests or values protected; and (iii) the impact of the measure on trade. [...] the weighing and balancing process also established the answer to the question of whether or not there was an alternative, less trade restrictive, measure that would achieve the same end as the contested measure.” See Bernasconi-Osterwalder et al. Al 2006, pp. 149-50; Gabiatti, Sonia., 2009, *Op. Cit.*, p. 37.

³⁸⁷ See Gabiatti, Sonia., 2009, *Op. Cit.*, pp. 36-37.

³⁸⁸ See Panel Report EC-Preferences para. 7.178-7.179.

and health is the most fundamental and important value, and that, accordingly, the test of "necessary" in such a case should be given the broadest possible meaning.³⁸⁹

While, India argued on the "necessity" requirement contending that the link between the Drug Arrangements and Article XX (b) is far-off. In their rebuttal, India argues that the Drug Arrangements, as a measure, provide more favourable treatment to developing countries and, as a measure to protect human health in the European Communities, are logically contradictory. The effect of the measure, according to India, is dependent upon several external factors which are not in the control of the European Communities and which bring uncertainty. Furthermore, India challenges that drug production and trafficking are organised crimes, motivated by profit alone, and preferential tariffs would not eradicate such crimes.³⁹⁰

Concerning whether the European Communities' measure complies with the chapeau to Article XX, the European Communities argue that the exclusion of other developing countries is not part of the "design and structure" of the Drug Arrangements, but rather of its application and, therefore, should be examined under the chapeau of Article XX.³⁹¹

While India in regard of the chapeau argues that the European Communities fails to show how the tariff preferences do not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade. India contends the fact that the Drug Arrangements are only limited to a closed set of 12 beneficiary countries is clear evidence of discrimination. Moreover, India maintains that the selection process for the Drug Arrangements is not transparent and that there is no published procedure for the application and selection of beneficiaries. There is no evidence to show that the European Communities had in fact conducted an objective assessment based on objective criteria.³⁹²

The panel on EC Tariff Preferences followed the same approach as the Panels on US Gasoline and EC Asbestos:³⁹³

"[...] In EC Asbestos, the panel followed the same approach as used in US — Gasoline: We must first establish whether the policy in respect of the measure for which the provisions of Article XX(b) were invoked falls within the range of policies designed to protect human life or health [...]."³⁹⁴

Following this jurisprudence, the panel needs to examine: (i) whether the policy reflected in the measure falls within the range of policies designed to achieve the objective of or, put differently, or whether the policy objective is for the purpose of, 'protect[ing] human ... life or health'. In other words, whether the measure is one designed to achieve that health policy objective; (ii) whether the measure is 'necessary' to achieve the said objective; and (iii) whether the measure is applied in a manner consistent with the chapeau of Article XX."³⁹⁵

The panel finds that the policy reflected in the Drug Arrangements is not one designed for the purpose of protecting human life or health in the European Communities and, therefore, the Drug Arrangements are not a measure for the purpose of protecting human life or health under Article XX (b) of GATT 1994.

³⁸⁹ See Panel Report EC-Preferences para. 7.181.

³⁹⁰ See Panel Report EC-Preferences para. 7.191.

³⁹¹ See Panel Report EC-Preferences para. 7.185.

³⁹² See Panel Report EC-Preferences para. 7.194.

³⁹³ See World Trade Organization, *WTO Analytical Index : Guide to WTO Law and Practice*, Second Edition, Volume I, Cambridge University Press, 2007, Para. 603, available at : http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20, last accessed : 21 November 2011.

³⁹⁴ See Panel Report EC - Asbestos case para. 8.184.

³⁹⁵ See Panel Report EC-Preferences para. 7.198–7.199.

Nevertheless, the panel considers it would be appropriate to go on to examine whether the measure is "necessary" within the meaning of Article XX (b).³⁹⁶

Respecting "*necessity of the measure*" the panel finds that the Drug Arrangements are not "necessary to protect human ... life or health", in compliance with Article XX (b) of GATT 1994.³⁹⁷ The panel examined whether the measure was applied in a manner consistent with the chapeau of Article XX. Specifically, the panel looked at the inclusion of Pakistan, as of 2002, as a beneficiary of the Drug Arrangements preference scheme and the exclusion of Iran, and found that no objective criteria could be distinguished in the selection process. Consequently, the panel was not satisfied that conditions in the 12 beneficiary countries were similar and they were not the same with those prevailing in other countries:³⁹⁸ The lack of evidence provided by European Union makes difficulties for the panel to assess the justifiability of the measure. For these reasons, the European Union has not established to the panel's satisfaction that the application of the measure does not constitute "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail".³⁹⁹

In conclusion, the panel found that the European Communities have not demonstrated that: (a) the Drug Arrangements are measures designed for the purpose of protecting human life or health in the European Communities; or that (b) the Drug Arrangements are "necessary" for the protection of human life or health in the European Communities. Consequently, the panel finds that the Drug Arrangements are not provisionally justifiable under Article XX (b). The panel also finds that the European Communities have not demonstrated that the Drug Arrangements are not being applied in a manner constituting arbitrary or unjustifiable discrimination between countries where the same conditions prevail.⁴⁰⁰ Based on these findings the panel on EC Preferences concludes that the European Communities have failed to demonstrate that the Drug Arrangements are justified under Article XX (b) of GATT 1994.⁴⁰¹

III. d. 2. Exception on Free-Trade Area and Customs Unions: Article XXIV of GATT 1994.

As noted by Hoekman, GATT allowed for exemptions to the MFN rule in the context of reciprocal preferential agreements and with respect to unilateral preferences granted to developing countries.⁴⁰² Further, Ukpe, also notes notwithstanding the fact that agreements concluded under GATT Article XXIV are WTO-plus agreements and are thereby not subject to the MFN principle in Article 1:I.⁴⁰³ The Article XXIV allows an exception to the obligations of GATT for certain regional arrangements. Jackson notes that the exception in Article XXIV applies to three types of arrangements: customs union; free trade areas; and "an interim agreement necessary for the formation of a customs union or of a free trade area."⁴⁰⁴

³⁹⁶ See Panel Report EC-Preferences para. 7.210.

³⁹⁷ See Panel Report EC-Preferences para. 7.223.

³⁹⁸ See World Trade Organization, *WTO Analytical Index : Guide to WTO Law and Practice, Second Edition, Volume I*, Cambridge University Press, 2007, Para. 597, available at : http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20, last accessed : 21 November 2011.

³⁹⁹ See Panel Report EC-Preferences para. 7.225-7.235.

⁴⁰⁰ See Panel Report EC-Preferences para. 7.236.

⁴⁰¹ See Panel Report EC-Preferences para. 8.1 (e).

⁴⁰² See Hoekman, Bernard., Martin, William J. and Braga, Carlos A. Primo, 2006, *Op. Cit.*

⁴⁰³ See Ukpe, 2000, *Op. Cit.*, p. 29.

⁴⁰⁴ See Jackson, *World Trade and the Law of GATT*, 100; John H. Jackson, 2000, *Op. Cit.*, p. 64.

Article XXIV of GATT allows the creation of free trade areas and customs unions under certain conditions. A customs union is defined as the creation of single custom territory such that duties and other regulations of commerce are eliminated with respect to the trade between the constituent territories and substantially the same duties and other restrictive regulations of commerce are applied to non-members of the union. Then, a free trade area defined as a group of territories when duties and other regulation of commerce are eliminated with respect to the trade between the constituent territories. Free trade areas and customs unions by their very nature discriminate against non-members.⁴⁰⁵ In addition, in a customs union, the members adopt a common schedule of tariffs and a system of regulation of trade with respect to products from the territories of non-members.⁴⁰⁶ While Article XXIV: 4 recognises the desirability of such entities, it also notes that their purpose should facilitate trade between the constituent territories and not raise barriers to the trade of other contracting parties with such territories. More specifically Article XXIV: 5 requires that the following creation of the area or union, duties and commercial regulations applied to non-members must not be higher or more restrictive than those applied before creation.⁴⁰⁷

The establishment of a customs union or free trade area requires departure from the MFN principle. If there were no such exception to the MFN principle, the elimination of customs duties between the participants would have been generalised to all GATT contracting parties.⁴⁰⁸

According to Jackson, the policy underlying Article XXIV exception as stipulated is a recognition of desirability of increasing freedom of trade by development, through voluntary agreements, of closer integration between the economies of the country parties to such agreements. While GATT makes an allowance for regional arrangements that do not have the effect of increasing restrictions on import from third countries.⁴⁰⁹ As noted by Folsom, Article XXIV requires the elimination of internal tariffs and other restrictive regulations of commerce on “substantially all” products originating in a customs union or free trade area and requires that tariffs and other regulations of commerce shall not be “higher or more restrictive” than before creation of the free trade area or customs union. However, the term “regulations of commerce” includes rules of origin that are critically unclear. The broad purpose of Article XXIV, acknowledged therein, is to facilitate trade among the GATT/WTO parties and not to raise trade barriers.⁴¹⁰

According to such agreements as stipulated in Article XXIV, the custom union and free trade area must contain a “plan and schedule for the formation of such customs union or free trade area within a reasonable length of time.” According to Jackson, none of the arrangements notified to GATT has satisfied the definitions of a free trade area or a customs union contained in Paragraph 8 of Article XXIV, although some evolved into one of these.⁴¹¹

The customs unions and free trade area are permitted under the WTO, where countries eliminating tariffs within the region and impose tariffs for countries outside

⁴⁰⁵ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, *Op. Cit.*, p. 23.

⁴⁰⁶ See Jackson, *World Trade and the Law of GATT*, 100; John H. Jackson, 2000, *Loc. Cit.*, p. 64.

⁴⁰⁷ See Cottier, Thomas., Mavroidis, Petros C; 2002; Davey, William J., Pauwelyn, Joost, *Loc. Cit.*, p. 23.

⁴⁰⁸ See Jackson, *World Trade and the Law of GATT*, 100; John H. Jackson, 2000, *Loc. Cit.*, p. 64.

⁴⁰⁹ See Jackson, *World Trade and the Law of GATT*, 100; John H. Jackson, 2000, *Loc. Cit.*, p. 64.

⁴¹⁰ See Folsom, Ralph H., 2008, *Op. Cit.*, p. 5.

⁴¹¹ See K. Dam, “*Regional Economic Arrangements and the GATT: The Legacy of a Misconception*”, *Univeristy of Chicago Law Review*, 1963, p. 615. See also Jackson, *World Trade and the Law of GATT*, 100; John H. Jackson, 2000, *Op. Cit.*, p. 64.

the region (non-contracting parties states). In the customs union system, the rates are centrally determined and common throughout the region. Recognizing this type of agreement and its economic values on trade creation and trade diversion, the GATT member states agreed to provide an exception of the MFN clause.⁴¹² According to Polley, the elimination of trade barriers generate trade creation within the area, yet, the member countries may trade less with countries outside the region.⁴¹³

The MFN principle is also applied in numerous regional trade agreements. As noted by Jackson, it is important to distinguish between MFN and “multilateralism” which are sometimes confused with each other. Multilateralism is an approach to international negotiation that involves the interaction of a large number of nation-states. MFN, instead, is a principle applied within negotiations, regardless of whether those negotiations are conducted multilaterally, plurilaterally or bilaterally.⁴¹⁴

III.d.3. Security Exception: Article XXI of GATT 1994.

However, there have been many scholars who have observed international trade law as a concept differing from the classical idea of state sovereignty and have regarded national security, borders and territory as state interests. Those matters are difficult to reconcile with the concept of market liberalisation.⁴¹⁵ The provision of Article XXI of the GATT proves that these traditional state interests continue to be a major concern of WTO Members.⁴¹⁶ As noted by Emmerson, the inclusion of Article XXI of GATT 1994 suggests formal recognition of state sovereignty and the members’ right to self-protection.⁴¹⁷ The Article XXI to GATT 1994 stipulates:

Nothing in this Agreement shall be construed :

- (a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or*
- (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests*
 - (i) relating to fissionable materials or the materials from which they are derived;*
 - (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;*

⁴¹² Polley, William J, 2004, *Op. Cit.*, pg. 2.

⁴¹³ Polley, William J, 2004, *Op. Cit.*, pg. 3.

⁴¹⁴ See World Trade Organization, World Trade Report 2007, 2007, *Op. Cit.*, p. 133.

⁴¹⁵ See D.M. McRae, *The Contribution of International Trade Law to the Development of International Law*, Collected Courses of The Hague Academy of International Law, 1996, v. 260, pp. 99-238, p. 130-131; UNCTAD-ICTSD, Resource Book on TRIPS and Development, Cambridge University Press, New York, 2005, p. 801, available at : http://www.iprsonline.org/unctadictsd/docs/6.6Securityexpectations_update.pdf, last accessed : 12 February 2011.

⁴¹⁶ See Mariano Garcia-Rubio, On the Application of Customary Rules of State Responsibility by the WTO Dispute Settlement Organs – A General International Law Perspective – Geneva, Studies and Working Papers, Graduate Institute of International Studies, 2000, p. 100; UNCTAD-ICTSD, Resource Book on TRIPS and Development, Cambridge University Press, New York, 2005, p. 802, available at : http://www.iprsonline.org/unctadictsd/docs/6.6Securityexpectations_update.pdf, last accessed : 12 February 2011.

⁴¹⁷ See Wesley A. Cann Jr, *Creating Standards of Accountability for the Use of the WTO Security Exception: Reducing the Role of Power Based Relations and Establishing a New Balance Between Sovereignty and Multilateralism*, 26 Yale Journal of International Law 413 (2001), at 417. See also Dapo Akande and Sope Williams, *International Adjudication on National Security Issues: What Role for the WTO?*, 43 Virginia Journal of International Law 365 (2002-3), at 371-2; David T. Shapiro, *Be Careful What You Wish For: U.S. Politics and the Future of the National Security Exception to the GATT*, 31 George Washington Journal of International Law & Economics 97 (1997), at 113. Cf Anne Orford, *The Politics of Collective Security*, 17 Michigan Journal of International Law 373 (1996), at 395; Emmerson, Andrew., *Conceptualizing Security Exceptions: Legal doctrine Or Political Excuse?*, Journal of International Economic Law Vol. 11 No. 1 _ Oxford University Press, 2008, p. 135, available at : <http://jiel.oxfordjournals.org/content/11/1/135.full.pdf+html>, last accessed : 12 February 2011.

- (iii) taken in time of war or other emergency in international relations; or
- (c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

The former Contracting Parties of the GATT 1947 (which still exists as the “GATT 1994” among WTO Members) were unwilling to activate the institutionalised dispute settlement mechanisms to handle with disputes involving the interpretation of the national security exceptions. The WTO is not regarded as an adequate forum for dealing with national security issues. Under GATT 1947, only four such cases reached the level of formalised dispute settlement, while no panel established since the creation of the WTO for dealing with these kinds of disputes has succeeded in producing a report.

According to the provision of security exceptions it is stipulated, that ‘nothing’ within the agreements can prevent WTO members from suspending their trade obligations to face legitimate security threats. In this regard whether the security exceptions are ‘self-judging’ and entirely deferential to ‘the politico-military community’, merely based on state subjectivity and unilateral, due to that exception it can be the excuses to escape from basic principles of the WTO. In other words, a new form can be used to practise protectionism. In order to avoid the potential of tensions between states because of unilateral actions the security exception contains some restrictions and is lawful, concerning derogation from their trade obligations, subject to review by a dispute settlement body. Security exception provisions are enacted from binding rules, procedures, ‘accountability, openness and equality’, so that security exceptions have judicially discoverable limitations.⁴¹⁸

The national security exception was a part of the general exceptions of the chapters of commercial policy and commodity agreements. It provided in the International Trade Organization 1946 the first draft prepared by the Preparatory Committee in London in October and November of 1946, the next draft was prepared by a technical drafting committee in New York in January and February of 1947.⁴¹⁹ Only at the meeting of the Preparatory Committee in Geneva from April to October 1947 it was decided to transfer the security exceptions from the general exceptions to a separate article at the end of the Charter, which was practically identical with the present text of GATT Article XXI.⁴²⁰

The applicability of the dispute settlement mechanism to the security exceptions was raised at the Geneva meeting. By placing Article XXI between the general exceptions (Article XX) and the dispute settlement provision (Article XXIII), the

⁴¹⁸ See Emmerson, Andrew., 2008, *Op. Cit.*, pp. 136-137.

⁴¹⁹ See GATT, *Analytical Index: Guide to GATT Law and Practice* (6th. rev. ed., 1995), at 608; See UNCTAD-ICTSD, *Resource Book on TRIPS and Development*, Cambridge University Press, New York, 2005, p. 802-803.

⁴²⁰ See GATT Doc. L/5426 (1982), GATT B.I.S.D. (29th Supp.), at 23 (1983). The text of the decision reads as follow:

“[...] Considering that the exceptions envisaged in Article XXI of the General Agreement constitute an important element for safeguarding the rights of contracting parties when they consider that reasons of security are involved; Noting that recourse to Article XXI could constitute in certain circumstances, an element of disruption and uncertainty for international trade and affect benefits accruing to contracting parties under the General Agreement;

Recognising that in taking action in terms of the exceptions provided in Article XXI of the General Agreement, contracting parties should take into consideration the interests of third parties which may be affected;

That until such time as the Contracting Parties may decide to make a formal interpretation of Article XXI it is appropriate to set procedural guidelines for its application;

The Contracting Parties decide that:

1. Subject to the exception in Article XXI:a, contracting parties should be informed to the fullest extent possible of trade measures taken under Article XXI.
2. When action is taken under Article XXI, all contracting parties affected by such action retain their full rights under the General Agreement.
3. The Council may be requested to give further consideration to this matter in due course [...].”

Contracting Parties to GATT 1947 made it clear that the dispute settlement mechanism would apply to the new article. Countries imposing economic sanctions on Argentina after the Falkland/Malvinas events were of the view that they were exercising an inherent right existing under general international law, which was merely reflected by Article XXI of GATT. This situation led Argentina to request an interpretation of such Article and then the Contracting Parties, although they did not interpret Article XXI, adopted a decision concerning Article XXI of the General Agreement.⁴²¹

According to Ackerman, Article XXI has been a factor in five GATT disputes, and these disputes have begun to articulate the meaning of the treaty language. This Article has been a factor in five GATT disputes that are beginning to establish a framework for interpretation.⁴²² Four of these cases reached panels; they consist of an early post Second World War dispute involving trade between the United States and Czechoslovakia, two cases concerning US trade with Nicaragua⁴²³, and a challenge to trade restrictions imposed by the European Community (EC) on Yugoslavia. The fifth dispute, which arose out of the Falklands War, did not go to a GATT panel, but raised some important issues.⁴²⁴

In 1949 Czechoslovakia challenged a US measure that banned the export of certain products to Czechoslovakia on national security grounds. The panel rejected Czechoslovakia's complaint, with the panel members referring to the provisions of Article XXI in general terms. For example, one delegate argued, "since the question clearly concerned Article XXI, the US action would seem to be justified because every country must have the last resort relating to its own security." Still, the specific provisions of the article were mentioned. Furthermore, when Czechoslovakia charged that the US construction of the term "war material" in Article XXI (b)(ii) was too expansive, the US delegate responded with a defence on the merits, arguing that the US export control regime was "highly selective."⁴²⁵

Czechoslovakia, in turn, chose the dispute settlement under Article XXIII and the US invoked, *inter alia*, Article XXI, not as a procedural defence but as a substantive one. Although the Contracting Parties "decided to reject the contention of Czechoslovakia's delegation that the Government of the US had failed to carry out its obligations under the Agreement through its administration of the issue of export licences",⁴²⁶ they did not altogether deny their formal Article XXIII jurisdiction over matters involving

⁴²¹ See UNCTAD-ICTSD, *Resource Book on TRIPS and Development*, Cambridge University Press, New York, 2005, pp. 806-807, available at : http://www.iprsonline.org/unctadictsd/docs/6.6Securityexpectations_update.pdf, last accessed : 12 February 2011.

⁴²² See Ackerman, Susan Rose, and Billa, Benjamin S., *Treaties and National Security*, Research Paper No. 351, John M. Olin Center for Studies in Law, Economics, and Public Policy, New York University Journal of International Law and Politics (JILP), 2007, p. 16, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1001460, last accessed : 14 February 2011.

⁴²³ See World Trade Organization, 'GATT Analytical Index', http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_08_e.htm#index15096 (accessed 4 October 2006). See *Nicaragua — Measures Affecting Imports from Honduras and Columbia*, WTO Doc WT/DS188/2 (2000); *Nicaragua — Council for Trade in Services and Goods*, WTO Doc S/C/N/ 115 (2000) (Notification Pursuant to Article XXI of the GATT 1994 and Article XIV bis of the GATS); Emmerson, Andrew., 2008, *Op. Cit.*, p. 141.

⁴²⁴ See Ackerman, Susan Rose., and Billa, Benjamin., *Treaties And National Security*, International Law And Politics, Vol. 40:437, pp. 462-463, available at : http://www.law.nyu.edu/ecm_dlv/groups/public/@nyu_law_website_journals_journal_of_international_law_and_politics/documents/documents/ecm_pro_058871.pdf, last accessed : 13 February 2011.

⁴²⁵ See Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Lo. Cit.*, p. 16.

⁴²⁶ See Decision of June 8, 1949, 2 GATT B.I.S.D. 28 (1952); See UNCTAD-ICTSD, *Resource Book on TRIPS and Development*, Cambridge University Press, New York, 2005, pp. 806-807, available at : http://www.iprsonline.org/unctadictsd/docs/6.6Securityexpectations_update.pdf, last accessed : 12 February 2011.

Article XXI of GATT 1947.⁴²⁷ Thus, disputants argued whether the action of the US fell within the treaty clause.⁴²⁸

Nicaragua vs United States (1984) (*Nicaragua I*) demonstrates the exclusive nature of the treaty language when a party claims a national security exception. In that case, Nicaragua challenged a Reagan Administration policy that drastically reduced US sugar imports from Nicaragua. The US declined to invoke Article XXI and argued instead that its actions were beyond the scope of GATT and hence beyond the panel's jurisdiction. The panel simply held the US in violation of GATT without examining the applicability of Article XXI. It did not interpret the US action as a valid exception to the treaty.⁴²⁹ According to GATT panel in *Nicaragua vs United States* (1984) (*Nicaragua I*), the treaty's language is a ceiling rather than a floor. The panel rejected the United States' claim of an implicit national security exception that would create an exception broader than the explicit text.⁴³⁰ No GATT panel has ever held that an implicit national security exception prevents derogation from being a violation.⁴³¹

The Reagan Administration's Central American policy gave rise to two cases relating to Article XXI. In 1983, the US decided to drastically reduce the share of sugar imports allocated to Nicaragua. The US did not block either the establishment of the panel or the adoption of its report. Neither did it invoke Article XXI or attempt to defend its actions in GATT terms. According to the 1984 panel report, "The United States stated that it was neither invoking any exceptions under the provisions of the General Agreement nor intending to defend its actions in GATT terms... and that the action of the US did of course affect trade, but was not taken for trade policy reasons".⁴³² Consequently, the panel did not examine whether the action could be justified under the security exception because it had not been invoked. However, this fact did not prevent the panel from finding that the US violated Article XIII (2).⁴³³

The third case, *Nicaragua vs United States* (1985-1986) (*Nicaragua II*), was Nicaragua's response to a complete import and export embargo imposed by the US.⁴³⁴ In 1985, the US decided to impose a complete import and export embargo on Nicaragua, which requested the establishment of a panel again. The position of the US in this case was considerably different to that adopted in the first dispute with Nicaragua. It managed to exclude from the terms of reference of the panel the possibility "to examine or judge the validity of or motivation for the invocation of Article XXI: (b) (iii) by the US."⁴³⁵ Some other GATT Contracting Parties, such as Canada and the European Communities agreed with the US that Article XXI issues were

⁴²⁷ See UNCTAD-ICTSD, Resource Book on TRIPS and Development, Cambridge University Press, New York, 2005, pp. 806-807, available at : http://www.iprsonline.org/unctadictsd/docs/6.6Securityexpectations_update.pdf, last accessed : 12 February 2011.

⁴²⁸ See Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Lo. Cit.*, p. 16.

⁴²⁹ See Report of the Panel, *United States—Imports of Sugar from Nicaragua*, 2.3, 4.4-4.7, L/5607 (Mar. 13, 1984), GATT B.I.S.D. (31st Supp.) at 67, 74 (1984), available at <http://www.worldtradelaw.net/reports/gattpanels/ussugarnicaragua.pdf>; Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Lo. Cit.*, p. 16.

⁴³⁰ See Recourse to Article XXIII:2 by *Nicaragua, United States—Imports of Sugar from Nicaragua*, L/5513, (1 July, 1983) (GATT Doc.) available at http://www.wto.org/gatt_docs/English/SULPDF/91010025.pdf; Communication from Nicaragua, *United States—Imports of Sugar from Nicaragua*, L/5492 (16 May, 1983), available at http://www.wto.org/gatt_docs/English/SULPDF/91000408.pdf; Report of the Panel, *United States—Imports of Sugar from Nicaragua*, 4.4-4.7, L/5607 (Mar. 13, 1984), GATT B.I.S.D. (31st Supp.) at 67, 74 (1984), available at <http://www.worldtradelaw.net/reports/gattpanels/ussugarnicaragua.pdf>; Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Lo. Cit.*, p. 16.

⁴³¹ See Ackerman, Susan Rose, and Billa, Benjamin, Vol. 40:437, *Op. Cit.*, p. 452.

⁴³² See *United States – Imports of Sugar from Nicaragua*, 13 March 1984, GATT B.I.S.D. (31st Supp.), para. 3.10.

⁴³³ See *United States – Imports of Sugar from Nicaragua*, 13 March 1984, GATT B.I.S.D. (31st Supp.), paras. 4.3, 4.5 and 4.7; Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Op. Cit.*, p. 17.

⁴³⁴ See Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Op. Cit.*, p. 17.

⁴³⁵ See GATT Doc. C/M/196, at 7 (1986).

political questions not subject to panel security. The panel nevertheless referred to the question in the following terms:

*"[...] If it were accepted that the interpretation of Article XXI was reserved entirely to the contracting party invoking it, how could the CONTRACTING PARTIES ensure that this general exception to all obligations under the General Agreement is not invoked excessively or for the purposes other than those set out in this provision? If the CONTRACTING PARTIES give a panel the task of examining a case involving an Article XXI invocation without authorising it to examine the justification of that provision, do they limit the adversely affected contracting party's right to have its complaint investigated in accordance with Article XXIII:2 [...]."*⁴³⁶

The panel determined that it was limited by its terms of reference not to examine US action, but it was made clear that, in general, panels could review invocations of Article XXI. By doing so, it drew on the well-established principle of national and international law that provisions of treaties must be interpreted in conjunction with other provisions in the same treaty. Hence, national security exceptions must be interpreted in light of other treaty provisions; they are not mere reflections of a general limitation on treaties that is independent of the explicit provisions in particular treaties. The content of a national security exception must come from the treaty itself, and will be subject to review according to the terms of the treaty.⁴³⁷

In the fourth and most recent case, the Socialist Federal Republic of Yugoslavia in 1991 challenged restrictions on trade that the European Community (EC) imposed in response to the Yugoslav civil war. As noted by Ackerman, the EC explicitly grounded its action in Article XXI. Although panel proceedings were suspended in 1993 in light of the uncertainty surrounding the status of the new Federal Republic of Yugoslavia (Serbia and Montenegro), the Council agreed to establish a panel to review the EC's invocation of Article XXI, and the EC did not claim that such review was barred.⁴³⁸

Following Argentina's invasion of the Falkland/Malvinas Islands in April 1982, the EC, Australia, and Canada imposed trade restrictions on Argentina. Instead of bringing the issue to the dispute settlement mechanism, Argentina decided to bring it before the GATT Council. In a communication circulated to all contracting parties, and in its oral presentations to the Council, Argentina claimed that the trade sanctions violated fundamental provisions under GATT. Such as violation of the MFN obligation under Article I and the ban on import restrictions under Article XI, which were imposed for non-economic reasons, namely reasons of political nature, in order to exert political pressure on Argentina. It also pointed out that except for the United Kingdom, the sanctions had been imposed by contracting parties that were foreign to the political conflict with Argentina on the Malvinas and that the measures taken had not been notified to Argentina. Finally, the Argentinean delegate tried to characterise the situation as one of economic aggression of developed countries against a developing country in violation of the special rules, which the developing countries were entitled to enjoy under GATT and under other international conventions.⁴³⁹

In a controversial GATT Council meeting, the representatives of the EC, Australia and Canada argued that measures were taken "on the basis of their inherent rights, of which Article XXI ("Security Exceptions") of the GATT was a reflection". They also recalled that the United Nations Security Council had passed Resolution 502 calling for

⁴³⁶ See United States – *Trade Measures Affecting Nicaragua*, 13 October 1986 (unadopted), GATT Doc. L/6053, para. 5.17.

⁴³⁷ See Ackerman, Susan Rose, and Billa, Benjamin., Vol. 40:437, *Op. Cit.*, p. 465.

⁴³⁸ See Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Op. Cit.*, p. 19.

⁴³⁹ See Reich, Arie., *The Threat of Politicization of the World Trade Organization*, Bar Ilan University, Israel, p. 12, available at : <http://www.tamas.gov.il/NR/rdonlyres/FD1D7AFB-B2B7-44C2-AFB804206079A1F2/0/ThreatofPoliticizationoftheWTOReich.pdf>, last accessed : 14 February 2011.

the withdrawal of Argentinean troops from the islands and the immediate cessation of hostilities, and therefore their actions could be seen as falling within either Article XXI(b)(3) or XXI(c). In any case, they reiterated this was not an issue in the relations between developing and developed countries.⁴⁴⁰ However, they could not obtain unanimous support for this interpretation of Article XXI, and many delegates were concerned that recognising Parties' "inherent rights" to define national security would give them *carte blanche* to undermine the treaty. Finally, they argued that measures under Article XXI did not require any notification to GATT or to the affected party. Then, the Council issued a "Decision Concerning Article XXI of the General Agreement" that reads (in relevant part) as follows:⁴⁴¹

Considering that the exceptions envisaged in Article XXI of the General Agreement constitute an important element for safeguarding the rights of contracting parties when they consider that reasons of security are involved;

Noting that recourse to Article XXI could constitute, in certain circumstances, an element of disruption and uncertainty for international trade and affect benefits accruing to contracting parties under the General Agreement;

Recognizing that in taking action in terms of exceptions provided in Article XXI of the General Agreement, contracting parties should take into consideration the interests of third parties which may be affected;

That until such time as the CONTRACTING PARTIES may decide to make a formal interpretation of Article XXI it is appropriate to set procedural guidelines for its application;

The CONTRACTING PARTIES decide that:

1. Subject to the exception in Article XXI:a, contracting parties should be informed to the fullest extent possible of trade measures taken under Article XXI.
2. *When action is taken under Article XXI, all contracting parties affected by such action retain their full rights under the General Agreement. . . .*⁴⁴²

Many other delegations spoke at the session, some supporting the Argentinean position and some supporting the EC position on the question of whether the trade sanctions amounted to a violation of GATT obligations and whether this was a North/South issue. However, almost all delegations expressed their concern about the introduction of political conflicts into GATT discourse, and questioned its ability to serve its purpose.⁴⁴³

Schloemann, Hannes L. et al., and Ackerman et al., propose that the WTO regularise the process of invoking the national security exception by allowing states to define their essential security interests subject to review for good faith as required by the Vienna Convention. In their view, the WTO should require states to provide a substantive justification on the merits to demonstrate such good faith. This solution, they claim balances sovereignty concerns, which require a state to be allowed to define its own security interests, with the need to prevent abuse. Each of these competing concerns is central to the viability of the treaty system.⁴⁴⁴

Emmerson argued that security exceptions are the necessary legal linchpins (backbone) to WTO Agreements, mediating political exigencies, while simultaneously orchestrating international economic integration. Because the security exceptions mediate traditional member sovereignty to assist, the WTO's legalised 'participatory vision', facilitating an evolution of state identity. The WTO members have included

⁴⁴⁰ See Reich, Arie, *Loc. Cit.*, p. 12.

⁴⁴¹ Ackerman, Susan Rose, and Billa, Benjamin., Vol. 40:437, *Op. Cit.*, pg. 466-467.

⁴⁴² *Decision Concerning Article XXI of the General Agreement*, L/5426 (Dec. 2, 1982), GATT B.I.S.D. (29th Supp.) at 23 (1983), available at http://www.wto.org/gatt_docs/English/SULPDF/91000212.pdf.

⁴⁴³ See Reich, Arie, *Loc. Cit.*, p. 12.

⁴⁴⁴ See Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Op. Cit.*, p. 20.

explicit security exceptions in WTO Agreements allowing for derogation from their obligations when their national security is threatened. The WTO Agreements, which include security exceptions, recognise that ‘security is pre-eminent because without it a state has no sovereignty, and its very existence is in doubt’.⁴⁴⁵

Lindsay suggests when entering an international legal regime, security exceptions provide the necessary means of justifying trade protectionism without the need to resolve the underlying tension ‘relating to sovereignty and the nature of WTO’.⁴⁴⁶ For WTO members, security exceptions represent ‘an indispensable escape mechanism or safety valve’⁴⁴⁷ when their very existence is under threat. The doctrinal security exceptions therefore operate as ordering mechanisms⁴⁴⁸, allowing for limited derogation from trade obligations with ‘some autonomous power ‘used to shape state behaviour.’⁴⁴⁹

Finally, as noted by Ackerman and Billa, no GATT panel has ever declared any part of Article XXI to be solely under the discretion of a State Party. Although there has been no WTO jurisprudence and no decision by a Dispute Settlement Body of WTO regarding Article XXI, it is fair to assume that arguments to review national security have now become even stronger. When the disputes emerge, it has to be resolved using “customary rules of interpretation of public international law” that includes “good faith.”⁴⁵⁰

III.d.4. Trade and Development: *Enabling Clause Decision of 28 November 1979.*

In 1971, the Contracting Parties to GATT approved a waiver of MFN under Article XXV, Paragraph 5 of GATT, for instituting the Generalised System of Preferences. The waiver allows for a departure from Article I obligations for a period of ten years, but actions resulting from the Tokyo Round negotiation have effectively perpetuated this departure. The waiver of the MFN obligation extends to all developed countries and allows them to extend preferential tariff treatment for developing countries without having to generalise such treatment to other GATT contracting parties.⁴⁵¹

The schemes adopted by the individual developed country to implement GSP vary in their terms. The preference schemes vary in terms of the products covered, the countries benefiting from the schemes, the level of tariff cuts, rules of origin, and whether the products on which the preferences are granted are subject to non-tariff barriers such as quotas or tariffs quotas. In addition, all of the schemes include safeguard mechanisms such as escape clause provisions or quantitative limitations on trade under preference schemes.⁴⁵²

It has been accommodated clearly about countervailing policy considerations the desire to aid developing countries and the desire to promote deeper trade

⁴⁴⁵ See Raj Bhala, ‘Book Review: *International Rules: Approaches from International Law and International Relations*’, 23 North Carolina Journal of International Law and Commercial Regulation 737 (1998), at 760; Emmerson, Andrew., 2008, *Op. Cit.*, p. 138.

⁴⁴⁶ See Peter Lindsay, ‘*The Ambiguity of GATT Article XXI: Subtle Success or Rampant Failure?*’, 52 Duke Law Journal 1277 (2003), at 1294; Emmerson, Andrew., 2008, *Op. Cit.*, p. 139.

⁴⁴⁷ See Wesley A. Cann Jr, ‘*Creating Standards of Accountability for the Use of the WTO Security Exception: Reducing the Role of Power Based Relations and Establishing a New Balance Between Sovereignty and Multilateralism*’, 26 Yale Journal of International Law 413 (2001), at 417; Emmerson, Andrew., 2008, *Op. Cit.*, p. 139.

⁴⁴⁸ See Cf David Kennedy, ‘*The Move to Institutions*’, 8 Cardozo Law Review 841 (1986–87), at 845; Emmerson, Andrew., 2008, *Op. Cit.*, p. 149.

⁴⁴⁹ See Emmerson, Andrew., 2008, *Op. Cit.*, p. 150.

⁴⁵⁰ See Ackerman, Susan Rose, and Billa, Benjamin S., 2007, *Loc. Cit.*, p. 20.

⁴⁵¹ See Jackson, 2000, *Op. Cit.*, p. 65.

⁴⁵² See McCuloh, ‘*United States Preferences : The Proposed Systems*’, Journal of World Trade law, 1974, pp. 216-217; Jackson, *World Trade and the Law of GATT*, 100; John H. Jackson, 2000, *Loc. Cit.*, p. 65.

liberalisation by encouraging customs unions and free trade areas, among others. These countervailing considerations, plus the usual and frequent government motivations of expediency or special “deals”, have led over the years to substantial and apparently growing departures from MFN. Whether the advantages of MFN treatment can be retained in the face of such trends remains to be seen.⁴⁵³

IV. The participation of developing countries in the Multilateral Trading System.

Throughout the 1960s and 1970s, developing countries viewed UNCTAD rather than GATT as the main institution through which they could promote their interests in international trade. Their representation in GATT described these priorities. Many developing countries were not members, and of those that were, a large number did not maintain official representatives resident in Geneva, but instead used representatives in other European capitals to cover GATT matters. Moreover, their participation in GATT negotiations prior to the Uruguay Rounds was “passive” in that they did not engage in a significant way in the mutual exchange of concessions on a reciprocal basis.⁴⁵⁴

Many developing countries played a very active role in the Uruguay Round negotiations and a large number decided to become members of WTO. Developing countries, in general, have become more effectively integrated in the international trading system, and several have become major exporters of manufactures. Trade policies in many countries have been liberalised, favouring an outward orientation and lower protection. In addition, there has been a growing appreciation of the importance of observing international rules in the conduct of trade as well as the need to safeguard trading interests through effective participation in the activities of the new organisation.

There are many developing countries that have significantly increased their capacity to participate in WTO activities in the aftermath of the Uruguay Round and whose representatives are playing an active role in the decisions of the organisation. An organisation like the WTO, and previously GATT, which works with consensus despite the fact that the countries represented are very different in their economic size, presents complex challenges in designing decision-making structures that result in an equitable representation of the interests of all participants. Their participation in formal and informal decision-making processes is substantial, although they frequently do not speak with one voice as their interests, depending on the issue, may diverge and result in the formation of different coalitions.⁴⁵⁵

Over the past fifty years, the multilateral trading system embodied of the World Trade Organization has contributed significantly to economic growth, development and employment. A major challenge for GATT/WTO has been how to incorporate developing countries into the trading system in ways that bring genuine benefits to these countries.⁴⁵⁶ As mentioned previously, the Doha Declaration is to reaffirm the principles and objectives set out in the Marrakech Agreement Establishing the World Trade Organization, and pledge to reject the use of protectionism.⁴⁵⁷ It is strongly

⁴⁵³ See John H. Jackson, 2000, *Op. Cit.*, p. 68.

⁴⁵⁴ See Michalopoulos, Constantine, The Participation Of The Developing Countries In The WTO, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=620518.

⁴⁵⁵ See Michalopoulos, Constantine.

⁴⁵⁶ See Ministerial Declaration, Adopted on 14 November 2001, Ministerial Conference, Fourth Session, Doha, 9 - 14 November 2001WT/MIN(01)/DEC/1, (01-5859), 20 November 2001, available at : http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm.

⁴⁵⁷ See World Trade Organization, World Trade Report 2008: Trade in a Globalizing World, Retrieved on October 2010 from : http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf. The timing of trade liberalization, the degree of protection in place before liberalization and technological change are some of the

believed that international trade can play a major role in the promotion of economic development and the alleviation of poverty.⁴⁵⁸

Since, the majority of WTO Members are developing countries⁴⁵⁹, the Fourth Session of the Ministerial Conference has placed their needs of economic development and interests at the main core of the Work Programme adopted in the Doha Declaration.⁴⁶⁰ The Work Programmes designed the positive efforts to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade equal with the needs. In this context, enhanced market access, balanced rules, and well-targeted, sustainable financed technical assistance and capacity-building programmes have important roles to play.⁴⁶¹

On 9-14 November 2001, trade ministers from member countries met in Doha, Qatar for the fourth WTO Ministerial Conference⁴⁶². The Doha Declaration is also known as Doha Development Agenda and provides the mandate for negotiations on a range of subjects, and other work including issues concerning the implementation of the present agreements.⁴⁶³ At that meeting, they agreed to undertake a new round of

elements that explain why certain developing countries have experienced increases in the skill premium – that is, the difference in wages between high- and low skilled workers after trade liberalization. Renewed interest has emerged recently in the evolution of inequality in industrialized countries and the role of trade in this evolution. Whereas “inequality” tended to be discussed in the 1980s and 1990s in terms of “high-skilled” versus “low-skilled” workers, more recent studies make a distinction between “high”, “medium” and “low skilled” workers, reflecting some concern about the evolution of wages of medium-skilled workers. Other studies try to make even more nuanced distinctions between different types of skills. There has also been increased interest in the evolution of the relative income of the “super rich” and in the evolution of labour as opposed to capital’ share of income. Trade theory predicts that increases in inequality in industrialized countries lead to increased calls for protectionism and that small and well-organized industries that stand to lose from trade tend to be successful in lobbying against trade liberalization.

⁴⁵⁸ See Conway, *Tim, Trade Liberalisation and Poverty Reduction*, Overseas Development Institute, London, 2004, Available at : <http://www.odi.org.uk/resources/download/2267.pdf>.

The Millennium Development Goals (MDGs) constitute a well-known example of a multidimensional approach to defining and measuring poverty, combining an income poverty measure (percentage of the world’s population living on less than US\$ 1/day, defined in 1995 purchasing power parity) with indicators of social or human development (e.g. under-five mortality rate).

⁴⁵⁹ The first point to note is the familiar one that developing countries now account for 74% of WTO membership compared to 66% in 1982. Only one new member, Liechtenstein, was added over the period that could be considered a developed economy. The overwhelming majority of the 43 new members added, the bulk since 1987, have been developing countries and, most recently a number of transition economies. Membership increased slightly by seven countries in the period 1982-1987, notably with the inclusion of such large developing countries as Mexico; and exploded with the addition of 36 new members hence. At present, total WTO membership accounts for over 90% of world exports, compared to slightly more than 75% in 1982. (Michalopoulos).

⁴⁶⁰ This is not to say that developing countries as a group lack influence. Quite the contrary, the two most recent ministerial conferences at Cancun and Hong Kong demonstrate that developing countries can exercise some considerable influence by pooling their resources and bargaining power. Moreover, while the Cancun Ministerial was more of a demonstration of the vetoing power (the Singapore issues), the Hong Kong Ministerial secured some positive gains for developing countries, notably the commitment by the EU, the US and other wealthy countries to phase out export subsidies on agricultural products by 2013. Even the cotton issue raised by four tiny West African states with extremely limited means was partially addressed against all odds, although partly because of a strong external pressure from NGOs and the media. The Doha Development Agenda has to be something more than rhetoric. (See Nordström, Håkan, *Participation of Developing Countries in the WTO : New Evidence Based on the 2003 Official Records*, National Board of Trade, Stockholm, Sweden).

⁴⁶¹ See Ministerial Declaration, Adopted on 14 November 2001, Ministerial Conference, Fourth Session, Doha, 9 - 14 November 2001WT/MIN(01)/DEC/1, (01-5859), 20 November 2001, available at : http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm.

⁴⁶² See Ministerial Conference is the high-level authority to made decisions in the WTO, which is the body of political representatives (trade ministers) from each member country. The Ministerial Conference must meet at least every two years. Operational decisions are made by the General Council, which consists of a representative from each member country. The General Council meets monthly, and the chair rotates annually among national representatives. Periodically, member countries agree to hold negotiations to revise existing rules or establish new ones. These periodic negotiations are commonly called “rounds.” The multilateral negotiations are especially important to developing countries, which might otherwise be left out of more selective agreements.

⁴⁶³ See Ministerial Declaration, Adopted on 14 November 2001, Ministerial Conference, Fourth Session, Doha, 9 - 14 November 2001WT/MIN(01)/DEC/1, (01-5859), 20 November 2001, available at : http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm.

multilateral trade negotiations. Before the Doha Ministerial, negotiations had already been underway on trade in agriculture and trade in services. These on-going negotiations had been required under the last round of multilateral trade negotiations (the Uruguay Round, 1986-1994).⁴⁶⁴ The 2003 World Trade Report stated, “The Doha Declaration marked a new departure in the GATT/WTO approach to technical assistance and capacity building.”⁴⁶⁵ There are 21 subjects listed in the Doha Declaration, which includes under the implementation-related issues and concerns.⁴⁶⁶

The Doha Declaration strongly reaffirms the commitment to the objective of sustainable development, as stated in the Preamble to the Marrakech Agreement. The Doha Declaration also encourages efforts to promote cooperation between the WTO and relevant international environmental and developmental organisations, especially in the lead-up to the World Summit on Sustainable Development to be held in Johannesburg, South Africa, in September 2002.⁴⁶⁷

In the Doha Ministerial Declaration, the trade ministers reaffirmed special and differential (S&D) treatment for developing countries and agreed that all S&D treatment provisions “[...] be reviewed with a view to strengthening them and making them more precise, effective and operational.” The negotiations have been split along a developing country and developed country. The deadlock of negotiations because the differences in the respect of Special and Differential (S&D) provisions, in this point, developing countries proposed shorter deadlines in negotiation to Special and Differential (S&D) provisions. While, developed countries wanted to leave deadlines open. The Special and Differential (S&D) provisions for Least Developing Countries (LDCs), including the tariff-free and quota-free access for LDC goods described in the NAMA⁴⁶⁸ section were agreed by the members in the Hong Kong Ministerial December 2005.⁴⁶⁹

Special and Differential (S&D) treatment provisions allow countries (often on a best-endeavour basis) to provide more favourable treatment for developing countries than to the remainder of the membership. Other provisions grant beneficiary developing countries rights that are not available to others. S&D is based on the assumption that developing countries are different from advanced economies and that temporary exemptions from the general rules (otherwise considered economically beneficial) constitute an appropriate response to particular development challenges. Developing countries may suffer from market imperfections and distortions not found in more advanced economies that obstruct their diversification into non-traditional

⁴⁶⁴ See Fergusson, Ian F., *World Trade Organization Negotiations: The Doha Development Agenda*, CRS Report For Congress, Order Code RL32060, Updated 18 January 2008, available at : <http://www.nationalaglawcenter.org/assets/crs/RL32060.pdf>.

⁴⁶⁵ See WTO, World Trade Report 2003. The 2003 World Trade Report also highlighted “that technology transfer had never been included explicitly on the GATT/WTO agenda before,” but now was part of the work program. Id. at 164. GATT refers to the General Agreement on Tariffs and Trade. See also Shaffer, Gregory, *Can WTO Technical Assistance and Capacity Building Serve Developing Countries?*, 2005.

⁴⁶⁶ See Agriculture, Services, Market Access for Non Agricultural Product, TRIPs, TRIMs, Competition Policy; Government Procurement, Trade Facilitation, WTO Rules, DSU, Trade and Environment, Electronic Commerce, Small Economies, Trade, Debt and Finance, Trade and Transfer of Technology, Technical cooperation and capacity building, Least-Developed Countries (LDCs) and Special and Differential Treatment.

⁴⁶⁷ See Ministerial Declaration, Adopted on 14 November 2001, Ministerial Conference, Fourth Session, Doha, 9 - 14 November 2001WT/MIN(01)/DEC/1, (01-5859), 20 November 2001, http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm.

⁴⁶⁸ Non-Agriculture Market Access as the large part of worldwide trade and also referred to as Industrial products or manufactured goods. NAMA as major step ahead in Uruguay Round for market access to developed countries and sharply increased predictability for Trade. The negotiations of NAMA successful in Uruguay Round with results some 50% cut in tariffs to the developed countries and new tariff bindings (maximum duties or “ceiling level”).

⁴⁶⁹ See Fergusson, Ian F., *World Trade Organization Negotiations: The Doha Development Agenda*, CRS Report For Congress, Order Code RL32060, Updated 18 January, 2008, available at : <http://www.nationalaglawcenter.org/assets/crs/RL32060.pdf>

activities. Resource constraints make it harder to adjust to the impact of trade liberalisation, to take advantage of new trading opportunities and to shoulder the costs associated with reform. While trade measures rarely present a first-best policy response, their use may be appropriate under certain circumstances and for a limited amount of time.⁴⁷⁰

Under the Doha Declaration, it mentioned that all of the negotiations and the other aspects of the Work Programme should take fully into account the principle of Part IV of GATT 1994, the Decision of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries.

⁴⁷⁰ See World Trade Organization, World Trade Report 2007 :Sixty Years Of The Multilateral Trading System: Achievements And Challenges, p. 330, para. 4, available at : http://www.wto.org/english/res_e/booksp_e/anrep_e/wtr07-2d_e.pdf.

Chapter III

The Generalised System of Preferences

The legal relationship between GATT/WTO and developing countries is primarily based on the major demand for trade preferences. Trade preferences are deemed as a tool to enable equality of treatment in conditions of inequality. Developing countries consider that GATT 1947 and the Havana Charter (ITO Charter) contained a large number of provisions benefitting producers from developed countries since export earnings are deemed as a significant factor to help developing countries improve their economic development. Therefore, developing countries demand that GATT should provide trade instruments that facilitate the increase of exports in developing countries. GSP is defined as a legal concept that exempts developing countries from applying certain legal disciplines and “asks” developed countries to recognise a series of unilateral obligations. Consequently, the establishment of GSP under the Enabling Clause does not impose a legal obligation on developed countries. In other words, GSP is a voluntary policy for developed countries and is placed as a national policy of the preference-granting country. There are various implementations of GSP; however, for the EU it is included under its Common Commercial Policy (CCP). GSP negotiations began in 1954 and were finalised by the establishment of the Enabling Clause, which institutionalised GSP permanently. Eventually, in 1995, it was incorporated as Part IV of the WTO Agreement.

I. The legal relationship between developed countries and developing countries in trade preferences.

According to Hudec, the legal relationship between GATT and WTO and developing countries is primarily based on the major demand for trade preferences. Due to the economic gap between developed countries and developing countries¹, GATT contracting parties, mostly consisting of developing countries, never agreed to the application of all the rules in the agreement.² Developing countries believed that GATT 1947 and the Havana Charter (ITO Charter) contained a large number of provisions benefitting producers from developed countries.³

During GATT negotiations, the developing countries proposed an “*escape clause*” from certain “*GATT disciplines*”, known as “*legal leniency*”. Inherently, such legal concept granted developing countries exemption from the application of certain legal disciplines and “*asked*” developed countries to recognise a series of unilateral obligations.⁴ Therefore, the establishment of GSP under the Enabling Clause does not impose a legal obligation for developed countries. The nature of preferences granted to developing countries is deemed as a “*voluntary policy*” of developed countries.

Such legal relationship was not established during “*overnight*” negotiations. It was influenced by so many factors and dynamic negotiations of GATT. The major shift

¹ See Noted by Hudec, 1987, p. 19: “[...] Prior to Second World War, the colonialism was govern the relationship between developed and under developed country. The colonialism system itself divided into *de jure* and *de facto* colonialism. *De jure colonialism* was occupying most of Africa and Asia countries while central and south America were colonies *de facto* [...]”.

² See Hudec, Robert E., *Developing Countries in the GATT/WTO Legal System*, Rowman & Littlefield, Cordell Hull Institute, Washington, DC, Gower Publishing Company Limited, UK, 1987, pp. 16-17, available at : <http://lawweb3.law.umn.edu/uploads/hy/Jz/hyJzgliHRF7Q3VUx-XRBZQ/wto-trachtman.pdf>, last accessed : 17 April 2011.

³ See Hudec, Robert E., 1987, *Op. Cit.*, p. 26.

⁴ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 16-17.

of such legal relationship was marked down by the recognition of “*special needs*” for the economic development of developing countries and LDCs.⁵

The “*Group of 77*” was established on 15 June 1964. It increased the bargaining power of developing countries in GATT negotiations. Such “*bloc*” was used to unify and strengthen the position of developing countries so they could participate in the negotiations effectively.⁶ At the end of the first session of UNCTAD, which was held in Geneva, 77 developing countries participated as signatories in the “*Joint Declaration*”.

The first Ministerial Meeting of the Group of 77 was held on 10 – 25 October 1967, in Algiers, where the “*Charter of Algiers*” was adopted. The Group of 77 gradually developed into a permanent institutional structure. The aim of the Group of 77 is to facilitate “[...]the countries of the South to articulate and promote their collective economic interests and enhance their joint negotiating capacity on all major international economic issues within the United Nations system, and promote South-South cooperation for development [...]”.⁸ The Group of 77 is considered as a manifestation of south-to-south cooperation.

Members of the Group of 77 currently include 131 developing countries. The Group of 77 is the largest intergovernmental organisation of developing countries in the United Nations. Indonesia and others ASEAN member states also joined the Group of 77.⁹ The highest political body of the Group of 77, namely “*the chairmanship*”, is rotated on a regional basis, and covers three regional groups: Africa, Asia and, Latin America and the Caribbean. The chairmanship tenure is for one year. The incumbent chairmanship of 2011 was held by the Republic of Argentina.

The supreme decision making body of the Group of 77 is the “*South Summit*”. The First and Second South Summits were held in Havana, on 10 – 14 April 2000, and in Doha, on 12 – 16 June 2005, respectively. The Third South Summit was held in Africa in 2011, the venues are determined according to geographical rotation.¹⁰ The “*Doha Plan of Action*”¹¹ was produced during the Second South Summit, thus it was adopted in the “*Doha Declaration*”.¹²

Along with the improvement of the bargaining position of developing countries in 1964, developed countries also started to shift their foreign trade policy. Developing countries came to understand that the policy of import substitution, which serves as a trade barrier, was not an effective tool to help improve their economic development;

⁵ See Hudec, Robert E., 1987, *Op. Cit.*, p. 37. See McDonald, Bryan, *The World Trading System : The Uruguay Round and Beyond*, Macmillan Press Ltd, London, 1998, p. 49. “[...] Developing countries succeeded in securing an exemption from the GATT obligations on the grounds that as developing countries they could not undertake the same obligations as the developed ones, but that they should nonetheless enjoy the benefits of concessions made and obligations undertaken by developed parties on the basis of the MFN principle. In return they would do their best to adhere to the GATT obligations [...]”.

⁶ See Hudec, Robert E., 1987, *Op. Cit.*, p. 42.

⁷ See The Annual Meeting of the Ministers for Foreign Affairs of the Group of 77 is convened at the beginning of the regular session of the General Assembly of the United Nations in New York. Periodically, Sectoral Ministerial Meetings in preparation for UNCTAD sessions and the General Conferences of UNIDO and UNESCO are convened, available at : <http://www.g77.org/doc/>, last accessed : 3 May 2011.

⁸ See The Group 77 in United Nations, available at : <http://www.g77.org/doc/>, last accessed : 3 May 2011.

⁹ See Member States of the Group of 77, available at : <http://www.g77.org/doc/members.html>, last accessed : 3 May 2011.

¹⁰ See The Group 77 in United Nations, available at : <http://www.g77.org/doc/>, last accessed : 3 May 2011.

¹¹ See Doha Plan of Action Second South Summits, G-77/SS/2005/2, available at : <http://www.g77.org/southsummit2/en/intro.html>, last accessed : 3 May 2011. See also http://www.g77-doha.org/general_info.htm, last accessed : 3 May 2011.

¹² See Doha Declaration, G-77/SS/2005/1, Second South Summits, G-77/SS/2005/2, available at : <http://www.g77.org/southsummit2/en/intro.html>, last accessed : 3 May 2011. See also <http://www.2southsummit.org/>, last accessed : 3 May 2011. See also <http://www.dohasummit.org/>, last accessed : 3 May 2011.

instead it hindered their industrialisation process. Developing countries started to increase their export earnings¹³ by expanding their market access through multilateral negotiations in order to obtain preferences for their products. Developing countries argued that one of the GATT objectives was “*to create trade conditions that would promote growing exports for everyone*”. Consequently, GATT should provide trade instruments that facilitate the increase of exports in developing countries.¹⁴

The initiative to facilitate the export earnings improvement of developing countries started in 1954 after the GATT review session. The GATT Ministers Meeting in November 1957, regarding “*the general state of, and the prospects for international trade*”, identified three major problems concerning trade failures of LDCs, cited as follows:

*“[...] the failure of the trade of less developed countries to develop as rapidly as that of developed countries, excessive short-term fluctuations in prices of primary products, and widespread resort to agricultural protection [...]”*¹⁵

In 1958, the Ministers Meeting established a group of experts to study such matters, thus the *Haberler Report*¹⁶ was issued. It concluded, “*the export earnings of most developing countries were unsatisfactory in terms of the resources needed for economic development*”. Export earnings were deemed as a significant factor to help developing countries improve their economic development. Therefore, it was necessary to provide wider market access for developing countries in order to increase their export earnings. In another meeting of the GATT trade ministers, the *Haberler Report* was adopted into the Action Programme, where its goals were to facilitate the demand of market access expansion of developing countries. In order to carry out such objective, a “*special working group*” was established, namely Committee III. However, it was difficult to meet such demand, and “*[...]it tended to take almost all the institutional energy allocated to developing country relations[...]*”.

The Action Programme had two main strategies. First, developed countries were required to use their “*negotiating authority to the maximum extent*” in order to minimise reciprocity from developing countries. This strategy was considered as a traditional trade negotiation approach, which was applied under contractual preferences, as carried out under ACP trade preferences. Second, it required developed countries to apply unilateral trade liberalisation “*without negotiation and without reciprocity*”. The second strategy implied the GSP policy that applied non-reciprocal principles and autonomous rights.¹⁷

In the Fifteenth Session, Committee III proposed a new kind of trade liberalisation, where it was argued that developing countries could not reach a certain level of trade liberalisation, including the reciprocity principle. The Committee III recognised that the existence of the economic gap significantly influenced the ability of developing countries to liberate their trade and to pay the same concessions as developed countries. Such proposal was approved by the Contracting Parties.

¹³ See Kemp, Murray C., *International Trade Theory : A critical review*, Routledge Studies in International Business and the World Economy, Routledge Taylor & Francis Group, London and New York, 2008, p. 133. “[...] the growing awareness among developing countries that economic growth is generally best promoted by a policy which emphasises export promotion [...]”.

¹⁴ See Hudec, Robert E., 1987, *Op. Cit.*, p. 43.

¹⁵ See *BISD*, 6th Supplement (1958), p. 18.

¹⁶ See Gottfried Haberler *et al.*, *Trends in International Trade*, Report by a Panel of Experts (Geneva: GATT Secretariat, 1958), hereafter cited as the Haberler Report.

¹⁷ See Hudec, Robert E., 1987, *Op. Cit.*, p. 43.

Developed countries were asked, "to examine their barriers to export from developing countries" in order to provide more favourable treatment to LDC exports.¹⁸

The application of a non-reciprocity principle in international trade entered a new era in May 1963 when the GATT trade ministers approved the declaration of duty free access for tropical products. Generally, the governments of developed countries seemed willing to accept the "idea that there should be certain areas of trade policy where the requirement of reciprocity is excluded".¹⁹

II. International trade theory: controversy of GSP as a trade distortion.

International trade is comparable to a "vast jungle"; it covers many aspects, for instance social and economic issues, and law, culture, and politics. All these aspects have their own significant role in building the multilateral trade system regime and are related to one another. For example, cultural aspects have been significant since ancient times when "long distance trade" began. Trade brought about cultural exchange and assimilation between nations, thus building human civilisations. Other aspects like natural and human resources have also played important roles in determining the different stages of economic development. Concerning GSP, it was established due to economic inequalities between trading partners, where some legal disciplines were considered disadvantageous to developing countries, being more advantageous to developed countries. GSP is deemed as the "species" of "genus" trade preferences based on its special characteristics.

The Ricardian theory, known as the comparative cost theory, is one of the traditional theories on international trade. The theory takes its name from the English economist, David Ricardo. He published this theory in 1817. The Ricardian theory explains "patterns of specialisation and trade by means of relative productivity differentials among countries". Early Ricardian theory focused on production structure, thus, in later development this theory integrated the role of preferences into the determination of international trade equilibrium.²⁰ According to the theory, it is assumed that perfect competition occurs when two countries engage in the international trade of goods or products.²¹ Additionally, every country has specialised production to export goods according to its comparative advantage.²²

It should be noted that economic and legal aspects are correlated and play crucial roles in the development of GSP. For instance, the effort to institutionalise generalised, non-discriminatory, and non-reciprocal preferences is considered a legal measure to balance economic inequality. In this regard, Hudec states that, "legal measures should never be taken for their own sake and should be economically beneficial". Therefore, legal measures have to be effective either legally or economically. Legal effectiveness means that legal measures must bring the kind of conduct desired. While, economic effectiveness is defined as a conduct that must, in turn, achieve the economic benefit desired.²³

In the case of GSP, legal issues concern economic issues. Inherently, GSP is considered as a legal discrimination measure to create certain market distortions that

¹⁸ See Hudec, Robert E., 1987, *Op. Cit.*, p. 45.

¹⁹ See Hudec, Robert E., 1987, *Op. Cit.*, p. 46.

²⁰ See Helpman, Elhanan., and Razin, Assaf., *A Theory of International Trade under Uncertainty*, Departement of Economics Tel-Aviv University, Tel-aviv, Israel, Academic Press Inch., A Subsidiary of Harcourt Brace Jovanovich Publisher, London, 1978, p. 5.

²¹ See Helpman, Elhanan., and Razin, Assaf., *Op.Cit.*, p. 11.

²² See Helpman, Elhanan., and Razin, Assaf., *Op.Cit.*, p. 12.

²³ See Hudec, Robert E., 1987, *Op. Cit.*, p. 140.

bring about economic benefits, particularly to developing countries. However, the legal measures of GSP are still considered controversial. The parties opposing GSP argue that its economic benefits are not of great significance compared to the harmful effects caused by discrimination. The policies of non-reciprocity and preferences towards developing countries are debatable and are criticised from both legal and economic perspectives.

Hudec writes that non-reciprocal treatment and preferential treatment are based on a “*one-sided legal relationship*” in GATT. It brings equality to the inequalities of international trade law. He states that true equality, requires legal rules to differentiate the needs and abilities of each individual subject. The equality principle (or non-discrimination principle) means that equal cases should be treated equally and unequal cases should be treated unequally. The Appellate Body decision on the *EC Preferences Case* states, “*identical treatment must be provided to similarly-situated beneficiaries*”. “*Similarly-situated*” is interpreted as “*the development, financial and trade needs to which the treatment responds*”. However, such concept goes against the traditional definition of equality in terms of “*identical legal obligations*” for all countries, conceived in the non-discrimination principle.²⁴

Furthermore, it is important to raise economic issues into the dimension of legal analysis, as stated by Hudec:

“[...] it would at least expose the possibility that the pre-1995 GATT legal policy was quite the opposite of what it seems [...]”²⁵

In this regard, if the “*legal leniency*” of trade preferences constitutes trade distortions it may actually be harmful to developing countries, in this case, the pre-1995 GATT legal policy is presumed as a gross distortion of an equality principle (MFN principle).²⁶

According to Hudec, inherently, there are three economic “*theories*” that are relevant to justify the existence of GSP in the international trade system. These theories consist of the *mercantilist doctrine*, *infant-industry doctrine*, and *preferences doctrine*. The *mercantilist theory*, considered as a “common” concept in the sphere of international trade theory, is based on the idea that exports are economically beneficial while imports are economically harmful.²⁷ The term “*the mercantile system*” was taken from Smith’s book “*The Wealth of Nations*”, in which he discusses “*the Principles of the Commercial or Mercantile System*”²⁸:

“[...] the different progress of opulence in different ages and nations has given occasion to two different systems of political economy, with regard to enriching the people. One can be referred to as the system of commerce, and the other that of agriculture. I shall endeavour to explain both as fully and distinctly as I can, and shall begin with the system of commerce. It is a modern system that is best understood in our own countries today [...]”

There are “*two great engines*” where the mercantile system is proposed to enrich each country with an “*advantageous balance of trade*”. Wherein a set of measures is designed to encourage exports, with another set of measures designed to discourage the import of manufactures and the loss of domestically produced new materials.²⁹ In

²⁴ See Hudec, Robert E., 1987, *Loc. Cit.*, pp. 140-141.

²⁵ See Hudec, Robert E., 1987, *Op. Cit.*, p. 143.

²⁶ See *Ibid.*, p. 143.

²⁷ See Hudec, Robert E., 1987, *Op. Cit.*, p. 144.

²⁸ See Wilson, Charles., *Mercantilism*, Historical Association by Routledge and Kegan Paul, Wyman & Sons Ltd., London, 1958, p. 3.

²⁹ See Wilson, Charles., 1958, *Op. Cit.*, p. 5.

mercantilism, government control is crucial to ensure the welfare and security of a state.

Based on the mercantilism idea, a state could increase its income and attain its welfare through export expansions. Market expansion creates a larger market for a country's own producers and traders, optimising its production to gain maximum profit, and generating more employment. Adversely, an increase in imports reduces the market share of a country's own producers and traders, causing lower profits and less employment.³⁰ The WTO policies have a "flavour of mercantilist" since they are established through mutual negotiations and balanced concessions.³¹ For instance, WTO doctrines strongly emphasise the principle of reciprocity in which it is shown that the reduction of trade barriers in the home country (increased imports) is matched by a similar reduction abroad (increased exports).³²

The second theory is "infant industry protections", also known as "domestic protectionism". According to this doctrine, government assistance needs to tackle various market imperfections in order to favour economic growth.³³ Economic analysis shows that the protection of infant industries is likely to justify and improve welfare. Protection should be removed at the appropriate time when the industry has developed and is able to compete with other advanced industries.³⁴ "Infant industry" protectionism at a certain economic level is acceptable, but only to a certain degree. It is removed when the industry is considered strong enough to compete in the international trade environment.³⁵ Economists recommend the "interventionist solution"³⁶ where government intervention is effectively expected to correct market distortions.³⁷

In the early period of GATT, developing countries intervened in their domestic market through import protections and imposed tariff barriers. During the 1970s and 1980s, interventions were expanded, where required, by the governments of developed countries, in their domestic markets, granting preferential treatment to the products of developing country exports.³⁸ Hudec considers such intervention as reasonable. Indeed, there are many imperfections in developing country markets. It is believed that government intervention can increase national economic welfare. Trade protections are deemed as the only one device aligned with government legal capacity as a market regulator.³⁹

The last theory is the "preferences theory". This theory highlights demands for the preferential treatment of developing countries such as the Generalised System of Preferences.⁴⁰ Most economists would agree that preferences could produce some economic benefits for developing countries.⁴¹ The trade preference system is considered an effective way to favour developing countries by lowering trade barriers unilaterally and by not imposing reciprocal concessions. A country has many

³⁰ See Hudec, Robert E., 1987, *Loc. Cit.*, pp. 144-145.

³¹ See McDonald, Bryan., *The World Trading System : The Uruguay Round and Beyond*, Macmillan Press Ltd, London, 1998, p. 25.

³² See Hudec, Robert E., 1987, *Loc. Cit.*, pp. 144-145.

³³ See *Ibid.*, pp. 144-145.

³⁴ See McDonald, Bryan., 1998, *Op. Cit.*, p. 20.

³⁵ See McDonald, Bryan., 1998, *Op. Cit.*, p. 6.

³⁶ See Hudec, Robert E., 1987, *Op. Cit.*, p. 145.

³⁷ See *Ibid.*, p. 145.

³⁸ See Hudec, Robert E., 1987, *Loc. Cit.*, p. 147.

³⁹ See *Ibid.*, p. 147.

⁴⁰ See Hudec, Robert E., 1987, *Op. Cit.*, p. 149.

⁴¹ See *Ibid.*, p. 149.

advantages if its external trade barriers are reduced. It helps the country's domestic consumers in getting various products at various prices, it also reduces inflation and enhances domestic industry competitiveness.⁴²

The establishment of the GSP seems to be a never-ending controversial story, both legally and economically. From a legal point of view, the GSP is considered as a "trade distortion" of non-discrimination principles in order to gain economic benefits. The "worthiness" value of such economic benefits is criticised since such distortion is harmful to market competitiveness. However, economists still consider the GSP policy to be justified under the framework of the infant industry theory and preferences theory.

III. Generalised System of Preferences under the GATT and WTO regime.

The demand for trade preferences by developing countries was answered through departure from the MFN principle. The existence of different stages of economic development is fundamental for the establishment of "preferences for development". Therefore, the preference-granting countries should not agree to trade preferences on the basis of "political, cultural, or even geographical ties".⁴³

The struggle of GSP establishment started in the 1960s. Thus, it was embodied into the "Enabling Clause" of 1979.⁴⁴ However, the special needs of developing countries were recognised at the very beginning of the GATT drafting negotiations. Developing countries "succeeded in obtaining recognition for the legitimacy of their basic premise" regarding special treatment to respond to their development needs. The special position of developing countries in GATT is recognised through some dispensation of the GATT legal disciplines.⁴⁵

From the 1950s to 1970s, developing countries continued to struggle to obtain a formal waiver to sustain the preferences policy, obviously, it would not comply with GATT rules. As noted by Hudec, developed countries argued that:

"[...] the objectives of the relationship between the GATT and the country remain clear and the existence of the commitment to those objectives is never in question [...]".

Abandoning GATT formalities by carrying out conduct that deviates from basic rules can lead contracting parties to a legal vacuum. Hudec concludes that developing countries and developed countries "need a legalistic approach", where both parties should lay down this concept into the legal framework. However, he does not agree that GSP should be imposed as an obligation for developed countries.⁴⁶

The negotiations of the preferences took almost six years (from 1964 – 1970) before being accepted by the international community.⁴⁷ Agreed Conclusions⁴⁸

⁴² See McDonald, Bryan., 1998, *Op. Cit.*, p. 23.

⁴³ See Yusuf, Abdulqawi, *Legal Aspects of Trade Preferences for Developing States: A Study in the Influence of Development Needs on the Evolution of International Law*, Martinus Nijhoff Publishers, The Hague, Netherland 1982., p. xix.

⁴⁴ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p. xix.

⁴⁵ See Hudec, Robert E., 1987, *Op. Cit.*, p. 25.

⁴⁶ See Hudec, Robert E., 1987, *Op. Cit.*, p. 36-37.

⁴⁷ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p. xix. See also Panel Report on the *EC-Preferences Case* Paragraph 7.64 : "[...]The Generalized System of Preferences ("GSP") has its origins in discussions that took place in the First Session of UNCTAD during the mid-1960s, as reflected in General Principle Eight and Recommendation A.II.1 in the Final Act of the First Session of UNCTAD. During the Second Session of UNCTAD, on 26 March 1968, a Resolution adopted on "Expansion and Diversification of Exports of Manufactures and Semi-manufactures of Developing Countries" (Resolution 21(II)). In this Resolution, UNCTAD agreed to "the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences which would be beneficial to the developing countries" and established a Special Committee on Preferences as a subsidiary organ of the Trade and Development Board, with a mandate to settle the details of the GSP arrangements. In 1970, UNCTAD's Special Committee on Preferences adopted Agreed Conclusions, which set up the agreed details of the GSP arrangement. UNCTAD's Trade and Development Board took note of these Agreed Conclusions on 13

contained detailed agreements of the preference schemes adopted by UNCTAD in 1970.⁴⁹ Status Agreed Conclusions had become a “contentious” issue in the EC-Preferences Case between the EU and India. The EU argued that “*Agreed Conclusions are not in the context of either the 1971 Waiver Decision or the Enabling Clause*”, since it was not a binding agreement. It was not established in connection with the conclusion of the 1971 Waiver Decision or the Enabling Clause.⁵⁰

While India argued differently, stating that the “*Enabling Clause incorporated the Agreed Conclusions through the 1971 Waiver Decision*”. India regarded the Agreed Conclusions as part of the Enabling Clause because they were agreed by consensus at UNCTAD and the 1971 Waiver Decision. It referred to the mutually accepted arrangement drawn up at UNCTAD.⁵¹

The Panel stated the importance of considering Agreed Conclusions status in the interpretation of the Enabling Clause.⁵² Since the Agreed Conclusions set out detailed and institutional arrangements of GSP, therefore, it had a significant role in the interpretation of the Enabling Clause.⁵³ In fact, the Trade and Development Board did not adopt the Agreed Conclusions. However, it did not change their legal status as an instrument conceiving agreed detailed arrangements of GSP.⁵⁴ The Panel considered that Section I of the Agreed Conclusions gave a hint to understanding the wording of “*responding to the development needs of developing countries*” stipulated in the Enabling Clause.⁵⁵

Institution of GSP was regarded as a “new concept” guiding the relationship between the world trading system framework of rich and poor nations. Establishment of the GSP scheme brought about reform to the trading structure, and dynamic policy emerged from trade and development, particularly governing relations between developed and developing countries.⁵⁶

Secretary General Raúl Prebisch’s report, entitled “*Towards a New Trade Policy for Development*”, strongly points out the demands and proposals from developing countries to restructure international economic relations. The developing countries’ disappointment of the trade regimes at that time was expressed in the report.⁵⁷

October 1970. In accordance with the Agreed Conclusions, certain developed GATT contracting parties sought a waiver for the GSP from the GATT Council. The GATT granted a 10-year waiver on 25 June 1971. Before the expiry of this waiver, the CONTRACTING PARTIES adopted a decision on “*Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries*” (the “*Enabling Clause*”) on 28 November 1979[...].”

⁴⁸ See UNCTAD , Official Records of the Trade and Development Board, Fourth Special Session, Supplement No. 1 (TD/B/322) , p. 1. See also Commentaries on the ILC’s Draft Articles 1978, p. 60 : “[...] The Special Committee on Preferences, established by resolution 21 (II) as a subsidiary organ of the Trade and Development Board, succeeded in reaching “agreed conclusions” on a generalized system of preferences which were annexed to decision 75 (S-IV) adopted by the Trade and Development Board at its fourth special session held at Geneva on 12 and 13 October 1970 [...].”

⁴⁹ See also Commentaries on the ILC’s Draft Articles 1978, p. 59-60: “[...] the opening sentence of General Principle Eight lays down that, international trade should be conducted to mutual advantage on the basis of the MFN treatment. The recognition of the trade and development needs of developing countries requires that, for a certain period, the MFN clause will not apply to certain types of international trade relations. Developed countries should grant concessions to all developing countries and should not, in granting these or other concessions, require a concessions in return from developing countries [...].”

⁵⁰ See Panel Report on *EC-Preferences Case* paragraph 7.76.

⁵¹ See Panel Report on *EC-Preferences Case* paragraph 7.69.

⁵² See Panel Report on *EC-Preferences Case* paragraph 7.80.

⁵³ See Panel Report on *EC-Preferences Case* paragraph 7.81.

⁵⁴ See Panel Report on *EC-Preferences Case* paragraph 7.84.

⁵⁵ See Panel Report on *EC-Preferences Case* paragraph 7.89

⁵⁶ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p. xix; See also Statement by the Representative of India Speaking on Behalf of the Members of the Group of 77”, UNTAC, Doc. TD/B/330, Annex II, p.8.

⁵⁷ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p.17.

Therefore, “the Prebisch Report” presented three approaches to solve development problems, consisting of⁵⁸:

- (a) International commodity agreements to give less developed producers of primary products the same price support and price stabilisation assistance as enjoyed by farmers from developed countries;
- (b) Preferential access for manufacturers and semi-manufacturers from developing countries to the markets of developed countries, to enable them to compete on equal terms with the manufacturers of those countries with the manufacturers compensating them for the competitive disadvantages of underdevelopment;
- (c) Preferential arrangements among developing countries, falling short of the GATT requirements for customs union and free trade areas, to permit them to gain the advantages of specialisation in a larger market.

The Prebisch Report was answered by accommodating such demand into international trade policy. Where it was expected to help poor countries increase their trade volume, export diversifications, and give assurance to their main commodities through fair and remunerative export prices.⁵⁹

During ITO negotiations, developing countries requested exemption from certain GATT general principles. Developing countries wanted ITO law to allow such “exemption” in order to establish the preferences system. Developing countries needed to protect their infant industries through tariff preferences and receive benefits from developed country tariff concessions without being obliged to offer equivalent tariff concessions of their own. Conversely, developing countries never proposed any demand for such preferences to be imposed as a legal obligation for developed countries.⁶⁰

The rules and principles set out in the Havana Charter and partly encapsulated in GATT 1947 “do not reflect a positive conception of the economic policy” without taking into account inequalities in the economic development of member states. In this regard, Abdulqawi notes as follows:

“[...] These rules and principles are also based on an abstract notion of economic homogeneity which conceals the great structural differences between industrial centres and peripheral countries with all their important implications. Hence, GATT has not served the developing countries as it has the developed ones. In short, GATT has not helped to create the new order which must meet the needs of development, nor has it been able to fulfil the impossible task of restoring the old order [...]”.⁶¹

“[...] Thus, it was considered that preferential reductions of tariffs on imports from developing countries would be beneficial because they would bring them closer to achieving equality of treatment with producers inside the national or multinational markets. The implementation of such preferences would also constitute a recognition of the necessity for asymmetry in the regulation of trade relations between developing and developed countries; and would bring about a differential treatment aimed to obtain effective equalisation in the end [...]”.⁶²

Therefore, trade preferences granted to developing countries and LDCs are justified in order to overcome inequalities of economic development that exist between developed and underdeveloped economies. Such provisions on preferences were not accommodated in the early GATT provisions.

⁵⁸ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.17. See also Nguyen, Josephine., *The Generalized System of Preferences*, The George Washington University, December 2008, available at : <http://internationalecon.com/students/JNguyen.pdf>, last accessed : 23 March 2010.

⁵⁹ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.17.

⁶⁰ See Hudec, Robert E., 1987, *Op. Cit.*, p. 22.

⁶¹ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.17.

⁶² See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p.20.

Furthermore, developing countries argued, “if protection for infant industries is acceptable in domestic markets, then preferences for infant industries should be acceptable on export markets”. Infant industry growth in developing countries requires a protected market to increase production efficiency. It is also important to improve the competitiveness of their products in order to compete with products from developed countries. Large market shares were not available in most LDCs because their low income influenced levels of consumption. Developing countries believed that tariff preferences could provide greater market access and favour their infant industry growth gradually. Tariff preferences have long been recognised as a justifiable instrument to develop industrialisation and economic growth.⁶³

Trade preferences are considered as a tool to enable equality of treatment in conditions of inequality. From a legal point of view, the Committee on Legal Aspects of the New International Economic Order states that “the equality principle (or non-discrimination principle) defines that equal cases should be treated equally and unequal cases unequal.”⁶⁴ It is analogous to preferential tax treatment that the rich would help the poor. Bulajic considers that preferential treatment for developing countries is “a must”. The MFN clauses seem difficult to apply in unequal relations between industrialised developed countries and developing countries.⁶⁵ It is believed that the economic gap could greatly affect the ability of market absorption.

The MFN clauses do not imply the guarantee of equality treatment. As written by Abdulqawi, “however valid the MFN principle may be in regulating trade relations among equals, it is not a suitable concept for trade involving countries of vastly unequal economic strength”. Furthermore, he also argues that “application of the MFN principle to trade relations between developed and developing countries was considered identical to discrimination; to treat equally countries that are economically unequal constitutes equality of treatment only from a formal point of view but amounts actually to inequality of treatment”.⁶⁶ There were several proposals presented in the Geneva Conference in 1964, which included reservations on the establishment of general preferences for developing country exports of manufactures and semi manufactures.⁶⁷

At that time, some developed countries responded positively to the launch of the general preferences principle, however, they had different views on the form and nature of the preferences. It is noted as follows:

“[...] the United Kingdom, supported by Holland, the Federal Republic of Germany and Denmark, held that there should be a single preferential scheme applied to all developing countries by all developed countries[...]”.⁶⁸

The United Kingdom, Holland, Germany and Denmark proposed uniformity of the GSP scheme granted to all developing countries without taking into account the difference of “development needs in developing countries”. The EU saw the preferential tariff treatment as a suitable instrument for assisting developing countries, but in fact at that time it applied selected preferences for selected developing countries.⁶⁹ This preferences system might lead to deviation from the actual objective of GSP, aimed to

⁶³ See *Ibid.*, p.20.

⁶⁴ See Recommendation of the Rapporteur of Sub-committee I, *Committee on Legal Aspects of the New International Economic Order*, pp. 131-32. See also Hudec, Robert E., 1987, *Op. Cit.*, p. 90.

⁶⁵ See Milan Bulajic, “*Legal Aspects of a New International Order*”, in Hossain (ed.), pp. 45-67. See also Hudec, Robert E., 1987, *Op. Cit.*, p. 90.

⁶⁶ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.20.

⁶⁷ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.21.

⁶⁸ See *Ibid.*, p.21.

⁶⁹ See Statement of the European Community’s policy at the GATT Ministerial meeting in May 1963, see GATT, BIDS, 12th Supplement (1964), pp. 39-40. See also Hudec, Robert E., 1987, *Op. Cit.*, p. 50.

encourage the economic growth of underdeveloped economic countries. Therefore some countries that proposed a “*selective system of preferences*”, noted as follows:

“[...] France and Belgium, on the other hand, expressed their support for a selective system of preferences, the terms of which would be negotiated either bilaterally by an industrial country and a developing country or by a joint committee of exporting and importing countries, and not ruling out reciprocal preferences to be granted by the developing countries. The French proposal was apparently aimed at the preservation of the EEC links with Associated African Countries, but it met a lot of criticism for it was believed that it should lead to the division of the developing countries into preferential compartments, and would also intensify their economic dependence on the developed countries [...]”⁷⁰

A selective system of preferences, proposed by France and Belgium, is not justified under non-discriminatory and generalised principles. In fact, under bilateral agreement negotiations the “*different favour treatment*” might occur within one or another beneficiary country.

Diversity of economic development stages and existence of special preferences between newly independent states of Africa and former colonial powers have caused internal disagreements among developing countries, with LDCs demanding special treatment, such as part of the market should be reserved for them. This develops as an embryo of differential treatment for the LDCs in the GSP. On the other hand, developed countries emphasised that no distinction should be made among beneficiaries.⁷¹ However, GSP has in fact evolved along with the dynamic change of the international economic situation. Moreover, developed countries created differentiation under their GSP scheme arrangement. For example, the EU GSP scheme provides three arrangements within the scheme, wherein two of the arrangements are dedicated to LDCs, and the third prescribes certain conditions (such as the approval of all conventions related to sustainable development and good governance).

The agreement of preference remained an unfinished issue within the Geneva Conference. Thus, a request was made to the UN General Secretary to establish a special committee consisting of governmental secretaries from developed and developing countries to find out the best method to implement such non-reciprocity preferences.

“[...] international trade should be conducted to mutual advantage on the basis of the MFN treatment and should be free from measures unfavourable to the trading interest of other countries. The developed countries should gain concessions to all developing countries and extend to developing countries all concessions they grant to one another, and should not, in granting these or other concessions, require any concessions in return from developing countries. New preferential concessions, both tariff and non-tariff, should be made to developing countries as a whole and such preferences should not be extended to developed countries [...]”⁷²

Resolution 21(II) 1968 established “*the Special Committee on Preferences as a permanent machinery within UNCTAD with terms of reference as described in Section VIII of the agreed Conclusions*”, and was adopted in the Third UNCTAD session held in Santiago (Chile). This resolution was considered as a solution to solve differences between developing countries and developed countries with respect to the institutionalised arrangements of GSP in the UNCTAD body.⁷³

⁷⁰ See Yusuf, Abdulqawi, 1982., *Loc. Cit.*, p.21.

⁷¹ See *Ibid.*, p.21.

⁷² See Yusuf, Abdulqawi, 1982., *Op. Cit.*, p.22.

⁷³ See Yusuf, Abdulqawi, 1982., *Op. Cit.*, p.143.

According to the “Agreed Conclusion”, the function of the Special Committee on Preferences is “to review the operation and effects of the GSP on exports and export earnings, industrialisation and the rate of economic growth of the beneficiary countries”⁷⁴, which consists as follows:⁷⁵

- a) An annual review and analysis of the functioning of the GSP+;
- b) A triennial review to assess the benefits of the GSP for beneficiary countries and the possibilities of improving the system and its operation;
- c) A comprehensive review towards the end of the initial period of the GSP, to determine, in light of the UNCTAD Resolution 21 (II) objectives, whether the preferential system should be continued beyond that period.

According to Howse, the Special Committee has issued numerous detailed reports on GSP implementations, often with detailed recommendations. Many reports and resolutions recommend UNCTAD to be a leading institution in supervising the implementation of the GSP.⁷⁶

The Special Committee on Preferences sets out non-reciprocal, generalised, and non-discriminatory principles, which were incorporated into the waiver of GSP 1971 and Footnote 3 of Paragraph 2 (a) of the Enabling Clause. These principles were opposed by most developed countries; however, they were supported by developing and socialist countries.⁷⁷ At that time, many trade preferences arrangements were given by developed countries based on colonial ties or “vertical preferences”, practically discriminating other developing countries that were not former colonies. Trade preferences based on colonies or ex-colonial ties existed before 1947 and were mostly practised by European countries. Such preferences were legally authorised by express exceptions under Article I of GATT.⁷⁸

The European Union (European Community) is the first initiator to grant trade preferences to developing countries and LDCs. On the other hand, the US rejects trade preferences without any reciprocity. The developed countries’ vote on the MFN obligation was essentially divided into two groups. Improvement of developing countries bargaining powers in the GATT negotiations placed the issue of trade preferences as the main item on the negotiating table. The EU became the starter that successfully granted preferences to developing countries and was followed by some developed countries.⁷⁹

After several years, the US accepted such trade preferences system, in terms of the GSP. Its acceptance contained political interests in order to put pressure on the EU to eliminate its selective preferences policy, especially to particular Mediterranean and African countries. The EU issued policies and established a special system of preferences in order to replace “selective preferences”, which is currently known as the Economic Partnership Agreements.⁸⁰

At the beginning of 1965, the Soviet Union was the first country to implement “a unilateral system of duty-free imports from developing countries, and it applies to all products”. It was followed by Australia in 1966 that applied a more restricted unilateral system. Thus, Hungary established the “Hungarian Preferential scheme”, in 1968, which

⁷⁴ See Robert, Howse., *India’s WTO Challenge to Drug Enforcement Conditions in the European Community Generalized System of Preferences: A Little Known Case with Major Repercussions for “Political” Conditionality in US Trade Policy*, 2003, available at : <http://www.worldtradelaw.net/articles/howsegsdrugs.pdf>, p. 393.

⁷⁵ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.143.

⁷⁶ See Robert, Howse., 2003, *Op. Cit.*, p. 393.

⁷⁷ See Yusuf, Abdulqawi, 1982., *Op. Cit.*, p.22.

⁷⁸ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 49-50.

⁷⁹ See *Ibid.*, pp. 49-50.

⁸⁰ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 59-60.

covered a wide range of products, including agricultural and industrial products. The US Generalised System of Preferences was established under title V of its Trade Act of 1974.⁸¹

The EU was the first “*initiator*” to institutionalise the GSP scheme that was applicable to all developing countries. The EU launched its first GSP scheme in 1971 permitting the duty-free entry of manufactured and semi-manufactured products from a number of developing states. However, certain sensitive items such as textiles and shoes were given less generous treatment.⁸²

The establishment of trade preferences aiming to help developing countries improve their economic development, in some way, greatly influenced the application of basic rules in international trade relations.⁸³ Another rule that was affected by the implementation of the GSP regime was the reciprocity principle. The reciprocity principle is one of the basic rules in international trade relations. In the GSP, the non-reciprocity principle was applied to govern trade relations between preference-granting countries and beneficiary countries.⁸⁴ Derogation from that basic principle aimed to ensure GSP functioned properly and should not be impeded by the operation of the MFN clause.⁸⁵

Since there was “*conflict of interest*” between developed countries and developing countries as to whether the GSP should be included as a new legal obligation under GATT, the GSP was eventually settled in the UNCTAD and not under GATT. The governments of developed countries principally agreed to grant preferences, but that agreement was never embodied into a contractual obligation, neither in UNCTAD nor in GATT.⁸⁶ UNCTAD carried out tasks to ensure that the general non-reciprocal system of preferences delivered benefits to all developing countries; it did not favour the so-called selected or vertical preferences (preferences of colonial ties).⁸⁷

In 1971, GATT adopted two waivers allowing two types of preference schemes. First, a ten-year waiver that set out the MFN obligations in Article I, to the extent necessary, and authorised the institutionalism of GSP. This waiver governed preferences granted by developed countries to developing countries. Second, a waiver permitting developing countries to exchange tariff preferences among themselves, under the terms of a Protocol stating that participation was open to all GATT developing countries.⁸⁸ This second waiver was considered as the embryo of what is now known as the Global System of Trade Preferences among Developing Countries (GSTP).⁸⁹ The waivers were subject to review after ten years. Both waivers had the common goal of favouring the economic development of countries through international trade.

However, two years before the waivers of general preferences were to expire, both were transferred into a permanent legal framework under the Enabling Clause

⁸¹ See also Commentaries on the ILC’s Draft Articles 1978, p. 63.

⁸² See Hudec, Robert E., 1987, *Loc. Cit.*, p. 59-60.

⁸³ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p.115.

⁸⁴ See *Ibid.*, p.115.

⁸⁵ See Yusuf, Abdulqawi., 1982., *Op. Cit.* p.100.

⁸⁶ See the explanation concerning the legal status of the Resolution 21(II) 1968 in the Chapter I which not legal binding.

⁸⁷ See also Commentaries on the ILC’s Draft Articles 1978, p. 60.

⁸⁸ See Hudec, Robert E., 1987, *Op. Cit.*, p. 50.

⁸⁹ See Global System of Trade Preferences, UNCTAD/PRESS/IN/SPA/2004/001, 16 June 2004, available at : http://www.unctadxi.org/templates/Press___897.aspx, last accessed : 4 December 2011. “[...] The Agreement on the Global System of Trade Preferences among Developing Countries (GSTP) has been established in 1988. The objective of this agreement is to facilitate exchange of trade preferences among developing countries in order to promote intra-developing-country trade. The original idea conceived in the ministerial meeting of the Group of 77 (G77) in Mexico City (1976) [...]”.

decision in 1979, and were then incorporated as Part IV of GATT in 1995. The establishment of the Enabling Clause in 1979 is considered as the embodiment of Article 15 of the Havana (ITO) Charter. Part IV of GATT 1995 is considered as the only legal instrument of GSP allowing governments to introduce preferences based on their national policy.⁹⁰

The GSP regime has some weaknesses that arise from its notion. Legally it does not impose compulsory obligations for developed countries to grant preferences to developing countries. The criteria set up by the preference-granting countries in the GSP scheme, for instance the rules of origin and product coverage in the GSP scheme, was criticised as being ambiguous and rigid and hindering its use.⁹¹ Based on this notion, developed countries have the right to withdraw, at any time, the preferences granted to developing countries when a violation towards its conditions occurs. In order to avoid misuse of the GSP an international organisation was needed to supervise and ensure that the GSP was working properly. Therefore UNCTAD and WTO were given the tasks of supervising and monitoring GSP implementation.⁹²

The UNCTAD Secretariat's task is to review and evaluate GSP implementation, which includes the preparation of studies and reports, factual material and other documentation necessary for the periodic review of the operations and effects of GSP.⁹³ The consultation session aimed to help beneficiary countries and preference-giving countries to maintain and develop further improvement of GSP.⁹⁴ The other tasks of the UNCTAD Secretariat include collecting factual documentation on the various aspects of GSP. This covers operation, use, information on the administration of ceilings, maximum amounts, and competitive exclusion, which are constantly published. The periodic reviews are used for the improvement of GSP and are based on the description and analysis of the real effects of GSP that are granted to the beneficiary countries.⁹⁵

Public consultation programmes on the GSP improvement programme are currently held by certain preference-granting countries that involve beneficiary countries or regional economic groupings.⁹⁶ The rapid development in the area of information technology has changed the methods of consultation from formal meetings to media consultation. A mid-term evaluation of the EU GSP scheme contains qualitative and quantitative assessment of the implementation.⁹⁷ The EU GSP scheme has recently launched online public consultation.⁹⁸ The EU is eager to cover the aspirations, opinions, suggestions and criticism of its GSP scheme as much as possible, in order to "respond positively" to the development need of developing countries.

The Directorate General for Trade of the European Commission is the institution responsible for the organisation of public consultation regarding the revision and updating of the GSP scheme. The consultation involves all parties with interest, including stakeholders in the EU and in third countries, together with the business community. The objective of the consultation is to gather opinions from all parties

⁹⁰ See Hudec, Robert E., 1987, *Loc. Cit.*, p. 50.

⁹¹ See Yusuf, Abdulqawi., 1982., *Loc. Cit.*, p.115.

⁹² See *Ibid.*, p.115.

⁹³ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p.147.

⁹⁴ See *Ibid.*, p.147.

⁹⁵ See *Ibid.*, p.147.

⁹⁶ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p.149.

⁹⁷ See http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146196.pdf, last accessed : 01 April 2011.

⁹⁸ See <http://trade.ec.europa.eu/consultations/index.cfm>, last accessed : 01 April 2011.

concerned to aid the “*Commission's work to set out a future proposal*” to the Council and Parliament on a successor regulation.⁹⁹

Regional economic consultations held by the EU with ASEAN include the forum of Consultations between ASEAN Economic Ministers and the European Union Trade Commissioner (AEM-EU). In the sixth meeting of AEM-EU¹⁰⁰, the Commissioner Mandelson discussed regional cumulation, since ASEAN is included as Group I of the cumulation of origin under the GSP scheme. The discussion emphasised the general rules of origin, and how to make them more development-friendly to the individual needs of developing countries.¹⁰¹

Appraisal carried out by preference-granting countries takes into account all aspects of evaluation to enhance the GSP scheme and to ensure benefits are properly used by beneficiary countries. Assessments must be made proportionally by considering whether all developing countries derive similar benefits from the GSP.¹⁰² This assessment system aims to control misuse of GSP utilisation by certain beneficiary countries. It should be considered that not all developing countries are granted similar product coverage under the GSP. In addition, not all beneficiary countries (developing countries) have equal economic powers and resources. Currently, GSP utilisation demands beneficiary countries to provide macro and micro infrastructures including “modern trade administration”. However, not all beneficiary countries are prepared for this, thus, sometimes monitoring and technical assistance are needed.

Abdulqawi agrees that the “specified conditions” set out in trade preferences for developing countries do not breach the non-discrimination principle under the MFN clauses. He deems that trade preference is directed at poor countries while MFN is directed at rich countries. Therefore MFN and trade preference are two different instruments designed to cope with two different problems. Those conditions are addressed to ensure that the “instruments of preferences” are able to create a path for poor countries to have full participation in the multilateral trading system.

*“[...] preferences for developing countries under specified conditions are complementary, and not contradictory to the principle of non-discrimination in trade. In fact, MFN for the rich and preferences for the poor countries – two instruments designed to deal with two different problems – would appear to be an optimal combination of policies [...]”*¹⁰³

Currently there are 13 national GSP schemes listed in the UNCTAD Secretariat, they consist of: Australia, Belarus, Bulgaria, Canada, Estonia, the EU, Japan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey and the US.¹⁰⁴ It should be underlined that the legal status of the GSP programme is permissive and not mandatory. It was established under the national system of preference-granting countries.¹⁰⁵

⁹⁹ See Public consultations available at : http://trade.ec.europa.eu/consultations/index.cfm?consul_id=142, last accessed : 01 April 2011.

¹⁰⁰ Held in Ha Long, Viet Nam, on 27 April 2005.

¹⁰¹ See Joint Media Statement, *The Sixth Consultation between the ASEAN Economic Ministers and the European Union Trade Commissioner (6TH AEM-EU Consultation)*, Ha Long, Viet Nam 27 April 2005, available at : <http://www.aseansec.org/17440.htm>, last accessed : 01 April 2011. See also Forum Europe, *Europe in Asia : The Outlook for ASEAN - EU Relations*, Brussels, 27 June 2001, Available at : http://trade.ec.europa.eu/doclib/docs/2004/october/tradoc_119457.pdf, last accessed : 01 April 2011.

¹⁰² See Yusuf, Abdulqawi., 1982., *Op. Cit.*, 1982, p.150.

¹⁰³ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, 1982, p.160

¹⁰⁴ See About GSP : <http://www.unctad.org/Templates/Page.asp?intltemID=2309&lang=1>

¹⁰⁵ See Hudec, Robert E., 1987, *Op. Cit.*, p. 50. See also the argument of the European Union which submitted to the Panel in the *EC Preferences Case* : “[...]developed countries are free to decide whether or not to apply a GSP. By the

Since details of the implementation of the GSP are not legally controlled, different kinds of GSP policy are created among preference-granting countries. Where each government of the preference-granting countries has its own policies in the determining of product coverage, margin of preference, the scheme of preferences, conditionality and other limits to be imposed on preference benefits. In the words of Grossman et al., the Enabling Clause “*text is otherwise silent on the range of goods to be covered by preferences*”, on the permissibility of other forms of “discrimination” among beneficiaries, and on the acceptability of attaching conditions (“reciprocity”) to preferential benefits.¹⁰⁶

For instance, US legislation has a number of conditions that could be used to disqualify unworthy recipient countries, as well as other quantitative limits to make sure that preferences are only applied when “needed”.¹⁰⁷ While, the EU designed its GSP scheme under certain conditions such as economic criteria, special incentives of sustainable development and good governance and arrangement for LDCs under EBA (everything but arms). Currently the EU has focused its new GSP scheme on the countries most in need. Therefore Grossman et al., consider that “*GSP benefits are a kind of gift, and preference-granting countries may well have been unwilling to confer them if constrained by tight non-discrimination (and other) requirements*.”¹⁰⁸ In this perspective, the Enabling Clause is as a meeting of the minds between two parties with different interests, with developed countries on the one side and developing countries on the other.

IV. Panel Reports and the Appellate Body decisions of the WTO on the EC-Preferences Case.

There have been legal disputes between developed and developing countries under GATT for four decades. With regard to the legal complaints submitted by developing countries, there has been a limited number of cases. From 1977 to 1985, there was an increase in the number of cases. There was a smaller number of legal complaints due to awareness and fear of developing countries to bring the developed countries before the international dispute settlement system. It is important to note that most developing countries that joined GATT are the former colonies of the so-called developed countries. Some developing countries entered GATT through succession based on colonial ties. As noted by Hudec, between 1977 and 1985, GATT received sixty-one formal legal complaints. They included twelve legal complaints from developing countries versus developed countries. This number was twice as high as the legal complaints rate pre-1960. There was significant progress when seven of these twelve legal complaints led to formal proceedings before a GATT Panel.¹⁰⁹ Apparently,

same token, they are also free to decide whether or not to grant preferences with respect to certain products, as well as to choose the depth of the tariff cuts [...]” (Panel Report on the *EC-Preferences Case* Paragraph 6.7).

¹⁰⁶ See Grossman, Gene M., & Sykes, Alan O., 2004., *Op. Cit.*, p. 10.

¹⁰⁷ See Hudec, Robert E., 1987, *Op. Cit.*, p. 60.

¹⁰⁸ See Grossman, Gene M., & Sykes, Alan O., 2004., *Op. Cit.*, p. 21.

¹⁰⁹ See *Hong Kong vs Norwegian Restrictions on Textiles Case*. Panel ruling of GATT violation (See BISD, 27th Supplement (1981), p. 119.); *Brazil vs European Economic Community Export Refunds on Sugar*. Panel report, unable to make definite ruling (See BISD, 27th Supplement (1981), p. 69.); *Chile vs European Economic Community Restrictions on Imports of Apples*. Panel ruling of GATT violation (See BISD, 27th Supplement (1981), p. 98.); *India vs United States Countervailing Duty Without Injury Finding*. Panel appointed, settled after first hearing (See BISD, 28th Supplement (1982), p. 113.); *Hong Kong vs European Economic Community (French) Quantitative Restrictions*. Panel ruling of violation (See BISD, 30th Supplement (1984), p. 129.); *Argentina, Brazil, Colombia, Cuba, Dominican Republic, India, Nicaragua, Peru and Philippines (with Australia) vs European Economic Community Sugar Regime (Export Subsidies)*. Further proceedings deferred pending commodity agreement negotiations. (See GATT Documents L/5309 (1982) and C/M/166 (1983).); *Argentina vs European Economic Community*

developed countries always seem to have behaved “correctly”. The GATT Panel handled each case “promptly and respectfully”. Each new case at that time was set as a precedent, to help solve future cases of a similar nature.¹¹⁰

Conversely, there were some legal complaints in GATT submitted by developed countries against the breach of rules committed by developing countries. The revival of the GATT “adjudication mechanism” in the 1970s raised the number of complaints. There were approximately 80 complaints submitted between 1970 and 1985. It has been noted that eight of those cases were submitted by developed countries (most of them filed by the US). These complaints were submitted against the practice of developing countries or against unlawful discrimination favouring developing countries through selective trade preferences. Four of these cases became formal decisions by the GATT Panel.¹¹¹

For example there was a case that involved a legal claim against Spain, where the Panel decided upon some “reasonably unsound legal rulings” that were seen as an effort to give a poor country some extra flexibility regarding the rules. There were two cases filed by the US against another developed country for illegal discriminatory conduct that granted favourable treatment to selected developing countries. The first case was submitted in 1972 about a complaint concerning British discrimination in favour of certain Caribbean countries. The second case was submitted in 1982 concerning discrimination carried out by the European Community in favour of certain Mediterranean countries.¹¹²

Part IV of GATT is placed as the “legal base”, supporting the position of developing countries in trade preferences. It is also used by developed countries as an excuse to issue government policy deviations from the GATT disciplines. Hudec argues that Part IV does not contain any specific exemption from the GATT rules (exclusion), thus, it is in line with the Appellate Body decision on the EC Preferences Case that upholds the findings of the Panel, where the Enabling Clause “does not exclude the applicability” of Article I:1 of GATT 1994. Developing countries consider Part IV of GATT 1994 as the recognition of their special development needs. The basic idea of Part IV is “market distortion” favouring developing countries to accelerate their economic development. The Enabling Clause gives permanent legal authorisation for developed countries to design GSP schemes under their national policy.¹¹³

IV. a. Panel Reports on the Drugs Arrangement Case.

On 25 March 2002 consultation on DSB was held as requested by India regarding the EU GSP scheme laid down in Council Regulation (EC) No. 2501/2001.¹¹⁴ India submitted a complaint related to the Special Arrangements under the EU GSP scheme, namely the “Drugs Arrangement”. The consultation session did not achieve any “mutually satisfactory resolution” between the parties. Therefore, the Dispute of Settlement Body established a Panel on 27 January 2003, as requested by India.¹¹⁵ The Drugs Arrangement under Council Regulation (EC) No. 2501/2001 was effective from 1

Falklands War Embargo. Claim of violation not resolved. Decision concerning Article XXI procedures adopted. (See GATT Document L/5317 (1982) and BISD, 29th Supplement (1983), p. 23.). See also Hudec, Robert E., 1987, *Op. Cit.*, p. 70.

¹¹⁰ See also Hudec, Robert E., 1987, *Op. Cit.*, p. 70.

¹¹¹ See also Hudec, Robert E., 1987, *Op. Cit.*, p. 71.

¹¹² See also Hudec, Robert E., 1987, *Op. Cit.*, p. 71.

¹¹³ See also Hudec, Robert E., 1987, *Op. Cit.*, p. 75.

¹¹⁴ See Request for Consultations by India, European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, 12 December 2002 (WT/DS246/1).

¹¹⁵ See Panel Report EC-Preferences paras. 1.1-1.12.

January 2002 to 31 December 2004.¹¹⁶ The Drugs Arrangement was only granted to a certain group of countries in compliance with criteria set out by the EU.¹¹⁷

According to Column I Annex I of the EU GSP regulation, there were twelve beneficiary countries granted with special arrangements to combat drug production and trafficking, consisting of Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru and Pakistan. Most of these beneficiary countries are Central/South American countries except for Pakistan.

The beneficiary countries listed in the Drugs Arrangement enjoyed more incentives of tariff reductions than other developing countries. The other developing countries excluded from the Drugs Arrangement had to pay the “*full duties applicable under the Common Customs Tariff*”. Duty free access to the EU market was only granted to the twelve beneficiary countries covering the products listed in the Drugs Arrangement. The twelve beneficiary countries of the Drugs Arrangement enjoyed *duty-free* access of the sensitive products listed in column G of Annex IV. While all other developing countries were only granted “*reductions in the duties applicable under the Common Customs Tariff*”.¹¹⁸

India, as an applicant, submitted complaints concerning Article 10 of Council Regulation No. 2501/2001. India states that the provision is inconsistent with Article I:1 of GATT 1994 and is not justified by the Enabling Clause under Paragraphs 2(a), 3(a) and 3(c).¹¹⁹ India also argues that the EU has not demonstrated that the Drugs Arrangement is justified under Article XX (b) of the General Exception of GATT 1994.¹²⁰

While on its written submission, the EU argues that the Enabling Clause excludes the application of Article I of GATT 1994.¹²¹ The EU also argues that the EU GSP is an “*autonomous right not an affirmative right*”, in this regard, it has implied that the Enabling Clause gives autonomy to the preference-granting country to set out criteria under its arrangement.¹²²

With respect to autonomous rights, the EU argues that the GSP is not an obligation for developed countries “*whether or not to apply*” including the freedom to decide “*whether or not to grant preferences*” to certain products.¹²³ India has rebutted the EU argument of autonomous rights. India considers the Enabling Clause as derogation from Article I:1 of GATT 1994.¹²⁴ Further, India maintains its argument that Paragraph 2 (a) is characterised as an affirmative defence because it has a legal function.¹²⁵ In this matter, India considers that the Enabling Clause is the successor of the 1971 Waiver Decision.¹²⁶ While, the EU argues that the Enabling Clause is a *sui generis* decision. In this regard, the Enabling Clause has been taken into consideration as the tool to achieve the main objectives and purposes of the WTO.¹²⁷

¹¹⁶ See Official Journal of the European Communities L 346/1, 31.12.2001, http://trade.ec.europa.eu/doclib/docs/2003/may/tradoc_113021.pdf

¹¹⁷ Refers to the section 4 article 10 paragraph 1 and 2 of Council Regulation (EC) No. 2501/2001.

¹¹⁸ See Panel Report EC-Preferences para. 2.8.

¹¹⁹ See Panel Report EC-Preferences para. 3.1. See also Request for Consultations by India WT/DS246/1, available at : http://docsonline.wto.org/GEN_highLightParent.asp?qu, last accessed : 09 March 2011.

¹²⁰ See Panel Report EC-Preferences Case para. 7.19.

¹²¹ See Panel Report EC-Preferences Case para. 7.20

¹²² See Panel Report EC-Preferences Case para. 3.5

¹²³ See Panel Report EC-Preferences Case para. 6.7.

¹²⁴ See Panel Report EC-Preferences Case para. 7.28.

¹²⁵ See Panel Report EC-Preferences Case para. 7.25.

¹²⁶ See Panel Report EC-Preferences Case para. 7.26.

¹²⁷ See Panel Report EC-Preferences Case para. 7.29.

Regarding submission Paragraphs 3 (c)¹²⁸ of the Enabling Clause, the EU argues that the term “*non-discriminatory*”, set out in Footnote 3, “*contextually*” supports the interpretation of the objectives to respond positively to the development needs of developing countries. The EU argues that the preference-granting country can set arrangement criteria under the framework, to respond positively to the development needs of developing countries. Moreover, the EU argues that developed countries could apply horizontal graduation criteria and/or determine beneficiary countries based on a set of objectives and non-discriminatory criteria.¹²⁹ In contrast with the EU, India has submitted its argument by interpreting the “*general*” needs of all developing countries, not referring to the country’s individual interests.¹³⁰

As regards the term “*non-discriminatory*” set out in Footnote 3, the EU argues that it must be interpreted in the specific framework of the Enabling Clause, as to seek “*to create unequal competitive conditions in order to respond to the special needs of developing countries*”.¹³¹ Regarding Paragraph 2 (a) the EU argues that the interpretation of India to take developing countries in terms of “*all developing countries*” would go against the objective of Paragraph 3 (c) in order to respond positively to the development needs of developing countries.¹³²

The Panel has examined the consistency of the Drugs Arrangement with Article I:1 of GATT 1994 and with the Enabling Clause. The first examination addresses whether Article I:1 of GATT 1994 applies to the measures falling under the Enabling Clause. The second whether India’s claim that the Drugs Arrangement has violated Article I:1 of GATT 1994 is sufficient. The third examination relates to the burden of proof, stating which party would be responsible for the establishment of the burden of proof regarding the inconsistency of the Drugs Arrangement with the Enabling Clause.¹³³

IV. a. 1. The nature of the Enabling Clause.

The EU argues that the Enabling Clause is not a waiver regulation but a *sui generis* decision. The Enabling Clause is the main tool to achieve the basic objectives and purposes of the WTO Agreement, namely special and differential treatment. The EU maintains that the Enabling Clause exists, “*side-by-side*”, with Article I:1 of GATT. The word “*notwithstanding*” in Paragraph 1 of the Enabling Clause completely excludes the application of Article I:1 of GATT.¹³⁴

Relating to the origin of the Enabling Clause, the Panel considers that the Enabling Clause is the essential instrument provided by GATT and WTO in order to encourage special and more favourable treatment for developing countries.¹³⁵ The Panel interprets the wording of “*notwithstanding*” in the Enabling Clause according to the dictionary¹³⁶ meaning, and concludes that the Enabling Clause provides permission to deviate from certain legal rules establishing obligations. According to this interpretation, the substance of the Enabling Clause is not different from other

¹²⁸Any differential and more favourable treatment provided under this clause: “[...] shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries [...]”.

¹²⁹ See Panel Report *EC-Preferences Case* para. 6.7

¹³⁰ See Panel Report *EC-Preferences Case* para. 6.7

¹³¹ See Panel Report *EC-Preferences Case* para. 6.10

¹³² See Panel Report *EC-Preferences Case* para. 6.13

¹³³ See Panel Report *EC-Preferences Case* para. 7.23

¹³⁴ See Panel Report *EC-Preferences Case* para. 7.29.

¹³⁵ See Panel Report *EC-Preferences Case* para. 7.31.

¹³⁶ See Panel Report *EC-Preferences Case* para. 7.44.

exceptions under Article I:1 (Articles XX, XXI and XXIV).¹³⁷ The Panel understands that the operation of the Enabling Clause is not prevented by Article I:1¹³⁸ and finds that Article I:1 of GATT 1994 is evidently a *"positive rule establishing obligations"*,¹³⁹ pursuant to the stipulation of the provision, where *"the obligations are for Members to accord to the like products of all Members, immediately and unconditionally, any advantage relating to, inter alia, custom duties accorded to products originating in any country."*¹⁴⁰

The Panel has analysed the absence of the *"legal obligation characteristic"* in the Enabling Clause, which means that the preference-granting countries are not obliged to undertake these measures.¹⁴¹ There is no binding legal obligation in the Enabling Clause that obliges developed countries to grant GSP to developing countries.¹⁴² In respect of Paragraph 1 of the Enabling Clause that stipulates *"contracting parties may accord differential and more favourable treatment to developing countries"*, the Panel has interpreted the word *"may"* as an optional measure. The Panel considers that GSP has to be *"generalised, non-discriminatory and non-reciprocal"* because of its limited authorisation of derogation.¹⁴³ The Panel defines the legal function of the Enabling Clause as *"to authorise derogation from Article I:1"* or as a *"positive rule establishing obligations"* in order to allow developed countries to provide GSP to developing countries.¹⁴⁴ Finally, the Panel finds that the Enabling Clause is *"in the nature of an exception to Article I:1 of GATT 1994"*¹⁴⁵, but it does not exclude the applicability of Article I:1 and that both apply concurrently.¹⁴⁶

In interpreting the term *"unconditionally"* as stipulated in the Article I:1 of GATT, the Panel's findings are different from the interpretation made by the EU. The EU interprets *"unconditionally"* to mean *"not requiring any compensation"*. Therefore, according to this interpretation, the EU justifies that the Drugs Arrangement *"is not a condition"*. India argues that the term *"unconditionally"* should be interpreted so that such *"advantage"* provided in the Drugs Arrangement *"must be accorded to the like products of all other Members regardless of their situation or conduct"*. The Panel finds that the granting of a special tariff under the Drugs Arrangement is based on the condition that the beneficiary countries must have experienced a certain extent of drug problems, and for this reason, the Panel considers that such arrangements are inconsistent with Article I:1 of GATT 1994.¹⁴⁷

IV. a. 2. The Panel's interpretation of Paragraph 3 (c) of the Enabling Clause.

The term *"non-discrimination"* in Footnote 3 should be interpreted simultaneously with the meaning of Paragraph 3 (c) because the two interpretations affect each other.¹⁴⁸ India's argument is correlated with Paragraph 3 (c), in order to *"respond positively"* it must be applied to developing countries as a whole.¹⁴⁹ Further,

¹³⁷ See Panel Report *EC-Preferences Case* para. 7.36.

¹³⁸ See Panel Report *EC-Preferences Case* para. 7.44

¹³⁹ See Panel Report *EC-Preferences Case* para. 7.37.

¹⁴⁰ See Panel Report *EC-Preferences Case* para. 7.37

¹⁴¹ See Panel Report *EC-Preferences Case* para. 7.37.

¹⁴² See Panel Report *EC-Preferences Case* para. 7.38.

¹⁴³ See Panel Report *EC-Preferences Case* para. 7.38.

¹⁴⁴ See Panel Report *EC-Preferences Case* para. 7.38.

¹⁴⁵ See Panel Report *EC-Preferences Case* para. 7.39.

¹⁴⁶ See Panel Report *EC-Preferences Case* para. 7.53.

¹⁴⁷ See Panel Report *EC-Preferences Case* paras. 7.55 – 7.60.

¹⁴⁸ See Panel Report *EC-Preferences Case* para. 7.65.

¹⁴⁹ See Panel Report *EC-Preferences Case* para. 7.65.

India argues that Paragraph 3 (c) must be interpreted in a “comprehensive manner” since this Paragraph does not permit discrimination between developing countries.¹⁵⁰ This is in line with India’s previous argument that “*there is nothing in the Enabling Clause which gives authorisation to developed countries unilaterally to modify its scheme addressed for individual developing countries*”.¹⁵¹

In its rebuttal, the EU insists upon the “objective criteria” in terms of Paragraph 3 (c). The EU claims that the Drugs Arrangement has satisfied the “objective criteria” as defined by them. The “*objective criteria*” consist of two elements in order to respond to the interpretation of “*non-discriminatory development needs*”. First, the different treatment must conform to reasonable aims. Second, the differences must be reasonable as a tool to attain such objective.¹⁵²

The EU argues that the interpretation submitted by India regarding “*non-discrimination for all developing countries*” is unacceptable. According to the EU, this makes Paragraph 3 (c) impossible to apply. The EU has seen that there is nothing in Paragraph 3 (c) that implies that the special needs of each and every developing country should be taken into account. The EU defines Paragraph 3 (c) as “*a purposive provision*” since it does not imply any legal obligation. Further, the EU considers that the Enabling Clause is an optional policy for developed countries.¹⁵³ With respect to Paragraph 3(c), the US as a third party has argued that GSP schemes need not be extended to “one size fits all” because differentiation was made based on the unequal development of developing countries.¹⁵⁴

In respect of the different opinions of the parties on the status of the Agreed Conclusions to the Enabling Clause, the Panel has examined Resolution 21(II), the history record of the Agreed Conclusions and the result of negotiations on the GSP arrangements. The Panel has come to the conclusion that the Agreed Conclusions consist of a preparatory work¹⁵⁵ for both the 1971 Waiver Decision and the Enabling Clause under Article 32 of the Vienna Convention.¹⁵⁶

IV. a. 3. Interpretation to respond positively to development needs.

According to the Panel’s findings, Paragraph 3 (c) of the Enabling Clause allows for the design and modification of the GSP schemes. The Panel interprets the phrase “*to respond positively*” as an encouragement, to improve levels of GSP product coverage and depth tariff cuts, which commensurate with development needs of developing countries.¹⁵⁷

IV. a. 4. Whether a GSP scheme can be accorded to less than all developing countries.

The Panel has considered embracing the development needs of “*each and every*” developing country in the GSP scheme.¹⁵⁸ The Panel has concluded that the design and modification of the GSP scheme should not cause differentiation in the treatment of preferences, unless, in the case of special treatment to the least-developed countries,

¹⁵⁰ See Panel Report *EC-Preferences Case* para. 7.68.

¹⁵¹ See Panel Report *EC-Preferences Case* para. 7.67.

¹⁵² See Panel Report *EC-Preferences Case* para. 7.70.

¹⁵³ See Panel Report *EC-Preferences Case* paras. 7.71 -7.75.

¹⁵⁴ See Panel Report *EC-Preferences Case* paras. 7.76 -7.76.

¹⁵⁵ See Panel Report *EC-Preferences Case* paras. 7.81 – 7.88.

¹⁵⁶ See the Prebisch Report and the establishment of the Special Committee on Preferences.

¹⁵⁷ See Panel Report *EC-Preferences Case* paras. 7.98 – 7.99.

¹⁵⁸ See Panel Report *EC-Preferences Case* paras. 7.100-7.106.

pursuant to Paragraph 2(d). There should be no other differentiation among developing countries.¹⁵⁹

IV. a. 5. "Non-discriminatory" interpretation in Footnote 3 of the Enabling Clause.

From the EU's perspective, discrimination exists when "*the equal situation is treated unequally*" or if "*unequal situations are treated equally*". The EU has interpreted the term "*non-discriminatory*" in Paragraph 2 (a) to mean that it does not prevent preference-granting countries from treating developing countries with different "development needs" differently, based on the "objective criteria".¹⁶⁰ Relating to "*non-discriminatory*" in Footnote 3, the Panel has considered that "*identical tariff preferences under the GSP scheme*" should be provided to all developing countries without any differentiation, "*except for the implementation of a priori limitation*", such as LDCs.¹⁶¹

India maintains the argument that there is no reference in the General Principle Eight of the First UNCTAD Session and the Agreed Conclusion, which expresses the notion that preference-granting countries are allowed to distinguish between developing countries.¹⁶² Under the framework of the Agreed Conclusion, the Panel considers the existence of "*a priori limitations*" where a legal basis is not provided to differentiate among developing countries other than the implementation of a priori limitations.¹⁶³ The EU interprets the word "*discriminate*" with a neutral meaning and negative meaning.¹⁶⁴ The Panel has taken into account "*the intention of the negotiators*" within Resolution 21 (II) and all others relevant to the preparatory works in order to provide the GSP scheme equally to all developing countries and to eliminate all differentiation in granting preferential treatment, with the exception of a priori limitations to LDCs.¹⁶⁵

With respect to the interpretation of the term "*developing countries*" stipulated in Paragraph 2 (a), the Panel considers that Paragraph 3 (c) provides an additional context to that paragraph. It means "*all developing countries*", with the exception referred to in Paragraph 2 (d).¹⁶⁶ The Panel interprets "*developing countries*" in terms of *all* developing countries, with the exception of the implementation of a priori limitations or it may mean *less than all* developing countries.¹⁶⁷ The Panel considers Paragraph 2(d) as an exception to Paragraph 2(a) that allows developed countries to provide special treatment to least-developed countries.¹⁶⁸ The Panel report concludes that the Drugs Arrangement is inconsistent with Article I:1 of GATT 1994 and it is not justified by Article 2(a) of the Enabling Clause or Article XX(b) of GATT 1994.¹⁶⁹

IV.b. Appellate Body decisions of the Drugs Arrangement Case.

The EU was not satisfied with the Panel's findings and conclusions on the Drugs Arrangement case relating to some specific issues and legal interpretations. Thus, the EU notified the DSU regarding its intention to appeal on 8 January 2004. The issues raised by the EU before the Appellate Body concerned the relationship between Article

¹⁵⁹ See Panel Report *EC-Preferences Case* para. 7.116.

¹⁶⁰ See Panel Report *EC-Preferences Case* para. 7.124.

¹⁶¹ See Panel Report *EC-Preferences Case* para. 7.161.

¹⁶² See Panel Report *EC-Preferences Case* paras. 7.120-7.121.

¹⁶³ See Panel Report *EC-Preferences Case* para. 7.140.

¹⁶⁴ See Panel Report *EC-Preferences Case* para. 7.122.

¹⁶⁵ See Panel Report *EC-Preferences Case* para. 7.144.

¹⁶⁶ See Panel Report *EC-Preferences Case* paras. 7.167 – 7.176.

¹⁶⁷ See Panel Report *EC-Preferences Case* para. 7.174.

¹⁶⁸ See Panel Report *EC-Preferences Case* para. 7.176

¹⁶⁹ See Panel Report *EC-Preferences Case* para. 8.1 (f).

I:1 of GATT 1994¹⁷⁰, legal interpretation of the words “*notwithstanding*” and “*developing countries*” in Paragraph 2 (a) and the term “*non-discriminatory*” in Footnote 3 of the Enabling Clause.¹⁷¹

The EU considers that the Panel “*erred*” in finding the relationship between Article I:1 of GATT 1994 and the Enabling Clause. According to the EU, the Panel “*erred*” when it concluded that the Enabling Clause is an “*exception*” to Article I:1 of GATT 1994 and that it applies to measures covered under the Enabling Clause.¹⁷² The Panel concluded that the Enabling Clause does not provide “*rules establishing obligations in themselves*”. The Panel’s findings considered the Enabling Clause as an exception of Article I:1 of GATT 1994, however, the EU argues that it must be characterised by stipulation after the article or stipulation in such article.¹⁷³

According to the EU, the Enabling Clause cannot be “*a mere exception*” to GATT 1994. It constitutes a “*special regime*” for developing countries to address inequalities among the members of WTO.¹⁷⁴ The EU considers the Enabling Clause as *lex specialis* applying to the exclusion of more general WTO rules on the same subject matter. Therefore, the EU deems that the Panel has “*disregarded*” such principle.¹⁷⁵ The EU argues that the Enabling Clause evidently distinguishes from the General Exception Article XX GATT 1994. General Exception allowing members to adopt “*legitimate policy objectives*” that are separated and distinguished from the objectives of the WTO Agreement, while the Enabling Clause is considered as a crucial tool to achieve the fundamental objectives of the WTO Agreement.¹⁷⁶ Thus, the EU considers the Enabling Clause to impose “*positive obligation*”.¹⁷⁷

The Enabling Clause constitutes the special and differential treatment of developing countries where its provisions are aimed to provide unequal competitive opportunities to respond to the needs of such countries. Hence, the EU has concluded that providing additional preferences to countries with particular development needs is not a discriminatory treatment under the framework of the Enabling Clause.¹⁷⁸

India maintains its argument that the Enabling Clause is an “*exception*” by asserting “*conditional rights*” contained in Paragraphs 2(a) and 3. India disagrees with the application of the *lex specialis derogate legi generali* principle to the Enabling Clause. It considers that both rules should be applied “*cumulatively*”.¹⁷⁹

The EU disagrees with the Panel that interprets “*developing countries*” to mean “*all*” developing countries. The EU also disagrees with the Panel’s interpretation of the term “*non-discriminatory*”, which requires preference-granting countries to provide “*identical*” preferences to “*all developing countries without differentiation*”, except when respecting a priori limitations.¹⁸⁰ The EU maintains its argument that the wording “*non-discriminatory*” gives authorisation to preference-granting countries to accord

¹⁷⁰ See Appellate Body Report in EC Preferences Case para. 7.8. Whether Enabling Clause is an exception” to Article I:1 of the GATT 1994 and whether the Enabling Clause “does not exclude the applicability” of Article I:1 of the GATT 1994.

¹⁷¹ See Appellate Body Report in EC-Preferences Case para. 127.

¹⁷² See Appellate Body Report in EC-Preferences Case para. 9.

¹⁷³ See Appellate Body Report in EC-Preferences Case para. 13.

¹⁷⁴ See Appellate Body Report in EC-Preferences Case para. 13.

¹⁷⁵ See Appellate Body Report in EC-Preferences Case para. 14.

¹⁷⁶ See Appellate Body Report in EC-Preferences Case para. 15.

¹⁷⁷ See Appellate Body Report in EC-Preferences Case para. 17.

¹⁷⁸ See Appellate Body Report in EC-Preferences Case para. 30.

¹⁷⁹ See Appellate Body Report in EC-Preferences Case para. 39.

¹⁸⁰ See Appellate Body Report in EC-Preferences Case para. 19.

differential tariff treatment under the GSP scheme to developing countries that have different development needs pursuant to the "*objective criteria*".¹⁸¹

The EU has argued that tariff differentiation under the GSP scheme is designed "*adequately*" in order to respond to different development needs.¹⁸² The terms stipulated in Footnote 3, consist of "*non-discriminatory, generalised, and non-reciprocal*", and should be interpreted comprehensively.¹⁸³ Furthermore, the EU argues that categorisation of developing countries is considered as the "*best achieved*" tool to attain the objective described in Paragraph 3 (c).¹⁸⁴

"Generalised" should be interpreted in accordance with the negotiating history of the GSP clauses, which intend to eliminate tariff preferences based on colonial ties. The EU interprets "*generalised*" in Footnote 3 so as to differentiate these preferences from the "*special*" preferences, which were formerly provided by most developed countries to selective developing countries based on political, historical, or geographical reasons.¹⁸⁵

With regard to "*non-reciprocal*", the EU considers this term as only to disallow reciprocity conditions.¹⁸⁶ The EU argues that the conditions established under the GSP scheme were aimed to attain the objective of the Enabling Clause, that is "*to respond positively to development needs*" without requiring any compensation from beneficiary countries.

The EU has identified three different scopes covered by Paragraphs 2 (a) and 2 (d). First, Paragraph 2 (a) covers preferences granted by all *developed countries*, whereas Paragraph 2 (d) is devoted to preferences granted by *any* WTO member. In terms of Paragraph 2 (a), it is solely addressed to encourage developed countries to provide trade preferences. Second, Paragraph 2 (a) only governs preferences in the framework of GSP, while Paragraph 2 (d) relates to any measure favouring developing countries. Third, Paragraph 2 (a) only covers tariff measures, but Paragraph 2 (d) applies to any kind of "*special treatment*".¹⁸⁷

Panama, as a third party in the EC Preferences Case, defines "*non-discrimination*" to not mean equal treatment. Panama considers that Paragraph 3(c) of the Enabling Clause contains "*flexibility*" allowing preference-granting countries to design a preferential treatment that "*effectively helps generalised needs*". Panama maintains the argument that the Drugs Arrangement satisfies the requirement of "*specific growth needs*" in Paragraph 3(c) of the Enabling Clause.¹⁸⁸

While the Andean Community¹⁸⁹ asserts a concept of "*a self-standing regime*" to justify the existence of the Enabling Clause in GATT. The Andean Community considers that Article I:1 of GATT 1994 does not apply to the GSP scheme.¹⁹⁰ In respect of the term "*non-discriminatory*", it considers that the "*Enabling Clause does not require that identical treatment be granted to all developing countries*". In other words, the prohibition of discrimination is considered as an order not to treat equal situations differently or different situations equally.¹⁹¹ The arguments presented by the Andean

¹⁸¹ See Appellate Body Report in *EC-Preferences Case* para. 33.

¹⁸² See Appellate Body Report in *EC-Preferences Case* para. 20.

¹⁸³ See Appellate Body Report in *EC-Preferences Case* para. 21.

¹⁸⁴ See Appellate Body Report in *EC-Preferences Case* para. 26.

¹⁸⁵ See Appellate Body Report in *EC-Preferences Case* para. 22.

¹⁸⁶ See Appellate Body Report in *EC-Preferences Case* para. 24.

¹⁸⁷ See Appellate Body Report in *EC-Preferences Case* para. 25.

¹⁸⁸ See Appellate Body Report in *EC-Preferences Case* para. 67.

¹⁸⁹ Acting as the third parties in the *EC-Preferences Case* appeal.

¹⁹⁰ See Appellate Body Report in *EC-Preferences Case* para. 57.

¹⁹¹ See Appellate Body Report in *EC-Preferences Case* para. 60.

Community are very similar to the EU arguments where discrimination only exists when equal situations are treated unequally or unequal situations treated equally.

The US considers the Enabling Clause as a "*positive rule establishing obligations in itself*", it is unrelated to Article I:1. Further, the US argues that the Enabling Clause is not similar to Article XX of GATT 1994. According to the US, the Enabling Clause is considered as a set of tools to "*encourage*" developed country members to grant tariff preferences to developing countries.¹⁹² At the same time, Paraguay considers the Enabling Clause as a substitution of the "*special preferences*". Therefore, it is deemed as a grant from developed countries to deliver benefits to all developing countries.¹⁹³

IV.b.1. Interpretation of "Non-Discriminatory" in Footnote 3.

The Appellate Body defines "non-discriminatory" as identical tariff preferences that must be granted to all similarly-situated beneficiary countries. Nevertheless, the disputing parties disagree on how to determine "*similarly-situated*" beneficiaries.¹⁹⁴ The Appellate Body refutes the Panel's finding, which considers that the Drugs Arrangement under EU GSP would lead to the collapse of the whole GSP System and the re-emergence of special preferences favouring certain developing countries. The Panel considers that the Drugs Arrangement does not comply with the objective Enabling Clause to grant "*generalised preferences*" to all developing countries. The Appellate Body disagrees with India's submission about "*formally equal treatment*" of non-discrimination in the sense of Footnote 3 to Paragraph 2(a).¹⁹⁵

The term non-discriminatory in Footnote 3 is linked to the indistinct definition of developing countries. Neither GATT nor WTO gives a definition or sets out any standard for a country defined as a developing country. Therefore, developing countries have the freedom to declare themselves as a developing country. With respect to such matters, the Comprehensive Review of the GSP, issued by the UNCTAD Secretariat, in April 9 1979, stated that due to various reasons some preference-granting countries have not recognised all developing countries that claim developing status as GSP beneficiaries.¹⁹⁶

"[...] Furthermore, in the administration of its schemes, certain preference-granting countries differentiate among beneficiaries with regard to the product coverage, the depth of tariff cut and/or the level of preferential imports admitted. Strictly speaking, such differentiation and selectivity contravenes the principle of non-discrimination [...]."

"[...] The principles on which generalised, non-reciprocal and non-discriminatory preferences should be based need to be reaffirmed, and the preference-giving countries should agree to take appropriate measures for the full observance of these principles. To this effect, they should extend generalised tariff preferences to all developing countries without discrimination, reciprocity or any other conditions [...]."

Referring to this report, Howse interprets the wording "*should agree*" as the absence of legal obligation or binding rules to oblige preference-granting countries to implement such principle. Non-discrimination and reciprocity are essential principles

¹⁹² See Appellate Body Report in *EC-Preferences Case* para. 74.

¹⁹³ See Appellate Body Report in *EC-Preferences Case* para. 71.

¹⁹⁴ See Appellate Body Report in *EC-Preferences Case* paras. 153-154.

¹⁹⁵ See Appellate Body Report in *EC-Preferences Case* para. 156.

¹⁹⁶ See Comprehensive Review of the Generalized System of Preferences, Report by the UNCTAD Secretariat 39, 153-54, UN Doc No TD/B/C.5/63 (Apr 9, 1979), in UN TDBOR, Operation and Effects of the Generalized System of Preferences 19, UN Doc No TD/b/C.5/71 (1981). See Robert, Howse., 2003, *Op. Cit.*, p. 394.

of the GSP that need to be adhered to. Developed countries need to agree in the future to take measures that will result in “*full observance*” of both principles.

IV.b.2. To “*respond positively*”.

According to the Appellate Body the word “shall” in Paragraph 3 (c), obliges the preference-granting countries to design the GSP scheme in order to “*respond positively*” to the “*needs of developing countries*”. The preference-granting countries have to grasp the meaning of “*respond positively*” in order to cover the “needs” of developing countries *collectively*.¹⁹⁷

According to the Panel’s findings, Paragraph 3(c) does not allow preference-granting countries to provide preferential tariff treatment exclusively to a sub-category of developing countries based on the needs that are only shared among those selected developing countries. While, the Appellate Body interprets that nothing in Paragraph 3(c) states whether it is required to respond to the needs of “*all*” developing countries or to the needs of “*each and every*” developing country.¹⁹⁸

The Appellate Body considers that the “*development, financial and trade needs*” of developing countries are subjects to change. Therefore, the Appellate Body recognises specific development needs that are only common to a certain number of developing countries.¹⁹⁹ The Appellate Body interprets the word “*commensurate*” in the Preamble of the Agreement Establishing WTO, to imply open recognition of different needs in different development stages and particular economic circumstances of developing countries”.²⁰⁰

Under Paragraph 3 (c), modification of the GSP scheme is allowed in order to “*respond positively*” to the development needs of beneficiary countries.²⁰¹ With the purpose of responding to the “needs of developing countries” that are not necessarily common, preference-granting countries may grant different treatment to their beneficiary countries.²⁰² The Appellate Body finds that the Enabling Clause contains sufficient restrictions on the permissible bases for discrimination. Thus, in order to be permissible, discrimination must “*respond positively*” to the “*needs of developing countries*.”²⁰³

IV.b.3. “*Objective standard*”.

According to the Appellate Body, the existence of “*development, financial or trade needs*” must be assessed based on an “*objective standard*”. Such objective standard should be provided with recognition of a particular need, as stipulated in the WTO Agreement or in the multilateral instruments adopted by international organisations.²⁰⁴ With regard to the sets of “objective standards”, Bartels comments that the Appellate Body is likely to have been referring to such instruments as “*evidence of a standard*”. There is a great difference between the ratification of an international instrument and its adoption into national law. The implementation or adoption of such international instrument could be used as the “*instrument*” to achieve the preference facilities. For instance, in the GSP Plus scheme, beneficiary countries are required to ratify and

¹⁹⁷ See Appellate Body Report in *EC-Preferences Case* para. 158.

¹⁹⁸ See Appellate Body Report in *EC-Preferences Case* para. 159.

¹⁹⁹ See Appellate Body Report in *EC-Preferences Case* para. 160.

²⁰⁰ See Appellate Body Report in *EC-Preferences Case* para. 161.

²⁰¹ See Appellate Body Report in *EC-Preferences Case* para. 160.

²⁰² See Appellate Body Report in *EC-Preferences Case* para. 162.

²⁰³ See Hudec, Robert E., 1987, *Op. Cit.*, p. 126.

²⁰⁴ See Appellate Body Report in *EC-Preferences Case* para. 163.

implement 27 international conventions in their national law. The Commission monitors and assesses their implementation in the beneficiary countries concerned. In fact, Bartels argues that “a country that has not ratified a convention might have precisely the same development needs as one that has”.²⁰⁵

The Appellate Body has emphasised that “the particular need at issue must, by its nature, be such that it can be effectively addressed through tariff preferences”. Consequently, the requirement of Paragraph 3(c) will be fulfilled when a preference-granting country performs GSP in the “positive” manner as recommended, to respond to widely-recognised “development, financial or trade needs”.²⁰⁶

International trade scholars characterise GSP as a grant from rich countries to poor countries that imposes non-trade conditionality. There is criticism concerning the “objective standard” set out by the preference-granting countries. For instance, in the “Report of the Consultative Board to the Director-General Supachai Panitchpakdi”, entitled “The Future of The WTO: Addressing institutional challenges in the new millennium”, issued in 2005, it was stated that:²⁰⁷

“[...]the major arguments of the critics include concerns that developing countries have been burdened with conditions unrelated to trade imposed by the preference-granting countries, that the product coverage and preference margins in GSP schemes are determined by the preference giving countries rather than by the needs of developing countries, that empirical studies have shown little benefits have in fact accrued to developing countries under the GSP, and that GSP beneficiaries tend to become over-reliant on preferences or trapped by the nature of the system at the expense of industrial and agricultural diversification [...]”

This report clearly points out the *burden conditions unrelated to trade imposed by preference-granting countries*. The objective standard should be endeavoured to respond positively to the development needs of developing countries. Instead, it has been seen as a burden that does not support positive correlation between trade and development. The objective standard set out by preference-granting countries is apparently to be based on political considerations rather than dealing with economic development problems of the beneficiary countries.

Declaration UNCTAD IX in 1996 stated that, “there is concern among the beneficiaries that the enlargement of the scope of the GSP by linking eligibility to non-trade considerations may detract value from its original principles, namely non-discrimination, universality, burden sharing, and non-reciprocity.”²⁰⁸ Howse notes that developed countries could not be fully sincere in the implement of the GSP scheme, which is unconditional and non-selective.²⁰⁹ Bartels also notes, “neither the Panel nor the Appellate Body mentioned the obligation of non-reciprocity” in order to facilitate and accommodate the interest of both parties. Developed countries are prohibited from requiring reciprocal trade concessions as conditions of granting GSP, however it does not prohibit them from requiring compliance with non-trade conditions.²¹⁰ The

²⁰⁵ See Bartels, Lorand., *The WTO legality of the EU's GSP+ arrangement*, p. 8. available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986525&rec=1&srcabs=667283, last accessed : 10 December 2010.

²⁰⁶ See Appellate Body Report in *EC-Preferences Case* para. 164

²⁰⁷ See Julia Ya Qin, *Defining Non-discrimination Under The Law Of The World Trade Organization*, p. 289. available at : <http://www.worldtradelaw.net/articles/qinnondiscrimination.pdf>

²⁰⁸ See UN Conference on Trade and Development, 9th Sess, Midrand Declaration and a Partnership for Growth and Development 12, 27, UN DOC TD/377 (24 May 1996).

²⁰⁹ See Robert, Howse., 2003, *Op. Cit.*, p. 394.

²¹⁰ See Bartels, Lorand., *The Appellate Body Report in European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, Wt/Ds246/Ab/R and Its Implications for Conditionality in GSP Programs, ,

applicability of conditions is justified with the purpose of controlling implementation of the GSP scheme to the target beneficiary or the country most in need.

IV.b.4. Development needs and similarly-situated.

The Appellate Body apprehends that the “needs of developing countries” are diverse and heterogeneous. Paragraph 3 (c) implies that preference-granting countries may not accord “identical” tariff treatment to “all” GSP beneficiaries²¹¹. As it is governed by the Enabling Clause that such differentiation has to be performed under certain circumstances as determined in the regulation.²¹² In addition, Paragraph 2(a) does not prohibit “per se” the granting of different tariff preferences to beneficiary countries.²¹³ Preferential policies should be directed towards the interests developing countries have in common, and to those interests shared by sub-categories of developing countries based on their special needs.²¹⁴

According to the Appellate Body, the term “developing countries” in Paragraph 2(a) must not be interpreted as “all” developing countries. Paragraphs 2(a) does not prohibit preference-granting countries from according different tariff preferences to different sub-categories of GSP beneficiaries.²¹⁵

The Appellate Body considers the Drugs Arrangement to be consistent with the term “non-discriminatory” in Footnote 3, as long as the “European Communities prove” at a minimum, that the preferences granted under the Drugs Arrangement are available to all GSP beneficiaries “similarly affected” by drug problems.

“[...] We found above that the term “non-discriminatory” in Footnote 3 to Paragraph 2(a) of the Enabling Clause does not prohibit the granting of different tariffs to products originating in different sub-categories of GSP beneficiaries, but that identical tariff treatment must be available to all GSP beneficiaries with the “development, financial [or] trade need” to which the differential treatment is intended to respond. The need alleged to be addressed by the European Communities’ differential tariff treatment is the problem of illicit drug production and trafficking in certain GSP beneficiaries. In the context of this case, therefore, the Drugs Arrangement may be found consistent with the “non-discriminatory” requirement in Footnote 3 only if the European Communities prove, at a minimum, that the preferences granted under the Drugs Arrangement are available to all GSP beneficiaries that are similarly affected by the drug problem. We do not believe this to be the case [...]”²¹⁶

The Appellate Body considers that the Drugs Arrangement fails to meet the requirement of “non-discriminatory” in Footnote 3 of the Enabling Clause, which requires that identical tariff treatment be available to all similarly-situated GSP beneficiaries. According to the Appellate Body there are at least 2 reasons to judge such arrangement as “failing to meet the requirement”, i.e. there is a “closed list” of beneficiaries and the regulation does not provide criteria or standards in order to differentiate beneficiaries under the Drugs Arrangement.

a. “[...] We recall our conclusion that the term “non-discriminatory” in Footnote 3 of the Enabling Clause requires that identical tariff treatment be available to all

p. 14, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=667283, last accessed : 10 December 2010

²¹¹ See Appellate Body Report in *EC-Preferences Case* para. 165

²¹² See Appellate Body Report in *EC-Preferences Case* para. 167

²¹³ See Appellate Body Report in *EC-Preferences Case* para. 167

²¹⁴ See Appellate Body Report in *EC-Preferences Case* para. 169

²¹⁵ See Appellate Body Report in *EC-Preferences Case* para. 175.

²¹⁶ See Appellate Body Report in *EC-Preferences Case* para. 183.

similarly-situated GSP beneficiaries. We find that the measure at issue fails to meet this requirement for the following reasons. First, as the European Community itself acknowledges, according benefits under the Drugs Arrangement to countries other than the 12 identified beneficiaries would require an amendment to the Regulation. Such a "closed list" of beneficiaries cannot ensure that the preferences under the Drugs Arrangement are available to all GSP beneficiaries suffering from illicit drug production and trafficking [...]."²¹⁷

- b. "[...] Secondly, the Regulation contains no criteria or standards to provide a basis for distinguishing beneficiaries under the Drugs Arrangement from other GSP beneficiaries. Nor did the European Communities point to any such criteria or standards anywhere else, despite the Panel's request to do so. As such, the European Community cannot justify the Regulation under Paragraph 2(a), because it does not provide a basis for establishing whether a developing country qualifies for preferences under the Drugs Arrangement. The European Community claims that the Drugs Arrangement is available to all developing countries that are "similarly affected by the drug problem". In this matter they argued the Regulation does not define the criteria or standards that a developing country must meet to qualify for preferences under the Drugs Arrangement, there is no basis to determine whether those criteria or standards are discriminatory or not [...]."²¹⁸

The Appellate Body concludes that the EU has failed to demonstrate proof in which their Drugs Arrangement scheme is not fulfilling the requirements of the "*non-discriminatory*" principle as stipulated in Footnote 3.²¹⁹

The Appellate Body has laid down its decisions on the EU appeal submissions. The Appellate Body has upheld two decisions on the Panel reports, stating that the Enabling Clause is an "*exception*" and "*does not exclude the applicability*" to Article I:1 of GATT 1994. With regards to the term "*non-discriminatory*", the Panel's findings stipulate that identical tariffs must be provided to "*all developing countries without differentiation, except for the implementation of a priori limitations*", while, conversely, the Appellate Body states that "*identical tariff preferences*" must be granted to "*all similarly-situated beneficiaries*". Nevertheless, the Appellate Body has established different reasons from the Panel and considers that the EU "*failed to demonstrate that the Drugs Arrangement is justified under Paragraph 2(a) of the Enabling Clause*".²²⁰ However, the Appellate Body seems to avoid answering the question "*what does it mean to be similarly situated?*"²²¹

Grossman et al. and Hudec indeed consider that the texts of the Enabling Clause are vague or ambiguous. For instance Footnote 3, it is assumed, was intended to create a binding non-discrimination obligation, but in fact, it is the lack of any definition that leads to a wide range of interpretations. In addition, Grossman et al., consider that the term "*discrimination*" has extremely elastic notion. This means naturally that the "term" is indeterminate. Concerning the term "*developing countries*" in Paragraphs 2(a) and 3(c) of Enabling Clause, it obviously seems to be difficult to make precise definitions since the WTO itself does not provide a precise standard or parameter to define developing countries. On the other hand, the EU GSP differentiates the beneficiaries of general arrangements and LDCs according to economic criteria (state income standard

²¹⁷ See Appellate Body Report in *EC-Preferences Case* para. 187.

²¹⁸ See Appellate Body Report in *EC-Preferences Case* para. 188.

²¹⁹ See Appellate Body Report in *EC-Preferences Case* para. 189.

²²⁰ See Appellate Body Decision in *EC-Preferences Case* para. 190.

²²¹ See Hudec, Robert E., 1987, *Op. Cit.*, p. 126.

as issued by the World Bank). The Appellate Body assumes that the drafters could have said “*all developing countries*,” but did not. Conversely, the drafters might have said “*particular*” or “*selected*” developing countries, or used some other phrasing to signify the “adequacy” of differential treatment, but did not. Therefore, the texts of the Enabling Clause are open for multi-interpretation.²²²

V. EU Economic integrations.

V.a. Early stage of integrations.

The Treaty of Westphalia of 1648 terminated thirty years of war in Europe, and shaped the EU of today. After the rise and fall of Napoleon, the Congress of Vienna, held in 1814, endeavoured to reinstate balance of power among the European states. Followed by the Paris Peace Conference, which was held in 1919 after the First World War.²²³

In May 1950, Robert Schuman, the French Foreign Minister at the time, gave a speech known as the “*Schuman Declaration*”. The speech was greatly inspired by Jean Monnet. It brought immense political implication after the Second World War by the establishment of a new world order. It was followed by the emergence of a new alliance between three powerful states consisting of France, Germany and the US.²²⁴

From a political perspective, it was the strategy to assure the security of France from Germany. Chancellor Konrad Adenauer, on behalf of Germany, acknowledged the Schuman Declaration, thus, followed by Italy, Belgium, Luxemburg, and the Netherlands. On 18 April 1951, those six countries signed the Treaty of Paris and established The European Coal and Steel Community (ECSC). The Treaty of Paris was the foundation of Common European Tax among the six contracting states.²²⁵

The ECSC covered two important aspects including politics and, security and economics. Due to the dynamic change in politics, the treaties had to be developed further. Followed by the failures of the European Defence Community project in 1954, due to refusal from the French assembly. Despite this, economics had to be further developed, which led to a new agreement. On 25 March 1957, the treaty establishing the European Economic Community (EEC) and the treaty establishing the European Atomic Energy Community (EURATOM), known as the Treaty of Rome, were signed. The Treaty establishing the European Community (TEC) was maintained as the legislative basis of the EU. TEC provided four fundamental freedoms consisting of the free circulation of people, services, capital, and goods.²²⁶

The next stage of integration development was the unification of the three treaties (ECSC, EEC, and EURATOM) on 1 July 1967, the so-called Merger Treaty. The Merger Treaty established a single Commission, a single Council of Ministers, and a European Parliament. The single Commission was established as an independent body representing the general interest of the Community, with the single Council of Ministers representing the member states and the European Parliament representing the European citizens.²²⁷

²²² See Grossman, Gene M., & Sykes, Alan O., 2004, *Op. Cit.*, p. 16.

²²³ See Altomonte, Carlo., Nava, Mario., 2005, *Loc. Cit.*, pp. 1- 4.

²²⁴ See Altomonte, Carlo., Nava, Mario., 2005, *Loc. Cit.*, pp. 1- 4.

²²⁵ See Altomonte, Carlo., Nava, Mario., 2005, *Loc. Cit.*, pp. 1- 4.

²²⁶ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 5.

²²⁷ See Leonard., Dick, et.al, *Guide to the European Union*, The Economist, 10th edition, Profile Books Ltd., Great Britain, 2010. See also Moussis, Nicholas., *Guide to European Policies*, 11th revised edition 2005, European Study Service, ISBN 2-930119-40-3, 2005.

The EEC customs union entered into force on 1 July 1968. It introduced the so-called CCT to govern the Union's trade relations with third countries. The Treaty of Luxemburg introduced the system of "own resources". According to the system of "own resources" the Union obtained "[...] all customs duties on products imported from non-member countries, all levies on agricultural imports and part of the financial receipts deriving from each country's value added taxes (VAT) [...]".²²⁸

The Single European Act (SEA) was signed in 1986 by twelve member states and was established in order to amend the Treaty establishing the European Community (TEC), aiming to restructure the decision-making mechanism. The SEA introduced "the principle of majority voting" in the Council.²²⁹

The 1990 Intergovernmental Conference (IGC), held by the European Council in Dublin, was successful in delivering the Treaty on the European Union (TEU). It gave contributed critically to the integration process. The Treaty on the European Union was signed in December 1991, in Maastricht, The Netherlands, and is known as The Treaty of Maastricht. TEU amended provisions relating to monetary union of TEC. The most important aspect of the TEU was the establishment of the two pillars of the EU, namely the "Common Foreign and Security Policy (CFSP)" and "Justice and Home Affairs". These two pillars carry out intergovernmental ways by unanimity. The Maastricht Treaty entered into force on November 1993.²³⁰

In June 1993, the Copenhagen European Council established the Copenhagen Criteria. The Copenhagen Criteria sets requirements for countries of Central and Eastern Europe (CEECs) who wants to joint the European Union. During accession process, the special Directorate General of the Commission entitled tasks to review and monitor the progress of the candidate's states in fulfilling such criteria.²³¹ Those criteria consists of :²³²

- a) Political Criterion : Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- b) Economic Criterion : The existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union;
- c) Legislative Criterion or Acquis Communautaire : The ability to take on the obligations of membership including adherence to the aims of political, economic & monetary union.

The amended TEU provides the European Council to set conditions of eligibility for states candidates to become members of the EU and codified existing practice under current "Copenhagen criteria". Treaty of Lisbon inserting to the Treaty a provision concerning "the right of a member state to withdraw from the Union, and sets out the procedure that could be used to negotiate a withdrawal".²³³

Treaty of Lisbon acknowledges member states' right to withdraw from the Union for the first time (Article 50, amended TEU). Member states have the right to decide leave the Union "in accordance with its own constitutional requirements". Member states

²²⁸ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 3.

²²⁹ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 4.

²³⁰ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 7.

²³¹ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, pp. 96 – 97.

²³² See Accession Criteria, available at : http://ec.europa.eu/enlargement/enlargement_process/accession_process/criteria/index_en.htm, last accessed : 23 March 2011.

²³³ See House Of Lords, *The Treaty of Lisbon: an impact assessment*, European Union Committee 10th Report of Session 2007–08, p. 18, available at : <http://www.parliament.the-stationery-office.co.uk/pa/ld200708/ldselect/lddeucom/62/62.pdf>, last accessed : 21 March 2011, p. 35

concerned have to notifying the European Council about its intention to withdraw from the Union. The withdrawal approval concluded on behalf of the Union's by the Council, based on a qualified majority vote. The consent of the European Parliament is needed before decision made by the Council. The decision of withdrawal enter into force two years after the notification of its intention to withdraw, except the European Council and the member state in concerned agreed to extend the negotiation. Any withdrawing state intending to apply for "re-admittance" must carry out the same mechanism as any other acceding country did.²³⁴

V.b. Market integration.

After the Second World War, some countries began "*quasi-liberalisation*", where they partially liberalised their trade (particularly goods) with certain partner countries. Such policy led to the creation of what is now known as the Regional Integration Agreements, or RIAs. One of the important Regional Integration Agreements is the EU. Inherently, there are two instruments of agreement used to reduce trade barriers with trade partners. These instruments are called the Free Trade Areas (FTA) Agreement and Customs Union (CU) Agreement. In the FTA Agreement, the contracting parties eliminate their trade barriers in the trade relationship with other contracting parties of the agreement, but they still preserve their "*independent restriction non-member states*". While in the customs union the state parties are obliged to remove their trade barriers to establish the internal market. The member states under the CU are subject to Common Customs Tariff (CCT), implemented by the member states to all non-member states. Therefore, the customs union is a Free Trade Area Agreement involving the harmonisation of the participating countries' trade policies.²³⁵ The TEC accommodates the provisions established by the Common Commercial Policy (CCP) allowing six founding member states of the EU to apply the CCT. The CCT entered into force on 1 July 1968.²³⁶

The integration of the EU can be considered as "*multinational integration*". Moussis defines the "*multinational integration*" process as "*the voluntary establishment by the treaties, concluded between independent states, of common institutions and the gradual development by them of common policies pursuing common goals and serving common interests*". Borrowing the words of Jean Monnet that:²³⁷

"[...] the intellectual father of European integration, is union between individuals or communities is not natural; it can only be the result of an intellectual process [...] having as a starting point the observation of the need to change. Its driving force must be common interest between individuals or communities[...]".

The common interest of the member states should be the foundation to establish common policies in the multinational integration process. The common policies must be established by common institutions in order to address common needs, to pursue common goals and to serve interest. This is in line with Articles 2 and 3 of the TEU.²³⁸

There are four phases in the "*continuously multinational integration process*" consisting of the customs union, common market, economic and monetary union and political union. The customs union is the first phase of "*multinational integration*" where it is placed as the fundamental foundation to develop further the integration

²³⁴ See *Ibid.*, p. 35.

²³⁵ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 35.

²³⁶ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 36.

²³⁷ See Moussis, Nicholas., 2005, *Op. Cit.*, p. 9. See also An empirical approach to European multinational integration, available at : http://www.europedia.moussis.eu/books/Book_2/2/1/1/02/index.tkl?all=1&pos=6.

²³⁸ See Moussis, Nicholas., 2005, *Op. Cit.* p. 9.

progress. In the customs union, contracting parties agree, by means of the treaty, to remove any custom duties, charges having equivalent effect or quantitative restraints on each other and to adopt an external “*CCT and common foreign trade policy*” in their relations with third states. There are two important components in establishing the customs union, that is, “*intra-community trade and external trade relations*” with non-member states. Intra-community trade covers measures of abolition of customs barriers, elimination of internal borders, veterinary and plant health legislation, and customs cooperation. External trade relations with non-member countries includes Common Customs Tariffs and a Community Customs Code.²³⁹

The second phase of the multinational integration process is the common market. The common market is used synonymously with the single market and internal market. The primary goal of the Treaty of Rome was to create a single European economic area by means of a common market.²⁴⁰ The common market proposed to eliminate all the barriers to intra-community trade with the aim of unifying the national markets into one single market.²⁴¹ The milestone of the EU common market was the creation of the single market in 1992, which was preceded by the adoption of the Single European Act in 1986.²⁴² The Single European Act codified a number of major economic preconditions for fair competition and long-term stability within the internal market. It introduced a new article (Article 102a) into the EEC Treaty concerning EMU and cooperation between member states.²⁴³ There are five important elements in the establishment of the common market consisting of the free movement of goods, free movement of workers, freedom of establishment, freedom of services movement, and free movement of capital.

The advanced phase of the multinational integration process was Economic and Monetary Union (EMU). The EMU in the EU started back in the 1970s when the original six members of the EU failed to establish EMU. The failures were caused by internal (in this regard the non-completion of a common market) and external (the collapse of the international monetary system) factors.²⁴⁴ Therefore, the common monetary policy and strong coordinated economic policies among member states was indispensable for establishing EMU. EMU was introduced by the Treaty of Maastricht in 1991²⁴⁵. It sets out convergent criteria (Maastricht Criteria) that must be fulfilled by member states covering areas of inflation rates, government finance, exchange rates and long term interest.²⁴⁶ The Treaty of Maastricht also introduced the single monetary policy based

²³⁹ See Moussis, Nicholas., 2005, *Op. Cit.* p. 63.

²⁴⁰ See Article 2 Treaty of Rome (TEC) : “[...] The Community shall have as its task, by establishing common market and progressively approximately the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase stability, an accelerated relations between the States belonging to it [...]”.

²⁴¹ See Judgement of May 5 Gaston Schul, case 15/81, ECR 1982, p. 1409 ; Moussis, Nicholas., 2005, *Op. Cit.* pp. 75-76.

²⁴² The Single European Act (SEA) was signed in 1986 and entry into force on 1 July 1987. In the words of the former President of the Commission, Jacques Delors: “[...] The Single Act means, in a few words, the commitment of implementing simultaneously the great market without frontiers, more economic and social cohesion, an European research and technology policy, the strengthening of the European Monetary System, the beginning of an European social area and significant actions in environment [...]”.

²⁴³ See EMU Historical Documentation, available at : http://ec.europa.eu/economy_finance/emu_history/history/part_a_1_b.htm, last accessed : 11 November 2011.

²⁴⁴ See Moussis, Nicholas., 2005, *Op. Cit.*, pp. 103 – 106.

²⁴⁵ See Article 121(1) of the TEC.

²⁴⁶ “[...] a). Inflation rate must no more than 1.5 percentage points above the average rate of the three EU member states with the lowest inflation over the previous year. b). A national budget deficit should at or below 3 percent of gross domestic product (GDP). c). National public debt should not exceeding 60 percent of gross domestic product. d). Long-term interest rates should be no more than two percentage points above the rate in the three EU countries with the lowest inflation over the previous year. e). The national currency is required to enter the

on a single currency managed by a single and independent central bank. EMU was established to support the general economic policy of the union, relying on the open market economy and free competition.²⁴⁷

According to the Treaty of Maastricht (TEU) EMU should be achieved in three stages.²⁴⁸ The first stage was the completion of liberalisation through capital movement in 1990. The main goal of this stage was deeper convergence of economic policies and closer cooperation between central banks, incorporating deeper reliability between monetary practices in the framework of the European Monetary System (EMS). The second stage of EMU began on the 1 January 1994 and was completed by 31 December 1998. During this stage, the TEU obliged each member state to avoid excessive public deficits and initiate steps leading to independence of its central bank. The convergent criteria were created in order to prepare the third stage of EMU. The third stage of EMU started by 1 January 1999 with the application of the single monetary policy and the single currency the Euro.²⁴⁹

The last phase of multinational integration is the establishment of political union. It includes justice and home affairs and common foreign and security policy as the main component. The members states need to agree in order to establish common institutions to implement common home and foreign policies. In addition, to monitor such implementation a common institution is required. Therefore, the phase of political union is the most difficult part of multinational integration since it requires heavy transfers of national competence to the common institutions.²⁵⁰

The terms of “*economic integration*” interpreted into dynamic and static senses. In dynamic sense it is defined as the process where economic borders between member states gradually remove, or national discrimination between integration partners is being eliminated. Its followed gradually by emerging separate national economic entities into single larger entity. In static sense it is defined as situation in which national components of a larger economic zone function together as one entity.²⁵¹ Economic intergration could bring some benefits, such as welfare, security, democracy and adherence of human right. Economic welfare attained when the prosperity of participating countries increased by eliminating inefficiencies and promoting specialization of production and policymaking cooperation.²⁵² The free exchange of goods promises a positive effect on the prosperity of all concerned. The consumers would have more choice of goods with competitive prices and qualities. Free movement of production factors permits optimum allocation of labour and capital. The market enlargement favouring new production possibilities that generate more employments.²⁵³ Economic integration can reduce tension between states to create peace and stability of the region. Implementation of democracy values is necessary in governing economic development. Human right safeguarded because its set out as the pre-condition to participate in the economic integration.²⁵⁴ Yet economic integration is not

Exchange Rate Mechanism II exchange rate mechanism two years prior to entry euro zone membership [...]”.

See Moussis, Nicholas., 2005, *Op. Cit.*, p. 108.

²⁴⁷ See Moussis, Nicholas., 2005, *Op. Cit.*, p. 107.

²⁴⁸ See EMU Historical Documentation, available at : http://ec.europa.eu/economy_finance/emu_history/history/part_a_1_c.htm, last accessed : 11 November 2011.

²⁴⁹ See Directives 90/142, OJ L 78, 24.03.1990. See Moussis, Nicholas., 2005, *Op. Cit.*, p. 107.

²⁵⁰ See Moussis, Nicholas., 2005, *Op. Cit.*, p. 121-122.

²⁵¹ See Molle, Willem., *The Economics of European Integration : Theory, Practice, Policy*, Fifth Edition, Ashgate Publishing Limited, England, 2006, *Op. Cit.*, p. 4.

²⁵² See Molle, Willem., 2006, *Op. Cit.*, p. 4.

²⁵³ See Molle, Willem., 2006, *Op. Cit.*, p. 9.

²⁵⁴ See Molle, Willem., 2006, *Op. Cit.*, p. 4.

the ultimate goals, but an instrument to attain higher objective economic and political interest.²⁵⁵

Market integration defined as a situation where the flows of the products, services, and factors between countries on the same terms and conditions as within countries. The market integration led into the creation of “single market” where the price of the goods traded between the states members has the same price with the domestic one.²⁵⁶ Internal market is one of the major elements in the economic integrations. Internal market is gradual elimination of economic borders between independent states in order to establish to “single entity of economic”.²⁵⁷

It is important to ensure Union’s common policies are not injuring the national interest of the member states.²⁵⁸ Any independent states that intended to joint the Union have to accept and conform (*acquis communitaires*) all of the criteria and procedures laid down by the “union”. Members states must deemed common policies developed based on the common interest of the group. The common policies supposed promote both political and economic integration of member states.²⁵⁹

VI. The EU external policies of international trade and development in respect of GSP.

The Treaty on the Functioning of the European Union (TFEU) is considered as the “*implementation part*” in order to carry out the Union’s functions.²⁶⁰ The TFEU comprises categories and areas of competences. Exclusive competences are defined as decision-making responsibility in particular policy fields. It covers exclusive, shared, and supportive competences.²⁶¹ Treaty of Lisbon endeavoured codification of competences distributed between the Union and member states.²⁶² The exclusive competences of the Union in the area of the CCP are clearly governed under Article 2 B of the Treaty of Lisbon (Article 3 Paragraph 1 (e) of the TFEU). It codifies the ECJ case law²⁶³, where member states do not have the power to enter into international agreements or legislate on matters of CCP.²⁶⁴

Before the Treaty of Lisbon entered into force exclusive competences of the EU included in the Part One-Title I (Categories and Areas of Union Competence) of the TFEU. Thus, it is amended by Article 2 B of the Treaty of Lisbon. The CCP is included under EU exclusive competences, which elaborated as follows:

1. The Union shall have exclusive competence in the following areas:
 - a) customs union;
 - b) the establishing of the competition rules necessary for the functioning of the internal market;

²⁵⁵ See Molle, Willem., 2006, *Op. Cit.*, p. 4.

²⁵⁶ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 36.

²⁵⁷ See Molle, Willem., 2006, *Op. Cit.*, p. 4.

²⁵⁸ See Moussis, Nicholas., 2005, *Op. Cit.*, p. 38.

²⁵⁹ See Moussis, Nicholas., 2005, *Op. Cit.*, p. 8-9.

²⁶⁰ See House Of Lords, *The Treaty of Lisbon: an impact assessment*, European Union Committee 10th Report of Session 2007-08, p. 18, available at : <http://www.parliament.the-stationery-office.co.uk/pa/ld200708/ldselect/lddeucom/62/62.pdf>, last accessed : 21 March 2011.

²⁶¹ See *Ibid.*

²⁶² See *Ibid.*

²⁶³ See F van den Berghe, *The EC’s Common Commercial Policy Revisited: What does Lisbon Add?*, *Global Trade and Customs Journal* 4, 275, 279, 2009; D Leczykiewicz, *Common Commercial Policy: The Expanding Competence of the European Union in the Area of International Trade*, *German Law Journal* 6, 1673, 1674, 2005 ; Krajewski, Markus., *The Reform of the Common Commercial Policy*, p. 11, available at: <http://www.europarl.europa.eu/document/activities/cont/201012/20101207ATT07788/20101207ATT07788EN.pdf>, last accessed : 3 April 2011.

²⁶⁴ See Opinion 1/75 *Local Costs* [1975] ECR 1355, at 1363-1364 ; Krajewski, Markus., *Op. Cit.*, p. 11.

- c) monetary policy for the Member States whose currency is the euro;
 - d) the conservation of marine biological resources under the common fisheries policy;
 - e) common commercial policy.
2. The Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or insofar as its conclusion may affect common rules or alter their scope.

In the customs union, member states are obliged to adopt CCT respecting their relations with all non-members states or third countries. It is stipulated in the Article 28 of TFEU (ex Article 23 TEC) as follows:

1. The Union shall comprise a customs union which shall cover all trade in goods and which shall involve the prohibition between member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries.
2. The provisions of Article 30 and of Chapter 2 of this Title shall apply to products originating in member States and to products coming from third countries which are in free circulation in member States.

Article 29 of TFEU (ex Article 24 TEC) regulates import formalities of customs duties or charges that has to be complied by the third countries for the purposes of free circulation within member states market. Yet such kind of customs duties or charges only imposed to the third countries that have not benefitted from a total or partial drawback of such duties or charges.

“[...]Products coming from a third country, shall be considered to be in free circulation in a member state, if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in that member state, and if they have not benefitted from a total or partial drawback of such duties or charges [...]”

TFEU accommodates provisions related to customs union. For instance, Article 30 (ex Article 25 TEC), Article 31 (ex Article 26 TEC), and Article 32 (ex Article 27 TEC) where these articles substantially are not being changed or modified in the Treaty of Lisbon. In the custom union “*customs duties on imports and exports*” between member states are removed. Moreover, it is also applied prohibitions of “*charges have equivalent effect*” and “*customs duties of a fiscal nature*”, which regulated by Article 30 of TFEU:

“[...] Customs duties on imports and exports and charges having equivalent effect shall be prohibited between member states. This prohibition shall also apply to customs duties of a fiscal nature [...]”

As governed by Article 31 TFEU, the CCT proposed by the Commission would need to be approved by the Council. While Article 32 paragraph (a) of TFEU, stipulated that the Commission given task to promote trade between member states and third countries. The EU GSP established under “*the umbrella*” of the CCP provisions. Before Treaty of Lisbon came into effect, CCP regulated under Article 207 of TFEU (ex Article 133 of TEC). This article amended by Article 188C of the Treaty of Lisbon. It is comprised six sub-articles (paragraph), as follows:

1. The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies. The common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action.

2. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy.
3. Where agreements with one or more third countries or international organizations need to be negotiated and concluded, Article 188 N shall apply, subject to the special provisions of this Article. The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The Council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union policies and rules.

The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to assist the Commission in this task and within the framework of such directives as the Council may issue to it. The Commission shall report regularly to the special committee and to the European Parliament on the progress of negotiations.

4. For the negotiation and conclusion of the agreements referred to in paragraph 3, the Council shall act by a qualified majority.

For the negotiation and conclusion of agreements in the fields of trade in services and the commercial aspects of intellectual property, as well as foreign direct investment, the Council shall act unanimously where such agreements include provisions for which unanimity is required for the adoption of internal rules.

The Council shall also act unanimously for the negotiation and conclusion of agreements:

- a) in the field of trade in cultural and audiovisual services, where these agreements risk prejudicing the Union's cultural and linguistic diversity;
 - b) in the field of trade in social, education and health services, where these agreements risk seriously disturbing the national organization of such services and prejudicing the responsibility of Member States to deliver them.
5. The negotiation and conclusion of international agreements in the field of transport shall be subject to Title V of Part Three and to Article 188 N.
 6. The exercise of the competences conferred by this Article in the field of the common commercial policy shall not affect the delimitation of competences between the Union and the Member States, and shall not lead to harmonization of legislative or regulatory provisions of the Member States insofar as the Treaties exclude such harmonization.'

The qualified majority in the CCP was introduced for the first time by the Treaty of Amsterdam and has been maintained under the current treaty. With respect to negotiation and conclusion of the agreements in the area of the CCP with one or more third countries, the Council act was based on the qualified majority except in certain areas determined by the treaty to act unanimity. The application of the qualified majority considered enhancing the efficiency of passing legislation more easily. As argued by Duff, *"the new Treaty will much enhance the Union's capacity to act by increasing the efficiency and effectiveness of the institutions and decision-making mechanisms"*. Neil O'Brien also argues that the qualified majority as the new voting system *"makes it considerably easier to pass legislation"*.²⁶⁵

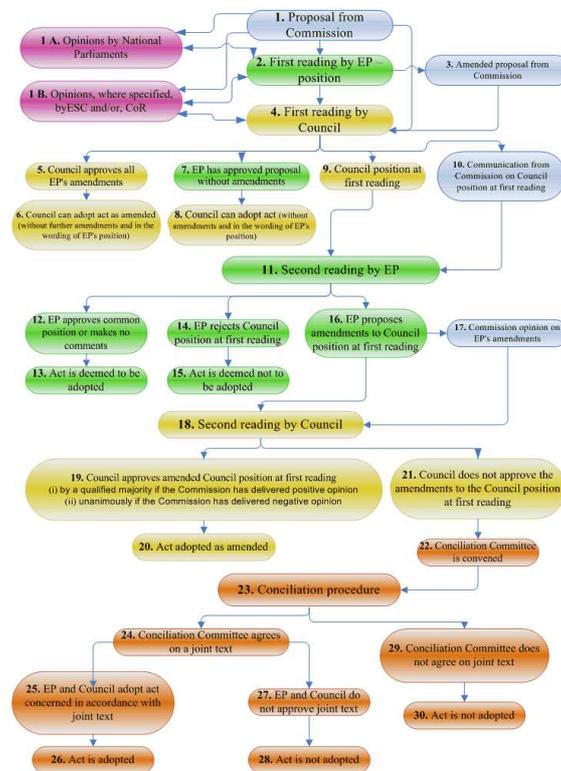
The crucial improvement of the Treaty of Lisbon is the significant increase of European Parliament roles in the area of the CCP.²⁶⁶ Treaty of Lisbon Paragraph 2

²⁶⁵ See House Of Lords, *The Treaty of Lisbon: an impact assessment*, European Union Committee 10th Report of Session 2007-08, p. 54, available at: <http://www.parliament.the-stationery-office.co.uk/pa/ld200708/ldselect/lddeucom/62/62.pdf>, last accessed : 21 March 2011.

²⁶⁶ See S Woolcock, *The potential impact of the Lisbon Treaty on European Union External Trade Policy*, SIEPS European Policy Analysis 8-2008, p. 1; Krajewski, Markus, *Op. Cit.*, p. 26.

Article 188C clearly stipulates the European Parliament's functioned as a “*co-legislator (co-decision mechanism)*” relating to the implementation of agreements and the adoption of internal autonomous trade policy measures.²⁶⁷ Therefore, the European Parliament also has the right to make amendments and veto power in internal measures. The European Parliament is supposed to play an active role in external trade policies.²⁶⁸ The European Parliament's approval is also required for the conclusion of all international agreements in respect of the CCP.²⁶⁹ In this regard, Duff considers that, “*the new Treaty will much enhance the Union's capacity to act by increasing the efficiency and effectiveness of the institutions and decision-making mechanisms*”.²⁷⁰ Co-decision procedures are governed by Article 294 of the TFEU and contain the principle of parity and the means that neither institution (European Parliament nor Council) may adopt legislation without the other's assent.²⁷¹

Figure 1. Diagram Co-Decision Procedures²⁷²



²⁶⁷ See M Cremona, *A Constitutional Basis for Effective External Action? An Assessment of the Provisions on EU External Action in the Constitutional Treaty*, EUI Working Papers LAW No. 2006/30, p. 31; Krajewski, Markus., *Op. Cit.*, p. 26.

²⁶⁸ See Krajewski, Markus., *Op. Cit.*, p. 26.

²⁶⁹ See Paragraph 2 Article 188C Treaty of Lisbon. J-M Grave, *The Impact of the Lisbon Treaty on Customs Matters: A Legal Analysis*, *Global Trade and Customs Journal* 108, 2010; J Wouters, D Coppens and B De Meester, *External Relations after the Lisbon Treaty*, in S Griller and J Ziller (eds), *The Lisbon Treaty – EU Constitutionalism without a Constitutional Treaty?* (2008), 185; M Cremona, *Op. Cit.*, p. 15; Krajewski, Markus., *Op. Cit.*, p. 28.

²⁷⁰ See House Of Lords, *The Treaty of Lisbon: an impact assessment*, European Union Committee 10th Report of Session 2007–08, p. 54, available at : <http://www.parliament.the-stationery-office.co.uk/pa/ld200708/ldselect/ldcom/62/62.pdf>, last accessed : 21 March 2011.

²⁷¹ See The Co-Decision or Ordinary Legislative Procedure, available at : http://ec.europa.eu/codecision/procedure/index_en.htm, last accessed : 9 August 2011.

²⁷² Cited from the Co-Decision or Ordinary Legislative Procedure, available at : http://ec.europa.eu/codecision/stepbystep/diagram_en.htm, last accessed : 9 August 2011.

The last sentence of Paragraph 1 article 188C of the Treaty of Lisbon implied the Principle of Consistency that should be applied in the CCP.²⁷³ It is pursuant with Article 188 A Treaty of Lisbon (Article 205 of TFEU) that stipulates :

“The Union's action on the international scene, pursuant to this Part, shall be guided by the principles, pursue the objectives and be conducted in accordance with the general provisions laid down in Chapter 1 of Title V of the Treaty on European Union.”

It is clearly stated that all of Union external action must conform to the principles written in the Chapter 1 of Title V of the Treaty on European Union. The TFEU also provide chapter related to the development cooperation with the third countries addressed for poverty reduction and eradication.

“[...] Union policy in the field of development cooperation shall be conducted within the framework of the principles and objectives of the Union's external action. The Union's development cooperation policy and that of the Member States complement and reinforce each other. Union development cooperation policy shall have as its primary objective the reduction and, in the long term, the eradication of poverty. The Union shall take account of the objectives of development cooperation in the policies that it implements which are likely to affect developing countries [...]”.²⁷⁴

Therefore, in the framework of development cooperation the Unions have to design policy favouring developing countries reducing and eradicating poverty, wherein it has been implemented through establishing GSP Scheme.²⁷⁵

VII. Common Commercial Policy under the Treaty of Lisbon.

The EU is the biggest “trading bloc” and the second biggest importer of goods in the world. In 2006, the EU had 18.1 % of world imports in goods.²⁷⁶ The implementation of the CCP had to rely on uniform principles. During the 1960s and 1970s the CCP mainly consisted of the CCT and other border measures. After the Second World War, tariffs served as the main instrument of trade protection.²⁷⁷

According to Krajewski, the EU CCP has two layers of principles and objectives, namely inner and outer layers. The specific trade policy objectives are contained in Article 206 of the TFEU (Article 188B Treaty of Lisbon), which is also considered an inner layer. The outer layer is reflected in Article 205 of the TFEU and Article 21 of the TEU (Article 10 A of the Treaty of Lisbon), where the CCP must comply with the general objectives and principles of the Union's external policy.²⁷⁸ The inner layer is addressed to establish harmonious development of world trade, and progressive elimination of barriers to trade. While the outer layer is aimed to facilitate trade liberalisation.²⁷⁹ Therefore, Article 206 of the TFEU is pursuant to the objectives of the world trading system.²⁸⁰

²⁷³ See Balan, George-Dian., *The Common Commercial Policy Under The Treaty of Lisbon : Re-thinking the European Constitution in an Enlarged European Union*, Advanced Issues of European Law, Jean Monnet seminar, 6th session, 20-27 April 2008, Dubrovnik, p. 3, available at : http://www.pravo.hr/_download/repository/GDB_JM_CCP.pdf, last accessed : 21 March 2011.

²⁷⁴ See Article 188 D of the Treaty of Lisbon (Article 208 TFEU/ex Article 177 TEC).

²⁷⁵ See Balan, George-Dian., 2008, *Op. Cit.*, p. 3.

²⁷⁶ See Conconi, Paola, *The EU Common Commercial Policy and Global/Regional Trade Regulation*, available at : [http://www.ecares.org/ecare/personal/conconi\\$/web/EUtrade.pdf](http://www.ecares.org/ecare/personal/conconi$/web/EUtrade.pdf), last accessed : 23 March 2011.

²⁷⁷ See Conconi, Paola.

²⁷⁸ See Krajewski, Markus., *Op. Cit.*, p. 4.

²⁷⁹ See A Dimopoulos, *The Effects of the Lisbon Treaty on the Principles and Objectives of the Common Commercial Policy*, EFARev 15, 155-157, 2010; Krajewski, Markus., *Op. Cit.*, p. 4.

²⁸⁰ See Krajewski, Markus., *Op. Cit.*, pp. 4-5.

The CCP considered as the most dynamic area of EU external policies. It is covering new development in the area of international trade such as intellectual property rights. Common policy is the “heart” of the multilateral integration process. Common policy established from intensive negotiations among the member states of the Union. In order to be accepted by all member states, the common policies should satisfy or at least, not injuring the national interests of the member states. For that reason the governments of member states must took apart in the decision making process. Theirs involvement carried out direct or indirect. Decision on the essential common policies needs transfers of national law sovereignty to supranational sovereignty.²⁸¹ Therefore, the member states national policy that falling under CCP must conform to the common policy. In the regard to the CCP European Court of Justice (ECJ) elaborate in the *Opinion 1/75,, Understanding on a Local Cost Standard (1975) ECR 1355*²⁸², as follows²⁸³ :

“[...] It cannot therefore be accepted that, in a field such as that governed by the understanding in question, which is covered by export policy and more generally by the common commercial policy, the Member States should exercise a power concurrent to that of the Community, in the Community sphere and in the international sphere. The provisions of Articles 113 and 114 concerning the conditions under which, according to the Treaty, agreements on commercial policy must be concluded show clearly that the exercise of concurrent powers by the Member States and the Community in this matter is impossible [...]”

The court considers CCP (Article 133 TEC) serving the operation of common market and safeguarding common interests of the Union’s.²⁸⁴ In brief, the Court’s analysis in the Opinion 1/75 contained various arguments to support the exclusive nature of the Union’s trade policy powers. The Court’s argues that defending the Union’s common interests requires exclusivity. Trade policy is essential element of economic interest. It would be very difficult to establish common policy if the member states are allowed to pursue their own trade interest.²⁸⁵

The EU GSP was established under Article 133 TEC that was amended by Article 207 of the TFEU, subsequently it was amended by the Treaty of Lisbon by Article 188 C.²⁸⁶ EU external actions were accommodated in TEU and/or of the TFEU. External actions covering areas of Common Foreign and Security Policy (CFSP), Common Security and Defence Policy (CSDP), CCP, development cooperation and economic, financial, and technical cooperation with third countries.²⁸⁷ With respect to the conception of trade liberalisation, the Opinion 1/78 stated that the Treaty nevertheless did not form barriers to the Union to develop a commercial policy that aimed to

²⁸¹ See Moussis, Nicholas., 2005, *Op. Cit.*, p. 38.

²⁸² See Opinion 1/1975 concerned a draft “Understanding on a Local Standard” which had been drawn up under the auspices of the OECD. This understanding concerned export credits. The participating government essentially agreed not to finance or covers credit, in respect of local costs related to export transactions (in effect, payment of the purchase price), for more than 100 percent of the value of the goods and services exported. The Commission asked whether the Union had the power to conclude the “Understanding” and, if so, whether that power was exclusive. Thus phrased, the question identified the two vital components in EU external powers calims: the scope of those powers and whether or not they are exclusive of the powers of member states. (A Dashwood and C Hillion, “Introduction”, in A Dashwood and C Hillion (eds), *The General Law of E.C. External Relations*, Sweet & Maxwell, 2000), pp.v-vi; Eeckhout, Piet., *External Relations of the European Union : Legal and Constitutional Foundations*, Oxford University Press Inc., New York, 2004, p. 12.

²⁸³ See Balan, George-Dian., 2008, *Op. Cit.*, p. 1.

²⁸⁴ See Eeckhout, Piet., 2004, *Op. Cit.*, p. 13.

²⁸⁵ See Eeckhout, Piet., 2004, *Op. Cit.*, p. 14.

²⁸⁶ See The EU and the Generalised System of Preferences, available at : http://europedia.moussis.eu/books/Book_2/7/24/05/index.tkl?all=1&pos=349, last accessed : 4 April 2011

²⁸⁷ See Balan, George-Dian., 2008, *Op. Cit.*, p. 2.

regulate the world market for certain products rather than at mere trade liberalisation. Therefore, the CCP measures must take into account the national interest of member states. It might have been thought that at the time of the Treaty drafting the trade liberalisation was the main idea.²⁸⁸ The establishment of the CCP is very important to secure the common market (internal market) from trade deflection and distortions of competition that potentially occur in trade liberalisation.

Common policy is needed to regulate and protect the common market from fraud and abuse. To implement common policy it requires common institutions that have supranational authority. Such supranational authority must have exclusive competency to ensure the common policies “implemented” properly.²⁸⁹

The Commission has plays crucial roles in the implementation of the CCP. The Commission authorized to propose new trade initiatives, managing tariffs and other trade policy instruments, and conducting trade negotiations.²⁹⁰ In the field of trade negotiations, the Commission has responsibility to ensure the agreements that negotiated comply with internal policies and rules of the Union.²⁹¹ The Opinion 1/78 interprets Article 133 of the TEC, which empowered the Union to formulate a commercial policy based on uniform principles. In addition, the Opinion 1/75 explained to the link between the unity of the common market (now internal market) and a uniform CCP.²⁹²

According to Opinion 1/78, Article 133 TEC is the “adequate” legal basis for the GSP adoption.²⁹³ The modern commercial policy needs to provide trade measures that facilitate achievement of development goals. Therefore, the Court considered development goals as an integral part of modern commercial policy. The reform of EU GSP system is reflecting of a new concept of international trade relations where sustainable development placed as the main goal.²⁹⁴

The Commission authorized to represent the EU and its member states in international organizations, such as WTO. In international trade negotiations, the EU member states is represented under “single voice”. The EU member states entitled rights to attend WTO meetings, however, only the European Commission that has competency to represents the entire of EU.²⁹⁵

Union’s single voice on CCP increases its political bargaining in the international trade negotiation.²⁹⁶ The CCP covering areas trade in goods and services²⁹⁷, commercial

²⁸⁸ See Eeckhout, Piet, 2004, *Op. Cit.*, p. 17.

²⁸⁹ See Molle, Willem., 2006, *Op. Cit.*, p. 10.

²⁹⁰ See Conconi, Paola.

²⁹¹ See Paragraph 3 Article 188C of the Treaty of Lisbon.

²⁹² See Eeckhout, Piet, 2004, *Op. Cit.*, p. 17.

²⁹³ See Case 45/86 Commission v. Council (1987) ECR 1493, Eeckhout, Piet, 2004, *Op. Cit.*, p. 18.

²⁹⁴ See Cf J Raux, *Politique de coopération au développement et politique commerciale commune*, in M Maresceau (ed), *The European Community’s Commercial Policy after 1992: The Legal Dimension* (Martinus Nijhoff, 1993) 157-95 ; Eeckhout, Piet, 2004, *Op. Cit.*, p. 18.

²⁹⁵ See Conconi, Paola.

²⁹⁶ See Balan, George-Dian., 2008, *Op. Cit.*, p. 12.

²⁹⁷ See Meinhard Hilf, *The ECJ’s Opinion 1/94 on the WTO : No Surprise, but Wise?*, 6 E]1L (1995) 245-259, available at : <http://www.ejil.org/pdfs/6/1/1293.pdf>. See also Eeckhout, Piet, 2004, *Op. Cit.*, p. 26. “[...] The opinion 1/94 was given upon the request, on the 6 April 1994, which submitted by the Commission to the Court. In their request the Commission asked whether the Community (Union) had exclusive competence to conclude the WTO Agreement, on the basis of (current) article 133 EC on its own, or in combination with implied powers pursuant to article (current) 95 and 308 EC Treaty. The Commission requested the ECJ under the procedure of Article 228(6) ECT2 to confirm the exclusive competence of the EC to conclude the WTO Agreement, which had been negotiated within the framework of the Uruguay Round [...]”

The ECJ ruled on 15 November 1994 :

1. The Community has sole competence, pursuant to Article 113 of the EC Treaty to conclude the multilateral agreement on trade in goods.

aspects of intellectual property and foreign direct investment. The ECJ Opinion 1/94. rules that all the WTO agreements on trade in goods fall under the Union's commercial policy competence.²⁹⁸

The ECJ Opinion 1/75 stated the Union's competence in trade matters has "exclusive" characteristic. The Union's competences are covering adoption of essential rules on external trade and governs regime for export and import. The application of uniformity principle designed to operate internal market and create single market under custom unions. Yet export-import regime contains provisions allowing member states to adopt measures on non-economic reasons²⁹⁹ such as public safety, public policy and public health.³⁰⁰

TEU introduced co-decision procedure that provide the "equal and joint responsibility" exercise by the European Council and the European Parliament. Treaty of Lisbon constitutes significant increase of co-decision procedure, its covering forty new policy areas³⁰¹. Under the article 188 C paragraph 2 of the Treaty of Lisbon, the European Parliament has given the important role in the decision making of EU CCP, its called as "ordinary legislative procedure".³⁰² It enhanced the function of the European Parliament in the legislative mechanism.

Traditionally, CCP encompass international policy dimension. The Article 188C of the Treaty of Lisbon (Article 207 of the TFEU) contains external and internal competence. The external competence regulates under paragraph 3 Article 188C of the Treaty of Lisbon. While, the internal competence regulates under paragraph 2 Article 188C of the Treaty of Lisbon, concerning implementation of CCP by "ordinary legislative procedure" or "co-decision mechanism".³⁰³

According to Krajewski, "the classical trade policy objectives" conceived in the Articles 3(5) and 21 of the TEU. The objective of "free and fair" trade accommodated in the article 3(5) of TFEU. Article 21 of the TFEU designed to promote liberalization under the framework of multilateral trading system. Article 21 of the TFEU, elaborated inter alia- as the means to integrate all countries into the world economy by "the progressive elimination of restrictions on international trade".³⁰⁴ The CCP Union should also consider non-economic policy objectives, such as human rights, equality and

2. The Community and its Member States are jointly competent to conclude GATS.

3. The Community and its Member States are jointly competent to conclude TRIPS.

²⁹⁸ See Eeckhout, Piet, 2004, *Op. Cit.*, pp. 26-27.

²⁹⁹ See General exception under Article XX GATT. See also Case 41/76 Donckerwolcke v. Procureur de la Republique (1976) ECR 1921 : The ECJ stated that "[...] measures of commercial policy of a national character were permissible after the end of transitional period only virtue of a specific authorization by the Community". Borrowing words from Eeckhout that the Court decision created authority for the Union to permit the member states to adopt certain commercial policy measures that derogate from the principle of uniformity [...].

³⁰⁰ See Eeckhout, Piet, 2004, *Op. Cit.*, pp. 349-352.

³⁰¹ "[...] Ordinary Legislative Procedure under Treaty of Lisbon covered provisions in the Title V of the TFEU such as area of Freedom, Security and Justice: border controls, legal immigration, judicial cooperation in civil matters with cross-border implications, judicial cooperation in criminal matters and police cooperation. While, in the area of market organisations, it has covered the Common Agricultural and Fisheries Policies (CAP and CFP), the common commercial policy, intellectual property rights and measures necessary for the use of the euro as the single currency [...]". See Joint Study, *The Treaty of Lisbon: A Second Look at the Institutional Innovations*, Joint CEPS, EGMONT and EPC Study, September, 2010, available at : http://www.epc.eu/documents/uploads/pub_1150_epc_egmont_ceps_-_treaty_of_lisbon.pdf, last accessed : 26 March 2011.

³⁰² See Joint Study, *The Treaty of Lisbon: A Second Look at the Institutional Innovations*, Joint CEPS, EGMONT and EPC Study, September, 2010, pp. 40-41, available at : http://www.epc.eu/documents/uploads/pub_1150_epc_egmont_ceps_-_treaty_of_lisbon.pdf, last accessed : 26 March 2011.

³⁰³ See Krajewski, Markus., *Op. Cit.*, p. 12.

³⁰⁴ See Krajewski, Markus., *Op. Cit.*, p. 8.

solidarity, sustainable development and the preservation and improvement of the quality of the environment, instead of liberalization of trade.³⁰⁵ Thus, Articles 205 and 207(1) of the TFEU, require CCP to comply with these objectives not only focussing on the reduction of barriers to trade.³⁰⁶

VIII. The driving force of the New Comitology to improve EU external trade governance within the framework of the Generalised System of Preferences.

Based on the ideas of Jean Monnet, the High Authority of the former ECSC (European Coal and Steel Community) had to be a permanent international secretariat of experts, working for the common good. This was in line with the so-called “*technocratic approach*” to policy-making, where government action follows the advice (and sometimes decision-making) of experts and technocrats. Therefore, the Commission should also be composed of independent experts in order to propose solutions to policy problems, to negotiate deals, to act as the “*engine*” of European integration, and to be the “*guardian*” of common European interest. From the very beginning, the Commission has been designed as a central decision- and policy-making institution with a multitude of tasks. Thus, the role of the Commission has become more crucial as an “*executive institution*” when dealing with the implementation of legislation and delegated rule making. As mandated by the treaties, the Commission also has a prominent role in external economic relations. Specifically, the Commission has the responsibility to prepare the Union budget, which is needed to implement Union regulations. The scope of direct administration carried out by the Commission is very limited. Therefore, service delivery and implementation of regulations depends largely on the national administrations of member states. The current Comitology was born from EU praxis, it was then formally recognised and disciplined by EU law, and finally – after the Lisbon Treaty – it was evolved to enhance the implementation of legislative acts. There are four procedures in the old Comitology discipline that consist of the advisory procedure, management procedure, regulatory procedure, and regulatory procedure with scrutiny. While the new Comitology has been simplified into two procedures, namely the advisory procedure and examination procedure. The regulatory procedure with scrutiny has been replaced by a delegated acts process. The new examination procedure combines the management procedure and regulatory procedure. In the implementation measures of the GSP scheme, the Commission should be assisted by a Generalised Preferences Committee. The main task of the Generalised Preferences Committee is to examine any matter relating to the implementation of GSP regulation, raised by the Commission or at the request of a member state. The Generalised Preferences Committee also has the task of assessing the effects of the current GSP scheme. Generally, the Comitology procedures that apply to GSP matters are linked to technical issues. The implementation measures of the current GSP regulation are based on the old Comitology decision, while the new Comitology Regulation applies to the new and upcoming GSP regulation. In this paper, we would like to examine the “driving force of the New Comitology to improve EU external trade governance within the framework of the Generalised System of Preferences”.

³⁰⁵ See Dimopoulos., 2010, *Op. Cit.*, p. 169; Krajewski, Markus., p. 8.

³⁰⁶ See Dimopoulos., 2010, *Loc. Cit.*, p.162; Krajewski, Markus., *Loc. Cit.*, p. 8.

VIII.a. Executive power in the European Union.

The legal origin of the EU derives from the exceptions of the GATT principles, prominently the MFN Principle. These exceptions create possibilities to establish a free trade agreement or customs union based on a preferential trade agreement among its members. The EU choose to form a customs union as its embryo to develop the skeleton of the Union. The EU is characterised as the distinguished international organisation or *sui generis*. The uniqueness of the EU system has evolved over the years particularly as an *autonomous* and *new "executive order"*. Concerning the legal nature of the EU, in 1962, the European Court of Justice set up a decision considering the EU as "*a new legal order of international law for the benefit of which the states have limited their sovereign rights*".³⁰⁷

The European Commission is considered as a "*novelty and idiosyncratic*" executive nucleus of the EU, even though there are particular organs that also "*attribute*" an executive function.³⁰⁸ The Commission extraordinarily portrays essential executive tasks in the political system of the Union. The Commission has been given the task to initiate legislations, thus, it becomes the "*agenda setter*" within the EU framework. In the area of trade and development policy, especially related to the GSP, the Commission's task includes conducting public consultation, publishing a working paper, and drafting a proposal for the next scheme of the GSP proposal. In addition, the Commission also publishes a green paper, which is described as a discussion document aimed to stimulate debate and launch the process of consultation, at a European level and on a particular topic. The green paper generally provides a wide range of ideas. The green paper³⁰⁹ is used as a tool to invite interested individuals or organisations to contribute views and information. The white paper³¹⁰ is issued as the follow up of the green paper. It functions as a vehicle to develop the proposal into legislation.

The role of the Commission becomes more crucial as an "*executive institution*" when dealing with the implementation of legislation and delegated rule making.³¹¹ As mandated by the treaties, the Commission has a prominent role in external economic relations. Specifically, the Commission has the responsibility to design the Union budget in order to implement Union regulations.³¹² In the GSP proposal, the Commission has estimated the budget affecting EU revenues.³¹³

According to Peterson, "*the European Commission is one of the most unusual administrations ever created. It was born as a body that would perform both mundane administrative and overtly political tasks. It has always found it difficult to perform then simultaneously and well*".³¹⁴ In the context of its executive function, the Commission is not "*business service delivery*", which has been distinguished from national

³⁰⁷ See Curtin, Deirdre., *Executive Power of the European Union : Law, Practices, and the Living Constitution*, Volume XII/4, Oxford University Press, 2009, p. 33.

³⁰⁸ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 29.

³⁰⁹ See Green Paper of the European Union, available at : http://europa.eu/documentation/official-docs/green-papers/index_en.htm.

³¹⁰ See White Paper of the European Union, available at : http://europa.eu/documentation/official-docs/white-papers/index_en.htm.

³¹¹ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 91.

³¹² See Curtin, Deirdre., 2009, *Loc. Cit.*, p. 91.

³¹³ See Legislative Financial Statement For Proposals Having A Budgetary Impact Exclusively Limited To The Revenue Side, European Commission, Proposal for a Regulation Of The European Parliament And Of The Council applying a scheme of generalised tariff preferences, {SEC(2011) 536 final},{SEC(2011) 537 final}, Brussels, 10.5.2011, COM(2011) 241 final, 2011/0117 (COD), available : http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147893.pdf, last accessed : 12 May 2011.

³¹⁴ See J Peterson (1999), *The Santer era : The European Commission in normative, historical and theoretical perspective*, Journal of European Public Policy, 6/1, pp 46-65, p. 60. Curtin, Deirdre., 2009, *Op. Cit.*, p. 91.

administration. The scope of direct administration carried out by the Commission is very limited. For example in the area of competition policy, there is more focus on policymaking and regulation. Therefore, service delivery and implementation of regulation extremely depend on the national administrations of member states.³¹⁵

The development of the Commission's tasks has influenced its autonomous powers where it "*cannot readily be regarded as involving a delegated function from the member states subject to control mechanisms*".³¹⁶ In the implementation regulations of common policies, the Commission is controlled by the member states by means of "*certain procedures*". The control mechanisms are also considered as one of the reasons for the creation of the Comitology procedures. Autonomous power is an intrinsic part of the distinctive Union method of adopting decisions at Union Level.³¹⁷

Along with Union development, powers are shared across several (governance) levels with their own rule making authority, thus causing "*fragmented authority*". This creates overlapping and conflicting powers between the authorities in the Union.³¹⁸ Mansfield defines executive power as literally meaning "*a power that is not autonomous but that is exercised on behalf of someone else or something else, for instance the people or the law*".³¹⁹ Curtin further describes that, "*the executive is considered as the subordinate to the will of others, for instance the legislatures, and ultimately the people*". Therefore, the executive is an agent given executive power by the people in a democratic political system.³²⁰

Executive power in the Union is considered as the "*delegation form*". In this regard, Curtin defines delegation as "*involving an actor, called a principal, relying on another actor, called an agent, to act on the principal's behalf*". The process of EU integration is understood as a series of vertical delegations of powers from the political member states to the Commission as a supranational (administrative executive actor).³²¹ Therefore, Curtin notes that, "*on a principal, agent reading, a seemingly supranational actor such as the Commission is constructed as being in fact driven by the political will of member states in a dependent relationship*".³²²

In the American legal perspective, the power exercised at the EU level is characterised as non-political (non-majoritarian) and with administrative characteristics. In this regard, the Union member states, as the political principals, limit the normative autonomy of their "agents", the institutions of the EU, to the administrative level.³²³ The Commission is considered as the agent of the member states to carry out tasks that are limited to the administrative level.

In the perspective of the "*delegation relationship principle*", policymaking powers and executive functions are carried out on a conjecture of separation rather than

³¹⁵ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 91.

³¹⁶ See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 91-92.

³¹⁷ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 92. "[...] Such powers given based on the Commission's exclusive right on legislation initiative, the budgetary powers of the Council of Ministers (and progressively those of the European Parliament), implementation by the Commission (and the Member States), as well as the adjudicatory role of the Court of Justice [...]".

³¹⁸ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 33.

³¹⁹ See HC Mansfield (1989), *Taming the prince : The ambivalence of modern executive power*, The Free Press, p xxvii. Curtin, Deirdre., 2009, *Op. Cit.*, p. 35.

³²⁰ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 35.

³²¹ See Further M. Pollack, *The Engine of European Integration: Delegation, agency and agenda-setting in the EU*, Oxford University Press, Oxford, 2003. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 36.

³²² See A Moravcsik, *Preferences and Power in the European Community: A liberal intergovernmental approach*, Journal of Common Market Studies, 31/4, 1993, pp. 473-524. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 36.

³²³ See PL Lindseth, *Democratic legitimacy and the administrative character of supranationalism: The example of the European Community*, Columbia L rev, 99/3, 1999, pp 628-739. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 37.

“complementarity” of politics and administration. In this regard, administrative power is separated from executive power in the political sense and is subordinate to it.³²⁴

According to Rutgers, the Europeans are likely to employ politics and administration as an internal subdivision of the executive.³²⁵ In the European perspective, the executive has two powers. First, political power is regarded as the leadership of society through the proposal of policy and legislation (agenda setting and the initiative and adoption of measures). Second, administrative power, is functioned in the implementation of law, distribution of public revenues, and passing of secondary and tertiary rules and regulations.³²⁶

Another scholar argues that political and administrative bureaucracy can be combined together. Joerges states that “*the oxymoron political administration refers to the tension between the adoption and the implementation of the purely technical decisions based on expertise (administration) and decisions involving the balancing of certain values (politics)*”. The legal theorist Rudolf Wiethölder develops the term “*politische Verwaltung*” that is considered as the founding concept of political administration.³²⁷ Joerges, combines the concept of administration by Max Weber with the concepts of social state administration and Wietholter’s notion of politics as a good order (gute Ordnung).³²⁸ Joerges uses the amalgamated certain concept of political administration to characterise the Comitology phenomenon. The adoption of technical regulation of certain (delegated) legislative measures commonly needs to address politically sensitive issues. Further, with respect to the implementation of regulations, this often requires integrating expert knowledge (technocrats) and certain additional considerations in increasingly complex decisions.³²⁹

According to General Lagrange, “*the Treaty is based upon delegation, with the consent of the member states, of sovereignty, to supranational institutions for a strictly defined purpose*”. This can be traced back to the establishment of the European Coal and Steel Community (ECSC) in 1951, where powers were delegated to institutions that could only function within the scope of those powers and within the policy framework set out in the treaty itself. In this regard, the Commission, as a supranational institution, should act independently of the member states with its main mission to protect and serve the general interest of the EU.³³⁰

The vertical delegation level is carried out by the principal concept. While, the horizontal delegation level is exercised where the Commission (and the Council), in particular, delegates *de facto* some of its own administrative executive power to other actors. The horizontal delegation is designed to improve the Commission and Council’s tasks to focus on their own works such as political tasks, which cover policy initiation, policymaking, and external representation. In the context of horizontal delegation,

³²⁴ See PL Lindseth, 1999. See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 37-38.

³²⁵ See M. Rutgers, 2000. See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 37-38.

³²⁶ See S Hix, 2005. See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 37-38.

³²⁷ See The original German term is politische Verwaltung and was developed by R Wietholter (1972), *Wirtschaftsrecht* in A Gorlitz (ed), *Handlexikon zur Rechtswissenschaft* (Munche: Ehrenwirt), pp. 531-9. See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 38-39.

³²⁸ See C Joerges, 2001, *Economic Order, Technical Realization, the hour of the executive: Some legal historian observations on the Commission White Paper on European Governance*, Jean Monnet Working Paper No. 6/01, p.10 et seq. Joerges also point out that the concept of political administration has to be read in the light of the work of Hans Peter Ipsen, the major authority on EU Law in Germany. See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 38-39.

³²⁹ See C Joerges, 2000, *Zusammenfassung un Perspektiven: Gutes Regieren im Binnenmarkt* in C Joerges and J Falke (eds), *Das Ausschusswesen der Europäischen Union: Praxis der Risikoregulierung im Binnenmarkt und ihre rechtliche Verfassung* (Baden-Baden: Nomos), pp. 349-382, p. 364. See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 38-39.

³³⁰ See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 44-45.

those institutions delegate the non-political tasks of management and administration to a “satellite actor”, such as executive agencies. Therefore, the institution of the Comitology Committees falls under the framework of horizontal delegation. Such practice gives a significant contribution of fragmentation to certain aspects of executive power within the Union’s institutional system in general. It influences the notion of development of the Commission as an executive institution.³³¹

VIII.b. The European Commission.

The High Authority of the European Coal and Steel Community (ECSC) and its successors are unique compared to the institutions in other international organisations. The supranational High Authority has the responsibility to determine the direction of two key industries throughout the member states. The High Authority is intended to be the main organ of decision-making.³³² When the Schuman Plan was presented in 1950, the central element of the High Authority consisted of independent experts authorised by the governments of the prospective member states. The High Authority was designed to regulate the market for coal and steel by making decisions that legally bound the member states.³³³

In the conceptions of Jean Monnet, the High Authority had to be a permanent international secretariat of experts working for the common good. In this way, he used a “technocratic approach” to policymaking where government action follows the advice of experts and technocrats. Moreover, Monnet emphasised that the High Authority had to be independent from the governments. The Commission can be taken as an example of an EU institution that was established to be a technocratic body. Therefore, the Commission should be composed of independent experts in order to propose solutions to policy problems, to negotiate deals, to constitute the motor of integration, and to be the guardian of common European interest.³³⁴ This is in line with Anchrit Willie, regarding “the integration and mediating function of the Commission”, he states as follow:³³⁵

“[...] was to be guided by the judgement of a technocratic elite rather than by political judgment since politicians are bound to be short-sighted and self-seeking, as they are subject to electoral mechanism. It would make for better governance to take the impartial, overall and long term view of the technocrat as a guardian of the European interest. The Commission’s role would hence depend on its expertise and its credibility as an impartial mediator between political views, conflicting national interests and interest group pressures [...]”.³³⁶

Therefore, from the very beginning the Commission has had the vital role of ensuring that the balance of power between the large and small member states carries out competences conferred by the treaties. The balance of power between large and small member states implemented in the EU is intended to make sure that the Union is functioning effectively. The system of the qualified majority vote is one of the factual proofs of such implementation (explicitly not only based on the size of the population).³³⁷

³³¹ See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 45-46.

³³² See Leonard., Dick, et.al, 2010, *Op. Cit.*, p. 6.

³³³ See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 61-62.

³³⁴ See Curtin, Deirdre., 2009, *Loc. Cit.*, pp. 61-62.

³³⁵ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 63.

³³⁶ See A Wille, Bringing the gap: Political and administrative leadership in a reinvented commission in M Egeberg (ed), *Institutional Dynamics and the Transformation of Executive Politics in Europe* (Mannheim : CONNEX Report Series 3), 2007a, pp. 7-41. See Curtin, Deirdre., 2009, *Loc. Cit.*, p. 63.

³³⁷ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 62.

In recent years, the essential roles of the Commission have been significantly recognised as a part of the executive power in the EU institutional configuration. Previously, the Commission acquired powers that could only be described as executive in nature. In such concept, the executive power tended to be administrative and heavily executive rather than political. However, exclusive power to initiate legislation in the legislative process, off course, was as an exception. The European Commission also acquired judicial and supervisory power. Therefore, in the past, the European Commission was only regarded as the “*administration of the Union, its civil service with limited and defined powers, nothing more than an administrative executive*”.³³⁸

Egeberg identifies the “*unique characteristic*” possessed by the European Commission as “*the only multipurpose executive body at the international level*” and organised separately from the Council of Ministers. Due to this separation, the European Commission can act relatively independently as an executive institution. The European Commission is also considered as “*the executive branch and higher layer of executive organisation*” to which the EU member states are related.³³⁹ The European Parliament appointed the Committee of Independent Experts a decade ago. It stated in the report that “*the Commission plays the part of the executive branch and holds sole power of legislative initiative*”. Hence, it developed the responsibility and accountability of the other participants in the political structure, that is, the Parliament and Council, and, above all, the citizens of Europe”.³⁴⁰

Curtin attempts to compare the similarity of the Commission, as the core of the Union’s Executive, with the executive at the national level. The Commission is composed of a series of executive politicians who are responsible for various administrative services. The common tasks of the Commission, in this regard, to initiate and formulate policy proposals, to implement policies, and to monitor its enforcement, are generally similar to the executive body at the national level.³⁴¹ The Commission’s executive core³⁴² covers political and purely administrative matters, rather than managerial tasks.³⁴³ The Commission is embodied in organisational and behavioural patterns that are extremely typical of executives, as similar to national settings.³⁴⁴ Therefore, it is concluded that the bureaucratic divisions of the Commission are comparable to ministries in national administrations and the role of Commissioners to those of Ministers.³⁴⁵

The Treaty of Lisbon provides the election of the Commission President by the European Parliament.³⁴⁶ This procedure aimed to enhance the democratic legitimacy of the Commission and to avoid the “*democratic deficit*” of the Union, which is due to the increasing “*politisation*” of the Commission.³⁴⁷ Such change influences the “*appointed*

³³⁸ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 63.

³³⁹ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 62.

³⁴⁰ See Committee of Independent Experts, *Second Report on the reform of the Commission: Analysis of current practice and proposals for tackling mismanagement, irregularities, and fraud*, vol II, 1999. See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 63-64.

³⁴¹ See M Egeberg, *The European Commission : The Evolving EU Executive*, ARENA Working Papers, WP 02/30, 2002. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 64.

³⁴² See A Wille, *The Normalization of European Commission : Politics and bureaucracy in an evolving executive*, forthcoming, 2010. See too Hix, *The Political System of the European Union 2nd edn*, The European Union Series (Basingstoke: Palgrave Mcmillan), 2005, p. 32. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 64.

³⁴³ See A Wille (2007a). See Curtin, Deirdre., 2009, *Op. Cit.*, p. 64.

³⁴⁴ See M Egeberg, 2006b., and S Suavierol, 2007., *Beyond the Myth of Nationality : A study on the Networks of European Commission officials* (Delft: Eburon), p. 14. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 64.

³⁴⁵ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 64.

³⁴⁶ See Article 17 (7) TEU Treaty of Lisbon.

³⁴⁷ See Curtin, Deirdre., 2009, *Loc. Cit.*, p. 64.

mechanism” of the president and the other members of the Commission. Before the Treaty of Nice entered into force, governments of the member states appointed the President of the Commission by common accord. Previously, the Treaty of Nice introduced “*qualified majority decision making*”, which was considered as significant progress, by effectively removing the veto right of any single member state. Practically, it mandates discussions that are more cooperative. The new post-Treaty of Nice procedures, as described in Article 214 (2) of TEC, provided that the Council meetings by the Composition of Heads of State of Government are acting by a qualified majority, nominate the person who is intended to be appointed as president of the Commission. The next procedure is the approval of the nomination by the European Parliament.³⁴⁸

The EU’s political system has its own unique structure, which develops along with political dynamics. In fact, according to Curtin, since the executive power is fragmented and dispersed across an increasing number of institutions and actors “*there is no equivalent of a national government at the level of the EU Political system*”. From the beginning the Commission was designed as a central decision making institution with multitask jobs.³⁴⁹

VIII.c. Comitology.

VIII.c.1. Definition of Comitology.

Piotr, defined Comitology “*as the existence and activity of special committees supervising the exercise of implementing powers conferred on the Commission*”.³⁵⁰ In this regard, Comitology has a “*supervisory*” function to supervise powers that have been conferred to the Commission to implement legislative acts. Through its special committees, the member states of the EU are able to supervise the implementing power performed by the Commission. The Comitology Committees participate in the creation of *tertiary* law. The Comitology Committee act is based on legal norms found both in primary and secondary law. The Comitology procedures are regulated under the Comitology decision.³⁵¹

The existence of Comitology has evolved in order to enhance the implementation of legislative acts. There are four procedures in the old Comitology regulation that consists of the advisory procedure, management procedure, regulatory procedure, and regulatory procedure with scrutiny. While the new Comitology has been simplified into two procedures, namely the advisory procedure and examination procedure. The regulatory procedure with scrutiny has been replaced by a delegated acts process. The new examination procedure combines the management procedure and regulatory procedure.³⁵²

Following contemporary development, Curtin describes the EU as a political union that constantly and gradually evolves. In political union, all areas of national policymaking are connected to policymaking at Union level. Most policies decided at Union level are implemented by non-legislative acts. In fact, non-legislative acts have played a crucial role in the “*Union overall output*”. Non-legislative acts refer to the executive action to operate a legislative decision. It should be noted that both European

³⁴⁸ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 92.

³⁴⁹ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 65.

³⁵⁰ See Tosiek, Piotr., *Comitology Implementation of EU Policies – Democratic Intergovernmentalism?*, Paper to be presented at the ECPR Fifth Pan-European Conference on EU Politics, Porto, 23-26 June 2010, available at : <http://www.jhubc.it/ecpr-porto/virtualpaperroom/026.pdf>, last accessed : 8 July 2011.

³⁵¹ See Tosiek, Piotr., 2010.

³⁵² See Tosiek, Piotr., 2010.

and national actors consist of politicians and bureaucrats,³⁵³ however, borrowing Curtin words, “*some of them may be wearing two hats and some others not*”.³⁵⁴ On the other hand, the existence of “*secretive and hidden committees*”³⁵⁵, known as “Comitology Committees”, increases the important role in the Union’s institutional system. Moreover, the Comitology procedure has faced many problems relating to delegation of powers, boundaries between various categories of legal acts, interinstitutional tensions³⁵⁶, and, unfortunately, the best formulation to solve this has not yet been found. Currently, Comitology is considered as a democratic intergovernmental element of the EU decision-making system.³⁵⁷

VIII.c.2. The existence of Comitology Committees in the EU executive framework.

According to Curtin, the existence of Comitology Committees in the EU institutional system can be analysed using a residual approach. The residual approach is considered as the appropriate approach to “*map out*” the EU institutional system that has been applied in practice. Moreover, it can be used to “*capture*” certain areas of executive power that have not been exercised by any of the institutions, or described as “*the power that is left over within the system*”. The Treaty of Lisbon categorises the powers left over after the determination of the legislative acts. They are defined as non-legislative acts. Non-legislative powers conferred to the Commission and the Comitology Committees are known as the “delegated legislation procedure”. Therefore, the Comitology Committees were established with the objective to exercise the left over non-legislative power in the EU institutional system.³⁵⁸

The existence of EU Committees, for instance the Comitology Committees, are considered as a response to the functional demands of the EU institutions related to technical information and (scientific) expertise throughout the formal decision-making process. However, there are still some questions concerning the existence of the EU Committees, such as: ‘What role do they play in EU policymaking?’ and ‘On which EU institutions do they rely?’ However, due to the dynamic process developments of the institutions those questions remain unanswered. The various forms of the EU Committees that spread across the policy areas are considered as the reason for such question being raised. The EU Committees are actively involved throughout the EU decision-making process, for instance in the expert groups of the Commission and the working groups of the Council, in the Comitology Committees at the implementation phase.³⁵⁹

Among the existing EU Committees, the Comitology Committees are considered as particular “*genus*”³⁶⁰ committees, which totally change the image of closed bureaucracy and unclear procedures into open bureaucracy and transparent procedures. For instance, in the implementation of the Generalised System of Preference, the Comitology Committees have a significant role in the determination of

³⁵³ For instance “New Eurocrats”, which refers to the Councils of Ministers (known as the Councils) that composed of national ministers as well as a shadow bureaucracy with both Eurocrats and national civil servants.

³⁵⁴ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 102.

³⁵⁵ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 103.

³⁵⁶ As noted by Piotr the “new interinstitutional tensions came up while the Commission began to promote a supranational vision, the Council defended the intergovernmental vision and the European Parliament, struggling for its position, was ambivalent”.

³⁵⁷ See Tosiek, Piotr., 2010.

³⁵⁸ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 53.

³⁵⁹ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 109.

³⁶⁰ Comitology Committee analogous as “genus” because it would be break down into “species” of certain Comitology Committee, for instance Comitology Committee of GSP.

the list of beneficiary countries, in the granting of special incentives, in graduation mechanisms, in safeguard measures, and in temporary withdrawals. In addition, the reports and reviews carried out by the GSP Committee are presented in the drafting of the new regulations of the GSP. The Comitology Committees control and balance the implementation of EU regulations. To sum up, the task of the Comitology Committees is to assist the Commission by advising or deciding the substance of implementation measures.³⁶¹

Over the decades the existence and function of the Comitology Committees has been considered as an “*unseen hand of European integration*” covered by “*mists of mystery*”. This term refers to the activities of the Comitology Committees that cover a wide range of policy areas. The term “*unseen hand*” is reflected in the report of the Select Committee of the House of Lords. It states that “*no list of them is publicly available nor is there an authoritative account of what each does*”. The new era of the Comitology world began in 1999 with the issuing of the Comitology decision. According to the Comitology decision that began in 2000, the Commission is obliged to publish annual reports on the working of the committees. Such reports significantly increase public transparency by providing a public window relating to the committees’ work, the types of procedures followed, the number of meetings held, and other related information.³⁶²

It has been 11 years since the Commission systematically provided such report and source of general information that can be tracked on an annual basis. Usually, such information is used to analyse previous policies and is used as reference for the drafting of new policies.³⁶³ In respect of GSP implementation, the Commission has implemented such obligation to provide and publish reports. Therefore, the information about the GSP reviews and reports can be accessed by internal EU institutions, beneficiary countries, traders, public societies and interested stakeholders. In this regard, Trondal states that the Comitology Committees “*represent underused laboratories for studying what happens when contrasting decision-making dynamics meet because such committees embody civil servants from different layers of government*”.³⁶⁴

As previously explained, the Comitology Committees established by the Council are made up of national civil servants and, in certain cases, scientific experts. Their task is to assist the Commission in exercising “*executive making tasks*”. Formally, the task of the Comitology Committees is merely to deliver opinions on draft decisions made by the Commission. Then the Commission formally adopts the successive instruments, for instance legal acts and administrative decisions. Therefore, “*the Comitology Committees do not act independently with unqualified discretion as they only advise on a decision of another actor*”. The Comitology Committees do not have delegated powers like the Commission. However, Curtin also notes as follows:

“[...] in fact, they take the process of discussion and debate as to precise provisions of its final draft implementing measures with the committee in order to ensure that

³⁶¹ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 110.

³⁶² See Curtin, Deirdre., 2009, *Op. Cit.*, p. 110.

³⁶³ “[...] According to the Curtin with regard of Commission report until 2007-2008 there were a total 269 Committees. According to Commission insider, Curtin noted, it estimated that the Commission has adopted in total approximately 80,000 executive rule making measures since the early 1960’s, of which approximately 12,000 are still in force. It seems from the following overview that the average number of opinions issued every year is well over 200. It must be noted that there may be conflicting sources as to numbers of measures adopted with so called “light type acts” adopted but not published in the Official Journal [...]”. See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 110-111.

³⁶⁴ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 112.

the Commission can adopt the draft implementing measures. This informal process gives a committee member more power than they might formally appear to have. In practice, it appears that the Commission almost never differs from the opinion of the committees. Moreover the issue is also whether they are in a position to substitute the opinions reached by expert scientists in highly technical policy areas [...]”.³⁶⁵

The Comitology Committees have shifted from their original function as a “control device on behalf of member states” into “supervisory Committees over the executive tasks” that are carried out by the Commission. Autonomous entities are created with a consensual style of decision making rather than diplomatic negotiations among member state representatives. A political scientist, Brandma, deems that “Comitology Committee members tend to be fully autonomous in organising their own work in Brussels”.³⁶⁶

Eventually, it should be admitted that Comitology has played a significant role in the EU executive process, especially in the delegated legislative process. The nature of Comitology is associated as arms of member states to control the implementation of regulation exercised by the Commission. Generally, in the EU system the Comitology Committees include experts employed by national or local governments, non-governmental research organisations, private enterprises, universities, and national civil servants. In 2006, about 64% of all delegated rule legislations adopted by the Commission passed through the Comitology Committees.³⁶⁷

VIII.c.3. Comitology from the legal history perspective.

From an historical perspective, the Comitology was established four years after the Treaty of Rome. However, the delegation of power to the Commission was not clearly regulated by the Treaty of Rome 1957. In 1961, the first Comitology Committee had begun with its work taking place in Brussels. According to Hardache and Kaeding, the establishment of the first Comitology Committee was rooted in the demand to build a control system because the Commission was given powers to implement legislation at the Union level.³⁶⁸ While Töller and Piotr only saw creation of the first Comitology Committees as an expression of intergovernmental thinking.³⁶⁹

The history of the Comitology procedure can be traced back to the very beginning of European Integration. Traditionally in the EU system, the Council of Ministers was considered as the “primary lawmaker” devised with a number of procedural strategies to “rein-in” (control) the Commission in the exercise (delegation) of executive power. Within the “plural executive system” of the EU, the Council of Ministers was crowned as the “original” executive power. The Commission was placed in the position as the “implementer” to carry out executive tasks delegated by the Council. Therefore, in the executive context, the Commission was considered as the agent of the Council.³⁷⁰

Since 1962, the Council has delegated some of its executive power in the area of Common Agricultural Policy (CAP) to the Commission. There has been an increasing number of executive tasks given to the Commission over the last two decades. Although the Commission is responsible for the implementation of general rules, the Council

³⁶⁵ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 119.

³⁶⁶ See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 119-120.

³⁶⁷ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 121.

³⁶⁸ See Hardacre, Alan., and Kaeding, Michael., *Delegated & Implementing Acts The New Comitology*, European Institute of Public Administration (Institut européen d'administration publique), available at :http://www.eipa.eu/files/publications/Comitology_Brochure_web.pdf, last accessed : 8 July 2011.

³⁶⁹ See Tosiek, Piotr., 2010.

³⁷⁰ See the Vertical approach.

considers that such powers should be controlled and the freedom of exercise of such powers should be limited. Therefore, the Commission proposes to establish purely advisory committees. Nevertheless, member states in the Council have turned the initial proposal of the Commission into something that is “quite unknown”, which differs from their own national legal and political systems. Under the Council powers, the management committees have established what has been described as a system that is more binding (non-parliamentary) to control over the Commission. This Committee is composed of representatives of the member states that are empowered to give detailed advice in the implementation of specific proposals made by the Commission.³⁷¹ The management committees still exist today, namely the management procedure. It is mainly used in managing EU funds and the Common Agricultural Policy.³⁷²

Until the end of the 1980s, Comitology was placed as the very background of the main decision-making processes. It was a large political phenomenon. In 1987, the Single European Act introduced “The Constitutionalisation of Comitology”, which brought Comitology into the area of politics.³⁷³ The roles of Comitology significantly increased along with the Union legislation development where it was necessary to delegate powers to the Commission to implement some rules at European level. Initially, the Comitology dealt with purely technical implementing measures, mostly in Common Agricultural Policy. With regard to the establishment of the Comitology Committees, the Council demanded the necessity to form a supervisory function.³⁷⁴

The legal base of Comitology can be found in Article 202 of the TEU. Along with the organisational development, the Comitology procedures experienced an excessive use within the implementation of regulations at Union level.³⁷⁵ The Comitology procedures applied were based on the demand to supervise and monitor the interest of the member states in the Union. Member states need to control the implementing power conferred to the Commission. The increase of the Comitology application in the area of legislation led to the establishment of the Comitology Decision 1999/468/EC of 28 June 1999, thus, amended by Council Decision 2006/512/EC of 18 July 2006. Article 202 of TEC has been replaced by Articles 290 and 291 of the TFEU. Both of those

³⁷¹ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 117.

³⁷² See Curtin, Deirdre., 2009, *Op. Cit.*, p. 117-118.

³⁷³ See Tosiek, Piotr., 2010.

³⁷⁴ See Hardacre, Alan., and Damen, Mario., *The European Parliament and Comitology: PRAC in Practice*, available at : http://aei.pitt.edu/12375/1/20090709111448_Art2_Eipascoop2009_01.pdf, last accessed : 8 July 2011.

³⁷⁵ “[...] Since its birth the Union has delivered lots legislations which dynamic, means that the law development within Union’s has changing very fast needs a good engine to accelerate its implementation. One of the engines of legislative acts to be implemented is the Commission [...]. We can take a look on a data which presented by Curtin regarding Legislative Acts which adopted by EU in 2005 – 2008 :

	2005	2006	2007	2008
EP+Council Regulation	19	44	21	48
EP+Council Directives	26	39	18	53
EP+Council Decisions	14	19	18	30
Council Regulations	118	164	129	137
Council Directives	10	26	5	14
Council Decisions	252	245	272	244
Commission Regulations	675	610	628	574
Commission Directives	54	75	53	53
Commission Decisions	645	698	644	609
Total	1813	1920	1788	1762

According to Alan and Kaeding in 2009 there were 266 comitology committees, 894 comitology committee meetings and 1808 implementing measures. This data has shown the significant role comitology in the EU.

articles have significant roles in the new Comitology procedures by providing two methods of delegation power to the Commissions.³⁷⁶

Article 290 of the TFEU stipulates, “a legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act”, this constitutes the *delegated acts*. The European Parliament or the Council may decide to revoke such delegation power. The delegated act may enter into force only if the European Parliament or the Council has expressed no objection within a certain period set out in the legislative act.³⁷⁷

Since the European project and activities on governance have developed dynamically, the need for the Comitology Committees has also increased. Therefore, the Comitology becomes the essential element in the EU legislation system.³⁷⁸ The Comitology overrated spread across policy areas including CCP. Most EU activities apply Comitology procedures.³⁷⁹

The EU sources of law have been reformed, due to its significant role in the Union decision-making practice. Article 289 of the TFEU laid down the formal differentiation between legislative and non-legislative acts. Furthermore, the differentiation of legislative acts, delegated acts, and implementing acts from the formal procedures will be explained.³⁸⁰

A legislative act characterised in the “*formal context*”, consists of regulations, directives, and decisions. Article 289 provides three types of formalities to adopt the legislative acts, e.g. ordinary legislative procedure, special legislative procedure or specific procedure.³⁸¹

A delegated act can be defined both formally and materially, which covers substance and procedures. The last sentence of Article 290 of the TFEU, remarks that the delegated act “*may not relate to individual matters but at the same time may not refer to essential elements of legislative acts*”.³⁸²

An implementing act is mainly characterised formally where the implementing powers are transferred to the member states. The powers would be conferred to the Commission or to the Council when uniformity is needed in the implementation of the acts. Article 291 of the TFEU prescribes that the member states should supervise the implementing body (the Commission). Since the European Parliament and the Council, as institutions that adopt the legislation and are conferred implementing powers, may not perform such control mechanism. The European Parliament is also not allowed to control the Council that acts as an implementing body. Moreover, both the European Parliament and the Council are obliged to adopt regulations laying down the rules and general principles concerning mechanisms for control exercised by member states.³⁸³

VIII.d. Comitology and control function.

There are three stages of implementation delegation of power, consisting of the co-decision procedure stage, commission stage and legislator stage.³⁸⁴ During the first

³⁷⁶ See Hardacre, Alan., and Kaeding, Michael.

³⁷⁷ See Tosiek, Piotr., 2010.

³⁷⁸ See Hardacre, Alan., and Damen, Mario.

³⁷⁹ See Hardacre, Alan., and Kaeding, Michael.

³⁸⁰ See Tosiek, Piotr., 2010.

³⁸¹ See Tosiek, Piotr., 2010.

³⁸² See Tosiek, Piotr., 2010.

³⁸³ See Tosiek, Piotr., 2010.

³⁸⁴ See Hardacre, Alan., and Kaeding, Michael..

stage, known as the co-decision procedure, the Commission formulates a legislative proposal to the Council and Parliament. Such proposal is used to delegate tasks back to the Commissions in order to implement concerned regulations. In this stage, the Parliament and Council decide together about the scope of delegation and the levels of control relating to the power of delegation, which they confer to the Commission. Thereafter, the legislators decide on the power delegation and the procedure to control such power.

In the second stage, the Commission has to draft implementing measures. It will be implemented under the delegated power conferred to them. The Commission has options to ask assistance from the Comitology Committee, experts group, or an agency (among others) in respect of drafting implementing measures. In the final procedure of this mechanism, the Commission has to take responsibility for the draft measures to be submitted to the committee for a vote or submitted directly to the legislators to ensure there is no objection.

The final stage relates to the control function of the legislator over the task delegated to the Commission. The control function over the Commission is delegated powers and is considered as a control balance over executives at Union level. There are five principles that must be applied in exercising the delegated power, consisting of “*speed, efficiency, flexibility, technical decision, and control*”.³⁸⁵

According to Article 202 TEC and Comitology Decision 1999/468/EC of 28 June 1999, amended by Council Decision 2006/512/EC of 18 July 2006, there are five different Comitology procedures, which consist of advisory, management, regulatory, regulatory with scrutiny and the safeguard procedure.³⁸⁶ Theoretically, as explained by Larsson and Maurer, there are “*five main concepts of integration*” related to Comitology. These five main concepts highlight the role of the Comitology Committees in the Union from different perception approaches.

The first concept called as “*intergovernmental vision*”. This concept divided into four models. The first model combines between traditional realistic and a neo-realistic school. It is emphasizing control function of the Comitology Committees over the Commission. In this point, the Comitology Committees positioned as an addition of national institutions. The second model is an “*administrative diplomacy*” or “*the liberal intergovernmentalist variant of neo-realism*”. In this second model the Comitology Committees considered as a diplomatic instrument used by governments over EU administration. The third model is an “*intergovernmental monitoring*” in which the Comitology Committees considered as bodies where governments coordinate their

³⁸⁵ “[...] Speed: Making adjustments to, or implementing, legislation through comitology can take a few months (only a few days in exceptional cases) – much faster than the legislative procedures. In this way legislation can be updated quickly and in keeping with events, science or markets; Flexibility : The comitology system is more flexible than the legislative procedures in terms of time -lines, obligations etc. This makes it easier to deal with technical legislation; Technical Decisions: Comitology concerns technical aspects of legislation, and as such represents a more appropriate level at which these decisions can be taken. The Commission will draft the measures but will be assisted by Member States and other sources of expertise (expert groups, EU agencies); Control: The comitology system is also about control over the Commission. The Commission is delegated the power to initiate technical implementing measures but all measures are subject to control by the Council and Parliament. The more sensitive the measures are deemed to be the more control the legislators will have; Efficiency, Comitology allows the legislators to concentrate on their core legislative work and moves technical work to the level of technical experts which is a more efficient allocation of tasks and work [...]”. Hardacre, Alan., and Kaeding, Michael.

³⁸⁶ See Hardacre, Alan., and Kaeding, Michael.

political and administrative positions. The fourth model named “*functional cooperation*”, its similar to to supranational visions.³⁸⁷

The second concept is a “*federalist vision*”. According to Larsson and Maurer; Piotr this concept is defined as follow :

“[...] the perception of committees is similar to the realistic one, but evaluation of such is of course completely different. Committees are tools of influence wielded by member states upon the supranational body, and as such they create significant obstacles to building the federal union and to effective problem solving. A better solution would be a strict division of powers between the state and the Union, which is connected to the autonomy of the decision-making process at these two levels based upon principle of subsidiarity [...]”³⁸⁸

In the federalist vision, the Comitology Committees considered as tools of member states and preventing practice of a federal union. This concept is emphasizing “*division of power*” between member states and Union (intergovernmental and supranational function).

The third concept is “*neofunctionalism and supranational technocracy*” related to the Comitology Committees tasks in the “*technical*” area:

“[...] Comitology committees are essential elements of the system aimed at technical problem solving. They are composed of experts who come from different states. Interactions among them improve their professional level and make finding the best solution possible. The most important role is played by representatives of the Commission [...]”.³⁸⁹

The fourth concept known as “*erosion and European megabureaucracy*”, its placed the Comitology committees as decision maker:

“[...] Comitology committees are perceived as decision makers that express the tendency to replace political decisions with administrative ones. Committee system is not effectively controlled by parliaments and courts, which is their main distinction from member states’ administrative systems. National civil servants forget that they represent both governments and societies. There is a place for the creation of a new independent bureaucratic and political space that is reluctant to open the decision-making process. Representation of various interests is lacking and the efficiency of committees is low [...]”³⁹⁰

The fifth concept is a mixed concept of “*governance, fusion theory, models of horizontal and vertical fusion*”, and also “*mixed administration*”. These elements are interdependent, it is described further as follow :

“[...] Comitology committees are seen as status quo defenders, and thus may not be linked with any vision of integration. They constitute a part of broad decision-making networks. In fusion theory the most important element of the decision-making process is the mixing of public instruments from many member states as well as Europeanization of supranational, national, regional and de-nationalized actors and institutions. Actors at all levels must adapt to a new situation and compete. Committees are specialized bodies for joint action. Horizontal (inside the committee system) and vertical (outside the committee system) interactions reflect the need for constructive problem solving in a good atmosphere [...]”.³⁹¹

³⁸⁷ See T. Larsson, A. Maurer, *Subproject 4: the Committee System, Legitimacy, Citizen's Perceptions and Acceptance of the EU-System of Governance* [in:] *Governance by Committee: the Role of Committees in European Policy- Making and Policy Implementation*, State of the Art Report, European Institute of Public Administration, Project No. SERD-1999-00128, May 2000, pp. 79-81; Tosiek, Piotr., 2010.

³⁸⁸ See T. Larsson, A. Maurer, 2000, *Op. Cit.*, pp. 81-82; Tosiek, Piotr., 2010.

³⁸⁹ See T. Larsson, A. Maurer, 2000, *Op. Cit.*, pp. 82-83 Tosiek, Piotr., 2010.

³⁹⁰ See T. Larsson, A. Maurer, 2000, *Op. Cit.*, pp. 83-84; Tosiek, Piotr., 2010.

³⁹¹ See T. Larsson, A. Maurer, 2000, *Op. Cit.*, pp. 84-87; Tosiek, Piotr., 2010.

From those five concepts concluded that the Comitology Committees played two vital roles, that is, the control tools of member states over the Union and the decision maker. In daily practices the Comitology Committees tasks mostly dealing with the technical areas.

In its early development, the Comitology mainly dealt with technical agricultural measures. Nowadays, the Comitology has developed rapidly across the policy areas of the EU. With respect to dynamicisation in the implementation of EU legislations, some issues have been raised relating to transparency, efficiency, and accountability. The establishment of the Regulatory Procedure with Scrutiny (RPS)³⁹², which is provided under Article 5a of Comitology Decision 1999/468/EC of 28 June 1999, was amended by Council Decision 2006/512/EC of 18 July 2006. The RPS procedure grants the European Parliament an important new power to the existing Comitology procedures. It has to be noted that, previously, the Parliament tried to increase its limited powers in this domain. Such powers increase the role of the European Parliament in co-decision procedures and effectively improve democratic control over Comitology decisions. The RPS procedures were established as a response to a number of the Parliament's demands regarding its involvement in the delegation of powers to the Commission.³⁹³

The RPS has given Parliament the power of veto in the area of so-called “*quasi-legislative measures*”. Such measures are considered as “*near-legislative measures*”, but remain non-essential. Therefore, this can be delegated to the Commission. The objective of such procedure is to improve the democracy in the process of Comitology. Further, as explained by Alan and Damen, “*whenever the co-legislators give up legislative powers in the interest of greater flexibility, speed of decision-making and need for technical expertise, they do so in the knowledge that they retain a power of veto over what is being adopted by the Commission*”.³⁹⁴

Some scholars³⁹⁵ have analysed Comitology from democratic perspectives using two approaches. First, Comitology is seen as the “*defect*” of the EU since it considers lack of transparency and the limitation of the participation of the European Parliament in the decision-making process. However, since the Treaty of Lisbon the role of the European Parliament has increased. Second, Comitology is seen from a “*non-majoritarian doctrine approach*”. This approach refers to the nature of the Comitology Committee tasks that deal with the technical and non-political sphere. In this regard, the Comitology Committees are considered as a “*non-majoritarian agency*” due to its functional expertise and are excluded from politics and the electoral cycle.³⁹⁶ The term non-majoritarian agencies is used by political scientists to refer to all those bodies and organs that are “*unelected*” in the national political process.³⁹⁷

The Comitology from the “*democratic character*” perspective includes “*accountability of decision-makers, balance of the system, efficiency and effectiveness, and openness and transparency*”. Therefore, since their existence the Comitology

³⁹² “[...] In 2006 the basic comitology decision was amended so as to add a new procedure, known as the regulatory procedure, known as the Regulatory Procedure with Scrutiny (also known by its French acronym PRAC). The main of this new procedure was to give the European Parliament, for the first time, a significant role in the supervision of the content of what might be called quasi-legislative acts [...]”. See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 118-119.

³⁹³ See Hardacre, Alan., and Damen, Mario.

³⁹⁴ See Hardacre, Alan., and Damen, Mario..

³⁹⁵ See Curtin, 2009, *Op. Cit.*, p. 45; Piotr, 2010:

³⁹⁶ See Tosiek, Piotr., 2010.

³⁹⁷ See F. Vibert, 2007; Curtin, 2009, *Op. Cit.*, p. 51.

Committees seem to be “invisible” within the Union’s system. This causes many citizens not to be aware of the existence of Comitology decision-making.³⁹⁸

VIII.e. Trade legislation and the Comitology procedures in respect of GSP.

As explained above, after the Treaty of Lisbon entered into force the competence of the European Parliament in the international trade agreement increased. Article 188 C of the Treaty of Lisbon was established as the umbrella of CCP. The significant increase of European Parliament power was applied in the co-legislator procedures with the Council concerning trade legislations and agreements.

VIII.e.1. Comitology current GSP regulation³⁹⁹.

Implementation measures of the current GSP regulation are based on the old Comitology decision.⁴⁰⁰ This is laid down in Recitals 25 of the regulation. In undertaking implementation measures of the GSP scheme the Commission should be assisted with a Generalised Preferences Committee.⁴⁰¹ The main task of the Generalised Preferences Committee is to examine any matter relating to the implementation of the GSP regulation, raised by the Commission or at the request of a member state.⁴⁰² The Generalised Preferences Committee also has the task to assess the effect of the current GSP scheme. Assessment based on the Commission reports, and the result will be used in the discussion for the next regulation. There are two Comitology procedures used in the current GSP, i.e. the regulatory procedure⁴⁰³ and advisory procedure⁴⁰⁴.

Generally, the Comitology procedures applied in the GSP measures are connected to technical areas. The Comitology procedures are applied in the measures of graduation mechanism, special incentive arrangement for sustainable development and good governance, special arrangement for the least-developed countries, temporary withdrawal, and the safeguard clause. With respect to temporary withdrawal or suspension of the preferential arrangements, the Commission is obliged to notify such measures to the Generalised Preferences Committee before the decision comes into effect.⁴⁰⁵

The regulatory procedure of Comitology is applied in deciding whether to grant the preferences request from developing countries to obtain facility of the special incentive arrangements for sustainable development and good governance.⁴⁰⁶ The regulatory procedures are also applied in the special arrangement for LDCs, in terms of measures concerning country withdrawal from the list of beneficiary countries. Such withdrawal is based on the exclusion of a concerned country from the LDCs list by the United Nations.⁴⁰⁷

³⁹⁸ See Tosiek, Piotr., 2010.

³⁹⁹ See Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011 applying a scheme of generalised tariff preferences for the period from 1 January 2009 to 31 December 2011.

⁴⁰⁰ See Decision 1999/468/EC of 28 June 1999 as amended by Decision 2006/512/EC of 22 July 2006 laying down the procedures for the exercise of implementing powers conferred on the Commission.

⁴⁰¹ See Paragraph 1 Article 27 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴⁰² See Paragraph 2 Article 27 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴⁰³ See Paragraph 4 Article 27 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011. See also Article 5 of Decision 1999/468/EC of 28 June 1999 as amended by Decision 2006/512/EC of 22 July 2006 laying down the procedures for the exercise of implementing powers conferred on the Commission.

⁴⁰⁴ See Paragraph 5 Article 27 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011. See also Article 3 Decision 1999/468/EC of 28 June 1999 as amended by Decision 2006/512/EC of 22 July 2006.

⁴⁰⁵ See Paragraph 3 Article 16 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴⁰⁶ See Paragraph 2 Article 10 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴⁰⁷ See Paragraph 8 Article 11 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

The advisory procedure of Comitology is also applied to initiate the investigation in respect of sufficient grounds to impose the temporary withdrawal.⁴⁰⁸ In the old Comitology decision, the advisory procedure was considered as the “quickest” procedure because the Committee can deliver its opinion, “if it is indispensable by taking a vote”, by using “simple majority” towards draft measures presented by the Commission. Then, the Commission has to take the “utmost account of the opinion delivered” and inform the committee that the opinion has been taken into account. However, the committee’s opinion does not have to be followed by the Commission. The advisory procedure of Comitology is also applied in the safeguard measures of GSP.⁴⁰⁹

The advisory procedures are also applied to adopt amendments of the Annexes of the current GSP regulation.⁴¹⁰ The amendments relate to the Combined Nomenclature, changes in the international status or classification of countries or territories, changes to the list of beneficiary countries under general arrangement due to graduation⁴¹¹ or removal⁴¹² and arrangement of lists of special incentives in sustainable development and good governance.⁴¹³

VIII.e.2. Comitology on the GSP proposal.

First, it should be noted that the examination procedures in the new Comitology decision are a merger of the management and regulatory procedures of the old Comitology. Overall, the implementation measures of the GSP proposal are very similar to the current GSP regulation. The simplification procedures in the new Comitology decision change the application of Comitology procedures in the GSP proposal, but to a limited extent. Let us take for instance the replacement of the regulatory procedure by the examination procedure.

Draft Article 38 of the GSP proposal stipulates that the new Comitology procedure under Regulation (EU) No. 182/2011 will soon be applied following the implementation of GSP. It will cover advisory procedures, examination procedures, and immediately applicable implementing acts. It also stipulates that the Generalised Preferences Committee has the task of assisting the Commission. Practically, the task of the Preferences Committee has not changed and is similar to the current GSP regulation to examine any matter relating to the application of this Regulation, raised by the Commission or at the request of a member state.

The new Comitology decision clearly stipulates implementations of legally binding Union acts requiring uniform conditions.⁴¹⁴ Consistently, the proposal of the GSP regulation states that uniform conditions are required for the implementation of the regulation. This uniformity requirement derives from the CPP legal basis. Thereof the implementing powers should be conferred on the Commission. The GSP proposal

⁴⁰⁸ See Article 17, 18, and 19 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴⁰⁹ See Article 20 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴¹⁰ See Article 25 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴¹¹ See Paragraph 1 Article 3 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴¹² See Paragraph 2 Article 3 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴¹³ See Article 10 Council Regulation (EC) No. 732/2008 as amended by EU Regulation No. 512/2011.

⁴¹⁴ See Recitals 1 Regulation (EU) No. 182/2011 : “[...] Where uniform conditions for the implementation of legally binding Union acts are needed, those acts (hereinafter ‘basic acts’) are to confer implementing powers on the Commission, or, in duly justified specific cases and in the cases provided for in Articles 24 and 26 of the Treaty on European Union, on the Council [...]”. See also Article 1 Regulation (EU) No. 182/2011 : “[...] This Regulation lays down the rules and general principles governing the mechanisms which apply where a legally binding Union act (hereinafter a ‘basic act’) identifies the need for uniform conditions of implementation and requires that the adoption of implementing acts by the Commission be subject to the control of Member States [...]”.

elaborates the application of the Comitology of each procedure in the implementation of its regulation.⁴¹⁵

First, the advisory procedure will be applied to the adoption of decisions on suspension from the tariff preferences of certain GSP sections and the initiation of a temporary withdrawal procedure.⁴¹⁶ The application of the advisory procedure in the proposal of the GSP regulation is almost unchanged from the current one. It is applied in the general arrangement⁴¹⁷ and the measures under special incentive arrangements for sustainable development and good governance.⁴¹⁸

Second, the examination procedure will be used for the adoption of decisions on safeguard investigations and suspension of the preferential arrangements where imports may cause serious disturbance to EU markets.⁴¹⁹ This procedure will be applied to general safeguard measures.⁴²⁰ Where products originating in a beneficiary country, under the GSP arrangements, imported in volumes and/or at prices, which cause, or threaten to cause, serious difficulties to EU producers of like or directly competing products, normal CCT duties on that product may be reintroduced under certain conditions. Therefore, once the conditions of such circumstances are fulfilled, the Commission has to adopt an implementing act to reintroduce the CCT duties in compliance with the examination procedure. Third, the Commission can adopt immediately applicable implementing acts or urgency procedures towards certain cases according to the regulation.⁴²¹

In respect of general temporary withdrawal, the adoption of decisions to initiate the procedure for or to terminate the temporary withdrawal procedure, must comply with the advisory procedure. The immediately applicable implementing acts applied for the temporarily withdrawal in the case of trade fraud, for example, fail to comply with the rules of origin of the products. The sufficient evidence of such conducts could be the justification for temporarily withdrawal in respect of all or of certain products originating in a beneficiary country.

Only immediately applicable implementing acts will be applied under strict justification of urgent need. Under this procedure, the Commission is allowed to implement an act without its prior submission to a Comitology Committee. This procedure should remain in force for a period not exceeding 6 months unless the basic act provides otherwise.⁴²² The proposal of the GSP regulation stipulates that the application of the immediately applicable implementing acts procedure must be

⁴¹⁵ See Recitals 26 European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences, {SEC(2011) 536 final},{SEC(2011) 537 final}, Brussels, 10.5.2011, COM(2011) 241 final, 2011/0117 (COD), available : http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147893.pdf, last accessed : 12 May 2011. See also Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for the control by the Member States of the Commission's exercise of implementing powers.

⁴¹⁶ See Recitals 26 of the European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences. See also Regulation (EU) No 182/2011.

⁴¹⁷ See Paragraph 2 and 3 Article 8 of the European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences.

⁴¹⁸ See Paragraph 3 and 8 Article 15 of the European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences.

⁴¹⁹ See Recitals 26 of the European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences. See also Regulation (EU) No 182/2011.

⁴²⁰ See Article 25, 26 and 27 of the European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences.

⁴²¹ See Recitals 26 European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences. See also Regulation (EU) No 182/2011.

⁴²² See Paragraph 2 Article 8 Regulation (EU) No. 182/2011.

applied in conjunction with the examination procedure. In the application of the examination procedure, if the Committee delivers a negative opinion, the Commission shall immediately revoke the implementing act adopted in compliance with the regulations in Paragraph 2 Article 8 of the new Comitology decision.⁴²³

VIII.f. Delegated and implementing powers in the GSP regulation after the Treaty of Lisbon.

The existence of the non-legislative act has caused complexity in understanding the existing EU legal system. As regulated under Article 288 of the TFEU (Ex 249 TEC)⁴²⁴, there are three types of legal instruments in the Union, consisting of “*regulation, directives, and decisions*”. This provision remains unchanged under the Treaty of Lisbon. In the new Comitology decisions, there are two procedures concerning “*acts adoption*”, which are known as the “*delegated act*” (previously called RPS or PRAC) and the “*implementing act*” (normal Comitology procedures).⁴²⁵

Under the Treaty of Lisbon, the delegated act and implementing act are included as “*non-legislative executive measures*”. The terms “*delegated act and implementing act*” seem to have a “*confusing use*”. However, the provisions of the Treaty of Lisbon attempt to distinguish both terms by defined “*delegated acts*” as acts “*that expand on elements of the legislative act within the framework worked out latter*”. Further Curtin describes that “*delegated legislative acts, working out the detail of legislation the idea presumably being that this will ensure that the legislature does not have to spend valuable time on the specifics of legislation but can delegate that task to the executive (the Commission) with more time and resources at its disposition*”. The powers delegated cover a range of areas from rules (on the technical and detailed elements that develop a legislative act) to the subsequent amendments of certain aspects of the legislative act. In any adoption of the legislative acts, the legislator has the power to determine the scope of the essential elements or degree of details required for the essential elements in a specific area and to what extent those elements should be expanded on by the delegated acts.⁴²⁶

There is a four-level hierarchy of legal acts in the EU laid down under Articles 288-292 of the TFEU. The first level of hierarchy of legal acts is treaty provisions. The second level of hierarchy of legal acts is legislative acts, adopted under the co-decision procedure and special legislative procedures.⁴²⁷ The third level of hierarchy of legal acts is delegated acts.⁴²⁸ The fourth level of hierarchy of legal acts is implementing acts.⁴²⁹

The distinction between “*legislative acts*” and “*non-legislative acts*” in the EU System is set out under the Treaty of Lisbon. Under the legislation framework, the European Parliament and the Council enact legislative acts. Legislative acts are adopted under ordinary or special legislative procedures. Non-legislative acts are implemented by the Commission and are divided into delegated acts and implementing acts. Therefore, there are two types of delegation of power. First, delegation of powers conferred to the Commission to adopt “*delegated acts*”. Second, delegation of powers conferred to the Commission to adopt “*implementing acts*” known as Comitology

⁴²³ See Paragraph 3 Article 8 Regulation (EU) No. 182/2011.

⁴²⁴ To exercise the Union’s competences, the institutions shall adopt regulations, directives, decisions, recommendations, and opinions.

⁴²⁵ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 121.

⁴²⁶ See Curtin, Deirdre., 2009, *Op. Cit.*, pp. 122-123.

⁴²⁷ See Article 289 of the TFEU.

⁴²⁸ See Article 290 of the TFEU.

⁴²⁹ See Article 291 of the TFEU.

procedures. Non-legislative acts adopted by the Commission, ought to be applied in general and may amend or supplement non-essential elements of a legislative act.⁴³⁰

According to Lenaerts, it is important to make a clear distinction between the legislative and executive acts of the Union. The distinction has to be based on the type of procedures and its adoption. In his opinion “*the autonomous regulations of a more technical nature would not justify a direct intervention of the legislator*” and take the form either of “*delegated legislation*”, or of “*executive acts*”.⁴³¹

Further, Lenaerts make the distinction between the application of “*heavy*” Comitology procedures and “*light*” Comitology procedures. Heavy Comitology procedures involve intervention of a regulatory committee or management committee and a strict control by the European Parliament, which includes a right of call back for the legislator in certain cases. Heavy Comitology procedures are applied in the delegated acts, since it “*would include the legislation adopted by the Council or, more frequently, by the Commission on the basis of a power granted either in a precise Treaty provision or in a legislative act (first category)*”.⁴³²

Light Comitology procedures are characterised as a consultative committee, finalised by the Commission under the control of the European Parliament. In this regard, light Comitology should be applied as “*executive acts*”, wherein, it includes acts adopted at the Union level or at the national level. The adoptions would be based on “*legislative*” provisions of the Treaties, a legislative act (adopted in compliance with the co-decision procedure) or a “*delegated act*”.⁴³³

Delegated acts are classified as “*ex ante*” control or subject to revocation. Article 291 Paragraph 3 of the TFEU provides the rules that govern the Comitology procedures of implementing acts. Where it is adopted under ordinary legislative procedures, known as a co-decision legislation procedure, the EP and the Council jointly enact the acts.⁴³⁴

There are two procedures used in the adoption of legislative acts, as laid down in Article 289 of the TFEU. Legal acts are adopted under these legislative procedures classified as “*legislative acts*”. First, they are known as co-decision procedures or ordinary legislative procedures and are defined as a standard procedure where the European Parliament and the Council jointly adopt a Commission proposal.⁴³⁵ Second, the so-called “*special legislative procedures*” are applied to specific cases⁴³⁶ provided by the Treaties.⁴³⁷

Non-legislative acts⁴³⁸ are the legal basis of the Comitology. Before the Treaty of Lisbon entered into force non-legislative acts were governed under Article 202 of the EC Treaty, thus, they were replaced by Articles 290 and 291 of the TFEU. Under the

⁴³⁰ See Brans, Hilde., *The Treaty of Lisbon - EU Decision Making Procedures*, available at : http://gain.fas.usda.gov/Recent%20GAIN%20Publications/The%20Treaty%20of%20Lisbon%20%20EU%20Decision%20Making%20Procedures_Brussels%20USEU_EU-27_2-19-2010.pdf, last accessed : 8 July 2011.

⁴³¹ See Georgiev, Vihar., *Commission on the Loose? Delegated Lawmaking and Comitology after Lisbon*, Paper prepared for the EUSA Twelfth Biennial International Conference, Boston, Massachusetts, 3-5 March 2011, Hyatt Regency Boston, available at : http://euce.org/eusa/2011/papers/5g_georgiev.pdf, last accessed : 8 July 2011.

⁴³² See Georgiev, Vihar., 2011.

⁴³³ See Georgiev, Vihar., 2011.

⁴³⁴ See Georgiev, Vihar., 2011.

⁴³⁵ See Article 294 of the TFEU.

⁴³⁶ For instance approval of the European Union budget.

⁴³⁷ See Brans, Hilde., 2010.

⁴³⁸ For instance the Generalized System of Preferences Rules of Origin laid down by Commission Regulation (EU) No 1063/2010 of 18 November 2010 amending Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code.

new Comitology system, non-legislative acts are divided into delegated acts⁴³⁹ and implementing acts⁴⁴⁰. The new Comitology act entered into force on 1 March 2011.⁴⁴¹

VIII.g. Delegated act.

VIII.g.1. Historical review.

Delegated acts are considered as the successor of the Regulatory Procedure with Scrutiny (RPS) due to some identical similarities. Therefore, as described by Curtin, the delegated act procedure is not a new invention, it covers the same scope of application covered by the pre-existing PRAC. However, the differences lie in the conditions to which the delegated acts are applied.⁴⁴² The delegated acts and RPS were established based on the power conferred by the legislator to the Commission with the aim of efficiency.⁴⁴³ However, in the implementation they are supervised and controlled by the legislator. Through delegated acts the Commission is given a power to supplement or amend the non-essential elements of the basic act.⁴⁴⁴ The European Parliament has the veto right in the adoption of delegated acts, which means the legislator can raise objection to anything that it disagrees with.⁴⁴⁵

The wording of the definition of delegated acts stipulated in Paragraph 1 Article 290⁴⁴⁶ of the TFEU sounds similar to that of the RPS as laid down in Decision 1999/468/EC and amended by Decision 2006/512/EC. In December 2009, the Commission issued communication, informing the European Parliament and the Council,⁴⁴⁷ concerning the implementation of delegated acts. The Communication contained the scope of delegated acts, a framework for the delegation of power, the procedure for adopting delegated acts, scrutiny of delegated acts and the *“model template to provide standard wording for the legislators to define the scope of the delegation of power in future legislative acts”*.⁴⁴⁸ The Commission concluded that the scope of the delegated acts is not exactly identical with RPS, even though, both the delegated acts and RPS are generally applied to amend or supplement certain non-essential elements of the legislative instrument. The Commission focused on the interpretation of the verbs *“amend”* and *“supplement”* in Article 290 of the TFEU. Vihar elaborates the distinction of designation and the purpose of the wording *“amend”* and *“supplement”*, as follows:

“[...] the Commission believes that by using the verb “amend” the authors of the new Treaty wanted to cover theoretical cases, where the Commission is empowered formally to amend a basic instrument, irrespective of whether the annex contains purely technical measures. With respect to the verb “supplement”, the Commission believes that the legislator should assess whether the future measure specifically adds

⁴³⁹ See Article 290 of the TFEU.

⁴⁴⁰ See Article 291 of the TFEU.

⁴⁴¹ See Article 16 Regulation (EU) No 182/2011.

⁴⁴² See Curtin, Deirdre., 2009, *Op. Cit.*, p. 123.

⁴⁴³ For instance to amend basic act.

⁴⁴⁴ See Hardacre, Alan., and Kaeding, Michael.

⁴⁴⁵ See Hardacre, Alan., and Kaeding, Michael.

⁴⁴⁶ “[...] A legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act. The objectives, content, scope and duration of the delegation of power shall be explicitly defined in the legislative acts. The essential elements of an area shall be reserved for the legislative act and accordingly shall not be the subject of a delegation of power [...]”.

⁴⁴⁷ See European Commission Communication from the Commission to the European Parliament and The Council concerning Implementation of Article 290 of the Treaty on the Functioning of the European Union, COM(2009) 673 final, Brussels, 9.12.2009, available at : <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0673:FIN:EN:PDF>, last accessed : 11 April 2011.

⁴⁴⁸ See Brans, Hilde., 2010-

new non-essential rules which change the framework of the legislative act, leaving a margin of discretion to the Commission [...]”.⁴⁴⁹

It is concluded that the scope of the implementation of the delegated acts is provided under the Treaty, while the details of the conditions for the implementation of the delegated powers is specified in every individual legislative act.

On the 11 April 2011, the Council issued a note from the Presidency about the delegations concerning the common understanding of delegated acts. The note contained practical arrangements and agreed clarifications, and preferences applicable to delegations of legislative power. It was regulated under Article 290 of the TFEU. It must be in accordance with the objectives, contents, scopes, and duration of delegation, and expressly defined in each “basic act”. The three main institutions of the Union, i.e. the European Parliament, the Council, and the Commission, shall cooperate in exercising their powers in accordance with the procedures laid down in the TFEU. The effective controls over the delegated power are carried out by the European Parliament and the Council. Therefore, it is necessary to establish appropriate contacts at an administrative level. It is also stressed that the Commission should carry out appropriate and transparent consultations, including those at an expert level.⁴⁵⁰

In respect of the technical implementations of the duration of the delegation of a basic act, the Commission may adopt delegated acts for an undetermined or determined period. However, when a determined period is provided, the basic act should provide the time duration, unless the European Parliament or the Council oppose to an extension not later than three months before the end of each period. However, it does not affect the revocation rights of the European Parliament or the Council.⁴⁵¹

VIII.g.2. How do delegated acts work in GSP?

Delegated acts are adopted to supplement or amend non-essential elements of legal acts. This refers to “*non-legislative acts of general application*”, which are aimed to “*supplement or amend laws*” on its “*non-essential elements*”.⁴⁵² In exercising the delegation of power, the Commission is controlled by the Council and the European Parliament under “shared competent procedures”. In such control mechanism, the Council and the European Parliament have the veto rights to refuse Commission measures and/or withdraw the delegation mandate that is given to the Commission.⁴⁵³

The Council and the European Parliament have to clearly set out the objectives, contents, scope, and duration of the delegation of power to the Commission in every establishment of a legislative act. If the European Parliament or the Council expresses

⁴⁴⁹ See Georgiev, Vihar., 2011. See also Curtin, Deirdre., 2009, *Op. Cit.*, p. 118 . “[...] According to the Court, delegated regulations discussed in such “comitology committees”, as they became known generically, may only amend or supplement certain non-essential elements of the law or framework law not covering essential elements of an area. This is an attempt to limit the remit of the tasks they carry out and to ensure the underlying legislation (framework law) will guide the exercise of delegated power by the Commission and the comitology committees [...]”.

⁴⁵⁰ See Council of European Union, *Note from Presidency to Delegations Subject: Common Understanding - Delegated Act*, Brussels, 10 April 2011, 8753/11, PE 164, INST 195, available at : <http://register.consilium.europa.eu/pdf/en/11/st08/st08753.en11.pdf>, last accessed : 18 May 2011.

⁴⁵¹ See *Council of European Union, Note from Presidency to Delegations Subject: Common Understanding - Delegated Act*, Brussels, 10 April 2011.

⁴⁵² See Stratulat, Corina., and Molino, Elisa., *Implementing Lisbon: what's new in comitology?*, Policy brief, European Policy Center, April 2011, available at : http://www.epc.eu/documents/uploads/pub_1258_implementing_lisbon_-_what_s_new_in_comitology.pdf, last accessed : 8 July 2011.

⁴⁵³ See Deutsche Bank AG, DB Research, *Comitology reloaded: On delegated acts and implementing acts*, January 14, 2011, available at : http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000268456.pdf, last accessed : 8 July 2011.

no objection within the time limit set by the legislative act, a delegated act may enter into force. The European Parliament votes on a majority of its members, while the Council uses a qualified majority.⁴⁵⁴ To sum up, the delegated powers are granted to the Commission to supplement or amend legislation, on the other hand the Council or the Parliament may use the veto right upon its adoption.

VIII.h. Implementing Act

It should be noted that the Treaty of Lisbon has brought some changes to trade legislations. In this regard, it also affects GSP legislation and its implementation as it is established under CCP. Under the Treaty of Lisbon, the CCP is subject to⁴⁵⁵ ordinary legislative procedures provided under Article 294 of the TFUE (Ex Article 251 TEC). Ordinary legislative procedures are defined as the joint adoption by the European Parliament and the Council of a regulation, directive, or decision on a proposal submitted by the Commission.⁴⁵⁶ Ordinary legislative procedures are also called “*co-decision procedures*” since they are jointly adopted by legislative institutions of the EU.⁴⁵⁷

The legal history of the new Comitology started in March 2010 when the Commission proposed a “*draft regulation on the mechanisms for control by member states of the Commission’s exercise of implementing powers*”. In the proposed draft regulations, the Commission outlines two main principles for the new regulation of the Comitology procedures. First, the member states are unilaterally responsible for controlling the Commission’s exercise of implementing powers. Second, the procedural requirements should be proportionate to the nature of implementing acts.⁴⁵⁸ The new Comitology decision requires “*the European Parliament and the Council to lay down the rules and general principles*” concerning mechanisms for control by member states over the Commission’s in exercising implementing powers.⁴⁵⁹

The implementing act is recognised in the Union Legal System as a “*rule making measure*” that implements the legislative or delegated act in the sense of adopting the necessary rules to apply it (or rules that correspond to the level of regulations at a national level) or actually applying it to specific cases (individual decisions). The implementing acts are carried out by the Commission based on standard Comitology procedures.⁴⁶⁰ The implementing is applied where “*uniform conditions for implementing legally binding Union acts are needed*”. Therefore, the legislator confers the appropriate implementing powers to the Commission to be implemented under the control of the member states.⁴⁶¹

On 16 February 2011 the new Comitology decision was issued under EU Regulation No. 182/2011, concerning “*mechanisms for control by member states of the Commission’s exercise of implementing powers*”.⁴⁶² After the new Comitology decision

⁴⁵⁴ See Brans, Hilde., 2010.

⁴⁵⁵ See Article 188 C Paragraph 2 (TFEU) Treaty of Lisbon : “[...] The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy [...]”.

⁴⁵⁶ See Article 289 Paragraph 1 of the TFUE.

⁴⁵⁷ See The Co-Decision or Ordinary Legislative Procedure, available at : http://ec.europa.eu/codecision/procedure/index_en.htm, last accessed : 18 July 2011.

⁴⁵⁸ See Georgiev, Vihar., 2011.

⁴⁵⁹ See Recital 4 Regulation (EU) No. 182/2011.

⁴⁶⁰ See Curtin, Deirdre., 2009, *Op. Cit.*, p. 123.

⁴⁶¹ See Brans, Hilde., 2010.

⁴⁶² See Regulation (EU) No 182/2011.

entered into force, the Commission issued Proposals called Omnibus I⁴⁶³ and Omnibus II⁴⁶⁴. Both proposals contain updates of the decisions in various ranges of trade legislations adopted in the EU. These proposals do not propose to amend the substance of the regulation, or, “do not touch” the essential core of the regulation established under the co-decisions procedure. The Omnibus Proposals are based on the existence of “delegated power” that is granted to the Commission to set out technical requirements, and to adjust existing legislation related to decision-making procedures.⁴⁶⁵

However, both of those proposals distinguish whether the regulation concerned is based on 1999 Comitology decisions or not. The Proposal of Omnibus I focuses on the procedures that are not based on the 1999 Comitology decision. The Omnibus I reviews whether such procedures are necessarily converted into implementing powers or delegated acts. While Proposal Omnibus II concerns the procedures that are based on the 1999 Comitology decision, where it is considered whether they should be converted into delegated powers or not.⁴⁶⁶

The Omnibus I covers 24 regulations from across the area, which includes all trade defence instruments, the regulation establishing the EU’s GSP, the EPA’s Market Access Regulation, the Trade Barriers Regulation, the Blocking statute responding to legislation with extra-territorial effect, and, a number of regulations implementing safeguard clauses and managing the implementation of bilateral agreements. The EU’s GSP is covered under Omnibus I, which means that all procedures under this regulation that are not based on the 1999 Comitology decision will be converted into implementing powers or delegated acts.⁴⁶⁷

The Omnibus II covers 10 regulations in various areas. It consists of instruments governing textile and steel trade, the regulation establishing the EU’s GSP, the EPA’s Market Access Regulation, the regulation preventing trade diversion of certain key medicines, a number of regulations managing bilateral agreements, and a regulation managing trade sanctions imposed against the US. The procedures under the EU’s current GSP that are based on the 1999 Comitology decision will be converted into delegated powers.⁴⁶⁸ Apparently, the new Comitology decision has brought significant impact to both the EU’s current GSP and the EU’s New Proposal of the GSP regulation.

The Proposal of Omnibus II addresses legislations relating to textiles and steel, certain elements of the EU’s GSP and the EPA’s Market Access Regulation. The Omnibus II is designed to review all legislations that contain Comitology after the Treaty of Lisbon entered into force. While the proposal of Omnibus I concerns trade policy and competition policy. Since most EU policy areas are subject to Comitology, especially trade policy. However, this has been excluded from the existing Comitology decision. Therefore, the EU GSP is excluded from Comitology, and converted into delegated acts.⁴⁶⁹

⁴⁶³ See Updating trade legislation procedures: the Omnibus I proposal, Brussels, 7 March 2011, available at : http://trade.ec.europa.eu/doclib/docs/2011/march/tradoc_147618.pdf, , last accessed : 28 March 2011.

⁴⁶⁴ See The Commission proposes to update trade legislation procedures: the Omnibus II proposal, Brussels, 15 June 2011, available at : http://trade.ec.europa.eu/doclib/docs/2011/june/tradoc_147978.pdf, last accessed : 1 July 2011.

⁴⁶⁵ See Article 290 Paragraph 1.

⁴⁶⁶ See The Commission proposes to update trade legislation procedures: the Omnibus II proposal, Brussels, 15 June 2011.

⁴⁶⁷ See Updating trade legislation procedures: the Omnibus I proposal, Brussels, 7 March 2011.

⁴⁶⁸ See The Commission proposes to update trade legislation procedures: the Omnibus II proposal.

⁴⁶⁹ See Updating trade legislation procedures: the Omnibus I proposal, Brussels, 7 March 2011.

Paragraph 2 Article 291 of the TFEU, stipulates that: “[...] uniform conditions are required for the implementation of binding acts, implementing powers may be delegated to the Commission, but principally the member states are responsible for the implementation of legal acts [...]”.⁴⁷⁰

Each legislative act that was enacted after 1 March 2011 has to be based on the new Comitology decision.⁴⁷¹ As explained, the new Comitology decision simplifies the Comitology procedures from five types of procedures⁴⁷² to two types of procedures, consisting of “advisory” and “examination” procedures. In both procedures, the committees are formed by representatives of member states and are chaired by the Commission in which they have the task of scrutinising the proposed implementing acts.⁴⁷³ The new Comitology decision provides two committee procedures, i.e., the advisory procedure, mirroring the previous advisory procedure as regulated under Article 3 of Decision 1999/468/EC, and a new “examination procedure”, replacing the “preceding management”⁴⁷⁴ and “regulatory”⁴⁷⁵ procedure”.

The examination procedure is applied in the implementing act, covering areas of common agricultural and the Common Fisheries Policy, environment, security, safety, and protection of health or safety of humans, animals or plants, and CCP. Further, the examination procedure is used for implementing measures of “general scope” and “programmes with substantial implications”, and regarding taxes. The advisory procedure should be used for all other measures.⁴⁷⁶

In the new Comitology procedures, all the mechanism is initiated by presentation of the Commission regarding the drafting of the implementing act. The committee gives its opinion regarding the draft. The validity of the opinion is determined by the specific procedure.⁴⁷⁷ In the advisory procedure, the Comitology Committee delivers its opinion, and if it is necessary this is done through voting. The Comitology Committee adopts the opinion by simple majority of its component members.⁴⁷⁸ The Commission takes the utmost account of the conclusions drawn from the discussions within the committee and of the opinion delivered.⁴⁷⁹ However, the Commission is not obliged to follow this opinion.⁴⁸⁰

While, in the examination procedures, the Comitology Committee must deliver its opinion upon draft measures using the Qualified Majority Vote (QMV) system for acts to be adopted on a proposal from the Commission. Such mechanism is regulated by Articles 16(4)⁴⁸¹ and (5)⁴⁸² of the TEU and Article 238(3)⁴⁸³ of the TFEU. The

⁴⁷⁰ See Deutsche Bank AG, DB Research, Comitology reloaded: On delegated acts and implementing acts.

⁴⁷¹ See Brans, Hilde., 2010.

⁴⁷² Advisory, management, regulatory, regulatory with scrutiny and the safeguard procedure.

⁴⁷³ See Stratulat, Corina., and Molino, Elisa., 2011.

⁴⁷⁴ “[...] The management procedure considered as the oldest comitology procedur which established in 1962 in the area of CAP. The management procedure considered restricts the Commission the least. In this procedure if a comitology committee objects to a Commission proposal by means of qualified majority vote, the matter is forwarded to the Council. In the absence of such a qualified majority against its proposal the Commission can go ahead with implementation [...]”. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 117-118.

⁴⁷⁵ Curtin noted that “[...] the regulatory procedure is much more restricting. The comitology committee has to first approve the draft measure by a qualified majority of its members before the Commission can go ahead. If a qualified majority of the committee is not in favour, then the matter must be forwarded to the Council as well [...]”. See Curtin, Deirdre., 2009, *Op. Cit.*, p. 117-118.

⁴⁷⁶ See Georgiev, Vihar., 2011. See also Stratulat, Corina., and Molino, Elisa., 2011. See also Hardacre, Alan., and Kaeding, Michael.

⁴⁷⁷ See Tosiek, Piotr..

⁴⁷⁸ See Paragraph 1 Article 4 Regulation (EU) No 182/2011.

⁴⁷⁹ See Paragraph 2 Article 4 Regulation (EU) No 182/2011.

⁴⁸⁰ See Hardacre, Alan., and Kaeding, Michael..

⁴⁸¹ “[...] As from 1 November 2014, a qualified majority shall be defined as at least 55 % of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65 % of the population

Comitology Committee can issue three different opinions, i.e., “*negative opinion, positive opinion and no opinion*”.⁴⁸⁴

First, the Commission adopts the draft implementing act when positive opinion is issued by the Comitology Committee.⁴⁸⁵ Second, if negative opinion is issued, then the Commission is not allowed to adopt the draft implementing act. However, when negative opinion is issued the Commission has two options. First, it can submit an amended version of the draft implementing act or a new version of the draft implementing act to the same committee within 2 months of issuance of the negative opinion. Second, it can submit the draft implementing act within 1 month of such issuance to the appeal committee for further consideration.⁴⁸⁶

Third, if no opinion is issued, the Commission can adopt the draft implementing act with referral to the Comitology Committee.⁴⁸⁷ The examination procedure in the area of CCP has been changed; the Commission cannot adopt the draft of the implementing act when no opinion has been issued by the Comitology Committee. With respect to the adoption of the draft anti-dumping or countervailing measures, where no opinion is delivered by the committee and the “*simple majority of its component members opposes the draft implementing act*”,⁴⁸⁸ the Commission should conduct consultations with the member states. Thus, within 14 days to 1 month later the Commission has to submit the draft measures to the Appeals Committee. Then, the Appeals Committee has to meet 14 days to 1 month later to make a final decision.⁴⁸⁹ The other procedure for the new Comitology decision is “*immediately applicable to the implementing act*”. In the old Comitology decision, this procedure was known as the safeguard procedure.

of the Union. A blocking minority must include at least four Council members, failing which the qualified majority shall be deemed attained. The other arrangements governing the qualified majority are laid down in Article 238(2) of the Treaty on the Functioning of the European Union [...]”.

⁴⁸² “[...] The transitional provisions relating to the definition of the qualified majority which shall be applicable until 31 October 2014 and those which shall be applicable from 1 November 2014 to 31 March 2017 are laid down in the Protocol on transitional provisions [...]”.

⁴⁸³ “[...] As from 1 November 2014 and subject to the provisions laid down in the Protocol on transitional provisions, in cases where , under the Treaties, not all the members of the Council participate in voting, a qualified majority shall be defined as follows:

(a) A qualified majority shall be defined as at least 55 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States. A blocking minority must include at least the minimum number of Council members representing more than 35 % of the population of the participating Member States, plus one member , failing which the qualified majority shall be deemed attained;

(b) By way of derogation from point (a), where the Council does not act on a proposal from the Commission or from the High Representative of the Union for Foreign Affairs and Security Policy, the qualified majority shall be defined as at least 72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States [...]”.

⁴⁸⁴ “[...] In the examination procedure the role of the Council is very significant. It noted by Curtine that the involvement of the Council has been obligatory under specific circumstances since comitology committees were established. In the old comitology decision, the management and regulatory procedure are two different procedures not being merged. In the previous management committee procedure state that, if a comitology committee gives a negative opinion, qualified majority can pass on the proposal to the Council that can then take a decision. In the previous regulatory procedure, the committees have three possibilities of opinion, i.e., negative opinion, positive opinion and no opinion. In the regard of no opinion or negative opinion, the proposal has to be referred to the Council that will then take a decision by qualified majority [...]”.

See Curtin, Deirdre., *Executive Power of the European Union : Law, Practices, and the Living Constitution*, Volume XII/4, Oxford University Press, 2009, p. 118.

⁴⁸⁵ See Paragraph 2 Article 5 Regulation (EU) No 182/2011.

⁴⁸⁶ See Paragraph 3 Article 5 Regulation (EU) No 182/2011.

⁴⁸⁷ See Paragraph 4 Article 5 Regulation (EU) No 182/2011.

⁴⁸⁸ See Subparagraph 1 Paragraph 5 Article 5 Regulation (EU) No 182/2011.

⁴⁸⁹ See Subparagraph 2 Paragraph 5 Article 5 Regulation (EU) No 182/2011.

Finally, it has been noted that the Comitology procedure in the current GSP is carried out by the Generalised Preferences Committee and is maintained for the coming GSP. The Generalised Preferences Committee was established as a part of the control mechanism in order to ensure that a transparent and fair system is implemented by the Commission. The new Comitology decision that replaced the old Comitology decision has created greater differences in the application of the Comitology procedure because of the simplification of the procedure.

IX. The EU GSP as derogation from the Common Customs Tariffs.

The Common Customs Tariffs (CCT) is the main characteristic of the customs union. The CCT plays an important role in the import duties from third countries. Since 1968, the member states have not been allowed to unilaterally carry out customs policies, for instance, to suspend customs duties or change CCT. The normal application of CCT can only be waived by the Council through the adoption of various tariff measure regulations.⁴⁹⁰ The CCT is regulated under Council Regulation 2658/87, and has been established to allow the tariff developments negotiated in the World Customs Organization (WCO) to be adopted into the Community system.⁴⁹¹ The Commission operates the CCT based on the principle laid down in Article 27 of the EC Treaty.⁴⁹² The establishment of CCT is based on Articles 23, 26, and 27 of the EC Treaty.⁴⁹³ Under certain conditions the Council or the Commission are able to authorise tariff quotas at reduced duty or duty free. Article 26 of the EC Treaty regulates a general power to adjust (the power to alter or suspend) duties in the CCT.⁴⁹⁴ The CCT establishment and operation by the Commission must be based on some principles that are set out as follows:⁴⁹⁵

- (a) The need to promote trade between member states and third countries;
- (b) Development in conditions of competition within the Community insofar as they lead to an improvement in the competitive capacity of undertakings;
- (c) The requirements of the Community as regards the supply of raw materials and semi-finished goods; in this connection the Commission must take care to avoid distorting conditions of competition between member states in respect of finished goods; and
- (d) The need to avoid serious disturbances in the economies of member states and to ensure rational development of production and expansion of consumption within the Community.

The CCT envisages general rules for the interpretation of nomenclature. It's compiled with general rules concerning nomenclature and duties. The Customs Code Committee also provide information on the interpretation of the tariffs.⁴⁹⁶ The CCT is consisting of twenty-one sections and conceiving ninety-nine Chapters. The first twenty-four of this Chapter regulate concerning "*agricultural products and products of the food industry*". All industrial products regulated in the rest of seventy-five Chapters.⁴⁹⁷ Products regulated by Euratom Treaty covered by special rules, thus, it included in the CCT annexed to Council Regulation 2658/87. The EU GSP accords tariff

⁴⁹⁰ See See Moussis, Nicholas., 2005, *Op. Cit.* p. 69.

⁴⁹¹ See Gormley, Laurence W., *EU Law of Free Movement of Goods and Customs Union*, Oxford University Press, New York, 2009, paragraph 2.01.

⁴⁹² See *Ibid.*, paragraph 2.02.

⁴⁹³ See *Ibid.*, paragraph 2.03.

⁴⁹⁴ See *Ibid.*, paragraph 2.04.

⁴⁹⁵ See *Ibid.*, paragraph 2.05.

⁴⁹⁶ See *Ibid.*, paragraph 2.10.

⁴⁹⁷ See *Ibid.*, paragraph 2.06.

preferences to all developing countries (beneficiary countries). Quotas and other types of modifications to the CCT applied under Article 26 of the EC Treaty. Member states not allowed modifying the level of charges imposed under the CCT (or other Community legislation) by unilaterally applying additional national duties and/or increasing the tariff.⁴⁹⁸

According to Article XXIV of WTO, Regional Trade Agreements (RTAs), for example customs unions, must fulfil two criteria : (i) they should not lead to an increase in average trade barriers against third parties; and (ii) they should lead to the lowering of tariffs and non-tariff barriers on “*substantially all*” trade between member countries.⁴⁹⁹ In the custom union, CCT applied to the goods originating from non-member states.⁵⁰⁰

The membership of Unions is the maximum preferential treatment of the EU. In other words, when a state entitled EU membership, they automatically entitled the privilege provided by the Union’s. The main characteristic of the Unions is integration through establishment common policies such as CCP, CAP, and competition policy, and common basic rules. These common rules and policies regulate the movement of goods, services, capital, and persons.⁵⁰¹

The “*association agreements*” defined as the agreement between the EU and the third states to establish of Custom Unions or Free Trade Area (FTA). This agreement also covers common rules on “*non-trade issues*” such as mobility of citizens, industrial standards, financial aid, and development. For example, the agreement between the EU, Iceland, Liechtenstein, and Norway, called as European Economic Association (EEA).⁵⁰²

Scheme of FTA, defined as the agreement establish between EU and third states. For example, Economic-Partnership Agreements (EPAs) negotiated between the EU and its former colonies from African Caribbean and Pacific (ACP) regions.⁵⁰³ Under the scheme of non-reciprocal preferences, EU established the GSP under the Enabling Clause 1979.⁵⁰⁴

De facto the EU establish a ranking of their preferential relationship with third states, as visualised in the “*pyramid of preferences*”. These structure of pyramid figure out the preferences degree. The lower rank of the preferential treatment granted by EU moving to the downward of pyramid, respectively. The left side indicated the legal instruments granting the preferential treatment such EU Memberships, Association Agreement, Cooperation Agreement, GSP, and CCP. While, on the right side indicated the general content of the treatment.⁵⁰⁵

⁴⁹⁸ See *Ibid*, paragraph 2.09.

⁴⁹⁹ See Conconi, Paola.

⁵⁰⁰ See International Center for Economic Growth, Near East Program, *Free Trade Agreements and Rules of Origin*, Policy Brief, Economic Policy Initiative Consortium Project, Brief#0012, Retrieved from : http://www.atdforum.org/IMG/pdf/Policy_Brief_RoO.pdf, Last Accessed : 9 April 2011.

⁵⁰¹ See Conconi, Paola.

⁵⁰² See Conconi, Paola.

⁵⁰³ See Conconi, Paola.

⁵⁰⁴ See Conconi, Paola.

⁵⁰⁵ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 358.

Figure 2. The Europe Union Pyramid of Preferences



The “*maximum preferential treatment*” granted by EU membership placed in the top of pyramid. The “*association agreement*” is the preferential treatment granted by EU in the form of custom union. It is requiring unanimous approval by the Council and the European Parliament. The third rank from the top pyramid is “*cooperation agreement*”. It is involving free trade provisions and some other forms of technical cooperation. The GSP placed in the second step upper the bottom of pyramid that grant reduction of common external tariffs countries or specific product as set out under the scheme. In the base of the EU pyramid of preferences placed the CCP, wherein no specific preferences granted except for the preferences ruled under WTO Agreement.⁵⁰⁶ In the bottom line of the pyramid, provide MFN Treatment scheme, which granted to the countries that excludes from trade preferences. Approximately three quarter of EU imports are covered by non-preferential (MFN) tariffs.⁵⁰⁷

The CCT established based on uniform character, and its purposed to secure common market from trade deflections. There are some derogations of CCT, for instance, elimination of customs between the member states under FTA or custom unions, elimination of tariff under contractual preferential agreement (Cotonou Covention) and partial of full suspension of customs duties on imports under GSP scheme. The CCT “*was intended to achieve an equalization of customs charges levies at the frontiers of the union on imports from non member states, in order to prevent any trade deflection and distortion of free internal circulation or competitive conditions*”.⁵⁰⁸

X. European Union Generalised System of Preferences scheme.

The basic concept of the GSP is “*offering*” developing countries and LDCs a reduction in customs duties for “*some*”⁵⁰⁹ of their products when entering the EU market. Its purpose is to accelerate beneficiary countries to the “*fullest participation and integration in global trade*”. It encourages the improvement of state revenue, GDP, and economic development of beneficiary countries, so that they are able to compete in trade liberalisation. This preference is “*offered*” to developing countries and LDCs under some eligibilities and criteria or conditions. It must be fulfilled before acquiring

⁵⁰⁶ See Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, pp. 361-362.

⁵⁰⁷ See WTO (2007) : Conconi, Paola.,

⁵⁰⁸ See Eeckhout, Piet., 2004, *Op. Cit.*, pp. 358-359.

⁵⁰⁹ See A scheme of generalised tariff preferences 2009-2011, available at : http://europa.eu/legislation_summaries/external_trade/cx0003_en.htm, last accessed : 26 June 2011.

such facility. The criteria or conditions should be established and are solely intended “to respond positively” to the development needs of the beneficiary country and not contrary to the generalised, non-discriminatory and non-reciprocal principles of the Enabling Clause. Since, the notion of GSP is voluntary for the developed country, the preference-granting country holds the right to determine a list of products of the beneficiary country that are granted a reduction in customs duties.

The EU GSP was first introduced in 1971. Thus, the GSP was reformed in 1994 to become more “development-oriented” and to focus on the poorest countries (countries most in need). It should correspond to the GATT instruments. The GSP should be able to promote the integration of the developing country into the world economy and multilateral trading system.⁵¹⁰

X.a. General Arrangement.

X.a. 1. Conditions and Eligibility.

General arrangement is granted to all beneficiary countries excludes LDCs. Since there is no “precise” definition of developing countries, EU set out the eligibility for developing countries to obtain such preferences based on country income classification issued by the World Bank. The World Bank classifies country income into three categories, i.e., low income, lower middle, and upper middle-income countries, depending on GDP per capita. The conditions set out in Article 3 of the current GSP regulation merely based on economic criteria.⁵¹¹

First, the beneficiary country should not classified by the World Bank as a high-income country during three consecutive years.⁵¹² Second, when the value of imports for the five largest sections of its imports covered by the GSP into the Community represents less than 75 % of the total GSP-covered imports from that beneficiary country into the Community, the beneficiary country excluded from the grantees.⁵¹³ The second condition used to control “*valume of imports*”. Its avoiding to exclude a beneficiary country that do not have export diversifications and its export highly depend on the GSP scheme. This conditions essentially addressed to ensure the beneficiary countries gain the real benefit from the GSP scheme.

Third, beneficiary country will be removed from the list of beneficiary countries when benefited from a preferential trade agreement with the Community that covers all the preferences provided by the GSP scheme.⁵¹⁴ This conditions established in order to avoid overlap of preferences with the same benefits to beneficiary country. This circumstance might occur since EU has various range schemes of trade preferences granted to the developing countries.⁵¹⁵

X.a. 2. Facilities and Benefits.

Some facilities and benefits are granted under current the general arrangement. There are 6350 products covered under current general arrangement listed in annex II

⁵¹⁰ See Eeckhout, Piet., 2004, *Op. Cit.*, pp. 359-360.

⁵¹¹ See Paragraph 1 Article 3 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵¹² See Paragraph 1 Article 3 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵¹³ See Paragraph 1 Article 3 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011 .

⁵¹⁴ See Paragraph 2 Article 3 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵¹⁵ See Conconi, Paola. See also Altomonte, Carlo., Nava, Mario., 2005, *Op. Cit.*, p. 362. “[...] Whereas both this scholars explained about European Union preferential relationship with third states under Common Commercial Policy, known as pyramid of preferences [...]”. See also Candau, Fabien, Fontagne, Lionel and Jean, Sébastien, *The utilisation rate of preferences in the EU*, Presented at the 7th Global Economic Analysis Conference, Washington D.C., 17-19 June 2004, available at : <https://www.gtap.agecon.purdue.edu/resources/download/1838.pdf>, last accessed : 11 March 2011.

Regulation (EC) No. 732/2008⁵¹⁶. In the previous GSP regulation the products coverage are divided into three category, i.e., “*very sensitive, sensitive and semi-sensitive products*”. The current GSP regulation simplified it into one single category, that is, “*sensitive products*”. Access of duties-free granted to non-sensitive products except for agricultural components, as stipulated in the Paragraph 1 Article 6 Council Regulation (EC) No 732/2008:

“[...] *Common Customs Tariff duties on products listed in Annex II as non-sensitive products shall be suspended entirely, except for agricultural components [...]*”.

The sensitive products listed in Annex II of the current GSP regulation, its CCT *ad valorem* duties reduced by 3.5 percentage points.⁵¹⁷ Products of Sections XI (a) and XI (b), textile products, and clothing materials given 20% tariff reduction.⁵¹⁸ The general arrangement provides specific provisions for sensitive products under CCT specific duties with 30% tariff reduction.⁵¹⁹ This facility revoked when the products graduated (section graduation) or removed from the list of preference.⁵²⁰ General arrangement GSP rates for sensitive products calculated in the following methods:

- a. A flat-rate reduction of 3.5 percentage points to the MFN duty, which applicable to the *ad valorem* duties.
- b. A 30% reduction in the MFN duty where only specific duties apply.
- c. In the case duties are composed of both *ad valorem* and specific duties, a flat-rate reduction of 3.5 percentage points applicable to the *ad valorem* duties only.
- d. Limited exceptions apply for textiles and clothing (products of sections XI (a) and XI (b)), whose MFN duties shall be reduced by 20%.

X.b. Special incentive arrangement for sustainable development and good governance.

X.b. 1. Conditions and Eligibility.

The Special Incentive Arrangement for Sustainable Development and Good Governance, known as GSP+, introduced in 2006. The GSP+ scheme established to promote the implementation of human rights, environment and internationally labour standard, good governance and combating corruption, and combating drugs trafficking. Tariff treatment of GSP+ granted based on “*economic vulnerability and the sustainable development criteria*”. This criteria set out the standard instrument of 27 international conventions, as listed in Annex III. Beneficiary country obliged to ratify and implement effectively such instrument under their national legislation. In 2006 to

⁵¹⁶ See United Conference on Trade and Development, *Generalized System of Preferences: Handbook on The Scheme of The European Community*, pp. 21 - 34, United Nations, New York and Geneva, 2008, available at : http://193.194.138.235/en/docs/itcdtsbmisc25rev3_en.pdf, last accessed : August 2010.

⁵¹⁷ See Paragraph 2 Article 6 of the Council Regulation (EC) No 732/2008. See also Paragraph 3 Article 6 Council Regulation (EC) No 732/2008, stipulated : “[...] Where preferential duty-rates, calculated in accordance with Article 7 of Regulation (EC) No 980/2005, on the Common Customs Tariff *ad valorem* duties applicable on 25 August 2008, provide for a tariff reduction, for the products referred to in paragraph 2 of this Article, of more than 3,5 percentage points, those preferential duty-rates shall apply [...]”.

⁵¹⁸ See Paragraph 2 Article 6 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵¹⁹ See Paragraph 4 Article 6 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011, stipulated : “[...] Common Customs Tariff specific duties, other than minimum or maximum duties, on products listed in Annex II as sensitive products shall be reduced by 30 % [...]”. For the application of the paragraphs 2 and 4 Article 6 Council Regulation (EC) No 732/2008, it should referred to paragraphs 5 and 6 as well of the same article, stipulated : “[...] Where Common Customs Tariff duties on products listed in Annex II as sensitive products include *ad valorem* duties and specific duties, the specific duties shall not be reduced. “Where duties reduced in accordance with paragraphs 2 and 4 specify a maximum duty, that maximum duty shall not be reduced. Where such duties specify a minimum duty, that minimum duty shall not apply [...]”.

⁵²⁰ See Paragraph 7 Article 6 Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011, stipulated : “[...] The tariff preferences referred to in paragraphs 1, 2, 3 and 4 shall not apply to products from sections in respect of which those tariff preferences have been removed, for the country of origin concerned, in accordance with Article 13 and Article 20(8) as listed in column C of Annex I [...]”.

2008, there are 14 developing countries granted GSP+ arrangement. The GSP+ deemed as the effective and efficient tool to promote sustainable development and good governance through trade. This scheme still maintained and unchanged until 31 December 2013⁵²¹.

The criteria of economic vulnerability on GSP+ set out in the Paragraph 2 Article 8. A beneficiary country qualified as vulnerable country based on categories, as follows:

- (a) A developing country, which is not classified by the World Bank as a high-income country during three consecutive years.
- (b) Whereas the five largest sections of its GSP covered imports into the Community represent more than 75 % in value of its total GSP covered imports, or in other words, it has a non-diversified economy.⁵²²
- (c) A developing country of which the GSP covered imports into the Community represent less than 1 % in value of the total GSP covered imports into the Community.⁵²³

Paragraph 1 Article 8 of the GSP regulation laid down requirement for beneficiary countries to obtain facilities of GSP+. Beneficiary countries has to meet this requirement before submitting a request of GSP+ facilities and benefits. These requirements obliges the candidate beneficiary country of GSP+ to :

- (a) It has ratified and effectively implemented 27 international conventions listed in Annex III in the current GSP regulation.
- (b) It has to give an undertaking to maintain the ratification of the international conventions and their implementing legislation and measures, and accepts regular monitoring and review of its implementation record in accordance with the implementation provisions of the conventions it has ratified.
- (c) It has to meet economic vulnerability criteria.

The Commission will keep reviewing and assessing the status of ratification and enforcement of the instrument in the beneficiary countries by examining available information from relevant monitoring bodies. The Commission submitting to the Council the summary report on the status of ratification and available recommendations provided by relevant monitoring bodies.⁵²⁴ It will be used as a discussion reference for the next regulation. This mechanism is aimed to ensure the GSP+ utilized by the beneficiary countries appropriately.

Only beneficiary country that meets the conditions set out by the regulation able to propose a request to obtain facilities of the GSP+ scheme.⁵²⁵ Therefore, beneficiary country needs to investigate their possibility of obtaining additional preferences under GSP scheme.⁵²⁶ Beneficiary country has to submit the writing request to the Commission accompanied with comprehensive information concerning the ratification of the related conventions. Beneficiary countries have to submit evidence of the adoption and implementation of those conventions in their national legislation.⁵²⁷ The Commission examining the request from the beneficiary country or territory on the

⁵²¹ See Paragraph 5 Article 1 Regulation (EU) No 512/2011 of the European Parliament and of The Council.

⁵²² “[...] Non diversified economy is measured according to the fact that its five largest sections of GSP-covered imports represent more than 75% in value of its total GSP-covered imports to the EU [...]”. See EU GSP Handbook.

⁵²³ Bartels noted that this criterion is not defined in terms of the country at issue, but in terms of EU imports, an entirely independent factor. As such, by definition it *cannot* be a relevant criterion for discriminating between developing countries.

⁵²⁴ See Paragraph 3 Article 8 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵²⁵ See United Conference on Trade and Development, *Generalized System of Preferences: Handbook on The Scheme of The European Community*, p. 13, United Nations, New York and Geneva, 2008, available at : http://193.194.138.235/en/docs/itcdtsbmisc25rev3_en.pdf, last accessed : August 2010.

⁵²⁶ See *Ibid*,

⁵²⁷ See Paragraph 2 Article 9 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

eligibility to obtain GSP+.⁵²⁸ The formalities and procedures to obtain GSP+ facility seen as obstacle for beneficiary countries, on the other hand, EU needs to ensure that GSP+ granted appropriately. In this point, Lorand Bartels criticizing GSP+ as follows:

“[...] a further difficulty with the EU’s GSP+ arrangement concerns the sequencing of the grant of preferences and the conditions to be met. Here the EU seems to have created a paradox. If one accepts the stated rationale for this arrangement, the GSP+ preferences are designed to enable countries to meet the cost of ratifying and implementing certain conventions. The problem is that the preferences are also only made available once this has been done. As there is a lead time before the benefits begin to flow, this means that the GSP+ beneficiaries are required to bear an immediate cost, which, in theory, will be compensated later [...]”.⁵²⁹

On this point of view, the conditions set out under GSP+ will burden extra cost to beneficiary countries. This extra cost is non-trade conditions, which probably not all the beneficiary countries could afford it. In addition, Bartels also noted, “*a country that has not ratified a convention may have precisely the same development needs as one that has*”.⁵³⁰

Moreover, the conditions of GSP+ seems do not taking into account existence of the territories as the GSP beneficiary, where they have the same right to obtain those facilities and benefits. The special territory, for instance Macao⁵³¹, lacks of the international legal personality required to ratify the conventions, consequently *ipso facto* ineligible for GSP+ preferences. Based on such reason Bartels criticized the GSP+ to comply with the condition set out by the Appellate Body regarding “*similarly situated*” interpretation on the same preferences.⁵³²

X.b.2. Facilities and Benefits.

Facilities and benefits of the GSP+ is designed to promote implementation of sustainable development and good governance in the beneficiary country. The GSP+ established as the response of specific needs of developing country to reduce poverty, increasing people welfare, recognition, and protection of human right, eliminating discrimination between man and woman, and improving economic development.. For instance, the international convention labor standard and environment deemed give directly influence toward industrialization in developing countries. As a matter of fact, many developing countries do not put enough concerns to social problems that indirectly resulted from the industrialization process. Such as standard minimum age of labor, wages standard, worker insurance protection, wages equality between man and woman, environmentally sounds waste management of industries, and corruption in the public services. In the end, the people welfare significantly contributes the economic growth of a country.

There are 6400 products coverage in the GSP+, listed in the Annex II of the current GSP regulation. The facilities and benefits provide under GSP+ scheme govern by Article 7 of the Council Regulation (EC) No 732/2008.⁵³³ Non-sensitive products

⁵²⁸ See Paragraph 1 (b) Article 9 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵²⁹ See Bartels, Lorand., *The WTO legality of the EU’s GSP+ arrangement*, available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=986525&rec=1&srcabs=667283, last accessed : 10 December 2010.

⁵³⁰ See Bartels, Lorand.

⁵³¹ See Annex I Beneficiary countries and territories of the Community’s scheme of generalised tariff preferences of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵³² See Bartels, Lorand.

⁵³³ See United Conference on Trade and Development, 2008. The calculation of GSP+ rate :

maintained duty-free entry, where “CCT *ad valorem* duties on all products listed in Annex II which originates in a country included in the special incentive arrangement for sustainable development and good governance shall be suspended.”⁵³⁴ In respect of sensitive product, duty free entry is applied, but when duty composed of both *ad valorem* and specific duties.⁵³⁵

X.c. EBA.

X.c. 1. Conditions and Eligibility.

The legal basis of special arrangement for LDC is paragraph 2 (d), paragraph 6, paragraph 7 and paragraph 8 of the Enabling Clause 1979.⁵³⁶ The policy to provide special arrangement for LDC due to consideration regarding special economic difficulties and particular development, financial and trade needs⁵³⁷ of LDC. Developed countries are required to design particular policy to “respond positively” such needs.⁵³⁸

According to the rules laid down in the Paragraph 8 Article 11 of the Council Regulation (EC) No 732/2008, the requirement to grant the special arrangement, the beneficiary country must includes in the UN list of the LDC. Means if the beneficiary country excluded from the UN list of the LDC, accordingly, the beneficiary country in should be withdrawn from the list of the special arrangement for the LDCs. After the beneficiary country removed from the list of grantees special arrangement for the LDC, according to the GSP regulation, it should be established a transitional period at least three years. Since the tariffs reduction for LDC under EBA regime almost zero percent, therefore, such transitions period is very crucial to provide opportunity for government and traders re-adjust their trade policies to compete in the market.

X.c. 2. Facilities and Benefits.

The beneficiary countries that included into the list of grantees special arrangement for the LDC entitled benefits for their products as follows:

1. Total suspension of duty for all eligible products, whether sensitive or non sensitive, whose duty is composed of *ad valorem* duty only.
2. Total suspension of duty for all eligible products, whether sensitive or non sensitive, whose duty is composed of specific duty only.
3. When the duty rate of an eligible product is composed of both *ad valorem* and specific duty, only the *ad valorem* duty is totally suspended, for instance the total payable tariff is the specific duty component only. If the tariff is composed of 10% (*ad valorem* duty) and 50 euros per 1,000 kg (specific duty), the total suspension of duty applies to the 10% part only, meaning that the full amount of the specific duty component continues to apply (in this case, 50 euros per 1,000 g).

⁵³⁴ See Paragraph 1 Article 7 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵³⁵ See Paragraph 2 Article 7 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011, stipulate : “[...] Common Customs Tariff specific duties on products referred to in paragraph 1 shall be suspended entirely, except for products for which the Common Customs Tariff duties include *ad valorem* duties. For products with CN code 1704 10 90, the specific duty shall be limited to 16 % of the customs value [...]”.

⁵³⁶ See Waiver Decision on the Generalized System of Preferences, GATT Document L/3545, 25 June 1971, BISD 18S/24 (attached as Annex D-2 to the Panel Report). See also Waiver Decision on Preferential Tariff Treatment for Least-Developed Countries, WT/L/304, 15 June 1999.

⁵³⁷ See Paragraph 6 of the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (Enabling Clause), GATT Document L/4903, 28 November 1979, BISD 26S/203.

⁵³⁸ This refers to the paragraph 3 (c) of the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (Enabling Clause), GATT Document L/4903, 28 November 1979, BISD 26S/203. See also Paragraph 6.7 Panel Reports in *EC-Preferences Case* : “[...] India overlooks that Paragraph 3(c) applies also with respect to the preferences for LDCs envisaged under Paragraph 2(d). It is obvious that such preferences must respond to the specific needs of the LDCs, and not to those of all developing countries. Moreover, India's interpretation would have the result that any GSP would have to be administered on a 'lowest common denominator basis [...]”.

- (a) The product coverage under this arrangement includes the entire product except arms.⁵³⁹
- (b) The Common Customs Tariff duties on all products from Chapters 1 to 97 of the Harmonised System totally suspended except those from Chapter 93.⁵⁴⁰
- (c) The Common Customs Tariff duties on the products under tariff heading 1006⁵⁴¹ reduced by 80 % until 31 August 2009, and suspended entirely with effect from 1 September 2009.⁵⁴²
- (d) The Common Customs Tariff duties on the products under tariff heading 1701⁵⁴³ reduced by 80 % until 30 September 2009, and suspended entirely with effect from 1 October 2009.⁵⁴⁴

Paragraph 6 Article 11 of the Council Regulation (EC) No 732/2008 laid down that the rule about import licence. Whereas, the imports of products under tariff heading 1701 under special arrangement for the LDCs required import licence. This rule is effective from 1 October 2009 to 30 September 2015.⁵⁴⁵

XI. Graduation and de-graduation system in the EU Generalised System of Preferences.

XI.a. The graduation doctrine

The “*graduation*” doctrine in the GSP was developed by the US, and was then adopted by the EU and Japan. Hudec defines the graduation doctrine as “*an advanced developing countries and the market access they get depends on their reciprocal concessions*”. Literally, graduation is defined as the condition when the non-reciprocity policy is no longer “*viable*”. Hudec stresses that the “*graduation*” principle demands reciprocity only from the “*more advanced developing countries*”. In this regard, Hudec does not directly mention developed countries but prefers to use the word “*advanced*” to classify developing countries to which the demands of reciprocity are applied.⁵⁴⁶ According to Hudec, the graduation mechanism is practically used in trade liberalisation, in the safeguard mechanism and in removing benefits from the GSP scheme.

The basic concept of graduation is defined when the “*advanced developing country*” has to offer reciprocity or developed countries will not grant any further trade liberalisation on their products.⁵⁴⁷ According to this basic idea, the word “*advanced*” removes the inequalities position that is used to justify legal “*leniency*” under the non-

⁵³⁹ It should be noted that “Everything but Arms” (EBA) initiative which established under Regulation (EC) No. 416/2001 amending Regulation (EC) No. 2802/98, has been incorporated into special arrangement for the LDCs under Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011 of The European Parliament and of The Council.

⁵⁴⁰ See Paragraph 1 Article 11 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵⁴¹ HS Codes of Heading 1006 is Rice.

⁵⁴² See Paragraph 2 Article 11 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011.

⁵⁴³ HS Codes of Heading 1701 is Cane or beet sugar and chemically pure sucrose, in solid form Raw sugar not containing added flavouring or colouring matter.

⁵⁴⁴ See Paragraph 3 Article 11 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011 of The European Parliament and of The Council. See also Paragraph 4 Article 11 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011. Following this regulation, “[...] by the period 1 October 2009 to 30 September 2012 the importer of products under tariff heading 1701 must undertake to purchase such products at a minimum price not lower than 90 % of the reference price (on a cif basis) set in Article 3 of Council Regulation (EC) No 318/2006 of 20 February 2006 on the common organisation of the markets in the sugar sector (1) for the relevant marketing year [...]”.

⁵⁴⁵ See Paragraph 5 Article 11 of the Council Regulation (EC) No 732/2008 as amended by Regulation (EU) No 512/2011 of The European Parliament and of The Council.

⁵⁴⁶ See Hudec, Robert E., 1987, *Op. Cit.*, p. 179.

⁵⁴⁷ See Hudec, Robert E., 1987, *Op. Cit.*, p. 180.

reciprocal principle.⁵⁴⁸ The basic concept of graduation also places the “*advanced developing country*” and developed country as equal trading partners, where trade concessions can be applied. As Hudec describes, “*the graduation doctrine merely carries the idea to declare that advanced developing countries are rich enough to pay concessions like everyone else*”.

The trade liberalisation framework applies the principle of fair competition and market economy. Under the trade liberalisation system, products and services enter global competition with a free price mechanism, where supply and demand has a significant role in the influence of the price.

Graduation is also applied in emergency safeguard measures that are imposed when imports of a particular product cause injury to a domestic industry.⁵⁴⁹ For instance in the GSP, normal CCT duties are applied to the product benefitting from GSP when the importation of the product originating in a beneficiary country “*causes or threatens to cause, serious difficulties to a Union producer of like or directly competing products*”. Graduation in this context safeguards measures that are not considered the standard definition of “*advanced developing country*”, since such graduation is classified as necessary conduct. Such graduation is usually applied to a certain kind of product and for valid periods, which means that the preferences tariff can be re-applied again to the product of concern.

The application of the graduation mechanism in the EU GSP is divided into two: “*total*” graduation, and “*section*” graduation. “*Total graduation*” is based on the concept that the benefits of the GSP are unilateral concessions that are granted to help developing countries. The GSP must lose its justification when countries reach a certain level of economic development. At that point, GSP treatment should be withdrawn entirely.⁵⁵⁰

As explained above, the graduation doctrine is defined as the condition when “*advanced developing countries*” may have to offer some degree of reciprocity if they wish to avoid a corrosion of their trade position. The limited concessions that are presently developed could cause exit from the “*graduation game*”, however, there is need for overall change in the trade policies of developing countries.⁵⁵¹

Noted by Hudec, the US continues to insist on making its own decisions about who is poor enough to be worthy of discrimination. It also claims the unilateral right to graduate most prosperous developing countries and to revoke preferences in individual product categories when they are no longer “*needed*” (in the EU GSP system it is known as section graduation).⁵⁵² Further, the US also points out that poverty is not the only criterion of moral desert.⁵⁵³ This means that poverty no longer becomes the only justification to consider whether a developing country deserves or does not deserve to receive GSP facilities.

Current US GSP legislation applies the “*moral worth*” of developing countries according to whether they are cooperating to help prevent the traffic of narcotics, the

⁵⁴⁸ Japan also used term “advanced” beneficiaries on their GSP graduation.

⁵⁴⁹ See Hudec, Robert E., 1987, *Op. Cit.*, p. 180.

⁵⁵⁰ See Hudec, Robert E., 1987, *Op. Cit.*, p. 181.

⁵⁵¹ See Hudec, Robert E., 1987, *Op. Cit.*, p. 183.

⁵⁵² See Hudec, Robert E., 1987, *Op. Cit.*, p. 191.

⁵⁵³. “[...] Desert is sometimes proposed as a fundamental principle of morality or justice: The good things in life should accrue to people in proportion to their moral desert or means as the condition of being deserving of something. This principle can be regarded as a regulatory ideal a standard for designing, assessing, and reforming institutions, laws, and social practices [...]”. See Arneson, Richard J., The Smart Theory of Moral Responsibility and Desert, version 8/23/02, available at : <http://philosophyfaculty.ucsd.edu/faculty/rarneson/smarttheory2.pdf>, last accessed : 12 September 2011.

counterfeiting of goods and the theft of intellectual property. The EU GSP scheme also uses “*non-trade conditionality*”, in the previous arrangement known as the Drugs Arrangement. Thus, it is replaced by a special incentive arrangement on sustainable development and good governance in which the requirements of ratifying and implementing 27 international conventions are imposed. Since the “*conditions unrelated to trade*⁵⁵⁴ or *non-trade considerations*⁵⁵⁵ are imposed”, anything can become a condition of moral worthiness.⁵⁵⁶

The Graduation mechanism is considered as an important “modification” of GSP implementation reform. However, for the beneficiary country that graduated from the scheme, the value of what the market access created under GSP is extremely reduced. The Graduation mechanism apparently proves that the GSP system is an unstable investment for developing countries, due to the notion of a “grant” from the preference-granting country.⁵⁵⁷ Graduation from the GSP list could affect the state income of the beneficiary country (export earnings) and traders (exporter in beneficiary country and importer in preference-granting country). Hudec argues that the GSP and other preference schemes are a bad investment for developing countries. It has been identified that market access is the main problem for developing countries where they lack the function of economic power.⁵⁵⁸

Graduation potentially worsens the trade conditions for the individual beneficiary countries that are excluded by the preference-granting country. Wherein, after graduation, the developing countries have to compete with other developing countries, which still receive GSP facilities. In other words, the beneficiary country excluded from the GSP list has a “*discriminatory advantage*” that did not exist before.⁵⁵⁹ The graduation mechanism could apparently be the most powerful “*weapon*” of the preference-granting countries to increase their position bargaining under the Enabling Clause to accord differential and more favourable treatment to developing countries.⁵⁶⁰ With respect to such clause, the principle of stability and predictability should be applied when preference market access is facilitated under the GSP scheme that has been removed. It is also important to induce new investment or to collect the value of investments already made.⁵⁶¹

According to Hudec, although GSP is a bad investment, it is not easy to erase such system from the world trading system. Graduation is considered as a good instrument to control the implementation of GSP for the countries in most need. However, it is not a good solution to invite discrimination in trade. Let us assume that the competitors still enjoy preferential facilities, this would disadvantage or maybe worsen the position of graduated countries. It should be noted, that discrimination still exists in trade and in this matter, graduation puts a country vis-à-vis with its competitor under discriminatory circumstances. Even though, “*advanced developing countries*” are able to endure such change and are maybe compelled to do so if they reach an income-export level where welfare claims become politically unacceptable. Nevertheless, it will never be possible to persuade them that graduation from GSP is for the sake of their economic

⁵⁵⁴ See Julia Ya Qin, *Defining Non-discrimination Under The Law Of The World Trade Organization*, available at : <http://www.worldtradelaw.net/articles/qin nondiscrimination.pdf>, p. 289.

⁵⁵⁵ See also Robert, Howse., 2003., *Op. Cit.*, p. 394.

⁵⁵⁶ See Hudec, Robert E., 1987, *Op. Cit.*, p. 191.

⁵⁵⁷ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 191-193.

⁵⁵⁸ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 192-194.

⁵⁵⁹ See Hudec, Robert E., 1987, *Op. Cit.*, p. 195.

⁵⁶⁰ “[...] developed countries have never accepted that they are only able to operate a GSP scheme where the scheme is completely unconditional and non-selective [...]”. See Robert, Howse., 2003, *Op. Cit.*, p. 395.

⁵⁶¹ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 191-193.

benefit.⁵⁶² In addition, Özden and Reinhardt have studied that when GSP preferences are removed by graduation, developing countries become less protectionist, and more competitive.⁵⁶³

XI.b. Graduation mechanism under EU GSP.

The graduation system under trade preferences is considered as a “*counter-reaction*”, wherein the *advance developing country* is revoked from trade preference beneficiary status. Since the 1970s, the graduation system has obtained some formal recognition under trade preferences. Nowadays, it has been adopted into the EU GSP. The graduation system was established in order to face the strong demands of enlargement of trade preferences that continue today.⁵⁶⁴ The graduation system is maintained for the New EU GSP scheme. The Graduation System is applied to all products in a section of the Combined Nomenclature (CN) code.⁵⁶⁵

The graduation system is also defined as the withdrawal of the beneficiary country when entire sections of products originating from the concerned country meet the standards of the graduation section.⁵⁶⁶ In this regard, graduation of the beneficiary country from the GSP scheme must be based on certain conditions referred to in sections of the CCT. The withdrawal of preferences would not be taken immediately but during the three consecutive years, the beneficiary country has to meet the standard of graduation. The evaluation of three consecutive years aims to apply principles of predictability and fairness in the graduation system. Such principles are used to minimise the “*effect of large and exceptional variations in import statistics*”. The most important standard of “*three consecutive years*” is also aimed to provide an “*early-warning system*” for traders in beneficiary countries before any graduation is executed.⁵⁶⁷

The beneficiary country graduates from the GSP if its export products are able to compete on the EU market. In other words, if the beneficiary country’s market performance reaches a certain standard as determined by the EU, the concerned beneficiary country will be assessed in the graduation mechanism. The standard of market performance for the beneficiary country can be interpreted when the level of competitiveness and import penetration are secured for further growth, even without preferential access to the EU market.⁵⁶⁸ Such graduation might lead to the suspension of preferences because it is considered that the concerned beneficiary country does not need the GSP scheme to increase its export earnings. The Commission argues that, “*given the high level of competitiveness, there is no further justification for a continuation of preferential tariff treatment*”.⁵⁶⁹

Therefore, the graduation mechanism should not be interpreted as a sort of penalty but as a parameter to measure the “*fruitfulness*” of GSP scheme implementation

⁵⁶² See Hudec, Robert E., 1987, *Op. Cit.*, p. 195.

⁵⁶³ See Hudec, Robert E., 1987, *Op. Cit.*, p. 163.

⁵⁶⁴ See Hudec, Robert E., 1987, *Op. Cit.*, pp. 16-17.

⁵⁶⁵ See United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 - 34, United Nations, New York and Geneva, 2008, available at : http://193.194.138.235/en/docs/itcdtsbmisc25rev3_en.pdf, last accessed : August 2010..

⁵⁶⁶ See Article 13 of the Council Regulation (EC) No. 732/2008.

⁵⁶⁷ See Recitals 20 of the Council Regulation (EC) No. 732/2008.

⁵⁶⁸ See available at : http://trade.ec.europa.eu/doclib/docs/2009/march/tradoc_142662.pdf, last accessed : 04 May 2011.

⁵⁶⁹ See Stevens, Christopher., Kennan, Jane., *GSP Reform: a longer-term strategy (with special reference to the ACP)*, Report prepared for the Department for International Development, Institute of Development Studies, February, 2005, p. 6, available at : http://www.acp-eu-trade.org/library/files/Stevens-Christopher-and-Kennan-Jane_EN_022005_IDS_GSP-reform-a-longer-term-strategy.pdf, last accessed : 04 May 2011.

in the beneficiary country concerned. Graduation is an indication of export boost in the beneficiary country. The graduation mechanism is designed to ensure that benefits from the scheme go to the targeted country that is most in need.⁵⁷⁰ In short, graduation is the crucial mechanism in “*focusing the GSP goals*”.⁵⁷¹

As mentioned above, there are two kinds of graduation mechanism under EU GSP.⁵⁷² The first mechanism is “*total exclusion*”, “*revocation*” or “*country graduation*” from the GSP scheme list.⁵⁷³ A beneficiary country is totally excluded from the GSP scheme when it meets two conditions. First, the beneficiary country has been classified by the World Bank as a high-income country over three consecutive years. Second, when the value of imports for the five largest sections of its imports covered by the GSP into the Union, represents less than 75 % of the total GSP covered imports from that beneficiary country into the Union.

The requirements of total exclusion set out in the previous GSP scheme⁵⁷⁴ were based on “*development index*”⁵⁷⁵, “*market share*”⁵⁷⁶ and “*specialisation index*”⁵⁷⁷. Panagariya defines the development index as a parameter measuring the “*country’s industrial development and participation in international trade relative to EU*”.⁵⁷⁸ The specialisation index refers to the importance of a sector in Community imports from a beneficiary country. It is based on the ratio between that country’s share in all imports

⁵⁷⁰ See Customs duties and procedures, *EU GSP 2009-2011 European Union agrees to maintain trade preferences for developing countries*, available at http://eeas.europa.eu/delegations/india/documents/eu_india/022_06_tariff_preferences_en.pdf, last accessed : 4 May 2011. See also : A simpler mechanism for graduation, available at : http://www.europa-eu-un.org/articles/fr/article_4337_fr.htm, last accessed : 4 May 2011. See also Stevens, Christopher., Kennan, Jane., 2005, *Op. Cit.*, p. 6.

⁵⁷¹ See Stevens, Christopher., Kennan, Jane., 2005, *Op. Cit.*, p. 5.

⁵⁷² See Panagariya, Arvind, *EU Preferential Trade Policies and Developing Countries*, 27 August, p. 13, available at : <http://129.3.20.41/eps/it/papers/0308/0308014.pdf>, last accessed : 04 May 2011.

⁵⁷³ See Article 3 paragraph 1 of the Council Regulation (EC) No. 732/2008.

⁵⁷⁴ See Article 12 of the Council Regulation (EC) No 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004 (Official Journal, L 211/1, 6.8.2008, EN), available at : http://trade.ec.europa.eu/doclib/docs/2003/may/tradoc_113021.pdf, last accessed : May 2011. The tariff preferences shall be removed in respect of products originating in a beneficiary country, of a sector which has met, during three consecutive years, either of the following criteria:

- (a) the country’s development index as defined in Annex II, is higher than -2 : Community imports from that country of all products of the sector concerned and included in the arrangements enjoyed by that country exceed 25 % of Community imports of the same products from all countries and territories listed in Annex I;
- (b) the country’s development index as defined in Annex II, is higher than -2 : the specialisation index of the sector concerned is higher than the threshold corresponding to that country’s development index, as defined in Annex II, and. Community imports from that country of all products of the sector concerned and included in the arrangements enjoyed by that country exceed 2 % of Community imports of the same products from all countries and territories listed in Annex I.

Development index	Threshold for the Specialisation index
= or > - 1,00	100 %
< - 1,00 and = or > - 1,23	150 %
< - 1,23 and = or > - 1,70	500 %
< - 1,70 and = or > - 2,00	700 %

⁵⁷⁵ See Annex II Council Regulation (EC) No 2501/2001. United Nations Conference on Trade and Development, Generalized System of Preferences, UNCTAD GSP Newsletter, Number 8, UNCTAD/DITC/TNCD/Misc/2005/7/, December 2005, available at : http://www.unctad.org/en/docs/ditctnctdmisc20057_en.pdf, last accessed : May 2011. Panagariya, Arvind, 2002, *Op. Cit.*, p. 13. Stevens, Christopher., Kennan, Jane., 2005, *Op. Cit.*, p. 6.

⁵⁷⁶ See Stevens, Christopher., Kennan, Jane., 2005, *Op. Cit.*, p. 6.

⁵⁷⁷ See Paragraph (b) Article 12 of the Council Regulation (EC) No 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004.

⁵⁷⁸ See Panagariya, Arvind, 2002, *Op. Cit.*, p. 13.

from all countries, and all products of the sector concerned, whether included in the preferential arrangements or not, and its share in all imports from all countries.⁵⁷⁹

The new conditions of total exclusion are addressed to ensure that a country, even if it is classified as a high-income country, is not excluded from the scheme if the country remains dependent on a few products for a large proportion of its exports to the EU.⁵⁸⁰ This indicates the high dependency and lack of diversification of export products from the beneficiary country.

There is another reason for total exclusion related to the Preferential Trade Agreements (PTAs). When a beneficiary country benefits from a preferential trade agreement with the Union that covers all the preferences provided by the present scheme to that country, it should be removed from the list of beneficiary countries.⁵⁸¹

The second mechanism is “*graduated section*” or “*product-specific graduation*”. This section is defined as any of the sections of the CCT as laid down by Regulation (EEC) No. 2658/87.⁵⁸² The graduated section was introduced in 1995 under Council Regulation (EC) No. 3281/94. The graduation mechanism came into effect on 1 January 1998 and is maintained under the present GSP regulation by simplification of its criteria.⁵⁸³

The previous mechanism in the “*graduated section*” was based on the combination of several criteria including: “*share of GSP imports*”, “*development index*”, and “*export-specialisation index*”.⁵⁸⁴ The current GSP system uses single “*straightforward*” conditions, where the share of the country’s imports under the GSP in the sector concerned reach a certain threshold.

As noted by Panagariya, under this mechanism the beneficiary country can be graduated or excluded from certain sectors of the GSP. The graduated section is regulated in Paragraph 1 Article 13, under the GSP regulation, and stipulates as follows:

“[...] when the average value of Community imports from that country of products included in the section concerned and covered by the arrangement enjoyed by that country exceeds 15 % of the value of Community imports of the same products from all beneficiary countries and territories over three consecutive years, on the basis of the most recent data available on 1 September 2007. For each of the Sections XI(a)⁵⁸⁵ and XI(b)⁵⁸⁶, the threshold shall be 12.5 % [...]”

Once export products from the beneficiary country achieve a certain level of competitiveness in a particular section, thus the section will be excluded from the GSP beneficiary. The graduated section is applied for general arrangement⁵⁸⁷ and special

⁵⁷⁹ See Annex II of the Council Regulation (EC) No 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004.

⁵⁸⁰ See United Nations Conference on Trade and Development, Generalized System of Preferences, UNCTAD GSP Newsletter, Number 8, UNCTAD/DITC/TNCD/Misc/2005/7/, December 2005.

⁵⁸¹ See Article 3 paragraph 2 of the Council Regulation (EC) No. 732/2008. See also United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 – 34, stipulates :

“[...] if a beneficiary country is covered by another free trade agreement with the EU that provides at least the same preferences provided by this GSP scheme, it too shall be removed from the GSP beneficiary country list [...]”

⁵⁸² See Article 2 paragraph b of the Council Regulation (EC) No. 732/2008.

⁵⁸³ See also United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 – 34.

⁵⁸⁴ See Article 12 and Annex II of the Council Regulation (EC) No 2501/2001. United Nations Conference on Trade and Development, Generalized System of Preferences, UNCTAD GSP Newsletter, Number 8, UNCTAD/DITC/TNCD/Misc/2005/7/, December 2005, available at : http://www.unctad.org/en/docs/ditctnadmisc20057_en.pdf, last accessed : May 2011.

⁵⁸⁵ Textiles.

⁵⁸⁶ Clothing.

⁵⁸⁷ See Article 6 of the Council Regulation (EC) No. 732/2008.

incentive arrangement for sustainable development and good governance⁵⁸⁸. Nevertheless, the graduated section set out in Paragraph 1 of Article 13 cannot be applied to a beneficiary country in respect of any section that represents more than 50 % of the value of all GSP covered imports into the Union originating from that country.⁵⁸⁹ This indicates that the degree of dependency of the beneficiary country on export earnings of that section is very high, so that section is exempted from graduation.⁵⁹⁰ The LDCs cannot be graduated under the EBA arrangement because the graduation mechanism is only applied to the general arrangement and special incentive arrangement for sustainable development and good governance.⁵⁹¹

With regard to the graduation mechanism, either total removal or graduated section, the Commission is obliged to give notification to the beneficiary country concerned.⁵⁹² This procedure is part of the implementation of the transparency and predictability principle in order to give assurance in doing business towards traders especially in the beneficiary country. The graduated section is applied for the whole period of GSP regulation. Wherein, the recent regulation was applied from 1 January 2009 to 31 December 2011.⁵⁹³

XI.c. Function of trade statistic in graduation and de-graduation.

The calculation of the graduated section is based on the Harmonized System (HS) Commodity Codes Section⁵⁹⁴ and statistical sources, which are taken from Eurostat's⁵⁹⁵ external trade statistics.⁵⁹⁶ Intra- and Extra-EU Trade Data (COMEXT) statistics serve as the basis to calculate the share of imports to check whether the graduation threshold has been reached. COMEXT⁵⁹⁷ is a database with statistics representing the commercial interchanges between the member states of the EU and between EU member states and their commercial partners.⁵⁹⁸

The main sources of statistical data on international trade are customs records. Following the adoption of the Single Market on 1 January 1993, customs formalities between member states were removed, and so there was a new data collection system. Intra-statistic (Intrastat) was set up for intra-EU trade. In the Intrastat⁵⁹⁹ system, intra-

⁵⁸⁸ See Article 7 of the Council Regulation (EC) No. 732/2008.

⁵⁸⁹ See Article 13 paragraph 4 of the Council Regulation (EC) No. 732/2008.

⁵⁹⁰ See European Union Delegation of the European Commission to Malaysia, *The new EU Generalized System of Preferences (GSP) and what it offers to Malaysia : Overview of the new EU-GSP scheme*.

⁵⁹¹ See available at : http://trade.ec.europa.eu/doclib/docs/2009/march/tradoc_142662.pdf, last accessed : 04 May 2011.

⁵⁹² See Article 3 paragraph 3 and Article 13 paragraph 3 of the Council Regulation (EC) No. 732/2008.

⁵⁹³ See Council Regulation (EC) No 732/2008 of 22 July 2008 and amending Regulations (EC) No 552/97, (EC) No 1933/2006 and Commission Regulations (EC) No 1100/2006 and (EC) No 964/2007.

⁵⁹⁴ See available at : http://trade.ec.europa.eu/doclib/docs/2009/march/tradoc_142662.pdf, last accessed : 04 May 2011.

⁵⁹⁵ See Council Regulation (EC) No 1172/95 of 22 May 1995 on the statistics relating to the trading of goods by the Community and its Member States with non-member countries (OJ L 118, 25.5.1995, p. 10). Regulation as last amended by Regulation (EC) No 1882/2003 of the European Parliament and of the Council (OJ L 284, 31.10.2003, p. 1).

⁵⁹⁶ See Article Article 13 paragraph 5 of the Council Regulation (EC) No. 732/2008.

⁵⁹⁷ See http://epp.eurostat.ec.europa.eu/portal/page/portal/external_trade/data/database

⁵⁹⁸ See United Conference on Trade and Development, *Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, Op. Cit.*, pp. 21 – 34.. See also *Graduation from the Generalised System of Preference Scheme of the European Union (EU - GSP Scheme)*, TDB RU 33 99 02, Vol 3, 12 January 1998, available at : <http://www.customs.gov.sg/NR/rdonlyres/2EBF119F-2F7B-4B88-A558-75760993103E/12772/98GraduationFromTheGeneralised1.pdf>, last accessed : 5 January 2011.

⁵⁹⁹ “[...] Intrastat System is statistics related to the trading goods between Member States, which is regulates by Paragraph (1) Article 5 of Council Regulation 638/2004 (OJ L102/1). Intrastat data is collected by the national authorities and the relevant natural or legal persons registered for Value Added Tax are responsible for providing the information for the intrastat system to their national authority; failure by any party responsible

EU trade data is collected directly from trade operators and monthly declarations are sent to the relevant national statistics administration. Information of extra-EU and intra-EU trade is collected by member states every month. External trade data are subject to frequent revisions, due to errors, omissions. When data for the latest period is released, thus, revised data for previous periods are also available.

External trade is trade statistics that track the value and quantity of goods traded between EU member states (intra-EU trade) and between member states and non-EU countries (extra-EU trade). It is the official source of information on imports, exports, and trade balance of the EU, its member states and the euro area. External trade statistics is an important data source for many public and private sector decision-makers at an international, EU and national level. The external trade statistics are used for several benefits, especially to support the Union's planning strategy on trade policy. For example: *"to inform multilateral and bilateral negotiations within the framework of the common trade policy; define and implement anti-dumping policy; evaluate the progress of the Single Market or the integration of EU economies; carry out market research by businesses and define their commercial strategy; and compile balance of payments statistics and national accounts"*.⁶⁰⁰

Council Regulation (EC) 1172/95 governs statistics collection in external trade between the EU and its member states with third countries.⁶⁰¹ Such statistics are compiled from all the goods that enter or leave the statistical territory of the Union. Those goods are subject to approval from customs procedures. Specifically, they are related to external trade, transit, customs warehouses, free zones, and free warehouses. Statistics are to be compiled on:⁶⁰²

- (i) those goods which, having entered the statistical territory of the Community are placed there under the customs procedure of release for free circulation, inward processing or processing under customs control.
- (ii) Those goods which, being due to leave the statistical territory of the Community:
 - (a) are placed there under customs export or outward processing arrangements;
 - (b) have as their customs destination re-exportation following inward processing or, where appropriate, processing under customs control.

The Union and its member states compile external trade statistics, however, the members states have an option not to collect data statistic relating to imports or exports exceeding 1,000 euros in value or 1,000 kg in net mass. The statistics that are transmitted to the Commission do not cover the goods that are released in free circulation after being subject to inward processing or processing, neither under customs control, nor goods contained in the list of exemptions. Specific movements of the goods are subject to special provisions.⁶⁰³

for providing information to fulfil his/her obligations renders him/her liable to the penalties which Member States must lay down. Simplification is provided for, so that parties whose annual value of intra-Union trade is below the thresholds prescribed are exempted from providing any Interstat information or may provide simplified information [...]" See Gormley, Laurence W., 2009, *Op. Cit.*, pp. 161-162, paragraph 5.59-560.

⁶⁰⁰ See http://epp.eurostat.ec.europa.eu/portal/page/portal/external_trade/introduction

⁶⁰¹ See Council Regulation (EC) 1172/95, OJ L118/14, as amended : Council Regulation 1172/95 is repealed and replaced by European Parliament and Council Regulation 471/2009 (OJ L152/23, 2009) as from 1 January 2010. See Regulation 471/2009, Article 12 Regulation 1172/95 has been implemented by Commission Regulation 1917/2000 (OJ 229/14, 2000), as corr Oj L3/28, 2011 and as amended by Commission Regulation 2001/669 (OJ L224/3, 2001), 2005/1949 (OJ L312/10, 2005). As to Nomenclature of countries and territories for the puposes of external trade statistics, see Commission Regulation 1833/2006 (OJ L354/19).

⁶⁰² See Gormley, Laurence W., 2009, *Op. Cit.*, p. 163, paragraph 5.61.

⁶⁰³ See Gormley, Laurence W., 2009, *Op. Cit.*, p. 164, paragraph 5.62.

Eurostat is the statistical office of the EU, which is based in Luxembourg. It publishes official, harmonised statistics on the EU and the euro area. It also offers a comparable, reliable, and objective description of Europe's society and economy. Most of the data and information are available for the EU, member states, candidate countries, EFTA member countries, and other European countries. Thus, it is also used by the regions and cities of the EU.⁶⁰⁴ While, Eurostat's COMEXT is an enormous external trade database for the EU. It contains monetary and physical data for intra and extra-EU. It consists of 15,000 products, 250 partner countries, and various time series. In other words, COMEXT is a statistics database that represents commercial interchanges between the member states of the EU and between EU member states and their commercial partners.⁶⁰⁵ The factsheet (description of a dataset) is part of the sub-section sources of macro-economic data in the Environmental Data Centre on Natural Resources and Products (EDCNRP).⁶⁰⁶

Statistical information is important when recalculating whether a beneficiary country that has graduated from a certain section can be granted re-inclusion or "*de-graduation*". In this regard, a certain product that has graduated from a section could be listed again and receive benefits under the GSP scheme.

XI.d. Graduation and de-graduation Indonesia and other ASEAN countries.

Along with the improvement of economic development, some countries and territories attain advanced development, thus, the EU has "graduated" them from the GSP beneficiaries list. On 19 December 1997, the EU informed the beneficiary countries concerned of such graduation. According to Article 3 of EC Council Regulation No. 2623/97⁶⁰⁷ Singapore, Hong Kong and South Korea had to graduate from the GSP scheme by 1 May 1998. Those countries and territory could no longer enjoy GSP benefits for any of their products as soon as graduation came into effect. Since then, no countries have been excluded from the later EU GSP schemes except for the graduated section.⁶⁰⁸

⁶⁰⁴ See http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:Eurostat

⁶⁰⁵ See United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 - 34.

⁶⁰⁶ See http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/EDCNRP_-_Eurostat_COMEXT

⁶⁰⁷ See Official Journal L 354, 30.12.1997, p. 9

⁶⁰⁸ See United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 - 34. See also Graduation from the Generalised System of Preference Scheme of the European Union (EU - GSP Scheme), 1998.

Table 1. ASEAN Countries Status in the European Union GSP⁶⁰⁹

No.	Countries	GSP Arrangement	Graduation	
			Graduated Section	Total Exclusion
1.	Indonesia	General arrangement	S-III Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.	
2.	Brunei Darussalam	General arrangement		
3.	Malaysia	General arrangement	S-III Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.	
4.	Philippines	General arrangement		
5.	Thailand	General arrangement	S-XIV Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coins.	
6.	Singapore			Graduated
7.	Lao People's Democratic Republic	EBA		
8.	Vietnam	General arrangement	S-XII Footwear, headgear, umbrellas, sun umbrellas, walking sticks, seat-sticks, whips, riding crops and parts thereof; prepared feathers and articles made therewith; artificial flowers; articles of human hair.	
9.	Cambodia	EBA		
10.	Myanmar	EBA		

In 2005 Indonesia graduated in two sections, that is, Sections III⁶¹⁰ and Sections IX.^{611 612} While, in 2002 Indonesia graduated from 3 sections, i.e., Sections X, XIX, and XXIII.⁶¹³ In 1998 Indonesia graduated in Chapter 15,⁶¹⁴ Chapters 44 to 46,⁶¹⁵ and Chapters 64 to 67.^{616 617}

The recalculation of 2004-2006 trade data led to re-inclusion ("*degradation*") of certain product sections for six beneficiaries under the 2009-2011 schemes. These included Algeria (for Section V "*Mineral products*"); India (for Section XIV "*Jewellery, pearls, precious metals and stones*"); Indonesia (for Section IX "*Wood and articles of wood*"); Russian Federation (for Section VI "*Products of the chemical or allied industries*" and Section XV "*Base metals*"); South Africa (for Section XII "*Transport equipment*"),

⁶⁰⁹ See Annex I Beneficiary countries (1) and territories of the Community's scheme of generalised tariff preferences to the Council Regulation (EC) No 732/2008 of 22 July 2008 and amending Regulations (EC) No 552/97, (EC) No 1933/2006 and Commission Regulations (EC) No 1100/2006 and (EC) No 964/2007 (*Official Journal* L 211/1, 6.8.2008, EN).

⁶¹⁰ Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.

⁶¹¹ Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basket ware and wickerwork.

⁶¹² See Annex I Beneficiary countries and territories of the Community's scheme of generalised tariff preferences Council Regulation (EC) No 980/2005 of 27 June 2005 applying a scheme of generalised tariff preferences (*Official Journal*, L 169/1, 30.6.2005, EN).

⁶¹³ See Annex I Beneficiary countries and territories of the Community's scheme of generalised tariff preferences Council Regulation (EC) No 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004 (*Official Journal*, L 211/1, 6.8.2008, EN).

⁶¹⁴ Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.

⁶¹⁵ Wood products.

⁶¹⁶ Footwear products.

⁶¹⁷ See Annex II Part I List of sectors and countries referred to in Articles 3 and 4 (a) Council Regulation (EC) No 2820/98 of 21 December 1998 applying a multiannual scheme of generalised tariff preferences for the period 1 July 1999 to 31 December 2001 (*Official Journal*, L 357, 30.12.1998, p. 1).

and; Thailand (for Section XVII "*Transport equipment*"). The GSP preferences suspended Vietnam for Section XII "*Footwear, headgear, umbrellas, sun umbrellas, and artificial flowers*".⁶¹⁸

XI.e. Graduation mechanism in US GSP.

The US defines the graduation mechanism as removal of GSP eligibility since the country is considered to have sufficiently developed or reached a certain level of competitiveness. It is considered to no longer need GSP benefits, either as a whole or with respect to one or more products.⁶¹⁹ In the US GSP graduation system, beneficiary graduation is decided by the President. A beneficiary country graduates when it has become a "*high income*" country. The President terminates the designation of such country as a beneficiary developing country. The standard to determine that a beneficiary country has transformed into a "*high income*"⁶²⁰ country is based on the official statistics of the World Bank. Graduation is effective as of 1 January of the second year following the year in which such determination was decided.⁶²¹

In addition, graduation considerations are not merely based on GDP criteria but they also take into account some other factors. The GSP Sub-committee has the task to review such related factors. Those factors include the country's general level of development; its competitiveness in regard to the particular product; the country's practices relating to trade, investment, and workers' rights; the overall economic interests of the US, including the effect continued GSP treatment would have on the relevant U.S. producers, workers and consumers; and any other relevant information.⁶²²

XI.f. Graduation mechanism in Japan.

In Japan the GSP graduation mechanism of advanced beneficiaries is excluded from the list of GSP beneficiaries under the annual review. Japan applies the "*graduation*" process starting with "*partial graduation*", if applicable, in order to mitigate its impact on "*graduating*" economies. In this regard, a beneficiary country will not directly get total graduation. In "*partial graduation*", a product of a beneficiary country or territory is excluded from the product coverage under three requirements. First, if the country or territory in question is classified as a high-income economy in the previous year's World Bank Atlas. Second, if it is not in the World Bank Atlas, the country in question needs to have the same level of GNP (gross national product) per capita. Third, if exports of the product to Japan exceed 25% of the world's exports of the product to Japan, and more than one billion yen.⁶²³

⁶¹⁸ See Column C of annex I to the regulation No. 732/2008 (*Official Journal* L 211, 6.8.2008) against column C of annex I to Regulation (EC) No. 980/2005 (*Official Journal* L 139/1,30.6.2005). See also United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 - 34. See also Graduation from the Generalised System of Preference Scheme of the European Union (EU - GSP Scheme), 1998.

⁶¹⁹ See United Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the United States of America, , UNCTAD/ITCD/TSB/Misc.58/Rev.2, United Nations, New York and Geneva, 2010, p. 122, available at : http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc_143993.pdf.

⁶²⁰ The per capita GNP limit is set at the lower bound of the World Bank's definition of a "high income" country (which was \$11,906 in 2009).

⁶²¹ See United Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the United States of America, 2010, *Op. Cit.*, p. 64.

⁶²² See United Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the United States of America, 2010, *Op. Cit.*, p. 123.

⁶²³ See Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the Japan, UNCTAD/ITCD/TSB/Misc.42/Rev.3, United Nations, New York and Geneva, 2010, *Op. Cit.*, p. 11.

Under Japan's GSP scheme, each country or territory and product are reviewed each year. With respect to the sets of requirements above, if any of those requirements are not met, preferential tariff treatment is granted. The de-graduation system is also recognised in Japan's GSP scheme. The de-graduation system is defined when a developing country has graduated from the GSP; it has the opportunity to re-apply GSP beneficiary status as long as it is not classified as a high-income economy for three consecutive years. In this regard, a developing country submits a written request.⁶²⁴

⁶²⁴ See United Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the Japan, UNCTAD/ITCD/TSB/Misc.42/Rev.3, United Nations, New York and Geneva, 2010, *Op. Cit.*, p. 11.

Tabel 2. ASEAN Countries Graduation from EU GSP.

Product Section	Description of the Product Section	Alphabetical code	Name of the Country or Territory concerned (ranked by descending order of covered imports)	Covered imports into EU (Value)				Covered imports into EU (% share)				Graduation Threshold for the Product Section	Removal/re-establishment of preferences
				2004	2005	2006	Average 2004-2006	2004	2005	2006	Average 2004-2006		
1	2	3	4	5				6				7	8
Section III	Animal or Vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.	ID	Indonesia	759,310	729,683	763,493	750,829	31,8 %	27,0 %	23,6 %	27,5 %	15 %	Removal
		MY	Malaysia	610,393	603,447	641,894	618,578	25,6 %	22,3 %	19,8 %	22,6 %	15 %	Removal
		Total Covered Imports		2,384,348	2,706,040	3,241,889	2,777,426						
Section IV	Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes	BR	Brazil	1,068,291	1,179,631	1,133,692	1,127,205	21,0 %	20,3 %	15,4 %	18,9 %	15 %	Removal
		Total Covered Imports		5,087,100	5,810,990	7,361,636	6,086,576						
Section V	Mineral Products	DZ	Algeria	1,070,223	1,167,347	1,333,438	1,190,336	15,4 %	10,8 %	11,1 %	12,4 %	15 %	Re-established
		Total Covered Imports		6,949,500	10,808,769	12,012,955	9,923,741						
Section VI	Products of the chemical or allied Industries	CN	China	2,532,612	3,345,805	4,115,547	3,331,321	26,8 %	28,5 %	30,9 %	28,7 %	15 %	Removal
		RU	Russia	1,443,984	1,837,003	1,578,687	1,619,891	15,3 %	15,7 %	11,9 %	14,3 %	15 %	Re-established
		Total Covered Imports		9,437,804	11,700,656	13,266,277	11,468,246						
Section VII	Plastics and articles thereof; rubber and articles thereof	CN	China	3,490,568	4,381,823	4,998,478	4,290,290	47,1 %	46,9 %	45,3 %	46,4 %	15 %	Removal
		Total Covered Imports		7,410,972	9,342,906	11,034,168	9,262,682						

Section VIII	Raw hides and skins, leather, furskins and articles thereof; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	CN	China	3,943,968	4,571,861	5,112,914	4,542,914	65,0 %	67,7 %	67,6 %	66,8 %	15 %	Removal
		Total Covered Imports		6,067,643	6,753,118	7,563,482	6,794,748						
Section 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	CN	China	454,129	608,738	744,878	602,582	22,4 %	27,7 %	31,0 %	27,0 %	15 %	Removal
		BR	Brazil	390,559	339,312	338,248	356,040	19,3 %	15,4 %	14,1 %	16,3 %	15 %	
		ID	Indonesia	246,754	272,874	184,706	234,778	12,2 %	12,4 %	7,7 %	10,8 %	15 %	Re-establishment
		Total Covered Imports		2,023,622	2,203,325	2,398,922	2,208,623						
Section XI a	Textiles	CN	China	1,700,092	2,184,156	2,546,024	2,143,424	28,9 %	35,3 %	36,9 %	33,7 %	12,5 %	Removal
		IN	India	1,225,105	1,263,732	1,411,293	1,300,043	20,8 %	20,4 %	20,6 %	20,6 %	12,5 %	Removal
		Total Covered Imports		5,882,671	6,187,411	6,899,794	6,323,292						
Section Xib	Clothings	CN	China	12,617,678	18,574,973	20,792,231	17,328,294	36,0 %	46,1 %	45,6 %	42,6 %	12,5 %	Removal
		Total Covered Imports		35,049,106	40,292,783	45,596,998	40,312,962						
Section XII	Footwear; headgear; umbrellas, sun umbrellas, walking sticks, seatsticks, whips, riding-crops and part thereof; prepared feathers and articles made therewith; artificial flowers; articles of human air	CN	China	3,957,011	6,047,463	6,750,759	5,585,078	42,7 %	54,5 %	55,0 %	50,7 %	15 %	Removal
		VT	Vietnam	2,178,945	2,119,691	2,111,055	2,136,564	23,5 %	19,1 %	17,2 %	19,9 %	15 %	Removal
		Total Covered Imports		9,272,106	11,097,859	12,273,576	10,881,180						

Section XIII	Articles of stone, plaster, cement, asbestos, mica or similar materials; ceramic products; glass and glassware	CN	China	1,502,377	2,328,612	2,756,017	2,195,669	52,5 %	63,6 %	66,5 %	60,9 %	15 %	Removal
		Total Covered Imports		2,861,670	3,661,340	4,144,386	3,555,799						
Section XIV	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof; imitation jewellery; coin	CN	China	880,281	998,339	1,096,704	991,775	38,1 %	35,7 %	34,5 %	36,1 %	15 %	Removal
		TH	Thailand	568,143	629,385	702,600	633,376	24,6 %	22,5 %	22,1 %	23,1 %	15 %	Removal
		IN	India	307,488	360,170	394,250	353,969	13,3 %	12,9 %	12,4 %	12,9 %	15 %	Re-establishment
		Total Covered Imports		2,309,524	2,797,267	3,179,186	2,761,992						
Section XV	Base metals and articles of base metal	CN	China	5,376,876	6,790,728	8,447,153	6,871,586	53,5 %	53,7 %	56,9 %	54,7 %	15 %	Removal
		RU	Russia	935,056	1,400,386	1,309,542	1,214,995	9,3 %	11,1 %	8,8 %	9,7 %	15 %	Re-establishment
		Total Covered Imports		10,050,236	12,645,676	14,845,612	12,513,841						
Section XVI	Machinery and mechanical appliances; electrical equipment; parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	CN	China	20,887,766	25,446,133	31,226,371	25,853,423	59,6 %	63,1 %	64,6 %	62,4 %	15 %	Removal
		Total Covered Imports		35,046,587	40,326,677	48,338,036	41,237,100						
Section XVII	Vehicles, aircraft, vessels and associated transport equipment	CN	China	1,437,466	2,103,882	2,578,315	2,039,888	23,4 %	27,0 %	23,7 %	24,7 %	15 %	Removal
		TH	Thailand	824,096	1,064,522	1,138,887	1,009,168	13,4 %	13,6 %	10,5 %	12,5 %	15 %	Re-establishment
		ZA	South Africa	674,317	687,455	793,566	718,446	11,0 %	8,8 %	7,3 %	9,0 %	15 %	Re-establishment
		Total Covered Imports		6,143,017	7,792,156	10,378,966	8,271,380						

Section XVIII	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical, instruments and apparatus; clocks and watches; musical instruments; parts and accessories thereof	CN	China	3,448,636	3,907,951	4,609,288	3,988,625	69,2 %	70,2 %	71,2 %	70,2 %	15 %	
		Total Covered Imports		4,983,578	5,566,882	6,473,719	5,674,726						
Section XX	Miscellaneous manufactured Articles	CN	China	8,626,214	9,877,054	10,523,969	9,675,746	80,6 %	82,9 %	83,1 %	82,2 %	15 %	Removal
		Total Covered Imports		10,702,499	11,914,420	12,664,223	11,760,380						

XII. Withdrawal mechanism in the EU Generalised System of Preferences.

XII.a. Withdrawal mechanism.

As regards the nature of the GSP scheme as the “gift”,⁶²⁵ “optional”, “not obligatory”,⁶²⁶ or “unilateral grant”⁶²⁷ from the developed country to the developing country. The preference-granting country has its right to determine the eligibility of a developing country in the GSP scheme.⁶²⁸ As noted by Abdulqawi, the rules of origin are considered as criteria or conditions that are designed as subject to change by the preference-granting country. According to Harris, conditions of the GSP are “not necessarily subject to any kind of negotiation with the beneficiary countries”. It is explained that conditions in the GSP established unilaterally by the preference-granting country, could be “modified” or “withdrawn” at any moment. Those scholars justify this nature as the weakness of GSP and may cause instability in the system of preferences. However, such nature is obviously reflected in the GSP, which is implied in the possibilities of temporary withdrawal in respect of all or certain products originating in a beneficiary country, on the grounds of certain reasons.⁶²⁹ However, the “unilateral” conditions are unpredictable and restrictive possibly creating a negative effect. This can also create obstacles and difficulties for developing countries to use GSP benefits. The preferential rules of origin are potentially misused, for instance they might serve as the non-barrier of trade.⁶³⁰

*“[...]it also took account of the fact that the countries establishing their own preferential scheme were free to withdraw their grants in whole or in part and that those grants were conditional upon the necessary waiver or waivers in cases where, as in the framework of the General Agreement on Tariffs and Trade, it was so prescribed [...]”.*⁶³¹

The withdrawal system of EU GSP is regulated in Chapter III Section 1 Article 15-19 Council Regulation (EC) No. 732/2008 and amended by Regulation (EU) No. 512/2011. The temporary withdrawal in the EU GSP is divided into three different functions. First, temporary withdrawal relates to international law violation under the conventions listed in Part A of Annex III,⁶³² due to the use of “prison labour” in processing exported goods,⁶³³

⁶²⁵ See Grossman, Gene M, and Sykes, Alan O., 2005.

⁶²⁶ See Yusuf, Abdulqawi, 1982., *Op. Cit.*, p.115.

⁶²⁷ See Harris, Jeremy T, Rules of Origin for Development: From GSP to Global Free Trade, IDB, Working Paper Series #IDB WP-135, November 2009, p. 5, available at: <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1801797>, last accessed : 14 February 2011.

⁶²⁸ See Miguel Izam, Rules of Origin and Trade Facilitation in Preferential Trade Agreement in Latin America, Serie, Comercio Internacional, Division of International Trade and Integration, Santiago, Chile, August, 2003, available at: <http://www.eclac.org/publicaciones/xml/0/13420/lcl1945i.pdf>, last accessed : 22 March 2011.

⁶²⁹ “[...] The preferential arrangements provided for in this Regulation may be withdrawn temporarily, in respect of all or of certain products originating in a beneficiary country, for any of the following reasons [...]”

⁶³⁰ See Stocker, Walter, *WCO Seminar On The Harmonization Of Non-Preferential Rules Of Origin*, Technical Officer, Origin Sub-Directorate, World Customs Organization, p. 4, available at: http://www.dga.gov.do/dgagov.net/uploads/file/seminario_regional_oma/01rules-of-origin-english.pdf, last accessed : 8 March 2011. International Center for Economic Growth, *Op. Cit.*, p. 1, available at: http://www.atdforum.org/IMG/pdf/Policy_Brief_RoO.pdf, last accessed : 9 April 2011

⁶³¹ See Commentaries on the ILC’s Draft Articles; see also Report of the International Law Commission on the Work of its Thirtieth session, 8 May – 28 July 1978, Official Records of the General Assembly, Thirty-third session, Supplement No. 10, Doc. A/33/10 ILC Report), 2 Yearbook of the International Law Commission (1978), p. 65.

⁶³² See Subparagraph (a) Paragraph 1 Article 15 Section 1 Chapter III Council Regulation (EC) No. 732/2008.

⁶³³ See Subparagraph (b) Paragraph 1 Article 15 Section 1 Chapter III Council Regulation (EC) No. 732/2008.

illicit drug trafficking and money laundering,⁶³⁴ unfair trading practices⁶³⁵ and infringement of “*conservation and management of fishery resources*”.⁶³⁶

With respect to the unfair trading practices regulated under WTO agreements in which the effect of such conduct, at first, has to be determined by the competent body of the WTO. Furthermore, the products subject to anti-dumping or countervailing measures under Council Regulation (EC) No. 384/96 of 22 December 1995⁶³⁷ and Council Regulation (EC) No. 2026/97 of 6 October 1997⁶³⁸, are excluded from Paragraph 1(d) Article 15 of Council Regulation (EC) No. 732/2008.⁶³⁹

Second, temporary withdrawal is related to the granting of the special incentive arrangement on sustainable development and good governance. Temporary withdrawal is applied to all or certain products originating from beneficiary countries under the conditions when national legislation no longer incorporates those conventions referred to in Annex III or if that legislation is not effectively implemented.⁶⁴⁰

Third, temporary withdrawal is related to the failure or non-compliance to the rules of origin. This type of temporary withdrawal is due to “*the fraud case; irregularities or systematic failure to comply with or to ensure compliance with the rules concerning the origin of the products and the procedures related thereto; or failure to provide the administrative cooperation as required for the implementation; and policing of the arrangements under the EU GSP scheme*”.⁶⁴¹

⁶³⁴ See Subparagraph (c) Paragraph 1 Article 15 Section 1 Chapter III Council Regulation (EC) No. 732/2008.

⁶³⁵ See Subparagraph (d) Paragraph 1 Article 15 Section 1 Chapter III Council Regulation (EC) No. 732/2008.

⁶³⁶ See Subparagraph (e) Paragraph 1 Article 15 Section 1 Chapter III Council Regulation (EC) No. 732/2008.

⁶³⁷ See Council Regulation (EC) No 384/96 of 22 December 1995 on protection against dumped imports from countries not members of the European Community (OJ L 56, 6.3.1996, p. 1). Regulation as last amended by Regulation (EC) No 2117/2005 (OJ L 340, 23.12.2005, p. 17).

⁶³⁸ See Council Regulation (EC) No 2026/97 of 6 October 1997 on protection against subsidized imports from countries not members of the European Community (OJ L 288, 21.10.1997, p. 1). Regulation as last amended by Regulation (EC) No 461/2004 (OJ L 77, 13.3.2004, p. 12).

⁶³⁹ See Paragraph 3 Article 15 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁴⁰ See Paragraph 2 Article 15 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. See also EU temporarily withdraws GSP+ trade benefits from Sri Lanka, Brussels, 15 February 2010, available at :http://trade.ec.europa.eu/doclib/docs/2010/february/tradoc_145799.pdf, last accessed : 19 June 2011. See also The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, Legislative Acts And Other Instruments, Interinstitutional File: 2009/0179 (NLE), 5470/10, WTO 14, SPG 3, RELEX 63, COASI 12, paragraph 3 and 4, available at : <http://register.consilium.europa.eu/pdf/en/10/st05/st05470.en10.pdf>, last accessed : 19 June 2011.

[...] It's indicated that the national legislation of Sri Lanka incorporating the International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child, was not being effectively implemented. The three conventions mentioned are listed as core human rights conventions respectively in points 1, 5 and 6 of Annex III, Part A, to Regulation (EC) No 732/2008... Article 15(2) of Regulation (EC) No 732/2008 provides for the temporary withdrawal of the special incentive arrangement for sustainable development and good governance granted pursuant to that Regulation, in particular if the national legislation incorporating the conventions referred to in Annex III to that Regulation, which have been ratified in fulfilment of the requirements of Article 8(1) and (2) of that Regulation, is not effectively implemented [...]. See also Notice on the GSP+/Sri Lanka issue, 19 October 2009, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145154.pdf, last accessed : 19 June 2011. See also http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145154.pdf. “[...] The Commission's findings are that the national legislation of Sri Lanka incorporating international human rights conventions, in particular the International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child, is not being effectively implemented [...].”

⁶⁴¹ See Paragraph 1 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

Administrative cooperation must be provided by the beneficiary country in order to implement the EU GSP scheme.⁶⁴² The beneficiary country should keep communications and send updates of the indispensable information regarding the implementation and policing of the rules of origin. The beneficiary country can assist the Union, based on a request from the customs authorities of the member states, to verify the origin of the goods and communicate the results in the required time. The beneficiary country can also assist the Union by allowing the Commission to coordinate and closely cooperate with the competent authorities of the member states, in order to verify the authenticity of documents or the accuracy of information relevant to obtaining the GSP scheme facilities.

The beneficiary country should undertake appropriate enquiries to identify and prevent infringement of the rules of origin. The beneficiary country must ensure compliance of the rules of origin in respect of regional cumulation. The beneficiary country must assist the Union in the verification of processes, in terms of the presumption of origin relating to fraud. The basic presumption of fraud is determined when massive exports from the beneficiary country occur, exceeding its usual level.

Non-compliance with rules of origin, and/or failure to provide administrative cooperation is the sufficient evidence for temporary withdrawal. It might lead to the suspension of the preferential arrangements.⁶⁴³ In the suspension mechanism, the Commission has to inform the Generalised Preferences Committee⁶⁴⁴. Thus, the Commission called the member states to take precautionary measures as necessary action in order to “safe” the Union’s financial interests. To carry out transparency principle, the Commission published a notice in the *Official Journal of the European Union*. The notice contains justifications for reasonable doubt about the implementation of the preferential arrangements and/or compliance by the beneficiary country with its obligations.⁶⁴⁵

The Commission should notify the beneficiary country concerned and the *Generalised Preferences Committee* of any decision taken before it come into effect. Any member states may refer the decision taken by the Commission to the Council within one month. The Council acting by a qualified majority and may take different decision within one month. According to the Paragraph 5 Article 16, the period of suspension shall not exceed six months.⁶⁴⁶

⁶⁴² See Paragraph 2 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁴³ See Paragraph 3 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁴⁴ As Stipulated by Paragraph 1 Article 27 of the Council Regulation (EC) No. 732/2008, “[...] the Commission shall be assisted by a Generalised Preferences Committee (hereinafter referred to as the Committee) [...]”. Paragraph 2 “[...] governs the competence of the Committee, which may examine any matter relating to the application of this Regulation, raised by the Commission or at the request of a Member State [...]”. Further, paragraph 3 stipulated “[...] the Committee shall examine the effects of the scheme, on the basis of a report from the Commission covering the period since 1 January 2006. This report shall cover all of the preferential arrangements, and the result will be presented in time for the discussion on the next Regulation [...]”.

⁶⁴⁵ See Paragraph 3 (c) Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. See also Current developments in Sri Lanka and the question of future trade preferences granted by the European Union to Sri Lanka, Brussels, 10 July 2008, available at : http://trade.ec.europa.eu/doclib/docs/2008/july/tradoc_139594.pdf, last accessed : 19 June 2011. “[...] The serious concerns about the human rights situation in this country and the alleged lack of compliance with Human Rights Conventions are raised regularly [...]”.

⁶⁴⁶ See The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, Legislative Acts And Other Instruments, Interinstitutional File: 2009/0179 (NLE), 5470/10, WTO 14, SPG 3, RELEX 63, COASI 12, available at : <http://register.consilium.europa.eu/pdf/en/10/st05/st05470.en10.pdf>, last accessed : 19 June 2011.

After the suspension period is depleted, the Commission should decide either to terminate the suspension or to extend the period of suspension in accordance with the procedure regulated by Paragraph 3 Article 16 of the regulation. To provide valid evidence, the member states shall communicate to the Commission all relevant information that justify the suspension of preferences or its extension.

Article 17 of the regulation stipulated the procedure to initiate investigation. In the case, the Commission or a member state receives information⁶⁴⁷ that justify temporary withdrawal and if it is considered as sufficient justifications for an investigation, they should inform the Committee and request for consultations.⁶⁴⁸ The consultations will take place within one month. The Commission can initiate an investigation within one month.

Paragraph 1 Article 18 stipulated that the Commission should publish a notification in the *Official Journal of the European Union* and inform the beneficiary country concerned.⁶⁴⁹ The notification provides a summary of the information received. Investigation carry out by cooperate with the beneficiary country concerned. In this point, the Commission should provide opportunity for the beneficiary country concerned to cooperate in the investigation.⁶⁵⁰

To provide sufficient evidence for justification the Commission has to collect all information that necessary. Such information includes the assessments, comments, decisions, recommendations and conclusions of the relevant supervisory bodies of the UN, the ILO and other competent international organizations. Assesment is used to justify the infringement committed under Article 15 Paragraph 1 (a) of the EU GSP regulation.⁶⁵¹

In addition, the Commission verifies the information received from economic operators of beneficiary country. The findings established based on the available facts. The information requested by the Commission must be provided within the period specified in the notice of investigation. The investigation period must be completed within one year. However, the Commission could extend this period in accordance with the procedure referred to in Article 27(5).

Based on Article 27, the Commission should submit the report findings to the Generalised Preferences Committee.⁶⁵² The investigation terminated if the findings not

⁶⁴⁷ See EU Generalised System of Preferences: Commission initiates investigation on the effective implementation of certain human rights conventions in Sri Lanka, available at : http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141139.pdf, last accessed : 19 June 2011. “[...] The Commission has received information, including reports and statements of the United Nations, as well as from other relevant publicly available sources, including non-governmental organisations, that indicate that the national legislation of the Democratic Socialist Republic of Sri Lanka incorporating international human rights conventions, in particular the International Covenant on Civil and Political Rights, the Convention Against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child, is not being effectively implemented [...]”

⁶⁴⁸ See Paragraph 1 Article 17 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁴⁹ See EU Generalised System of Preferences: Commission initiates investigation on the effective implementation of certain human rights conventions in Sri Lanka, available at : http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141139.pdf, last accessed : 19 June 2011. “[...] The investigation is considered to be launched on the date of publication of the “Notice pursuant to Article 19(1) of Council Regulation (EC) No 980/2005 of the initiation of an investigation with respect to the effective implementation of certain human rights conventions in Sri Lanka. Any interested party is invited to submit comments on the matter under investigation within four months of the launching of the investigation [...]”

⁶⁵⁰ See Paragraph 1 Article 18 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁵¹ See Paragraph 3 Article 18 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁵² See Paragraph 1 Article 19 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. See also Commission Of The European Communities, Report on the findings of the investigation with respect to the effective implementation of certain human rights conventions in Sri Lanka, C(2009) 7999, Brussels, 19 October 2009, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145152.pdf, last accessed : 19 June 2011. See also

sufficient to justify temporary withdrawal.⁶⁵³ The termination of investigation and its main conclusion announced in the *Official Journal of the European Union*.⁶⁵⁴ In the case the Commission findings meet sufficient evidence to justify temporary withdrawal in respect of serious and systematic violation of principles laid down in the conventions listed in Part A of Annex III, referred to Article 15 Paragraph 1 (a), the situation in beneficiary country will be monitored and evaluated during six months.⁶⁵⁵ The Commission will notify the decision to beneficiary country and publish a notice in the *Official Journal of the European Union*.⁶⁵⁶ Unless, before the end of the period, the beneficiary country make a commitment to take necessary measures to conform, “in a reasonable period of time”, with the conventions referred to in Part A of Annex III. If the Commission considers temporary withdrawal necessary, they will submit an appropriate proposal to the Council. The temporary withdrawal decided by the Council within two months by means of a qualified majority^{657, 658} The temporary withdrawal will enter into force six months⁶⁵⁹ after it decided.⁶⁶⁰

Commission of the European Communities, Report Investigation pursuant to Article 18(2) of Council Regulation (EC) No 980/2005 with respect to the protection of the freedom of association and the right to organise in El Salvador, Brussels, C(2009) 7934, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145210.pdf, last accessed : 19 June 2011.

⁶⁵³ See Paragraph 2 Article 19 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. See also Commission Of The European Communities, Commission Decision of 20 October 2009 concerning providing for the termination pursuant to Article 19(2) of Council Regulation (EC) No 732/2008 of the investigation initiated by Commission Decision 2008/316/EC with respect to the protection of the freedom of association and the right to organise in El Salvador, Brussels, C(2009) 7936, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145209.pdf, last accessed : 19 June 2011.

⁶⁵⁴ See Notice pursuant to Article 19(2) of Council Regulation (EC) No 732/20081 of the termination of an investigation with respect to the protection of the freedom of association and the right to organise in the Republic of El Salvador, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145208.pdf, last accessed : 19 June 2011.

⁶⁵⁵ See Paragraph 3 Article 19 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, Legislative Acts And Other Instruments, Interinstitutional File: 2009/0179 (NLE), 5470/10, WTO 14, SPG 3, RELEX 63, COASI 12, available at : <http://register.consilium.europa.eu/pdf/en/10/st05/st05470.en10.pdf>, last accessed : 19 June 2011.

⁶⁵⁶ See Paragraph 3 Article 19 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. See also Notice on the GSP+/Sri Lanka issue, 19 October 2009, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145154.pdf, last accessed : 19 June 2011.

“[...] The Commission's findings are that the national legislation of Sri Lanka incorporating international human rights conventions, in particular the International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child, is not being effectively implemented. In the light of these findings, the Commission will now consider whether a temporary withdrawal of some or all of Sri Lanka's GSP+ benefits is called for and make a suitable proposal to EU Member States in the Council. If such a proposal is made and subsequently adopted by the Council, it would enter into force six months after the date of adoption [...]”.

⁶⁵⁷ See Paragraph 4 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008. See also The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, Legislative Acts And Other Instruments, Interinstitutional File: 2009/0179 (NLE), 5470/10, WTO 14, SPG 3, RELEX 63, COASI 12, available at : <http://register.consilium.europa.eu/pdf/en/10/st05/st05470.en10.pdf>, last accessed : 19 June 2011. Article 2 :

“[...] With respect to the period of application of Regulation (EC) No 732/2008, the Council, acting by qualified majority, on a proposal from the Commission, shall re-establish the special incentive arrangement for products originating in Sri Lanka, if the reasons justifying the temporary withdrawal no longer prevail [...]”.

⁶⁵⁸ See Paragraph 4 Article 19 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁵⁹ See The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, Legislative Acts And Other Instruments,

XII.b. Case Study: Temporary withdrawal and suspension from GSP+ of Sri Lanka.

The following case study concerns the mechanism of temporary withdrawal from the special incentive arrangement for sustainable development and good governance (GSP+) towards the Democratic Socialist Republic of Sri Lanka.

The GSP+ facilities granted to Sri Lanka⁶⁶¹ are conditional. Sri Lanka, as the beneficiary country, must fulfil the requirements of eligibility as established under the GSP regulation. When national legislation no longer incorporates the relevant international conventions or if legislation is not effectively implemented, therefore, the regulation provides provisions for the temporary withdrawal of certain products or all GSP+ benefits. The EU maintains the objective of GSP+ as an incentive to strengthen improvements to the condition of human rights in Sri Lanka. The Commission is undertaking an investigation to clarify the situation and propose appropriate action towards information accepted that “*allegedly*” justifies such temporary withdrawal. Such information was submitted by interested parties in “*response to a public notice, available reports, statements and information of the United Nations as well as other publicly available reports and information from relevant sources, including nongovernmental organisations*”. Under the framework of parallel political dialogue, the Commission also considers the information provided by Sri Lanka. In the case of Sri Lanka’s GSP+, the Commission’s investigation was launched in October 2008,⁶⁶² thus its investigation completed and approved a report on its findings on 19 October 2009.⁶⁶³

Under Commission Decision 2008/938/EC⁶⁶⁴ Sri Lanka was included in the list of beneficiary countries that were granted special incentive arrangements for sustainable development and good governance for the period from 1 January 2009 to 31 December 2011. However, in 2005 the investigation was initiated in respect of non-compliance relating to human rights conventions.⁶⁶⁵ This investigation was launched under Council Regulation (EC) No. 980/2005 of 27 June 2005, applying a scheme of generalised tariff preferences.⁶⁶⁶ In its findings, the Commission found indications that Sri Lanka did not

Interinstitutional File: 2009/0179 (NLE), 5470/10, WTO 14, SPG 3, RELEX 63, COASI 12, available at : <http://register.consilium.europa.eu/pdf/en/10/st05/st05470.en10.pdf>, last accessed : 19 June 2011. Article 3 : “[...] This Regulation shall enter into force six months after its adoption, unless the Council before then, on a proposal from the Commission pursuant to Article 19(5) of Regulation (EC) No 732/2008, decides otherwise [...]”.

⁶⁶⁰ See Paragraph 5 Article 19 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁶⁶¹ See Article 8 of the Council Regulation (EC) No. 732/2008.

⁶⁶² See EU temporarily withdraws GSP+ trade benefits from Sri Lanka, Brussels, 15 February 2010, available at : http://trade.ec.europa.eu/doclib/docs/2010/february/tradoc_145799.pdf, last accessed : 19 June 2011.

⁶⁶³ See Notice on the GSP+/Sri Lanka issue, 19 October 2009, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145154.pdf, last accessed : 19 June 2011. See also Press release, Generalised System of Preferences (GSP), EU temporarily withdraws GSP+ trade benefits from Sri Lanka, Brussels, 15 February 2010, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=515&serie=316&langId=en>, last accessed 17 June 2011.

⁶⁶⁴ See Commission Decision 2008/938/EC of 9 December 2008 on the list of the beneficiary countries which qualify for the special incentive arrangement for sustainable development and good governance, provided for in Council Regulation (EC) No 732/2008 applying a scheme of generalised tariff preferences for the period from 1 January 2009 to 31 December 2011 (OJ L 334, 12.12.2008, p. 90).

⁶⁶⁵ See International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, and Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child. These three International Conventions is listed in the Part A, Annex III, Council Regulation (EC) No. 732/2008.

⁶⁶⁶ See The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, Legislative Acts And Other Instruments,

effectively implement the three conventions mentioned, which are listed as core human rights conventions respectively in points 1, 5 and 6 of Annex III, Part A of Council Regulation (EC) No. 732/2008.⁶⁶⁷

Sri Lanka's temporary withdrawal from GSP+ was based on Article 15(2) of Regulation (EC) No. 732/2008, where it provides the temporary withdrawal of the special incentive arrangement for sustainable development and good governance.⁶⁶⁸ In order to assess, "*whether the national legislation of the Democratic Socialist Republic of Sri Lanka incorporated and implemented effectively the conventions related to human rights*"⁶⁶⁹, therefore, the Commission Decision 2008/803/EC⁶⁷⁰ was issued to initiate investigation⁶⁷¹. The investigation focused on reports and statements by UN Special Rapporteurs and Representatives, other UN bodies and reputable human rights NGOs.⁶⁷²

According to Paragraph 2 Article 18 of the Council Regulation (EC) No. 732/2008⁶⁷³, "*during the whole period of investigation the Commission provided Sri Lanka with every opportunity to cooperate in the investigation*". Sri Lanka had given opportunity to submit their commentary on the comprehensive findings of the experts. These experts groups appointed by the Commission to provide an independent legal assessment related to the investigation⁶⁷⁴. However, Sri Lanka took the decision "*not to cooperate with, or participate in the investigation*".⁶⁷⁵ On 19 October 2009, the Commission delivered the findings report, as follows :

"[...] that the national legislation of Sri Lanka incorporating international human rights conventions, specifically the International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child, is not effectively implemented [...]"⁶⁷⁶

In accordance with Article 19(1) of Regulation (EC) No 732/2008, on 17 November 2009 the Commission submitted the findings report to the Generalised Preferences Committee.⁶⁷⁷ On 15 February 2010, EU decided to withdraw Sri Lanka from GSP+ scheme. The suspension applied for six months.⁶⁷⁸ After the period of suspension ended, the

Interinstitutional File: 2009/0179 (NLE), 5470/10, WTO 14, SPG 3, RELEX 63, COASI 12, paragraph 2, available at : <http://register.consilium.europa.eu/pdf/en/10/st05/st05470.en10.pdf>, last accessed : 19 June 2011.

⁶⁶⁷ See *Ibid.*, paragraph 3.

⁶⁶⁸ See *Ibid.*, paragraph 4.

⁶⁶⁹ See The International Covenant on Civil and Political Rights, the Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment and the Convention on the Rights of the Child.

⁶⁷⁰ See Commission Decision 2008/803/EC of 14 October 2008 providing for the initiation of an investigation pursuant to Article 18(2) of Council Regulation (EC) No 980/2005 with respect to the effective implementation of certain human rights conventions in Sri Lanka (OJ L 277, 18.10.2008, p. 34).

⁶⁷¹ See Paragraph 1, Paragraph 3 Article Article 18 of the Council Regulation (EC) No. 732/2008.

⁶⁷² See The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, paragraph 5.

⁶⁷³ The Commission shall provide the beneficiary country concerned with every opportunity to cooperate in the investigation.

⁶⁷⁴ See also Françoise Hampson, Leif Sevón and Roman Wieruszewski, The Implementation of certain Human Rights Conventions in Sri Lanka : Final Report, 30 September 2009, available at : http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145153.pdf, last accessed : 17 June 2011.

⁶⁷⁵ See The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka, paragraph 6.

⁶⁷⁶ See *Ibid.*, paragraph 7.

⁶⁷⁷ See *Ibid.*, paragraph 10.

⁶⁷⁸ See EU temporarily withdraws GSP+ trade benefits from Sri Lanka, Brussels, 15 February 2010, available at : http://trade.ec.europa.eu/doclib/docs/2010/february/tradoc_145799.pdf, last accessed : 19 June 2011. See also Article 3 The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the

Commission submits a proposal to the Council to re-establish the special incentive arrangement for Sri Lanka.⁶⁷⁹

XII.c. General overview temporary withdrawal provisions in the proposal of the GSP Proposal.

On 10 May 2011, the Commission proposed a regulation applying to a GSP scheme. This proposal encompassed the draft of the GSP proposal. It was formulated to enhance the GSP scheme, making it more predictable, transparent, and stable for traders either from the EU or the beneficiary country. Therefore, some changes and revisions were made to the GSP proposal. The revision aimed to ensure that the GSP scheme focused on the country most in need and responded positively to the development needs of the beneficiary country.

Council Regulation (EC) No. 732/2008 applied a scheme of GSP that expired on 31 December 2011. Therefore, in order to ensure the operation of the scheme, on 11 May 2011 Regulation (EU) No. 512/2011 of the European Parliament and the Council was issued, amending the previous regulation. Under Regulation (EU) No. 512/2011, the scheme provided under Council Regulation (EC) No. 732/2008 is applicable until 31 December 2013.⁶⁸⁰ The new regime of the GSP scheme is expected to be implemented by 1 January 2014.

Temporary withdrawal is one of the subjects to be revised. In the proposal of the GSP regulation, temporary withdrawal provisions are regulated in Chapter V Articles 19 – 21. Practically, this has been reduced from five⁶⁸¹ provisions to three provisions. In general, Article 19 of the draft GSP regulation regulates temporary withdrawal in the three schemes (general arrangement, special incentive arrangement for sustainable development and good governance, and special arrangement for the least-developed countries). There are two paragraphs under draft Article 19, which have been changed by the addition of some words, for instance:

Paragraphs 1 (c) and (d):

- (c) serious shortcomings in customs controls on the export or transit of drugs (illicit substances or precursors), or failure to comply with international conventions on anti-terrorism and money laundering;
- (d) serious and systematic unfair trading practices including those affecting the supply of raw materials, which have an adverse effect on the Union industry and which have not been addressed by the beneficiary country. For those unfair trading practices, which are prohibited or actionable under the WTO Agreements, the application of this Article shall be based on a previous determination to that effect by the competent WTO body;

Draft Article 19 Paragraph 1 (c) added “*compliance to the international conventions on anti-terrorism*” in which this condition does not exist under current provisions. The EU set out this condition as its serious concern to encourage the beneficiary country to fight

special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka.

⁶⁷⁹ See also Article 2 The Council of European Union, Implementing Regulation of the Council temporarily withdrawing the special incentive arrangement for sustainable development and good governance provided for under Regulation (EC) No 732/2008 with respect to the Democratic Socialist Republic of Sri Lanka.

⁶⁸⁰ See Paragraph 5 Article 1 Regulation (EU) No 512/2011 of The European Parliament and of The Council of 11 May 2011 amending Council Regulation (EC) No 732/2008.

⁶⁸¹ In the Council Regulation (EC) No 732/2008 the temporary withdrawal provisions are accommodated under Articles 15 to Article 19.

terrorism. The international convention on anti-terrorism is considered as a non-trade aspect, where its implementation could occur some burdens to the beneficiary country. However, the significance of the policy to fight terrorism and trade are still questioned. Draft Article 19 Paragraph 1 (d) considers the serious and systematic unfair trading practices affecting the supply of raw materials, wherein, this wording is not included under current provisions. It seems that the EU puts a high concern in order to minimise domestic injury from unfair trading practices.

In order to ensure that the GSP scheme is not being abused and/or to minimise trade deflection by controlling and monitoring that the preferential rules of origins comply with the regulations, the proposal of the GSP regulation maintains this provision under draft Article 21. This provision also provides administrative cooperation in order to ensure the compliance implementation of the preferential rules of origin under the GSP regime.

As a consequence of temporarily withdrawal from the tariff preferences, draft Article 19 Paragraph 10⁶⁸² of the proposal of the GSP regulation provided an adoption of the “*delegated acts*” in order to amend Annex II,⁶⁸³ Annex III,⁶⁸⁴ and Annex IV⁶⁸⁵ of the regulation. The adoption of the delegated acts in the proposal of the GSP regulation were stipulated under draft Article 37⁶⁸⁶, due to the legal consequences of an “*open ended system*” GSP scheme. According to Article 290 of the TFEU that the EU co-legislator⁶⁸⁷, that is, the Commission will be conferred delegation power to “*to amend or supplement certain non-essential elements of the legislative acts*”.⁶⁸⁸ The delegated acts do not touch the core of the regulation solely aimed for the implementation of the regulation to be operated properly.

XIII. Safeguard measure under EU GSP.

XIII.a. General overview of the current and future safeguard clauses under the GSP scheme.

The application of the safeguard clause in the GSP scheme seems to be contradictory with the basic philosophy of GSP that aims to “*increase*” export earnings and generate revenue of developing countries and LDCs. A safeguard measure is commonly understood as the “*escape clause*” or “*emergency exit*”. This means that it would only be imposed under certain circumstances. Such presumed and assessed circumstances will threaten or lead to

⁶⁸² “[...] Where the Commission considers that the findings justify temporary withdrawal for the reasons referred to in paragraph 1, it shall be empowered, in accordance with Article 36, to adopt delegated acts to amend Annex II, III, IV, whichever is applicable, in order to temporarily withdraw the tariff preferences referred to in Article 1(2) [...]”.

⁶⁸³ See Lists of Beneficiaries Countries of the General Arrangement.

⁶⁸⁴ See Lists of Beneficiaries Countries of the Special Incentive Arrangement for Sustainable Development and Good Governance.

⁶⁸⁵ See Lists of Beneficiaries Countries of the Special Incentive Arrangement for the Least Developed Countries.

⁶⁸⁶ “[...] Delegated acts adopted under this Article shall enter into force without delay and shall apply as long as no objection is expressed in accordance with paragraph 2. The notification of a delegated act adopted under this Article to the European Parliament and to the Council shall state the reasons for the use of the urgency procedure. (2) Either the European Parliament or the Council may object to a delegated act in accordance with the procedure referred to in Article 36(4). In such a case, the Commission shall repeal the act without delay following the notification of the decision to object by the European Parliament or the Council [...]”.

⁶⁸⁷ The Council and The European Parliament.

⁶⁸⁸ See Council Of The European Union, *Factsheet : Entry into force of new comitology rules*, PRESSE 42, 7070/11, Brussels, 28 February 2011, available at : http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/genaff/119516.pdf, last accessed : 20 June 2011.

"serious injury" to the domestic business of actors or producers.⁶⁸⁹ The application of the safeguard measure must be based on the evidence resulting from investigation, where such harmful injury may exist or has existed.

According to Adam Smith in the "*Wealth of Nations*", "*relaxing trade barriers generally raises the wealth of the nations involved*".⁶⁹⁰ Economically speaking the inclusion of safeguard clauses in the EU GSP regulation can be understood logically. In order to attract traders or producers from beneficiary countries to export their goods into the EU, the GSP scheme grants a reduction of tariffs and removes trade barriers. In addition, such tariff reductions aim to help the goods and products from the beneficiary country to be able to compete in the EU market. However, the preference-granting countries have an obligation to secure their internal market and domestic producers from "serious injury" of such policy. Since then the safeguard clause has been called the "*remedies clause*".⁶⁹¹

Trade barriers significantly reduced after the establishment of GATT 1947. The enabling clause also contributed to the elimination of trade barriers for developing countries under generalised, non-reciprocal, and non-discriminatory principles. The main objective of trade barrier reduction is to promote trade liberalisation and to open more market access for developing countries.

As explained above, the GSP grant benefits through tariff reductions to the beneficiary country goods in order to support its product in its competition within the EU markets. According to Adam Smith, "*if a foreign country can supply us with a commodity cheaper than we ourselves can make, better buy it off them with some part of the produce of our own industry, employed in a way in which we have some advantage*". Fair competition is only present when the consumer has a wide choice of goods. In this regard, the availability of a "*like product*" with the competitive prices and range of quality has driven product competitiveness. When the tariff duties are imposed on the "*like product*" imported from developing countries and LDCs, instead of increasing the cost of production, the final price of the product on the market is affected. Higher tariffs could discourage a "*like product*" from the developing countries and LDCs from competing on the market. Developing countries and LDCs needs to increase their export revenues for their economic development, for instance combating poverty, generates employment, to support the development of infant industries and Small and Medium Enterprises (SMEs). Economists believe there is a "*positive domino effect*" between export boosts, employment availability, poverty alleviation, and that an increase in GDP will accelerate developing countries and LDCs into trade liberalisation. As acknowledged, trade liberalisation reflects the spirit of the WTO.

Under current GSP regulation, safeguard clauses accommodated under Section 2 Article 20-22. The GSP proposal⁶⁹² provides 13 provisions on safeguard, accommodated in

⁶⁸⁹ See General Principles Safeguard Measures: Technical Information on Safeguard Measures, available at : http://www.wto.org/english/tratop_e/safeg_e/safeg_info_e.htm, last accessed : 21 June 2011.

⁶⁹⁰ See Irwin, Douglas A. *Against the Tide: An Intellectual History of Free Trade*. New Jersey: Princeton University Press, 1996; Wilson, Garret., *The Safeguards Clause : The Rational, Operations, and Prospects of GATT Article XIX*, International Economics, Essay 1, University of London, School of Oriental and African Studies, MA International Studies and Diplomacy 1998/9, 8 December, 1998, available at : <http://www.garretwilson.com/essays/economics/gattarticlexix.html#Irwin>, last accessed : 21 June 2011.

⁶⁹¹ See Wilson, Garret., *The Safeguards Clause : The Rational, Operations, and Prospects of GATT Article XIX*, available at : <http://www.garretwilson.com/essays/economics/gattarticlexix.html>, last accessed : 21 December 2011.

⁶⁹² See European Commission, Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences, {SEC(2011) 536 final},{SEC(2011) 537 final}, Brussels, 10.5.2011, COM(2011) 241

the Article 19-31. The GSP proposal regulate safeguard in the two different sections, i.e., *General Safeguards* and *Safeguards in the Textile, Agriculture and Fisheries Sectors and Safeguards in the Textile, Agriculture, and Fisheries Sectors*.⁶⁹³ Safeguards measures can be applied when imported products “on terms which cause, or threaten to cause, serious difficulties to a Community producer of like or directly competing products”. Article 22 paragraph 1 and 2 of the GSP proposal elaborated definition of the “like product” and “like or directly competing products”, as follows :

“[...] For the purpose of this Chapter, ‘like product’ means a product which is identical, i.e. alike in all respects, to the product under consideration, or, in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration [...]”.

“[...] Where a product originating in a beneficiary country of any of the three arrangements referred to in Article 1(2), is imported in volumes and/or at prices which cause, or threaten to cause, serious difficulties to European Union producers of like or directly competing products, normal Common Customs Tariff duties on that product may be reintroduced in accordance with the following provisions [...]”

Article 22 paragraph 3 of the GSP proposal provides definition of “interested parties” as “those parties involved in the production, distribution and/or sale of the imports mentioned in paragraph 1 and of like or directly competing products”. Safeguard measures is necessary when its occurs extreme increases volumes and/or at prices of imported products under GSP scheme, which cause, or threaten to cause, serious difficulties to European Union producers of like or directly competing products is present in the EU markets.

The definition of “interested parties” elaborated further in the Article 24 paragraph 2 the GSP proposal stipulated as follows :

“[...] an investigation shall be initiated upon request by a Member State, by any legal person or any association not having legal personality, acting on behalf of Union producers, or on the Commission’s own initiative if it is apparent to the Commission that there is sufficient prima facie evidence, as determined on the basis of factors referred to in Article 23, to justify such initiation. The request to initiate an investigation shall contain evidence that the conditions for imposing the safeguards measure set out in Article 22(1) are met. The request shall be submitted to the Commission. The Commission shall, as far as possible, examine the accuracy and adequacy of the evidence provided in the request to determine whether there is sufficient prima facie evidence to justify the initiation of an investigation [...]”

The terms of “interested parties” describes as public entities (*member states, the Commission*), or private entities (*any legal person or any association not having legal personality, acting on behalf of Union producers*). These parties allowed to submit a request of safeguards investigation against the allegations under “*certain circumstances as referred by Article 22 paragraph 1*” of the GSP proposal. If “*sufficient prima facie evidence*” available,

final, 2011/0117 (COD), available at : http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147893.pdf, last accessed : 12 May 2011. (The Proposal of the new GSP Regulation, 2011.)

⁶⁹³ See Article 30 : “[...] Without prejudice to the provisions of Section I of this Chapter, where imports of products included in Annex I to the Treaty on the Functioning of the European Union cause, or threaten to cause, serious disturbance to European Union markets, in particular to one or more of the outermost regions, or these markets’ regulatory mechanisms, the Commission, on its own initiative or at the request of a Member State, after consulting the committee for the relevant agriculture or fisheries common market organisation, shall suspend the preferential arrangements in respect of the products concerned in accordance with examination procedure referred to in Article 38(3) [...]”

the Commission on its own initiative can initiate an investigation. The terms of “*prima facie evidence*” referring to the “*factors*” used to measure “*deterioration in economic and/or financial situation suffered by European Union producers*”. These factors are defined in the Paragraph 4 Article 20 of the current GSP regulation and Article 23 of the GSP proposal. According to Article XIX of GATT and Agreement on Safeguard the investigation procedures is necessary before the safeguards measure applied.

The terms of *prima facie evidence* “and” suffer deterioration in their economic and/or financial situation, gives clear legal interpretation of safeguards measures procedures.⁶⁹⁴ The wording of “*deterioration*” literally interpreted as the “*ongoing situation*” according to “*prima facie evident*” presumed “*threaten to cause*” serious injury in economic and/or financial situation. The measurement of “*deterioration*” have to consider some factors, such as market share, production, stocks, production capacity, bankruptcies, profitability, capacity utilization, employment, imports, and prices. Article 25 of the GSP proposal, emphasize that safeguard measures only taken based on justification of “*the necessity*” when deterioration of the economic and/or financial situation of European Union producers takes a place and difficult to be remedied.⁶⁹⁵ When negative “*deterioration*” found in the end of investigation, it means that conditions to apply safeguards measures are not fulfilled. Therefore, the Commission must adopt a decision terminating the investigation and proceeding.⁶⁹⁶ The implementation of safeguards regulation in the new GSP regulation referred to the Regulation (EU) No 182/2011 of The European Parliament and of The Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission’s exercise of implementing powers.⁶⁹⁷

XIII.b. Compliance with the WTO law on the safeguard measures

Safeguard clauses in the GSP in line with the paragraph 1 (a) and (b) Article XIX of the GATT concerning “*Emergency Action on Imports of Particular Products*”, stipulates as follows:

- (a) If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.

⁶⁹⁴ See Article 23 The Proposal of the new GSP Regulation, 2011.

⁶⁹⁵ “[...] On duly justified grounds of urgency relating to deterioration of the economic and/or financial situation of European Union producers which would be difficult to repair, the Commission shall be empowered to adopt immediately applicable implementing acts in accordance with the urgency procedure referred to in Article 38(4) to reintroduce normal Common Customs Tariff duties for a period of up to 12 months [...]”.

⁶⁹⁶ See Article 27 The Proposal of the new GSP Regulation, 2011. “[...] Where the facts as finally established show that the conditions set out in Article 22(1) are not met, the Commission shall adopt a decision terminating the investigation and proceeding in accordance with the examination procedure referred to in Article 38(3). Such a decision shall be published in the Official Journal of the European Union. The investigation shall be deemed terminated, if no decision is published within the period referred to in Article 24(4) and any urgent preventive measures shall automatically lapse [...]”.

⁶⁹⁷ See Paragraph 3 Article 38 of The Proposal of the new GSP Regulation, 2011. “[...] Where reference is made to this paragraph, Article 5 of Regulation (EU) No 182/2011 shall apply [...]”

The sub-paragraph (b) governs the application of safeguards measure under preference trade agreement:

- (b) If any product, which is the subject of a concession with respect to a preference, is being imported into the territory of a contracting party in the circumstances set forth in sub-paragraph (a) of this paragraph, so as to cause or threaten serious injury to domestic producers of like or directly competitive products in the territory of a contracting party which receives or received such preference, the importing contracting party shall be free, if that other contracting party so requests, to suspend the relevant obligation in whole or in part or to withdraw or modify the concession in respect of the product, to the extent and for such time as may be necessary to prevent or remedy such injury.

In general, Article XIX of the GATT allows member states to take a “*safeguards*” measures in order to protect a specific domestic industry from unpredicted imports boost of any product that “*causing, or which is likely to cause, serious injury to the industry*”.⁶⁹⁸ Sub-Paragraph (b) has implied that the preference granting country allowed applying safeguards measures in order “*to prevent or remedy serious injury and to facilitate adjustment*”.⁶⁹⁹

Article 20 Paragraph 1 of the current GSP regulation stipulates the safeguard measures that can be applied, under the requirement “*where a product originating in a beneficiary country is imported on terms which cause, or threaten to cause, serious difficulties to a Community producer of like or directly competing products*”. Safeguard measures are performed by “*reintroducing, at any time, at the request of a Member State or on the Commission’s initiative normal CCT duties on that product*”. According to this provision, the safeguard measures apply under GSP regulation adopting the essential conditions of GATT safeguard measures, for instance “*cause, or threaten to cause, serious difficulties*”. This means that the measures will only be applied under such circumstances. The term “domestic producer” under the GSP regulation refers to the community producer that is presumed to be injured from such circumstances. The GSP is established under the derogation of CCT,⁷⁰⁰ which means that the beneficiary country will be excluded from the application of such rules. The safeguard measures taken by the EU “*reintroduce*” CCT duties on the product concerned. Article 20 Paragraph 2⁷⁰¹ of the GSP regulation governs investigation in order to justify such measures.

The formal decisions to initiate the investigation are carried out by the Commission. The investigation is announced in the *Official Journal of the European Union*. It contains the “*summary of the information received, and any relevant information sent to the Commission*”. The Commission has to verify all of the information received with the beneficiary country concerned and any other relevant sources.⁷⁰² During such investigations, the Commission

⁶⁹⁸ See Agreement on Safeguard, available at : http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#IAgreement, last accessed : 20 May 2011.

⁶⁹⁹ See Paragraph 1 Article 5 concerning *Application of Safeguard Measures* of the Agreement on Safeguard.

⁷⁰⁰ See Gormley, Laurence W., 2009, *Op. Cit.*, paragraph 2.09. See also Altomonte, Carlo., Nava, Mario., 2005.

⁷⁰¹ “[...] The Commission shall take a formal decision, within a reasonable period of time, to initiate an investigation. Where the Commission decides to initiate an investigation, it shall publish a notice, in the *Official Journal of the European Union*, announcing the investigation. The notice shall provide a summary of the information received, and state any relevant information to be sent to the Commission. It shall specify the period, which shall not exceed four months from the date of publication of the notice, within which interested parties may make their views known in writing [...]”.

⁷⁰² See Paragraph 3 Article 20 Council Regulation (EC) No. 732/2008 as amended by Regulation (EU) No 512/2011 : “[...] The Commission shall seek all information which it deems necessary, and may verify the information received with the

collects the information related to the Union producers, which covers ten factors: market share, production, stocks, production capacity, bankruptcies, profitability, capacity utilisation, employment, imports, and prices. These factors are examined to determine whether there are serious injuries to the Community producers. The periods of investigation must be completed within six months from the date the notification is published. The Commission could extend the periods of investigation after carrying out consultation with the Generalised Preferences Committee.⁷⁰³ There are certain products from Section XI (b) must be removed from the preferences, referred to article 13(1)⁷⁰⁴ of GSP regulation, where imports of those products :

- (a) increase by at least 20 % in quantity (by volume), as compared with the previous calendar year; or
- (b) exceed 12,5 % of the value of Community imports of products from Section XI(b) from all countries and territories listed in Annex I during any period of twelve months.

This provision only applies to general arrangement and special incentive arrangement for sustainable development and good governance. The special arrangement for LDC is excluded from the application of such provisions.⁷⁰⁵ The Commission should make notification to beneficiary country about safeguard measure decision. The notification also sent to the Council and the member states.⁷⁰⁶ The notification given to the beneficiary country before the safeguards decision come into effect is complying with Paragraph 2 Article XIX of the GATT⁷⁰⁷.

XIV. Preferential rules of origin.

XIV.a. Rules of origin under the international trade system.

XIV.a.1. Definition of rules of origin.

The OECD defines rules of origin as a law, regulation, and administrative procedure that determine a product's country of origin. It is used as an instrument for customs

beneficiary country concerned and any other relevant source. It may be assisted by officials of the Member State on whose territory verification might be sought, if that Member State so requests [...]."

⁷⁰³ See Paragraph 4, 5, 6, and 7 Article 20 Council Regulation (EC) No. 732/2008 as amended by Regulation (EU) No 512/2011

⁷⁰⁴ "[...] The tariff preferences referred to in Articles 6 and 7 shall be removed, in respect of products originating in a beneficiary country of a section, when the average value of Community imports from that country of products included in the section concerned and covered by the arrangement enjoyed by that country exceeds 15 % of the value of Community imports of the same products from all beneficiary countries and territories over three consecutive years, on the basis of the most recent data available on 1 September 2007. For each of the Sections XI(a) and XI(b), the threshold shall be 12,5 % [...]."

⁷⁰⁵ See Paragraph 8 Article 20 Council Regulation (EC) No. 732/2008 as amended by Regulation (EU) No 512/2011. "[...] This provision shall not apply to countries benefiting from the special arrangement for the least-developed countries referred to in Article 11, nor to countries with a share of imports into the Community, as defined in Article 13(1), not exceeding 8 %. The removal of the preferences shall take effect two months after the date of publication of the Commission's decision to this effect in the Official Journal of the European Union [...]."

⁷⁰⁶ See Paragraph 1 and 2, Article 22 Council Regulation (EC) No. 732/2008 as amended by Regulation (EU) No 512/2011.

⁷⁰⁷ "[...] Before any contracting party shall take action pursuant to the provisions of paragraph 1 of this article, it shall give notice in writing to the contracting parties as far in advance as may be practicable and shall afford the contracting parties and those contracting parties having a substantial interest as exporters of the product concerned an opportunity to consult with it in respect of the proposed action. When such notice is given in relation to a concession with respect to a preference, the notice shall name the contracting party which has requested the action. In critical circumstances, where delay would cause damage which it would be difficult to repair, action under paragraph 1 of this article may be taken provisionally without prior consultation, on the condition that consultation shall be effected immediately after taking such action [...]."

authorities to take measures in order to determine the necessary treatment to be given to imported goods such as quota limitation, tariff preferences, or anti-dumping duty.⁷⁰⁸

The Kyoto Convention (International Convention on the Simplification and Harmonisation of Customs Procedures) defines rules of origin as “*specific provisions, developed from principles established by national legislation or international agreements applied by a country to determine the origin of goods*”.⁷⁰⁹

Paragraph 1 Article I Part I of the Agreement on Rules of Origin stipulates rules of origin “*as those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods provided such rules of origin are not related to contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond the application of Paragraph 1 of Article I of GATT 1994*”.⁷¹⁰

According to the customs union, rules of origin serve to identify the origin of the product with the purpose of determining the applicable customs regime. For instance, imported goods or products subject to GSP tariff preferences are granted derogation from CCT based on their originating countries. According to Article 24 of the Community Customs Code, “*goods whose production involved more than one country shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing and working in an undertaking equipped for that purpose and resulting in the manufacture of a new product or representing an important stage of manufacture*”.⁷¹¹

To sum up, rules of origin are the criteria to determine the national source of goods.⁷¹² In other words, rules of origin are defined as sets of requirements to determine “originating” goods traded between preferential trading partners.⁷¹³

XIV.a.2. Rules of origin from a legal and historical perspective.

The legal history of the “*origin*” of imported goods started when the World Customs Organization (WCO) was established. The embryo of the WCO stems from the Study Group, which was created by the Committee for European Economic Co-operation. This Committee consists of thirteen European government representatives. The objective of this Study Group is to examine “*the possibility of establishing one or more inter-European customs union*” under the legal framework of GATT. This Study Group consists of two Committees: the Economic Committee and the Customs Committee.

The Economic Committee is considered as the “*seed*” of the Organisation for Economic Co-operation and Development (OECD). The Customs Committee led to the establishment of the Customs Co-operation Council (CCC), which came into force in 1952. The CCC was governed by the Council Body. The “*First Council Session*” held on 26 January 1953, took place in Brussels and was attended by seventeen representatives from various

⁷⁰⁸ See Glossary statistical terms, available at : <http://stats.oecd.org/glossary/detail.asp?ID=4992>, last accessed : 21 March 2011.

⁷⁰⁹ See Annex K The Revised Kyoto Convention, See also Stocker, Walter, *Op. Cit.*, p. 2.

⁷¹⁰ See Paragraph 1 Article I Part I of the Agreement on Rules of Origin stipulate, available at : http://www.wto.org/english/docs_e/legal_e/22-roo.pdf, last accessed : 8 April 2011.

⁷¹¹ See EC Regulation 2913/1992. See also See Eeckhout, Piet, 2004, *Op. Cit.*, p. 361.

⁷¹² See Technical Information on Rules of Origin, available at : http://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm, last accessed : 21 March 2011.

⁷¹³ See Naumann, Eckart., *Rules of Origin under EPAs: Key Issues and New Directions*, Paper for Tralac Conference October 2005, p. 4, available at : http://www.tralac.org/unique/tralac/pdf/20051018_ROO_paper.pdf, last accessed : 9 April 2011.

European countries.⁷¹⁴ On 18 May 1978, the Customs Cooperation Council (CCC) concluded the “*International Convention on the Simplification and Harmonisation of Customs Procedures*”, known as the “*Kyoto Convention*”. This Convention is recognised as the first international agreement regulating the rules of origin, and entered into force on 25 September 1974. The Kyoto Convention is not a binding agreement. However, the Kyoto Convention lays down the important criteria in defining the rules of origin, consisting of “*wholly produced or wholly obtained*” and “*substantial transformation*”.⁷¹⁵ The wholly produced or wholly obtained goods automatically have an “*originating*” status. The origin of goods manufactured in two or more countries are determined by where the last “*substantial transformation*” took place.⁷¹⁶ There are three methods to determine “*substantial transformation*”, i.e, *Change of Tariff Classification* (CTC) or *Change in Tariff Heading*, *Value Added* (VA), and *Technical Requirement or Specific Processing*.⁷¹⁷

On 18 March 1975, the EU adopted Council Decision 75/199/EEC concerning the “*international convention on the simplification and harmonisation of customs procedures and accepting the Annex thereto concerning customs warehouse*”. This council decision entered into force on 26 September 1974.⁷¹⁸

The “*WCO*” was officially launched in 1994.⁷¹⁹ Afterwards in Brussels, on 26 June 1999, the *Protocol of amendment to the International Convention on the Simplification and Harmonisation of Customs Procedures* was signed. The EU adopted the Protocol amendment by Council Decision 2003/231/EC concerning “*the accession of the European Community to the Protocol of Amendment to the International Convention on the simplification and harmonization of customs procedures*”. Such council decision entered into force on 3 February 2006. The legal base of its adoption is the CCP.⁷²⁰

The establishment of the WTO brought rules of origin into the table of multilateral trade negotiations. The Agreement on Rules of Origin was concluded in Marrakech as part of the Uruguay Round. It entered into force on 1 January 1995. The objective of this agreement is to provide “*harmonisation and clarify rules of origin*” in international trade. It

⁷¹⁴ See Treaties Office Database, Protocol of amendment to the International Convention on the simplification and harmonisation of customs procedures (Revised Kyoto Convention), available at : <http://ec.europa.eu/world/agreements/prepareCreateTreatiesWorkspace/treatiesGeneralData.do?step=0&redirect=true&treatyId=7181>, last accessed : 08 April 2011.

⁷¹⁵ See Gibbon, 2008 : “[...] frequently within preferential rules of origin, exporters from beneficiary country are expected to conform to more than one method of proving ‘substantial transformation’. However, the prevalence of the use of multiple methods does not seem to have been measured in the literature [...]”. See also Cadot, Olivier., de Melo, Jaime., and Pérez, Alberto Portugal., *Rules of Origin for Preferential Trading Arrangements: Implications for AFTA of EU and US Regimes*, CREA-Institut de macroéconomie appliqué, Université de Lausanne, Juni 2006, available at : <http://www.hec.unil.ch/crea/publications/autrespub/china.pdf>, last accessed : 11 February 2011.

⁷¹⁶ See Falvey., Rod and Reed, Geoff., *Rules of Origin as Commercial Policy Instruments*, Research Paper 2000/18, Centre for Research on Globalisation and Labour Markets, School of Economics, University of Nottingham, available at : http://www.nottingham.ac.uk/shared/shared_levpublishations/Research_Papers/2000/00_18.pdf, last accessed : 9 April 2011.

⁷¹⁷ See Izam, Miguel, 2003. See also Gibbon, Peter, 2008. See also Naumann, Eckart., 2005. See also Falvey., Rod and Reed, Geoff., 2000.

⁷¹⁸ See Treaties Office Database, International convention on the simplification and harmonisation of customs procedures (Kyoto Convention), <http://ec.europa.eu/world/agreements/prepareCreateTreatiesWorkspace/treatiesGeneralData.do?step=0&redirect=true&treatyId=483>

⁷¹⁹ See Treaties Office Database, Protocol of amendment to the International Convention on the simplification and harmonisation of customs procedures.

⁷²⁰ See *Ibid.*

has to be noted that this Agreement only regulates non-preferential trade.⁷²¹ However, in the customs union, non-preferential and preferential of origin are applied in its international trade relations.⁷²²

XIV.a.3. Scope of rules of origin.

The concept of origin is defined as the “*economic*” nationality of goods in international trade.⁷²³ In practice, there are two types of origins, non-preferential and preferential origin. The non-preferential rules of origin are used under general commercial policy measures, for instance, as anti-dumping measures, quantitative restrictions, or tariff quotas.⁷²⁴ Non-preferential rules of origin are used for the purposes of trade statistics; application of labelling and marking requirements; and for government procurement.⁷²⁵ The source of imports (origin of goods) determines the import duties and restrictions.⁷²⁶ The rules of origin are also used as an instrument of import prohibitions and trade embargoes. Non-preferential rules of origin are used to attain different policy objectives established under national acts, regulations, or administrative procedures. In the customs union, a single set of rules of origin is applied to all member states.⁷²⁷ Therefore, rules of origin serve as a discretionary trade policy instrument.⁷²⁸

The preferential origin is given to imported goods by the beneficiary country under special arrangements, such as GSP. In other words, preferential origin is “*granted only to the certain countries subject to the conditions of trade preferences*” due to its nature in the selective trade arrangement.⁷²⁹ By certificate preferential rules of origin the goods are allowed to enter preference-granting country markets at a reduced rate or zero rate of duties.⁷³⁰ The Agreement on Rules of Origin in Paragraph 2 Annex II defines rules of origin:

*“as those laws, regulations and administrative determinations of general application that are applied by any Member to determine, whether goods qualify for preferential treatment under **contractual** or **autonomous** trade regimes leading to the granting of tariff preferences going beyond the application of Paragraph 1 of Article I of GATT 1994”.*⁷³¹

According to UNCTAD, there are various types of preferential rules of origin depending on the agreement of the contracting parties under the Regional Trading

⁷²¹ See Background Note, The Agreement on Rules of Origin of the WTO, June 1998, available at : http://www.acici.org/aitic/documents/notes/download/note14_eng.pdf, p. 1, last accessed : 11 April 2011; See also Izam, Miguel, 2003, *Op. Cit.*, p. 11. Also see the review documents : UN (2001); UN (2002a) and UN (2002b), all of which refer to the most recent contributions of UN/CEFACT on the question of rules of origin.

⁷²² See Gibbon, Peter., 2008.

⁷²³ See Naumann, Eckart., 2005, *Op. Cit.*, p. 4.

⁷²⁴ See http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/index_en.htm. See also Paragraph 2 Article I Part I of the Agreement on Rules of Origin stipulate, available at: http://www.wto.org/english/docs_e/legal_e/22-roo.pdf, last accessed : 8 April 2011.

⁷²⁵ See <http://www.unctadindiaroo.org/>. See also Paragraph 2 Article I Part I of the Agreement on Rules of Origin stipulate, available at : http://www.wto.org/english/docs_e/legal_e/22-roo.pdf, last accessed : 8 April 2011. See also Falvey., Rod and Reed, Geoff., 2000.

⁷²⁶ See Technical Information on Rules of Origin, available at: http://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm, last accessed : 8 March 2011.

⁷²⁷ See Stocker, Walter, *Op. Cit.*, p. 4.

⁷²⁸ See Naumann, Eckart., 2005.

⁷²⁹ See Miguel Izam, 2003.

⁷³⁰ Available at http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/index_en.htm

⁷³¹ See Agreement on Rules of Origin, available at: http://www.wto.org/english/res_e/booksp_e/analytic_index_e/roi_01_e.htm, last accessed : 9 April 2011.

Arrangements (RTAs).⁷³² Since there is “no binding agreement or international standard governing preferential rules of origin”⁷³³, the rules of origin can be different from country to country.⁷³⁴ The term “contractual” refers to the Economic Integration Agreement, whereas “autonomous” is interpreted as preferential, and is granted under the international legal framework, such as GSP.⁷³⁵ When based on its legal basis, the establishment of GSP is considered as an autonomous preferential arrangement.⁷³⁶

The rules of origin plays an important role in the implementation of GSP in order to determine whether imported goods receive preferential treatment or MFN treatment.⁷³⁷ The movement of goods within the customs union has to fulfil “the import formalities” or “comply with provisions on free circulation”, which are not based on the origin status.⁷³⁸ The regulation on free circulation is covered under Article 29 of TFUE (ex Article 24 TEC). The EU preferential rules of origin specifically regulate the procedures and administration requirements for goods released into free circulation on the market.

XIV.a.4. Concept of origin and trade deflection.

The basic concept of the rules of origin is to identify the “nationality” of goods. In this regard, the “nationality” of goods imposes the legal consequence of trade policy instruments that are applied to the goods. In order to determine such “nationality”, there are legal or administrative requirements that must be fulfilled by the traders, known as origin criteria.⁷³⁹

The definition of “wholly obtained goods” always involves two words “when on where”. For instance, when on where goods naturally occur; live animals are born and raised; plants harvested; or minerals extracted or taken in a single country. The waste resulted from manufacturing or processing operations or from consumption, which is produced from the wholly obtained goods. This is also included in the definitions of “wholly obtained goods”.⁷⁴⁰

Preferential rules of origin require two essential components, “criteria of origin” and “documentary evidence”.⁷⁴¹ Documentary evidence is used as a legal support declaring the “origin” of goods. An adequate and authenticate certificate of origin is required. Based on such documents, the customs officers can determine what type of trade policy measure to apply to the goods. Documentary evidence has created fragmentation in the implementation of the rules of origin. However, the customs union administration rules of

⁷³² See UNCTAD-ROO Database, available at : <http://www.unctadindiaroo.org/>, last accessed : 9 April 2011.

⁷³³ See Naumann, Eckart, 2005.

⁷³⁴ See Glossary statistical terms, available at: <http://stats.oecd.org/glossary/detail.asp?ID=4992>, last accessed : 21 March 2011.

⁷³⁵ See Miguel Izam, 2003.

⁷³⁶ See Commission of the European Communities, The Rules of Origin in Preferential Trade Arrangements; Orientations for the future, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Brussel, 16.3.2005, COM (2005) 100 final, available at : <http://www.eclac.org/publicaciones/xml/0/13420/lcl1945i.pdf>, last accessed : 11 February 2011. See also Enabling Clause 1979. See also Appellate Body Decision on EC Preferences Case; See Council Regulation (EC) No. 732/2008.

⁷³⁷ See Technical Information on Rules of Origin, available at: http://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm, last accessed : 8 March 2011.

⁷³⁸ See Taxation and Customs Union, available at: http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/index_en.htm, last accessed : 8 March 2011.

⁷³⁹ See Stocker, Walter, *Op. Cit.*, p. 2.

⁷⁴⁰ See Stocker, Walter, *Op. Cit.*, p. 3.

⁷⁴¹ See Stocker, Walter, *Op. Cit.*, p. 4.

origin are established based on uniformity and simplicity.⁷⁴² New barriers in trade should not be created.

Trade deflections take place in preferential rules of origin when the producer from the non-beneficiary country places their production in the beneficiary country in order to receive benefits from preferential rules of origin. The preference-granting country tends to establish restrictive requirements regarding transformation. This policy aims to ensure that the goods originated from the beneficiary country and the benefit of such preferences is truly enjoyed and utilised to achieve its objective. Therefore, in order to prevent trade deflection, rules of origin are necessary in all trade preferences.⁷⁴³

However, restrictive regulation of preferential rules of origin has caused difficulties either administratively or technically for the producer of the beneficiary country. This could be considered as the new “*non-tariff barrier to trade*”. As a matter of fact, the producer from the beneficiary country has to fulfil such restrictive requirements, otherwise the preference-granting country may withdraw the benefits of such preference.⁷⁴⁴ Therefore, the rules of origin have a discriminatory nature since they may be used as an “*exclusion mechanism*”⁷⁴⁵. It could become a hidden tool for protectionism, leading to discrimination”.⁷⁴⁶ The rules of origin also have some positive impact on the area of intellectual property rights, such as geographic indication and state of the art.⁷⁴⁷

The standard consignment document plays a crucial role in preventing transshipment.⁷⁴⁸ Transshipment is considered as a form of trade deflection in preferential trade. Such conduct is identified as potentially hampering realisation of GSP. In this regard, real benefits from trade preferences will not be enjoyed and utilised directly by the beneficiary country but are taken by a third state. Hence, trade deflections are defined as abuse by a third state to take the advantages given by preference-granting country through the GSP scheme.

The consignment standard is included as a requirement in the rules of origin. The consignment standard requires direct shipment. The goods must be shipped directly from the beneficiary countries to the preference-granting country. The consignment document is used to avoid the “*manipulation or fraud*” of the origin of products.

XIV.a.5. Basic principles of rules of origin.

Three basic principles are applied in the rules of origin, that is, simplicity, predictability, and efficiency. These principles are in line with the principles applied in the GSP.⁷⁴⁹ The principle of simplicity emphasises that rules of origin must be comprehensible

⁷⁴² See International Center for Economic Growth, *Op. Cit.*, p. 1.

⁷⁴³ See Cadot, Olivier., de Melo, Jaime., and Pérez, Alberto Portugal., 2006.

⁷⁴⁴ See International Center for Economic Growth, *Op. Cit.*, p. 1.

⁷⁴⁵ See Izam, Miguel, 2003, *Op. Cit.*, p. 13. See also the review documents : UN (2001); UN (2002a) and UN (2002b), all of which refer to the most recent contributions of UN/CEFACT on the question of rules of origin.

⁷⁴⁶ See Izam, Miguel, 2003, *Op.Cit.*, p. 14. See also the review documents : UN (2001); UN (2002a) and UN (2002b), all of which refer to the most recent contributions of UN/CEFACT on the question of rules of origin.

⁷⁴⁷ See Izam, Miguel, 2003, *Op. Cit.*, p. 12. See also the review documents : UN (2001); UN (2002a) and UN (2002b), all of which refer to the most recent contributions of UN/CEFACT on the question of rules of origin.

⁷⁴⁸ See Gibbon, 2008 : “[...] includes transshipment as part of trade deflection when non beneficiary country via beneficiary country commit fraud in order to obtain the margin of preference available under the scheme under autonomous preferential trade [...]”. See also Naumann, Eckart., 2005.

⁷⁴⁹ See Communication From The Commission To The Council, The European Parliament and The European Economic and Social Committee Developing countries, international trade and sustainable development: the function of the Community’s generalised system of preferences (GSP) for the ten-year period from 2006 to 2015. “[...] The EU’s

and transparent. The principle of simplicity is applied in order to avoid “*ambiguous interpretation*” or “*fraudulence*” in the application of rules of origin. The principle of predictability emphasises the aspect of “*consistency*”. In this regard, rules of origin must guarantee that the stability of its implementation gives traders or producers in the beneficiary country the opportunity to anticipate the “unpredictable” situation in international trade. The principle of efficiency covers efficient, speedy, and simple administrative procedures in the application of the rules of origin. Relating to administrative cooperation procedures, the EU preferential rules of origin require the beneficiary country to apply the modern public administrative system. The EU rules of origin are established under Union legislation. This is based on the principle of fairness, transparency, predictability, consistency, and neutrality.⁷⁵⁰

XIV.a.6. The WTO Agreement on Rules of Origin.

The WTO Agreement on Rules of Origin was adopted in Marrakech. It entered into force on 1 January 1995. This Agreement consists of four parts⁷⁵¹, nine articles, and 2 Annexes. The WTO Agreement on Rules of Origin lays down crucial principles that have to be applied by the member states in the establishment of their national rules of origin. In the preamble of the agreement, it is mentioned that the member states must apply the transparency principle when establishing laws, regulations, and practices relating to rules of origin. These principles have also been adopted by Article 3 Paragraph (d) and (e) of the WTO Agreement on Rules of Origin that stipulates as follows:

“[...] (d) the rules of origin are administered in a consistent, uniform, impartial and reasonable manner; (e) their laws, regulations, judicial decisions and administrative rulings of general application relating to rules of origin are published as if they were subject to, and in accordance with, the provisions of Paragraph 1 of Article X of GATT 1994; [...]”

These principles are applied in order to “*create further liberalisation and expansion of world trade*” and “*strengthen the role of GATT*”. Article 3 Paragraph (e) elaborates on the implementation of transparency principle. It is clearly stipulated that member states must publish “*their laws, regulations, judicial decisions, and administrative rulings of general application relating to rules of origin*”.

Annex II “*Common Declaration with regard to Preferential Rules of Origin*” aimed to respond to the existence of trade preferences granted by developed country.⁷⁵² Paragraph c Article 3 of the Common Declaration used to enhance implementation of transparency in the rules of origin procedures.⁷⁵³

Generalized System of Preference must be stable, predictable, objective and simple. It must be made more accessible to traders [...].”

⁷⁵⁰ See Jones, Vivian C., and Martin, Michael F., International Trade: Rules of Origin, RL34524, CRS Report for Congress, Congressional Research Service, January 11, 2011, available at: <http://www.fas.org/sgp/crs/row/RL34524.pdf>, last accessed : 11 February 2011.

⁷⁵¹ Part I (Definitions And Coverage); Part II (Disciplines to Govern the Application of Rules of Origin); Part III (Procedural Arrangements on Notification, Review, Consultation and Dispute Settlement); Part IV (Harmonization of Rules of Origin).

⁷⁵² See Appellate Body Decision in *EC-Preferences Case* para. 190.

⁷⁵³ “[...] their laws, regulations, judicial decisions and administrative rulings of general application relating to preferential rules of origin are published as if they were subject to, and in accordance with, the provisions of paragraph 1 of Article X of GATT 1994 [...]”

XIV.b. Rules of origin in the EU Generalised System of Preferences.

In the implementation of GSP, rules of origin function to prevent “*fraud*” and “*trade deflection*”. The violation of the rules of origin can be used as justification to withdraw the beneficiary country from the GSP list.⁷⁵⁴ Compared to MFN, the rules of origin that are applied to preferential trade are more restrictive.⁷⁵⁵ One of the most crucial elements of the rules of origin is the allocation or limitation of non-originating materials or external contents of imported goods from the beneficiary country.

The “*fraud*” that potentially occurs could reduce or eliminate the benefits provided by GSP. For instance, the goods and products from the beneficiary country are granted tariff reductions under the GSP scheme, on the other hand, the beneficiary country may lack the production resources such as technology and materials. This circumstance may be misused by other parties in order to take the benefits by “*counterfeiting*” the origin of goods.⁷⁵⁶ The requirement of the minimum local and regional value content aims to generate growth in the small-scale business sector in developing countries. This requirement is indirectly addressed to achieve one of the objectives of GSP to eradicate poverty in developing countries. The regulation of domestic or regional contents and the specified processing requirement aim to generate employment and help economic development through trade.⁷⁵⁷ On the other hand, the strict restriction on external contents also increases the cost of production. The strict restriction on the external content will limit producers from the beneficiary country to having less choice in efficient complementary materials. Under such circumstances, the production continuity of the beneficiary countries can be injured by high cost production.

The EU GSP seriously treats “*trade deflection*” with respect to cases of fraud, irregularities, or systematic failure to comply with the rules of origin.⁷⁵⁸ Therefore, the EU as the preference-granting country could impose “*temporarily withdrawal in respect of all or of certain goods originating in a beneficiary country*” when such fraud or failure occurs. This withdrawal policy is categorised as a unilateral sanction since the legal nature of the GSP is an optional policy. However, Paragraph 2 Article 16 Council Regulation (EC) No. 732/2008 requires “*administrative cooperation*”, *inter alia*, for instance, Sub-paragraph (d) stipulates “*appropriate inquiries to identify and prevent contravention of the rules of origin*”. In this regard, the EU exercises its right as preference-granting country by holding the confidentiality principle in giving justification on such fraud conduct or trade deflection. Paragraph 1 Article 17 Council Regulation (EC) No. 732/2008 stipulates that the Commission or a member state has to inform the Generalised Preferences Committee⁷⁵⁹ when there is sufficient justification to initiate an investigation of such conduct. According to Paragraph 2 Article 27 Council Regulation (EC) No. 732/2008 the Generalised Preference Committee has the task “*to examine any matter relating to the application of this*

⁷⁵⁴ See Harris, Jeremy T, 2009, *Op. Cit.*, pp. 7-9. See also International Center for Economic Growth, Near East Program, Free Trade Agreements and Rules of Origin, p. 1.

⁷⁵⁵ See Gibbon, Peter, 2008.

⁷⁵⁶ See Cadot, Olivier., de Melo, Jaime., and Pérez, Alberto Portugal., 2006.

⁷⁵⁷ See Harris, Jeremy T., 2009, *Op. Cit.*, pp. 7-9. See also International Center for Economic Growth, *Op. Cit.*, p. 1.

⁷⁵⁸ See Paragraph 1 Article 16 of the Council Regulation (EC) No. 732/2008 :

“[...] The preferential arrangements provided for in this Regulation may be withdrawn temporarily, in respect of all or of certain products originating in a beneficiary country, in cases of fraud, irregularities or systematic failure to comply with or to ensure compliance with the rules concerning the origin of the products and with the procedures related thereto, or failure to provide the administrative cooperation as required for the implementation and policing of the arrangements referred to in Article 1(2) [...]”.

⁷⁵⁹ See Paragraph 1 Article 27 of the Council Regulation (EC) No. 732/2008.

Regulation, raised by the Commission or at the request of a member state". The mechanism of withdrawal and suspension in the GSP is discussed in separate sections in this study.

The rules of origin have a crucial role in the implementation of the EU GSP scheme in order to prevent trade deflection. Recitals 21,⁷⁶⁰ Paragraphs 1⁷⁶¹ and 2⁷⁶² Article 5 Council Regulation (EC) No. 732/2008, stipulates that rules of origin are used to ensure that the benefit of GSP is enjoyed and utilised properly by the beneficiary countries to fulfil their "development needs". The Commission emphasises that the rules of origin must comply with the objectives of the GSP scheme.⁷⁶³ The preferential rules of origin of the EU are regulated by Commission Regulation (EEC) No. 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code, whereas, now this regulation was amended by Commission Regulation (EU) No. 1063/2010 on 18 November 2010. This new regulation was applied by 1 January 2011. The Commission Regulation (EU) No. 1063/2010 is established under Article 290 of the TFEU as "non-legislative acts".

The gap and inequalities of economic development between states creates an obstacle in implementing equal treatment of concession. In this regard, the international trade community has responded through the establishment of some preferences directed to developing countries. However, as noted above, this preferential system also has its own weakness in its implementation. It is needed to ensure that the actual benefits of GSP are enjoyed and utilised directly by the beneficiary countries. This objective is in compliance with the WTO legal framework, such as the Enabling Clause and the Doha Development Agenda, in order to improve market access for developing countries to developed countries.⁷⁶⁴ In this way, the beneficiary countries are encouraged to accelerate their integration in the world trading system.

Trade is still considered as an effective tool to encourage developing countries to integrate into the world economy, especially through enhancing market access. Controlling and monitoring the implementation of the rules of origin can maximise the utilisation of the Generalised System of Preferences by market improvement.⁷⁶⁵ Therefore, it is deemed that revision of the rules of origin will deliver its concrete advantages directly, to which the Generalised System of Preferences is directed. In the Communication from the Commission

⁷⁶⁰ "[...] The rules of origin concerning the definition of the concept of originating products, the procedures and the methods of administrative cooperation related thereto, laid down in Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code, applied to the tariff preferences provide by this Regulation, in order to ensure the benefit of this scheme goes only to those beneficiary countries which the scheme is intended to benefit [...]."

⁷⁶¹ "[...] The tariff preferences provided shall apply to imports of products included in the arrangement enjoyed by the beneficiary country in which they originate [...]."

⁷⁶² "[...] For the purposes of the arrangements referred to in Article 1(2), the rules of origin concerning the definition of the concept of originating products, the procedures and the methods of administrative cooperation related thereto, shall be those laid down in Regulation (EEC) No 2454/93 [...]."

⁷⁶³ See European Commission, Directorate-General for Trade, Trade policy the EU's relations with the rest of the world, Office for Official Publications of the European Communities, Luxembourg, 2006, available at : http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc_128505.pdf, last accessed : 23 September 2010.

⁷⁶⁴ See Recitals 3, Commission Regulation (EU) No. 1063/2010 of 18 November 2010.

⁷⁶⁵ See Cadot et al (2005a, 2005b, 2006); Gibbon (2008) : "[...] having demonstrate an relationships between rules of origin restrictiveness at product level and preference under-utilisation [...]"; "[...]a growing consensus amongst trade economists is evident to the effect that there is clear link between restrictiveness and under-utilisation, since tariff lines with the highest preference margins are normally subject to the most restrictive rules of origin [...]."

to the Council concerning *“The Rules of Origin in Preferential Trade Arrangements; Orientations for the future”*, it was stated that:⁷⁶⁶

“[...] The rules of origin are an essential component of Community trade policy, especially where tariff preferences have to be granted to goods only originating in given countries or groups of countries. Therefore, they must be consistent with the overall objective of those preferences of strengthening economic integration between the partners and in particular of facilitating the full insertion of developing countries into the world economy and supporting their economic and social development [...]. The Commission intends to target GSP *“on the countries that most need it and must encourage regional cooperation between developing countries by various means. The GSP should assist these countries to attain a level of competitiveness which could make them self-supporting economically and full partners in international trade [...]”*

The revision of the GSP rules of origin aims to create more *“relaxed”* and *“simplified”* procedures.⁷⁶⁷ As noted by the European Commission, such simplification is designed to *“guarantee easier access to the community market”* under GSP. Further, the new revision of the EU GSP rules of origin aims to enhance the implementation of the transparency principle.⁷⁶⁸

Revisions of the preferential rules of origin are deemed as a crucial issue within international trade liberalisation. Therefore, on 18 December 2003 the Commission responded to such demand through discussion and the publication of a consultation paper on *“the future of rules of origin in preferential trade arrangements”* the so-called *“Green Paper”*.⁷⁶⁹ The Green Paper was *“adopted”* by the Commission on 16 March 2005.⁷⁷⁰ The Green Paper mapped out some crucial problems related to the implementation of preferential rules of origin. To gather the opinions and consultations, the Commission involved third states, such as the beneficiary countries of the GSP. The new approach to the preferential rules of origin, particularly in the GSP, was changed into a *“development-orientated arrangement”*. In this regard, the EU intended to apply the preferential rules of origin for the sake of development.⁷⁷¹

As mentioned above, the urgency of the simplification of the preferential rules of origin⁷⁷² was based on considerations where the previous rules of origin were considered *“too complex and too restrictive”*. According to the Commission’s impact assessment, the

⁷⁶⁶ Commission of the European Communities, *The Rules of Origin in Preferential Trade Arrangements; Orientations for the future*, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Brussel, 16.3.2005, COM (2005) 100 final, available at : <http://www.eclac.org/publicaciones/xml/0/13420/lcl1945i.pdf>, last accessed : 11 February 2011.

⁷⁶⁷ See *The Future of Rules of Origin*, available at : http://ec.europa.eu/taxation_customs/customs_duties/rules_origin/preferential/article_777_en.htm, last accessed : 13 April 2011. See also Miguel Izam, 2003. Izam (2003) noted that “[...] rules of origin has implication to the trade facilitation and efficiency, which covered both private and public sector [...]”. Izam, has put a highlight on the “simplicity and clarity administrative procedure which applies on the certification of origin”. However, the system establishment of such system cannot be separated from the institutions concerned such as trade institution and customs office.

⁷⁶⁸ Commission of the European Communities, *The Rules of Origin in Preferential Trade Arrangements; Orientations for the future*, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee.

⁷⁶⁹ See *The European Commission, Green Paper The Future of Rules of Origin in Preferential Trade Arrangements*, A summary report of the results of the consultation process, COM(2003)787, 18 December 2003, available at: http://ec.europa.eu/taxation_customs/resources/documents/origin_consultation_final.pdf, last accessed : 14 April 2011.

⁷⁷⁰ European Union Communication, *The rules of origin in preferential trade arrangements: Orientations for the future*.

⁷⁷¹ See Recitals 2 of the Commission Regulation (EU) No. 1063/2010.

⁷⁷² See Recitals 3 of the Commission Regulation (EU) No. 1063/2010.

rules of origin was identified as one of the “reasons” for low utilisation of certain goods that benefited under the trade preferences.⁷⁷³ The Commission’s impact assessment concluded that the rules of origin should be applied on “a sector-by-sector rather than a product-by-product basis”. Such assessment also emphasises the “development-friendly principle” as part of the purpose of the GSP.

In the GSP rules of origin, the “single criterion”⁷⁷⁴ is used to determine the “nationality” of goods. Value-added⁷⁷⁵ criterion is applied to goods that are “not wholly obtained in a beneficiary country”. The adequate processing “threshold value” must be respected.⁷⁷⁶ During the revision process of the rules of origin, the value-added threshold is a crucial issue between internal and external stakeholders.⁷⁷⁷

In order to determine “real added-value” it is important to consider production capacity of the beneficiary country and sufficient processing operations⁷⁷⁸. The percentage of added-value should not exceed the production capabilities of developing countries. The sufficient processing evaluation can be measured using a method “value added test”.⁷⁷⁹ Based on the “value added test”, a product is considered as originating only if the contents of the non-originating materials in the imported product, after the working process, do not exceed the threshold value (referred to as the minimum Local Value Content or Regional Value Content), which is “expressed as a percentage of the net production cost of the final product”. The percentage of value added content should be based on economic analysis and GSP objectives. The value added criterion is applied to prevent any misapplication or circumvention of the preferences. However, the value added criterion should not hamper efficiency and competitiveness by increasing production costs.⁷⁸⁰

With respect to LDCs, Commission Regulation (EU) No. 1063/2010 provides “maximum content of non-originating⁷⁸¹ materials up to 70 %”. Such regulation is based on the consideration to generate industrialisation in LDCs. It reflects the divergent of industrial capabilities of beneficiary countries.⁷⁸² Furthermore, the “criteria of origin” and

⁷⁷³ See Recitals 5 of the Commission Regulation (EU) No. 1063/2010.

⁷⁷⁴ See ODI (2006); Cadot et al (2005); Gibbon (2008). “[...] in the Generalized System of Preferences “VA” was the sole test in 10-13% of tariff lines [...]”.

⁷⁷⁵ Describe by Gibbon (2008), that preferential trade “[...] may require an exported good of beneficiary country to embody a minimum local VA, have specified originating parts comprising a specific share of final value, or embody a maximum import content measured in value terms [...]”. VA should be calculated on the base price (for instance : Ex-works, Net Production Cost, FOB, CIF, etc). Where VA rules are applied EU Generalized System of Preference (refer to Commission Regulation (EU) No 1063/2010 of 18 November 2010). The level of local VA required has usually fallen in a range of 25-60%.

⁷⁷⁶ See Recitals 6 of the Commission Regulation (EU) No 1063/2010.

⁷⁷⁷ See Naumann, Eckart, 2005.

⁷⁷⁸ See also Gibbon (2008) : “[...] sufficient processing operations or used to called as technical requirement”, in this regard, preference granting country may require that “one or more specified manufacturing operation must take place on the good in the beneficiary country for it to be classified as originating [...]”.

⁷⁷⁹ Commission of the European Communities, The Rules of Origin in Preferential Trade Arrangements; Orientations for the future, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Brussel. See also Gibbon, Peter, 2008 : “[...] importing country considers the amount of value added in a good in a given exporting country sufficient for it to be counted as an export from that country [...]”.

⁷⁸⁰ Commission of the European Communities, The Rules of Origin in Preferential Trade Arrangements; Orientations for the future, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee.

⁷⁸¹ See Paragraph 1 (o) Article 67 of the Commission Regulation (EU) No 1063/2010, defined “[...] maximum content of non-originating materials as the maximum content of non-originating materials which is permitted in order to consider a manufacture as working or processing sufficient to confer originating status on the product. It may be expressed as a percentage of the ex-works price of the product or as a percentage of the net weight of these materials used falling under a specified group of chapters, chapter, heading or sub-heading [...]”.

⁷⁸² See Recitals 7 of the Commission Regulation (EU) No. 1063/2010.

“economic justification” are linked with the real economic benefit going to the beneficiary countries concerned. In order to ensure the process of production carried out in the beneficiary country, the regulation provides *“a list of insufficient working or processing operations that can never confer origin”*. However, there are limited changes of this list in the revised version.⁷⁸³ The list of sufficient working or processing operations and wholly obtained goods are adopted as *“unilateral arrangements”* that are in line with the preferential origin of GSP.⁷⁸⁴

Since, the certificate of origin is issued by the beneficiary, importers do not have the burden to pay any duty, when the declaration of origin is found to be *“incorrect”*. Importers are considered to act in good faith. Therefore, the authorities in the beneficiary country must apply prudential principles when issuing such certificates because the loss will not go to the *“EU’s own resources”*, but to their traders and producers.⁷⁸⁵

As regards *“free circulation”* within the EU, it is required to check whether the supplier is a registered exporter in the beneficiary country concerned or not. The beneficiary country has to set up *“an electronic record of registered exporters”*, therefore, the application of e-Trade is needed to support such service.⁷⁸⁶ The principle of transparency is carried out by the publication of *“non-confidential registration data of exporters”*.⁷⁸⁷

Article 67 distinguishes between *“exporter and registered exporter”*. Paragraph 1 (t) Article 67 defines the exporter as *“a person exporting the goods to the EU or to a beneficiary country who is able to prove the origin of the goods, whether or not he is the manufacturer and whether or not he himself carries out the export formalities”*. Then, Paragraph 1 (u) Article 67 defines the registered exporter as *“an exporter who is registered with the competent authorities of the beneficiary country concerned for the purpose of making out statements on origin for the purpose of exporting under the scheme”*.

It is clearly regulated that in order to receive facilities under the GSP scheme, the concerned exporter from the beneficiary country has to be registered at the competent authorities of that beneficiary country. In addition to ensuring the GSP facilities are utilised properly, such registration is also used for trade statistics and analysis. For instance, the data can be used by the beneficiary country to provide trade statistics related to the utilisation of the GSP scheme by the domestic exporter. Paragraph 3 Article 69 Commission Regulation (EU) No. 1063/2010 stipulates that the information about the *“registered exporter”* must be provided by governmental authorities of the beneficiary country and the customs authorities of member states in the form of an electronic database.

Commission Regulation (EU) No. 1063/2010 amends Articles 66 to 97 Part I, Title IV, Chapter 2 of Regulation (EEC) No. 2454/93. This revision of the regulation covers the *“definition of the concept of originating goods”*, the procedures, and the methods of administrative cooperation designed for the application of the GSP scheme.⁷⁸⁸ The revision makes a distinction between the definitions of a *“product”* and *“goods”*. A product is defined as a manufactured product, even if it is intended for later use in another

⁷⁸³ See Recitals 8 of the Commission Regulation (EU) No. 1063/2010.

⁷⁸⁴ See Recitals 25 of the Commission Regulation (EU) No. 1063/2010.

⁷⁸⁵ See Recitals 17 of the Commission Regulation (EU) No. 1063/2010.

⁷⁸⁶ See Recitals 18 of the Commission Regulation (EU) No. 1063/2010.

⁷⁸⁷ See Recitals 19 of the Commission Regulation (EU) No. 1063/2010.

⁷⁸⁸ See Article 66 Sub Section 1 Section 1 of the Commission Regulation (EU) No. 1063/2010.

manufacturing operation.⁷⁸⁹ While, goods are defined as both materials and goods.⁷⁹⁰ Materials refer to any ingredient, raw material, component, or part, used in the manufacture of the product.⁷⁹¹ Manufacture is defined as any kind of working or processing included in assembly.⁷⁹²

XIV.b.1. Role of e-trade in administrative cooperation rules of origin.

Paragraph 1 (a) Article 68 stipulates that the beneficiary country is required to provide “*administrative structures and systems*” in order to be able to implement the rules and procedures determined by the regulation. This provision is also related to the importance of building an integrated system to support the implementation of the “*accumulation of origin*”. It is needed to setup administrative cooperation between the authorities concerned in the beneficiary country, with the Commission and the customs authorities of the member states. Further, Paragraph 1 (b) Article 68 regulates such cooperation.

To carry out such cooperation, the beneficiary countries are obliged to inform the names and addresses of the authorities within their jurisdiction, which have the authorisation to register and to withdraw exporters from the “*record of registered exporters*”. The authorities of the beneficiary country are defined as “*part of the governmental authorities of the country concerned, or act under the authority of the government*”. In addition, any change relating to such cooperation must be informed immediately to the Commission.⁷⁹³ Article 71 clearly stipulates that failure of the competent authorities of a beneficiary country to comply with Articles 68(1), 69(2), 91, 92, 93 or 97g or systematic failure to comply with Article 97h (2), could lead to temporary withdrawal from preferences under the scheme for that country. With the purpose of performing the transparency principle, the Commission should publish such data and any updates in the *Official Journal of the European Union* (C series) as stipulated by Article 70.

Article 72 of the preferential rules of origin describes the concept of originating goods as stipulated in the Article 75 and 76. Paragraph 1 Article 75 provided lists of the “*wholly obtained*” products, as follows :

- (a) Mineral products extracted from its soil or from its seabed;
- (b) Plants and vegetable products grown or harvested there;
- (c) Live animals born and raised there;
- (d) Products from live animals raised there;
- (e) Products from slaughtered animals born and raised there;
- (f) Products obtained by hunting or fishing conducted there;
- (g) Products of aquaculture where the fish, crustaceans and molluscs are born and raised there;
- (h) Products of sea fishing and other products taken from the sea outside any territorial sea by its vessels;
- (i) Products made on board its factory ships exclusively from the products referred to in point (h);
- (j) Used articles collected there fit only for the recovery of raw materials;
- (k) Waste and scrap resulting from manufacturing operations conducted there;

⁷⁸⁹ See Paragraph 1 (d) Article 67 Section 1 of the Commission Regulation (EU) No. 1063/2010.

⁷⁹⁰ See Paragraph 1 (e) Article 67 Section 1 of the Commission Regulation (EU) No. 1063/2010.

⁷⁹¹ See Paragraph 1 (c) Article 67 Section 1 of the Commission Regulation (EU) No. 1063/2010.

⁷⁹² See Paragraph 1 (b) Article 67 Section 1 of the Commission Regulation (EU) No. 1063/2010.

⁷⁹³ See Article 66 Commission Regulation (EU) No. 1063/2010.

- (l) Products extracted from the seabed or below the seabed which is situated outside any territorial sea but where it has exclusive exploitation rights;
- (m) Goods produced there exclusively from products specified in points (a) to (l).

When product originating from the beneficiary country exported to another country and returned to the same beneficiary country, it would not be entitled origin from beneficiary country concerned. Except it “*demonstrated*” that such products is the same products and not undergone of any treatment.⁷⁹⁴ It is not allowed to transform the product under any circumstances except the process to keep the product in the “*good condition*”. The custom authorities is allowed to ask traders or exporters to provide supporting document as evidence, such as, bills of lading⁷⁹⁵ or factual or concrete evidence based on marking or numbering of packages or any related document.⁷⁹⁶

Products considered as the originating product of beneficiary country when all of the elements of the products wholly obtained in the country of origin. The set of products that accumulated from originating and non-originating materials would be deemed as “*originating*” if the content of non-originating materials does not exceed 15 % of the ex-works price of the set.⁷⁹⁷

XIV.b.2. Cumulative origin of the European Union Generalised System of Preferences.

The cumulative origin of GSP is regulated in Paragraph 3 Article 5 of Council Regulation (EC) No. 732/2008.⁷⁹⁸ Cumulation of origin is defined as a certain group of countries under the preferential tariff treatment that is given “*identical rules of origin*”. This sort of facility gives a certain group of countries the possibility to cooperate together in the manufacturing product.⁷⁹⁹ Article 67 of Commission Regulation (EU) No. 1063/2010 defines four different types of cumulation: bilateral cumulation, regional cumulation, extended cumulation, and cumulation with goods originating in Norway, Switzerland, and Turkey.⁸⁰⁰ According to Harris, “[...] *cumulation is the provision that allows materials which meet the requirements of the rules of origin in one country to be considered as originating in another when determining the originating status of goods produced using those materials in the latter [...] cumulation zone is defined as the set of countries from which a producer may source cumulable materials*”.⁸⁰¹ While Bhagwati noted the establishment of cumulation of origin under the FTA based on the “*spaghetti bowl*” approach, inefficiency in trade policy has been created.⁸⁰²

⁷⁹⁴ See Article 73 of the Commission Regulation (EU) No. 1063/2010.

⁷⁹⁵ “[...] A document signed by a carrier (a transporter of goods) or the carrier's representative and issued to a consignor (the shipper of goods) that evidences the receipt of goods for shipment to a specified designation and person”, available at: <http://legal-dictionary.thefreedictionary.com/bill+of+lading>, last accessed : 21 April 2011. “A document issued by a carrier, or its agent, to the shipper as a contract of carriage of goods. It is also a receipt for cargo accepted for transportation, and must be presented for taking delivery at the destination [...]”, see available at : <http://www.businessdictionary.com/definition/bill-of-lading-B-L.html>, last accessed : 21 April 2011.

⁷⁹⁶ See Paragraph 2 Article 74 of the Commission Regulation (EU) No 1063/2010.

⁷⁹⁷ See Article 82 of the Commission Regulation (EU) No 1063/2010.

⁷⁹⁸ “[...] Regional cumulation within the meaning and provisions of Regulation (EEC) No 2454/93 shall also apply where a product used in further manufacture in a country belonging to a regional group originates in another country of the group, which does not benefit from the arrangements applying to the final product, provided that both countries benefit from regional cumulation for that group [...]”.

⁷⁹⁹ See Recitals 10 of the Commission Regulation (EU) No 1063/2010.

⁸⁰⁰ See also Gibbon, Peter, 2008.

⁸⁰¹ See Harris, Jeremy T, 2009, *Op. Cit.*, p. 5.

⁸⁰² See Bhagwati, Jagdish and Krueger, Anne O. “U.S. Trade Policy: the Infatuation with Free Trade Agreements,” in *The Dangerous Drift to Preferential Trade Agreements*, AEI Press, 1995. *Dangerous Drift to Preferential Trade Agreements*, AEI Press, 1995; Jones, Vivian C., and Martin, Michael F., 2011, *Op. Cit.*, p. 6.

Bilateral cumulation is defined as “a system that allows products which are originating from EU to be considered as originating materials in a beneficiary country when they are further processed or incorporated into a product in that beneficiary country”.⁸⁰³ In addition, Article 83 Sub-section 3 of Commission Regulation (EU) No. 1063/2010 is a special provision governing bilateral cumulation.

Regional cumulation is defined as “a system whereby products originating in a country, which is a member of regional group (for instance ASEAN), are considered as materials originating in another country of the same regional group (or a country of another regional group where cumulation between groups is possible) when further processed or incorporated in a product manufactured in one of those countries in the regional group”.⁸⁰⁴ In this regard, regional groups are referred to as a group of countries between which regional cumulation applies.⁸⁰⁵ In pursuance of Article 86, there are four regional groups, consisting of:

- (a) Group I: Brunei, Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam;
- (b) Group II: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru, Venezuela;
- (c) Group III: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka;
- (d) Group IV: Argentina, Brazil, Paraguay and Uruguay.

Article 86 Paragraph 2 Sub-paragraph b (ii), stipulates, with regard to ensuring the appropriate implementation of the regional cumulation, that the countries of regional groups have to provide the administrative cooperation needed with the EU. This includes fostering administrative cooperation among the members of regional groups. The Secretariat of the regional group has the task of giving notification to the Commission with regards the undertaking of such requirements.⁸⁰⁶ For instance, the Secretariat of Group I is organised by Group I: the General Secretariat of the Association of Southeast Asian Nations (ASEAN), then Group II is organised by: the Andean Community – Central American Common Market and Panama Permanent Joint Committee on Origin, and Group III is organised by: the Secretariat of the South Asian Association for Regional Cooperation (SAARC).⁸⁰⁷

The EU regional cumulation rules⁸⁰⁸ provides “possibility” of using products or materials originating from the graduated country, as stipulates by Article 5 paragraph 3 Regulation (EC) No. 732/2008 :

“regional cumulation within the meaning and provisions of Regulation (EEC) No 2454/93 shall also apply where a product used in further manufacture in a country belonging to a regional group originates in another country of the group, which does

⁸⁰³ See Paragraph 1 (f) Article 67 of the Commission Regulation (EU) No. 1063/2010.

⁸⁰⁴ See Paragraph 1 (h) Article 67 of the Commission Regulation (EU) No. 1063/2010.

⁸⁰⁵ See Paragraph 1 (k) Article 67 of the Commission Regulation (EU) No. 1063/2010.

⁸⁰⁶ See Article 86 Paragraph 2 subparagraph c of the Commission Regulation (EU) No. 1063/2010.

⁸⁰⁷ See United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21- 34.

⁸⁰⁸ “[...] Under the EC rules for regional cumulation, materials or parts imported by a member country of one of these three groupings from another member country of the same grouping for further manufacture are considered as originating products of the country of manufacture and not as third-country inputs, provided that the materials or parts are already products originating in the exporting member country. Originating products are those that have acquired origin by fulfilling the individual origin requirements under the basic EC rules of origin for GSP purposes [...]”. See United Conference on Trade and Development, Generalized System of Preferences: Handbook on The Scheme of The European Community, pp. 21 - 34, United Nations, New York and Geneva, 2008.

not benefit from the arrangements applying to the final product, provided that both countries benefit from regional cumulation for that group”.⁸⁰⁹

Article 72 of the Commission Regulation (EU) No. 1063/2010 regulates the EU GSP regional cumulation.⁸¹⁰ For instance, a product originating in Indonesia incorporating goods originating from Singapore can enjoy EU GSP preferences, although Singapore have already graduated⁸¹¹ from the GSP. Singapore included into Group I of the regional cumulation⁸¹² with other ASEAN member states.⁸¹³

There are some products and materials that excluded from the regional cumulation as listed in Annex 13b. It should be noted, that *“the tariff preference applicable in the EU is not the same for all the countries involved in the cumulation”*.⁸¹⁴ Through cumulation of origin the products could get more favourable tariff treatment than the one who directly exported to the EU.⁸¹⁵

Article 86 paragraphs 4 stipulated about working or processing requirements carry out in the beneficiary country in the case of regional cumulation between countries in the same regional group exist. Paragraph 5 regulates about possibility of regional cumulation performed between countries of Group I or Group III based on the request of authority in beneficiary country concerned. Paragraph 6 elucidated the conditions to determine the origin of goods when products manufactured in the beneficiary country of Group I or Group III using materials originating in the country that belong to the other group.⁸¹⁶

XIV.b.3. Derogations.

The possibility of *“derogation”* has been regulated under Sub Section 4, Article 89 of Commission Regulation (EU) No. 1063/2010. The beneficiary country *“may be granted a temporary derogation”* under certain conditions as regulated in Section 1. Such *“derogation”* is given based on *“the Commission’s initiative or as a response to a request from a beneficiary country”*. The periods of *“derogation”* are limited based on the duration of the effects of the internal or external factors that cause it or the time needed by the beneficiary country to achieve conformity with the rules.⁸¹⁷ The *“derogation”* request should be proposed to the Commission in writing and include the reasons for derogation, and be supported with appropriate documentation.⁸¹⁸ During the period of derogation the

⁸⁰⁹ See Official Journal L 211/1, 6.8.2008.

⁸¹⁰ See Commission Regulation (EU) No. 1063/2010 and Council Regulation (EC) No. 2623/97, *Official Journal L 354*, 30.12.1997, p. 9.

⁸¹¹ According EC Council Regulation No. 2623/97 dated 19 Dec 97, there are three beneficiary countries, which consist of Singapore, Hong Kong and South Korea graduated from EU GSP Scheme by 1 May 1998.

⁸¹² “[...] Singapore’s status within the regional cumulation mechanism applicable to ASEAN will not be affected after the graduation i.e. products manufactured in Singapore can be used as inputs in the products of another ASEAN beneficiary country. This will enable the manufacturer in the ASEAN beneficiary country to qualify his products for the EU GSP Scheme under ASEAN Cumulation [...]”. (*Graduation from the Generalised System of Preference Scheme of the European Union (EU – GSP Scheme)*, TDB RU 33 99 02 Vol 3, 12 January 1998, available at : <http://www.customs.gov.sg/NR/rdonlyres/12772/98GraduationFromTheGeneralised1.pdf>, last accessed : 04 May 2011).

⁸¹³ See United Conference on Trade and Development, *Generalized System of Preferences : Handbook on The Scheme of The European Community*, 2008, *Op. Cit.*, pp. 21 – 34.

⁸¹⁴ See Article 86 paragraph 3 subparagraph a of the Commission Regulation (EU) No. 1063/2010.

⁸¹⁵ See Article 86 paragraph 3 subparagraph b of the Commission Regulation (EU) No. 1063/2010.

⁸¹⁶ See Paragraph 6 (a) and (b) Article 86 of the Commission Regulation (EU) No. 1063/2010.

⁸¹⁷ See Paragraph 2 Article 89 of the Commission Regulation (EU) No. 1063/2010.

⁸¹⁸ See Paragraph 3 Article 89 of the Commission Regulation (EU) No. 1063/2010.

beneficiary country has to provide information to the Commission with regard to the utilisation of derogation.⁸¹⁹

XIV.b.4. Export procedures in the beneficiary country.

Sub section 5 regulates the implementation of e-trade in the export procedures in the beneficiary country. Paragraph 1 Article 91 states that the competent authorities of the beneficiary country have to establish and update the electronic data record of their registered exporters. The authorities of the beneficiary country are obliged to make any data changes and updates immediately, for instance if there is an exporter being withdrawn from the registered exporter. Paragraph 2 of the same Article elucidates the information included in the electronic record.⁸²⁰ The competent authorities of the beneficiary country are required to send notification to the Commission regarding the national numbering system used for designating registered exporters, which usually start with ISO alpha 2 country codes.⁸²¹

To get registration number as registered exporter, the exporters in the beneficiary country have to apply⁸²² to the competent authorities in their country.⁸²³ The registered exporter will directly remove from the record whenever “no longer meet the conditions for exporting any goods under the preferential scheme” or “no longer intend to export related goods”.⁸²⁴ Under the certain circumstances competent authorities in the beneficiary country may withdraw the exporter from the record of registered exporters if the registered exporters convicted conduct a trade fraud related to rules of origin :

“[...] intentionally or negligently draw up, or cause to be drawn up, a statement on origin or any supporting document which contains incorrect information which leads to irregularly or fraudulently obtaining the benefit of preferential tariff treatment”.⁸²⁵ In other words, the committing trade deflection will lead to withdrawal of exporter from record of registered exporters [...]”.

The withdrawal of registered exporters will take in effect for the future (non-retroactive principle).⁸²⁶ The exporters that have been removed from the registered exporters have possibility to be re-applied as registered exporter under certain condition, for instance they have to “remedied” the “situation” caused their withdrawal.⁸²⁷

The EU preferential rules of origin provide some requirement to the exporters from the beneficiary country. Paragraph 1 Article 94 of the regulation obliged exporters to maintain appropriate commercial accounting records for production and supply of goods

⁸¹⁹ See Paragraph 4 Article 89 of the Commission Regulation (EU) No. 1063/2010.

⁸²⁰ The record shall contain the following information:

- (a) name and full address of the place where Registered Exporter is established/resides, including the identifier of the country or territory (ISO alpha 2 country code);
- (b) number of Registered Exporter;
- (c) products intended to be exported under the scheme (indicative list of Harmonized System chapters or headings as considered appropriate by the applicant);
- (d) dates as from and until when the exporter is/was registered;
- (e) the reason for withdrawal (registered exporter’s request /withdrawal by competent authorities). This data shall only be available to competent authorities.

⁸²¹ See Paragraph 3 Article 91 of the Commission Regulation (EU) No. 1063/2010.

⁸²² The exporter must submitted form 13c about application to become a registered exporter.

⁸²³ See Article 92 of the Commission Regulation (EU) No. 1063/2010.

⁸²⁴ See Paragraph 1 Article 93 of the Commission Regulation (EU) No. 1063/2010.

⁸²⁵ See Paragraph 2 Article 93 of the Commission Regulation (EU) No. 1063/2010.

⁸²⁶ See Paragraph 3 Article 93 of the Commission Regulation (EU) No. 1063/2010.

⁸²⁷ See Paragraph 4 Article 93 of the Commission Regulation (EU) No. 1063/2010.

qualifying for preferential treatment. Keeping all available evidence relating to the material used in the manufacture; to keep all customs documentation relating to the material used in the manufacture; and keeping the statement on origin made out for at least three years. This obligation also applied to the suppliers to keep their suppliers' declarations certifying the originating status of the goods.⁸²⁸

Statement of origin defined as *"a statement provide by the exporter indicating that the exported goods comply with the rules of origin of the preferential scheme"*. This letter used for the purpose of free circulation in order to claim the benefit of preferential tariff treatment. In the context of cumulation origin, such letter used to prove the originating status of the goods.⁸²⁹ Exporter provides statement of origin for theirs' customer in the EU either in English or French language, and it is pursuant to Annex 13d.⁸³⁰ One statement of origin only allowed for one consignment. However, in the paragraph 3 Article 96 it stipulated that the single statement used for some consignments under certain conditions.⁸³¹ Consignment defined as *"goods which are either sent simultaneously from one exporter to one consignee or covered by a single transport document covering their shipment from the exporter to the consignee or, in the absence of such document, by a single invoice"*.⁸³²

XIV.b.5. Procedures at release for free circulation in the European Union.

Sub section 6 of the regulation lays down the procedures of free circulation in the EU market. The statement of origin is used as the reference to issue the customs declaration of free circulation release.⁸³³ Article 97a stipulates the exemption to provide the statement of origin under certain technical conditions. For example products that are sent as small packages from private persons to private persons and the total value of which does not exceed 500 euros or goods forming part of travellers' personal luggage and the total value of which does not exceed 1,200 euros.

XIV.b.6. Control of origin.

Control of origin is regulated in Sub section 7 Article 97g of the regulation. The competent authorities of the beneficiary country must perform *"verifications of the originating status of goods at the request of the customs authorities of the member states and regular controls on exporters on their own initiative"*. In this regard, the competent authorities of the beneficiary countries have the right to call for any evidence and to carry out any inspection of the exporter's accounts.

The technical procedures and methods of administrative cooperation are regulated by section 1 A of the regulation. Paragraph 1 Article 97k lays down the requirements that should be fulfilled by the beneficiary country. For example, the rules of origin; the rules for completion and issue of certificates of origin Form A; the provisions for the use of invoice declarations; the provisions concerning methods of administrative cooperation; and the

⁸²⁸ See Paragraph 2 Article 94 of the Commission Regulation (EU) No. 1063/2010.

⁸²⁹ See Paragraph 1 (v) Article 67. See also Paragraph 1 and Paragraph 2 Article 95 of the Commission Regulation (EU) No. 1063/2010.

⁸³⁰ See Paragraph 3 Article 95. See also Article 97o, 97p and 97q of Section 1A of the Commission Regulation (EU) No. 1063/2010.

⁸³¹ See Article 96 of the Commission Regulation (EU) No. 1063/2010.

⁸³² See Paragraph 1 (s) Article 67 Section 1 of the Commission Regulation (EU) No. 1063/2010.

⁸³³ See Paragraph 1 Article 97 of the Commission Regulation (EU) No. 1063/2010.

provisions concerning granting of derogations. The competent authorities of the beneficiary country are obliged to cooperate with the Commission or the member states in order to perform monitoring, verification and origin investigations.⁸³⁴ A proof of origin will only be valid for 10 months from the date of issue in the exporting beneficiary country. It should be submitted to the customs authorities of the importing preference-granting country between those periods.⁸³⁵ The proof of origin is also used to obtain the tariff preferences.⁸³⁶

Section 1 A provides export procedures in the beneficiary country. For instance, the certificate of origin Form A should be issued on the written application form.⁸³⁷ The exporter or its authorised representative must submit appropriate supporting documents proving the exported goods qualify for the issuance certificate of origin Form A. The certificate has to be issued as soon as the export takes place.⁸³⁸ There are exceptions under certain circumstances when the certificate of origin is issued after the exportation of the product. For instance, the competent government authorities reject to issue certificate of origin Form A due to some technical reasons.⁸³⁹ Certificate of origin Form A or invoice declarations submitted to the customs authorities of preference granting country will be used for procedures of the customs declaration.⁸⁴⁰

Before the goods entering the preference granting country market free circulation it must have a customs declaration. Pursuant to Article 97s Section 1 A the beneficiary country is obliged to notify the Commission the names and addresses of the governmental institutions located in their territory that are authorized to issue certificates of origin Form A, to control of the certificates of origin Form A and the invoice declarations. The beneficiary country must send that information with specimen of the stamps used by authorities concerned. Article 97t regulates about the technical procedures that ought to be carried out in the verification of the certificates of origin form A and invoice declarations.

Annex I, Annex 13a of the Commission Regulation (EU) No 1063/2010 provide "*list of working or processing operation that confer originating status*", and it is applied for all goods. Materials excluded from regional cumulation laid down in Annex II, Annex 13 b. It is not all goods listed in Annex 13a covered by GSP.

XIV.c. The implications of rules of origin to the economic development of developing countries.

The significance of the rules of origin becomes crucial in the EU GSP in order to support the economic development of developing countries. Many scholars and researchers have written about the significant relationship between trade and economic development in developing countries.⁸⁴¹

⁸³⁴ See Paragraph 2 Article 97k of the Commission Regulation (EU) No. 1063/2010.

⁸³⁵ See Paragraph 5 Article 97k of the Commission Regulation (EU) No. 1063/2010.

⁸³⁶ See Paragraph 1 Article 97n of the Commission Regulation (EU) No. 1063/2010.

⁸³⁷ See Paragraph 1 Article 97k of the Commission Regulation (EU) No. 1063/2010.

⁸³⁸ See Paragraph 2 Article 97l of the Commission Regulation (EU) No. 1063/2010.

⁸³⁹ See Paragraph 2 Article 97l of the Commission Regulation (EU) No. 1063/2010.

⁸⁴⁰ See Paragraph 1 Article 97n of the Commission Regulation (EU) No. 1063/2010.

⁸⁴¹ See Gibbon, Peter (2008); Cadot, Olivier, et.al (2006:2007); Jones, Vivian C., et.al., (2011); Augier, Patricia, et.al; Dieter, Heribert, (2008); Harris, Jeremy T, (2009); Falvey, Rod et.al, (2000); Brenton, Paul, (2003); Fink, Carsten, et.al (2007); Lazaro, Dorothea C., et.al (2006); Estevadeordal, Antoni, et.al, (2005); Estevadeordal, Antoni, et.al, (2009); Naumann, Eckart, (2005); Cornejo, Rafael, et.al; anagariya, Arvind., et.al, (2003); Medalla, Erlinda M., et.al.

The rules of origin govern cross border goods movement in international trade relations. The rules of origin are not applied to goods or products that are manufactured and sold inside the country itself.⁸⁴² The rules of origin also influence investment and production decisions.⁸⁴³ The production decision includes the “*production factor*” and “*profit maximising firms*”. One of the production factors is the source materials of the goods. Production efficiency is influenced by the use of good quality materials with the lowest price. This factor triggers the establishment of the FTA and PTA between potential trading partners. According to Heydon and Izam, almost 55% of international trade in goods is performed under the preferential arrangement.⁸⁴⁴

Globalisation causes complexity in the determination of the origin of goods. As noted by Jones, “*contemporary globalised manufacturing*” has been proved to create complexity in the implementation of the rules of origin.⁸⁴⁵ Falvey et al., when determining the origin of goods, consider this as a crucial issue in international trade in goods since the manufacturing process takes place in more than one country.⁸⁴⁶

Hummels et al.; Jones & Marjit; Deardorff; and Augier note that “*changing patterns of multinational production*” has caused “*fragmentation*”, “*vertical specialisation*”, or “*outsourcing*” of goods production.⁸⁴⁷ For instance, the emergence of the Multinational Corporation (MNC) or Transnational Corporation (TNC) has also created difficulties with respect to the determination of the origin of goods. For instance, production of MNC or TNC takes place in more than one country and leads to fragmentation of production.⁸⁴⁸ This situation creates complexity in the implementation of the rules of origin.⁸⁴⁹

Based on its nature the rules of origin used as a justification tool to apply “*discriminatory trade policies*”. Therefore, the treatment applied to the goods will be different depend on the origin of the goods. The rules of origin divided into non-preferential and preferential automatically would affect the customs treatment to the goods.⁸⁵⁰

The rules of origin have significant economic value when the goods entering the market. Izam, noted that the rules of origin has “*financial implication*” with the price and “*the allocation of productive resources*”,⁸⁵¹ The rules of origin affect the treatment of customs office on imposing the customs and duties to the products. Therefore, origin of goods would influence the price of the goods when competing in the markets.

Economist considers rules of origin as a “*factor of production*”. In this point, rules of origin have strong relation with “*profit maximizing firms*”. Based on economist it is important to analyze the various type rules of origin, related to investment, source of raw materials or intermediate materials, manufacturing activities, transportation cost, goods final assemble and availability of labours. The company or producer tends to establish

⁸⁴² See International Center for Economic Growth, *Op. Cit.*, p. 1.

⁸⁴³ See Naumann, Eckart, 2005.

⁸⁴⁴ See Izam, Miguel, 2003, *Op. Cit.*, p. 13.

⁸⁴⁵ See Jones, Vivian C., and Martin, Michael F., 2011, *Op. Cit.*, p. 11.

⁸⁴⁶ See Falvey, Rod and Reed, Geoff., 2000, *Op. Cit.*, p. 14.

⁸⁴⁷ See Augier, Patricia, Gasiorek, Michael, and Lai-Tong, Charles., *The Impact of Rules of Origin on Trade Flows*, available at: <http://www.defi-univ.org/IMG/pdf/0301.pdf>, last accessed : 11 February 2011.

⁸⁴⁸ See International Center for Economic Growth, Near East Program, Free Trade Agreements and Rules of Origin, Policy Brief, Economic Policy Initiative Consortium Project, p. 1.

⁸⁴⁹ See Izam, Miguel, 2003, *Op. Cit.*, p. 13. Also see the review documents : UN (2001); UN (2002a) and UN (2002b), all of which refer to the most recent contributions of UN/CEFACT on the question of rules of origin.

⁸⁵⁰ See International Center for Economic Growth, *Op. Cit.*, p. 1.

⁸⁵¹ See Izam, Miguel, 2003, *Op. Cit.*, p. 13.

theirs' production or business activities in the countries that have the "lowest total costs production",⁸⁵² this also includes "cost to enter into the final market".⁸⁵³

XV. Trade facilitation and utilisation of the European Generalised System of Preferences.

XV.a. Evolutions of international trade facilitation from ancient times to modern times.

The origin of international trade stems from "long distance trade"⁸⁵⁴ and developed along with human civilisation. International trade started in 2500 BC when people used to practise the "free exchange of goods" or "bartering". Archaeologists have discovered that in ancient times the Sumerians of Northern Mesopotamia achieved immense welfare from sea trade in textiles and metals. Before 2000 BC, the exchange of olive oil and wine for grain and metal benefited the Greeks.⁸⁵⁵ International taxation was the essential part of trade facilitation in business activity two thousand years ago. Traders from Mesopotamia, Greece and Phoenicia achieved their prosperity in Mediterranean Trade.⁸⁵⁶

The early stages of modern commerce instruments and distant settlements existed in Greece in approximately 340 BC. For instance banking and credit, insurance, trade treaties, together with special diplomacies and other privileges.⁸⁵⁷ This reflects that trade preferences in international trade have been practised for 2350 years.

After the decline of Greece, the Roman Empire became a strong empire and started to expand its imperialism to the East. Trade relationships with the east began with the Chinese Empire by 1st century AD. This trade relationship was carried out along the Silk Road and developed many trade routes and complex trading patterns by sea. The war between the imperials led to the absence of peace and disturbed the movement and circulation of goods. Such situation caused the loss of distant markets because of perilous travel for traders.⁸⁵⁸

Due to the insecure and unstable situation of that time, thus, the Greeks became the international trader superpower by mobilising their armies to secure long distant trade.⁸⁵⁹ The Greeks took full advantage both of their military and intellectual leadership by asserting their authority over trade. In 500 BC, Greece achieved its advanced economy in the mass production of goods.⁸⁶⁰ While, the Romans achieved equal regional dominance a few hundred years later. The promotion of international business played a vital role in the Roman Empire. Its military power made Rome become the Great Empire. Military interference in the trading system was regulated by Pax Romana, or Roman Peace. This

⁸⁵² The cost of capital, the cost of labour, the skill level of labour, the cost of raw or intermediate materials, transportation cost and taxation obligation which imposed.

⁸⁵³ See International Center for Economic Growth, *Op. Cit.*, p. 1.

⁸⁵⁴ See Crouzet, François., *A History of the European Economy, 1000-2000*, University of Virginia Press, USA, 2001, p. 3.

⁸⁵⁵ See Seyoum, Belay., *Export-Import Theory, Practices and Procedures*, Second Edition, The Haworth Press, Taylor & Francis, New York, 2009, p. 1.

⁸⁵⁶ See Liu, 1998; Lymer, Andrew, and Hasseldine, John., *The International Taxation System*, Kluwer Academic Publisher Group, Massachusetts, USA, 2002; Hewitt, Paul., Lymer, Andrew., and Oats, Lynne., *History of International Business Taxation*, University of Birmingham U.K and University of Warwick, UK, p. 44.

⁸⁵⁷ See Seyoum, Belay., 2009, *Op. Cit.*, p. 1.

⁸⁵⁸ See *Ibid.*, p. 1.

⁸⁵⁹ See Czinkota et.al., 1985; Lymer, Andrew, and Hasseldine, John., 2002; Hewitt, Paul., Lymer, Andrew., and Oats, Lynne., *Op. Cit.*, p. 44.

⁸⁶⁰ See Taggart and McDermott, 1993; Lymer, Andrew, and Hasseldine, John., 2002; Hewitt, Paul., Lymer, Andrew., and Oats, Lynne., *Op. Cit.*, p. 44.

treaty gave assurance to the traders that they would receive protection from the Roman army. They were also provided a safe passage along the roads to Rome where traders eventually conducted business.⁸⁶¹ In this regard, the Roman Empire gave trade facilitation to the traders through its military guard to protect the safety of the traders during their passage to carry out trade in Rome.

Along with the decline of the Roman Empire in the fifth century, the papacy (papal supremacy) emerged as a strong institution in such an unsteady world. The emergence of church power in the eleventh century supported the Crusades.⁸⁶² The traders shipped their goods on a regular basis to the Crusaders “*who had by now established themselves on the east coast of the Mediterranean*”.⁸⁶³

Following the breakdown of the Roman Empire, thus, Constantinople had become the successor of Rome, which was generally accepted as the centre of international trade. Constantinople remained the centre of international trade for approximately one hundred and fifty years until 650 AD. Throughout this period, the authority who disagreed with the notion of cross-border trade ruled almost the entire continent of Europe.⁸⁶⁴

Through the discovery of the new continent and the introduction of new ideas, customs, and products from the East, international trade was restored in the West. The products from the east, especially from Egypt, Syria, India, and China, such as carpets, furniture, sugar, and spices, brought about new markets and the growing commercial life of the West. These new markets generated economic growth and prosperity in some Italian cities. International trade took place through stagnant periods, until Venice and Genoa began to exploit their strategic locations to maximise their business potential.⁸⁶⁵ Thus, the development of both cities replaced Constantinople as the leading centres of international commerce.⁸⁶⁶

Rising commercial financial needs of traders and travellers widely introduced the usage of letters of credit, bills of exchange, and insurance of goods in transit.⁸⁶⁷ The absorption of goods in the market and the implementation of trade facilitation were helped by a common language. Most Germanic tribes, which flowed into the Roman Empire, were very fast in learning the language and the laws of their hosts.⁸⁶⁸ A common language was regarded as a tool in trade facilitation because it increased the market share of the goods. Trade does not only transfer goods, but also common languages, commercial law, culture, preferences and technology.⁸⁶⁹

Non-policy elements is one of the factor to build close relation between countries. Non-policy elements include geographic proximity (distance and common borders), commonality of language, legal systems, and history. On the other hand, such “*non-policy*

⁸⁶¹ See Czinkota et.al, 1985; Lymer, Andrew, and Hasseldine, John., 2002; Hewitt, Paul., Lymer, Andrew., and Oats, Lynne., *Loc. Cit.*, p. 44.

⁸⁶² See Seyoum, Belay., 2009, *Op. Cit.*, p. 1.

⁸⁶³ See Taggart and McDermott, 1993; Lymer, Andrew, and Hasseldine, John., 2002; Hewitt, Paul., Lymer, Andrew., and Oats, Lynne., *Op. Cit.*, p. 44.

⁸⁶⁴ See *Ibid.*, p. 44.

⁸⁶⁵ See *Ibid.*, p. 44

⁸⁶⁶ See Persson, Karl Gunnar, *An Economic Hsitory of Europe : Knowledge, Institutions and Growth, 600 to the Present*, Cambridge University Press, UK, 2010, pg.17.

⁸⁶⁷ See Seyoum, 2009, *Op. Cit.*, p. 1.

⁸⁶⁸ See Persson, Karl Gunnar, 2010, *Op. Cit.*, pg.17.

⁸⁶⁹ See *Ibid.*, p. 14.

elements” also might create “*natural barriers*” to trade facilitation, particularly related to geographical matters.⁸⁷⁰

The international trade relations is influenced by the propinquity and likeness between trading partners. Neighbouring states used to trade more rather than with economies entities in distant or faraway states. This pattern of trade created a trade network, and led to the creation of regional economic organization. Along with trade expansion, states that not included in the network had less market compared to the member of trade network. In the old times when land transportation costs very expensive, in long distance trade traders only transported commodities of luxury goods such as silk, but not commodities like grain. Technology of transportation and information technology has brought influence in international trade.⁸⁷¹

XV.b. Definition of trade facilitation.

Some authors have concluded that there is no uniform definition given to trade facilitation. For instance, as noted by Zanamwe, “*there is no agreed definition of trade facilitation*”. This is due to the variety of international and regional organisations that define trade facilitation in line with their mandates and objectives.⁸⁷² While Wilson et al. and Jean also note that there is “*no universal understanding of trade facilitation*”⁸⁷³, whereas, each definition reflects different perspectives. The broad concept of trade facilitation is defined as interventions of the private and public sectors in order to support the cross-border movement of goods.

The United Nations Economic Commission for Europe (UNECE) defines trade facilitation as a comprehensive and integrated approach to reduce the complexity and transaction cost to be more efficient, transparent, and predictable, based on international norms, standard, and best practices.⁸⁷⁴ APEC defines trade facilitation in broad sense as the simplification, harmonization, use of new technologies and other measures to address procedural and administrative impediments to trade, i.e., customs procedures, environment regulatory, standard harmonization, business mobility, electronic commerce, and administrative transparency.⁸⁷⁵ The World Bank referring trade facilitation to the domestic policies, institutions, and infrastructures associated with the movement of goods across borders, which includes ports, customs administration, transit, transportation systems for trade, and the management of information and technology.⁸⁷⁶ WTO defines the objective of trade facilitation as the simplification and harmonization of international trade procedures, which includes activities of collecting, presenting, communicating and processing data required for the movement of goods in international trade.⁸⁷⁷ According to the WTO definition, the objectives of trade facilitation is “*to simplify formalities and*

⁸⁷⁰ See Christophe Maur, Jean., *Regionalism and Trade Facilitation: A Primer*, Policy Research Working Paper, WPS4464, The World Bank Development Research Group Trade Team January 2008, available at : <http://siteresources.worldbank.org/EXTAFRUBSUBSAHTRA/Resources/wps4464-Regionalism-Facilitation.pdf>, last accessed : 12 April 2011.

⁸⁷¹ See Persson, Karl Gunnar, 2010, *Op. Cit.*, p. 14.

⁸⁷² See Zanamwe, Gainmore, *Trade facilitation and the WTO: a critical analysis of proposals on trade facilitation and their implications for African countries*, Working Paper No 5/2005, September 2005, available at : http://www.tralac.org/cause_data/images/1694/20050927_WP5_Zanamwe.pdf, last accessed : 26 May 2011;

⁸⁷³ See Wilson et al., 2002; Christophe Maur, Jean., 2008.

⁸⁷⁴ See UNECE: 2002; Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁸⁷⁵ See APEC: 2002; Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁸⁷⁶ See World Bank, 2004; Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁸⁷⁷ See WTO 1998; Grainger, Andrew., 2007.

procedures related to foreign trade and transit of goods, to harmonize applicable regulations and laws, and to standardize and integrate definitions as well as requirements of information, and the use of information".⁸⁷⁸ The common practitioners' defined trade facilitation in simple term as *"the simplification, harmonization, standardization and modernization of trade procedures"*.⁸⁷⁹

Trade facilitation also defined as the simplification of trade interface between trader and trader or trader and authorities. Trade interface consists of many elements and continually develops based on the needs of the traders and the authorities.⁸⁸⁰ International trade interface divided into intangible⁸⁸¹ aspect and tangible⁸⁸² aspect. The tangible aspect related to *"international supply chain"*. It is influenced by geography: transport; storage; and physical examination and presentation of documentation at customs agencies.⁸⁸³ The tangible aspect is including legal documents and physical examinations.⁸⁸⁴ Thus, trade facilitation associated with the effort to *"to improve the regulatory interface between government bodies and traders at national borders"*.⁸⁸⁵

Given that trade facilitation functions as a trade interface, Grainger notes that its objectives are *"to reduce trade transaction costs at the interface between business and government"*.⁸⁸⁶ In this regard, Grainger connects such reduction efforts with the customs activities that are connected between the governments and traders in both the beneficiary country and the preference-granting country. For instance, to obtain the reduction of tariffs under the GSP scheme, the government of the beneficiary country issues certificate of origin form A and the customs office in the preference-granting country makes a declaration of such goods in order to obtain the reduction of tariffs under the GSP. Furthermore, customs activities also play a role in the free circulation of goods.

The implementation of trade facilitation involves a wide range of factors, however, difficulties are created when enforcing its principles.⁸⁸⁷ For instance, the simplification of foreign trade procedures needs support from technological information systems, infrastructure, facilities, and capable human resources. These factors are considered as an obstacle for the beneficiary country. The lack of human resources are also included as the beneficiary country challenge. Human resources development is considered as a high investment cost for beneficiary countries. However, it has been proven that such investment would generate more benefits for their economic development. In this way, trade facilitation is considered as a concept that favours the enhanced control and balance of additional burdens on legitimate⁸⁸⁸ traders.⁸⁸⁹ Improved facilitation of trade should lead to the increase in economic growth and enhanced competitiveness for their industries by

⁸⁷⁸ See Sheikhan, Pegah., *Trade Facilitation in the Multilateral Trading System: An Analysis of the Doha Round Negotiations on Trade Facilitation*, Department of Law School of Economics and Commercial Law, University of Gothenburg, 2008, available at : http://gupea.ub.gu.se/bitstream/2077/19714/1/gupea_2077_19714_1.pdf, last accessed : 25 May 2011.

⁸⁷⁹ See Grainger, Andrew., 2007.

⁸⁸⁰ See Christophe Maur, Jean., 2008.

⁸⁸¹ For example intangible aspect is payment procedure.

⁸⁸² For example tangible aspect is infrastructure and transport facilities.

⁸⁸³ See Christophe Maur, Jean., 2008.

⁸⁸⁴ See *Ibid.*

⁸⁸⁵ See Grainger, Andrew., 2007.

⁸⁸⁶ See *Ibid.*

⁸⁸⁷ See *Ibid.*

⁸⁸⁸ Legitimate trader under GSP scheme refer to the registered exporters of beneficiary country.

⁸⁸⁹ See Grainger, Andrew., 2007.

reducing unnecessary bureaucratic requirements and harmonising relevant processes. At the same time, it is ensured that each country has the right to protect itself from unlawful trade practices.⁸⁹⁰

XV.c. Trade facilitation: the international trade law perspective.

In modern times, trade facilitation principles are based on the simplifying, standardising, harmonising and modernising of international trade procedures. In order to implement those principles, a number of international, regional, and national organisations have drafted a wide variety of trade facilitation recommendations. According to Grainger, this is generally centred on encouraging best practices, enhancing cooperation between traders or business actors and government, adopting technical standards and harmonising trade and customs procedures.⁸⁹¹

XV.c.1. The United Nations Economic Commission for Europe (UNECE).⁸⁹²

UNECE was founded in 1947 and is considered as “an international central point” of trade facilitation recommendations, standards, and specifications.⁸⁹³ UNECE was established under the auspices of the Economic and Social Council (ECOSOC) of the United Nations.⁸⁹⁴ One of its main goals is to promote “pan-European economic integration”. UNECE’s member states consist of 56 countries that cover the EU, non-EU Western and Eastern Europe, Southeast Europe and the Commonwealth of Independent States (CIS) and North America. These member countries are encouraged to communicate and cooperate on economic and sector issues. UNECE is a supporter organisation of the United Nations (UN) global mandates in the economic field by providing analysis, policy advice and assistance to governments and promoting cooperation with other global actors and key stakeholders, especially the business community. In this regard, UNECE also arranges norms, standards, and conventions to facilitate international cooperation in international business activities.⁸⁹⁵

In the multilateral trading system, UNECE is deemed as a multilateral policy to facilitate greater economic integration and cooperation among its member states, promoting sustainable development and economic welfare. There are some activities conducted by UNECE to implement such policies, for instance policy dialogue, negotiation of international legal instruments, development of regulations and norms, exchange and application of best practices as well as economic and technical expertise, and technical cooperation for countries with economies in transition. The UNECE also contributes to improve the effectiveness of the United Nations through the regional implementation of outcomes of global United Nation Conferences and Summits defined by ECOSOC.⁸⁹⁶

⁸⁹⁰ Draft WTO Trade Facilitation, Negotiations Support Guide, A Guidebook to assist developing and least-developed WTO Members to effectively participate in the WTO Trade Facilitation Negotiations, Prepared by the Centre for Customs & Excise Studies, University of Canberra, for and on behalf of the World Bank 2005.

⁸⁹¹ See Grainger, Andrew., 2007.

⁸⁹² See UNECE Legal Instruments, Norms and Standards - Trade Facilitation, available at : <http://www.unece.org/leginstr/trade.htm>, last accessed : 29 May 2011.

⁸⁹³ See List of Trade Facilitation Recommendations, available at : http://www.unece.org/cefact/recommendations/rec_index.htm, last accessed 29 May 2011.

⁸⁹⁴ The others similar organization are the Economic and Social Commission for Asia and the Pacific (ESCAP), the Economic Commission for Latin America and the Caribbean (ECLAC), the Economic Commission for Africa (ECA) and the Economic and Social Commission for Western Asia (ESCWA).

⁸⁹⁵ See <http://www.unece.org/about/about.htm>.

⁸⁹⁶ See Objectives and Mandate http://www.unece.org/oes/nutshell/mandate_role.htm

The UNECE has played a crucial role in the field of trade facilitation through its Centre for Trade Facilitation and Electronic Business (UN/CEFACT).⁸⁹⁷ In other words, UNECE is a host of the UN/CEFACT.⁸⁹⁸ UN/CEFACT was established in 1996, to replace the UNECE Working party No. 4 formed in 1960 for the facilitation of international trade procedures.⁸⁹⁹ The establishment of the UN/CEFACT as a United Nations body aims to enhance “*capability of business, trade, and administrative organisations, from developed, developing, and transitional economies, to exchange products and relevant services effectively*”. The UN/CEFACT focuses on “*facilitating national and international transactions, through the simplification and harmonisation of processes, procedures and information flows, and so contributes to the growth of global commerce*”.⁹⁰⁰

The UN/CEFACT functioned as a “*forum to develop, initiate and consolidate work by other international organizations*”⁹⁰¹, such as WTO, WCO, OECD, UNCITRAL, UNCTAD, ISO, IEC, and ITU.⁹⁰² UN/CEFACT manage a range of document and electronic messaging standards that used in international trade transactions such as the United Nations electronic Trade Documents (UNeDocs) and Electronic Data Interchange for Administration, Commerce, and Transport (EDIFACT).⁹⁰³ UN/CEFACT also provides 33 trade facilitation recommendations and range of electronic business standards and technical specifications.⁹⁰⁴ In 2004, UN/CEFACT introduced the Single Window concept.⁹⁰⁵

XV.c.2. Trade facilitation under the WTO Regime.

Trade facilitation has been incorporated into the WTO. There are some articles that are related to the implementation of trade facilitation that were accommodated in GATT 1994. For instance Agreements on Customs Valuation, Import Licensing, Pre-shipment Inspection, Rules of Origin, Technical Barriers to Trade and the Agreement on Sanitary and

⁸⁹⁷ See Grainger, Andrew., 2007.

⁸⁹⁸ See *Ibid.*

⁸⁹⁹ See *Ibid.*

⁹⁰⁰ See UN/CEFACT, available at : <http://www.unece.org/cefact/about.htm>, last accessed 29 May 2011.

⁹⁰¹ The trade facilitation activities perform under UN/CEFACT covers, as follows:

- (a) Analysing and understanding the key elements of international processes, procedures and transactions and working for the elimination of constraints;
- (b) Developing methods to facilitate processes, procedures and transactions, including the relevant use of information technologies;
- (c) Promoting both the use of these methods, and associated best practices, through channels such as government, industry and service associations;
- (d) Coordinating its work with other international organizations such as the World Trade Organization (WTO), the World Customs Organization (WCO), the Organization for Economic Co-operation and Development (OECD), the United Nations Commission on International Trade Law (UNCITRAL) and the United Nations Conference on Trade and Development (UNCTAD), notably in the context of a Memorandum of Understanding for a Global Facilitation Partnership for Transport and Trade;
- (e) Securing coherence in the development of Standards and Recommendations by co-operating with other interested parties, including international, intergovernmental and non-governmental organizations. In particular, for UN/CEFACT Standards, this coherence is accomplished by cooperating with the International Organization for Standardization (ISO), the International Electrotechnical Commission (IEC), the International Telecommunication Union (ITU) and selected non-governmental organizations (NGOs) in the context of the ISO/IEC/ITU/UNECE Memorandum of Understanding (MoU). These relationships were established in recognition that UN/CEFACT's work has broad application in the areas beyond global commerce and that interoperability of applications and their ability to support multi-lingual environments, are key objectives.

⁹⁰² See Grainger, Andrew., 2007. See also See UN/CEFACT, available at : <http://www.unece.org/cefact/about.htm>, last accessed 29 May 2011.

⁹⁰³ See UNECE 2006c; Grainger, Andrew., 2007.

⁹⁰⁴ See UN/CEFACT 2005; UNECE 2005; Grainger, Andrew., 2007.

⁹⁰⁵ See UN/CEFACT 2004; Grainger, Andrew., 2007.

Phytosanitary Measures.⁹⁰⁶ There are three major articles in GATT that are considered focal points of trade negotiations in trade facilitation, which consists of Article V (Freedom of Transit), Article VIII (Import and Export Procedure), and Article X (Transparency and Administration of Trade).⁹⁰⁷

Trade facilitation is one of the types of aid for trade that includes capacity-building initiatives, it has promoted many customs modernisation programmes and e-trade applications.⁹⁰⁸ As we know, the international trade formalities involve the collection of duties⁹⁰⁹ and administration of tariff measures that are governed by customs procedures.⁹¹⁰ Therefore, it is imperative to establish a uniform, simple, and transparent system of trade facilitation in order to reduce the cost of trade and eliminate discrimination of trade. Cross border co-operation between states is needed, especially in the sphere of customs services and administration to achieve the “*common objective of facilitating trade*”.⁹¹¹

Trade facilitation is one of the challenges in multilateral trade negotiations that has to be agreed among the WTO members in order to provide a trade facilitation system that is accessible to all traders across the world. Developing countries, especially GSP beneficiary countries, should take the benefits gained from the WTO agreement on trade facilitation into consideration as they would assist their trade institutions and traders by developing an efficient system in “*cross border formalities*”.

Trade facilitation negotiating history started at a national, bilateral, and regional level.⁹¹² Since 1996, trade facilitation was included as one of the major agendas of the Singapore Ministerial Conference in 1996.⁹¹³ Nevertheless, developing countries strongly expressed their objection⁹¹⁴ to the beginning of negotiations on these issues.⁹¹⁵ The Council for Trade in Goods (CTG) played a role in the Singapore Ministerial Declaration by providing guidance as follows: “*to undertake exploratory and analytical work, drawing on the work of other relevant organisations, on the simplification of trade procedures in order to assess the scope for WTO rules in this area*”. The Singapore Ministerial Declaration recommends the WTO to take more comprehensive action in the respect of trade facilitation issues.⁹¹⁶

In 1998, the Council on Trade in Goods (CTG) organized symposium on trade facilitation. At the four meeting of CTG, September 1998 and July 1999, the discussion focused on export-import formalities and requirements, issues of physical movements of consignments and the significance of ICT in trade. Developed members countries in the preparatory work for the Seattle Ministerial Conference proposed to establish an additional legal framework on existing WTO rules with purposed to maximize

⁹⁰⁶ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹⁰⁷ See Grainger, Andrew., 2007. See also Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁹⁰⁸ See *Ibid.*

⁹⁰⁹ Such customs and duties collection will become the state revenue or state income of the country concerned.

⁹¹⁰ See Grainger, Andrew., 2007.

⁹¹¹ See Christophe Maur, Jean., 2008.

⁹¹² See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha., Multilateral Agreement on Trade Facilitation : *Important but Complex Agenda for South Asia*, available at : <http://www.cuts-international.org/SAFIT/chp5-TradeFacilitation.pdf>, last accessed : 26 May 2011.

⁹¹³ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

⁹¹⁴ See The reason behind the rejection of developing country in the WTO negotiation of trade facilitation will be further discussed.

⁹¹⁵ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹¹⁶ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

transparency, simplification, and harmonization of trade procedures and provide capacity-building programme for developing countries.⁹¹⁷ On the other side, developing countries maintained the result of the Singapore Conference. They are not so enthusiastic and consider that new WTO obligations not urging yet.⁹¹⁸

Trade facilitation negotiation divided into two groups of interest, developed countries, and developing countries on the other side. For instance, EU argues about the importance of binding rules on trade facilitation under WTO legal framework. While developing countries stand to oppose the establishment of new binding rules of trade facilitation under WTO.⁹¹⁹ The developing countries refused to have new binding obligations in the WTO that “*exceed their implementation capacities*”, however, many of them supporting of the purposes of trade facilitation.⁹²⁰ Some developing countries argues that such binding rules does not provide much benefits, but rather burden them with new obligations that have to be implemented in their limited condition. For instance, developing countries will be burdened with the extra cost budget to prepare the infrastructure.

XV.c.2.1. Trade facilitation negotiations under the Doha Development agenda.

The fourth Ministerial Conference in Doha on 2001, known as the Doha Ministerial Declaration, aimed to enhance revenues and trade advantages for developing countries. The Doha Ministerial Declaration launched the Doha Development Agenda that covers twenty (21) subjects, such as the Singapore issues, agriculture, Non-Agricultural Market Access (NAMA), services, WTO rules (anti-dumping, subsidies, regional trade agreements) and trade and environment.⁹²¹ In line with the objectives of the Doha Ministerial Declaration, trade facilitation was brought onto the negotiating table of the Doha round as one of the major points in the Singapore Ministerial Conference. Trade facilitation is acknowledged in Paragraph 27 of the Doha Declaration⁹²², as follows:

“[...] recognising the case for further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations. In the period until the Fifth Session, the Council for Trade in Goods shall review and as appropriate, clarify and improve relevant aspects of Articles V, VIII and X of GATT 1994 and identify the trade facilitation needs and priorities of members, in particular developing and least-developed countries. We commit ourselves to ensuring adequate technical assistance and support for capacity building in this area [...]”.

There are three important points that should be noted in Paragraph 27 of the Doha Declaration:

- (a) All the members recognise that there is a case for expediting the movement, release, and clearance of goods including goods in transit.

⁹¹⁷ See *Ibid.*

⁹¹⁸ See *Ibid.*

⁹¹⁹ See *Ibid.*

⁹²⁰ See *Ibid.*

⁹²¹ See Sheikhan, Pegah., 2008.

⁹²² See Doha WTO Ministerial 2001: Ministerial Declaration, WT/MIN(01)/DEC/1, 20 November 2001, Adopted on 14 November 2001, available at : http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm, last accessed : 29 May 2011.

- (b) Enhancement of technical assistance and capacity building needs by developing countries in trade facilitation.
- (c) The Council for Trade in Goods (CTG) needs to review, clarify and improve current provisions of GATT 1994 that relate to trade facilitation and to identify the trade facilitation needs of WTO members, particularly those needs of developing countries.⁹²³

The third point constitutes the directive of the Singapore Ministerial Declaration to the Council on Trade in Goods (CTG) of the WTO to discover and analyse ways to simplify the movement of goods across international borders.⁹²⁴ Since trade facilitation issues do not have an independent working group for discussions and negotiations, the CTG was specifically assigned to tackle the concerned issues. From 1997 to 1999, the CTG was given the task to collect information on a wide range of trade facilitation aspects from several regional and multinational organisations, private enterprises, and industry groups, respecting their reports of the experiences they had in their work on trade facilitation.⁹²⁵ The main objective of the current negotiations on trade facilitation in the Doha Round is to promote enhancements on judicial and administrative international trade procedures.⁹²⁶ The Doha Ministerial Declaration is considered as a positive progress to the establishment of binding rules regulating trade facilitation.⁹²⁷

There are several important issues related to trade facilitation raised before the Doha Ministerial. It is summing up as follows: (a) the cost of implementation of trade facilitation measures; (b) the importance of providing simplified official requirements in applying information technology; (c) the significant of trade facilitation to Small and Medium Enterprises; and (d) the efforts to promote a mutual relationship between governments (public sector) and the traders (private sector).⁹²⁸

Respecting principles of transparency and simplification some measures were proposed, covering : (a) publications and making easily accessible all administrative rules and amended procedures; (b) advance ruling; (c) establishment of enquiry points; (d) minimum procedures of trade; (e) modern customs practices; (f) adaptation of international standards; and (g) 'single window' submissions.⁹²⁹

The "July Package" of 2004 adopted as the follow up of deadlock in Cancun Ministerial Meetings. This package considered as framework agreements that provides broad guidelines for completing the Doha round negotiations. Through this package, the WTO members brought the negotiations back on the table. In this package, trade facilitation separated as an independent subject of Doha Development Agenda (DDA) and no longer related to the Singapore Issues.⁹³⁰

The Annex D of the "July Package" 2004 stipulated about the Negotiating Group on Trade Facilitation (NGTF).⁹³¹ The first issue discussed in the negotiations concerning

⁹²³ See also Sidley Austin Brown & Wood LLP, and affiliated partnership, *Updated Analysis of the Doha Round of Trade Negotiations: New Opportunities & Challenges for Global Business*, 2002, available at: <http://www.sidley.com/db30/cgi-bin/pubs/dohaupdate.pdf>, last accessed : 26 May 2011.

⁹²⁴ See *Ibid.*

⁹²⁵ See Sheikhan, Pegah., 2008.

⁹²⁶ See *Ibid.*

⁹²⁷ See Sidley Austin Brown & Wood LLP, 2002.

⁹²⁸ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

⁹²⁹ See *Ibid.*

⁹³⁰ See Sheikhan, Pegah., 2008.

⁹³¹ See Annex D paragraph 10 of the decision adopted by the General Council of the WTO on 1 August 2004, available at : http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm, last accessed : 30 May 2011.

clarification and improvement of Articles V, VIII and X of the GATT 1994.⁹³² Several WTO members presented papers on their experiences on trade facilitation. The major concerns addressed on excessive documents, lack of transparency, inadequate procedures, and a lack of modernization of customs and other government agencies.⁹³³ The *July Package* 2004 deemed as the guidance for the WTO Doha Round negotiations on trade facilitation.

“[...] trade Facilitation: taking note of the work done on trade facilitation by the Council for Trade in Goods under the mandate in paragraph 27 of the Doha Ministerial Declaration and the work carried out under the auspices of the General Council both prior to the Fifth Ministerial Conference and after its conclusion, the General Council decides by explicit consensus to commence negotiations on the basis of the modalities set out in Annex D to this document [...]”.⁹³⁴

The Technical Assistance and Capacity Building (TA/CB) included as integral parts of the negotiations and linked to the outcome. The paragraph 4 Annex D of “*July package*” encourages the WTO Members to identify trade facilitation needs and priorities related to cost implications of implementation, particularly developing countries and LDC.⁹³⁵

The Hongkong Ministerial Declaration 2005, focused on the improvement and clarification of Articles V, VIII and X of the GATT as well as provisions for effective cooperation between customs and other authorities on trade facilitation.⁹³⁶

We recall and reaffirm the mandate and modalities for negotiations on Trade Facilitation contained in Annex D of the Decision adopted by the General Council on 1 August 2004.⁹³⁷

“[...] work needs to continue and broaden on the process of identifying individual Member's trade facilitation needs and priorities, and the cost implications of possible measures. The Negotiating Group recommends that relevant international organizations be invited to continue to assist Members in this process recognizing the important contributions being made by them already, and be encouraged to continue and intensify their work more generally in support of negotiations [...]”.⁹³⁸

Developing countries have to identify their needs and priorities by carry out consultation that involved various stakeholders including customs officials, traders, various government departments, civil society, and non-governmental organizations.⁹³⁹

In the “*July Package*” 2008, the NGTF encourage developing and LDC to fully participate and gain benefit from the negotiation :⁹⁴⁰

⁹³² See Sheikhan, Pegah., 2008.

⁹³³ See *Ibid.*

⁹³⁴ See Paragraph (g) of the decision adopted by the General Council of the WTO on 1 August 2004, available at : http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm, last accessed : 30 May 2011.

⁹³⁵ “[...] as an integral part of the negotiations, Members shall seek to identify their trade facilitation needs and priorities, particularly those of developing and least-developed countries, and shall also address the concerns of developing and least-developed countries related to cost implications of proposed measures [...]”. See See Annex D paragraph 4 of the decision adopted by the General Council of the WTO on 1 August 2004, available at : http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm, last accessed : 30 May 2011.

⁹³⁶ See Draft WTO Trade Facilitation, Negotiations Support Guide, A Guidebook to assist developing and least-developed WTO Members to effectively participate in the WTO Trade Facilitation Negotiations, Prepared by the Centre for Customs & Excise Studies, University of Canberra, for and on behalf of the World Bank 2005.

⁹³⁷ See Paragraph 33 Trade Facilitation negotiations of Ministerial Declaration, Doha Work Programme, WT/MIN(05)/DEC, 22 December 2005, Adopted on 18 December 2005, available at : http://www.wto.org/english/thewto_e/minist_e/min05_e/final_text_e.htm#tradfa, last accessed : 30 May 2011.

⁹³⁸ See Paragraph 5 Annex E, Ministerial Declaration: Annexes, Doha Work Program, WT/MIN(05)/DEC, 22 December 2005, Adopted on 18 December 2005, available at : http://www.wto.org/english/thewto_e/minist_e/min05_e/final_annex_e.htm#annexe, last accessed : 30 May 2011.

⁹³⁹ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

"[...] technical assistance and support for capacity building is being provided to developing and least-developed countries to help them to fully participate in and benefit from the negotiations, in particular by assisting them individually, on request, to conduct a national assessment to identify their needs and priorities in the area of trade facilitation. The programme of needs assessment will contribute to the successful conclusion of these negotiations [...]"⁹⁴¹

The technical assistance and capacity building are the heart of trade facilitation negotiations.⁹⁴² Trade facilitation requires enormous investment in infrastructure that many poor countries difficult to afford it.⁹⁴³

XV.c.2.2. Developing countries on trade facilitation negotiation.

As explained above, the definition of developing countries is not precisely defined by the WTO but the country concerned declares its own status.⁹⁴⁴ While there is a set of standards that should be fulfilled, which is widely recognised by the international community, in the definition of a developed country. Those standards cover a high income per capita, high human index development, and high GDP.⁹⁴⁵ Since the majority of the WTO member states are developing countries, as a consequence, their full participation in the WTO negotiations is strongly needed. In this regard, this is related to their active participation in trade facilitation negotiations under the legal framework of the WTO in order to improve efficiency and to reduce the high cost of trade at an international level. Essentially, the improvement of trade facilitation is aimed to give maximum benefits to WTO members, particularly to developing countries.

The refusal of developing countries to commence negotiation on Singapore issues, especially on trade facilitation lead the failure of Cancun Ministerial Meeting in September 2003.⁹⁴⁶ Demand of agreement on trade facilitation is based on the strong concern of the significance transparency, efficiency, and procedural uniformity of cross-border flow of goods and services.

"[...] developing countries were not convinced that binding rules in the World Trade Organization (WTO) would be necessary, or helpful, in this area. From the beginning of trade facilitation as a separate issue (added to the agenda at the WTO Singapore Ministerial Meeting in 1996), developing countries have not shown enthusiasm to negotiate a multilateral agreement of trade facilitation commitments. While some developing countries have even suggested that trade facilitation remain a national, bilateral or regional concern, others have asked that the agreement – if members insist on creating standards through the WTO – be a list of voluntary guidelines, or an agreement based on capacity building, rather than a legally binding rule-based agreement [...]"⁹⁴⁷

⁹⁴⁰ See Report By The Chairman of the Negotiating Group Trade Facilitation, TN/TF/6, (08-3495), 18 July, 2008, available at : http://www.wto.org/english/tratop_e/dda_e/meet08_texts_e.htm, last accessed : 30 May 2011.

⁹⁴¹ See Paragraph 5 Report By The Chairman Of The Negotiating Group Trade Facilitation, TN/TF/6, (08-3495).

⁹⁴² See Zanamwe, Gainmore, 2005 ; Zanamwe, Gainmore, 2009.

⁹⁴³ See *ibid.*

⁹⁴⁴ See Who are the developing countries in the WTO?, available at : http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm, last accessed : 30 May 2011. "[...] There are no WTO definitions of "developed" and "developing" countries. Members announce for themselves whether they are "developed" or "developing" countries. However, other members can challenge the decision of a member to make use of provisions available to developing countries [...]"

⁹⁴⁵ See Sheikhan, Pegah., 2008.

⁹⁴⁶ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹⁴⁷ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

“[...] The main reason why developing countries opposed negotiations on trade facilitation is that they were concerned that such an agreement would have a negative impact on their domestic policies. They do not have adequate negotiating resources or the capacity to implement the resulting obligations. More importantly, they were opposed to binding rules on trade facilitation because they did not want to be hauled before the dispute settlement body for failing to implement commitments [...]”.⁹⁴⁸

Developing countries argue that trade facilitation should not be undertaken through binding multilateral agreement of WTO. The lack of infrastructure of developing countries creates difficulty to meet the standard requirements. It also imposes extra budget for developing countries in order to upgrade their trade infrastructures.⁹⁴⁹ When the binding rules established it must be implemented, but in the absence of capability of implementation, it might create disputes between contracting parties.⁹⁵⁰

On the other side, some developed countries WTO members, consists of Canada, the EU, Japan, Switzerland and the US, “*campaigned comprehensive rules governing trade facilitation*”. According to EU a rules based approach will guarantee transparency and predictability for traders, ensure political commitment to reform, and ensure appropriate measures.⁹⁵¹ In addition, developed countries argue that trade facilitation is significant to increase international trade and states revenues, especially for developing countries.⁹⁵²

XV.c.2.3. The negotiations history of trade facilitation articles under GATT 1994.

Trade facilitation articles existed prior to the establishment of GATT 1947. There are some international agreements on trade that contained some principles or rules relating to trade facilitation. In the negotiating history of GATT 1947, an essential rule on trade facilitations was included in the agreement. There are three essential provisions related to trade facilitation, i.e. Articles V, VIII and X. Since 1995, they have been incorporated into the WTO Agreement. For more than fifty years, trade facilitation provisions in GATT have developed to a lesser extent. The establishment of WTO has brought trade facilitation provisions into multilateral trade negotiations.⁹⁵³

XV.c.2.3.1. The Article X of the GATT.

The Article X of the GATT 1994 governs transparency of the publication and administration of trade regulations.⁹⁵⁴ International Convention relating to the Simplification of Customs Formalities 1923 is the evidence of international concerns on the trade facilitation.⁹⁵⁵ The essentials content of Article X of the GATT is similar to Article 38 of the Havana Charter⁹⁵⁶. Both of the provisions require the member states to provide information about their national laws and regulations to the organization.

Paragraph 1 Article 38 of the Havana Charter 1948, stipulates:

⁹⁴⁸ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹⁴⁹ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

⁹⁵⁰ See Sidley Austin Brown & Wood LLP, 2002. See also Sheikhan, Pegah., 2008.

⁹⁵¹ See *Ibid.*

⁹⁵² See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

⁹⁵³ See Sheikhan, Pegah., 2008.

⁹⁵⁴ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹⁵⁵ See *Ibid.*

⁹⁵⁶ See United Nations Conference on Trade and Employment, Held at Havana, Cuba, From November 21, 1947, To March 24, 1948, Final Act and Related Documents Interim Commission for the International Trade Organization, Lake Success, New York, April, 1948, pp. 55-56, available at: http://www.wto.org/english/docs_e/legal_e/havana_e.pdf, last accessed : 10 November 2010.

"[...] laws, regulations, judicial decisions and administrative rulings of general application made effective by any Member, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefore, or affecting their sale, distribution, transportation, insurance, warehousing, inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. Agreements affecting international trade policy which are in force between the government or governmental agency of any Member country and the government or governmental agency of any other country shall also be published. Copies of such laws, regulations, decisions, rulings and agreements shall be communicated promptly to the Organization. The provisions of this paragraph shall not require any Member to divulge confidential information the disclosure of which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private [...]"

Paragraph 1 Article X GATT, 1994 :

"[...] laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. Agreements affecting international trade policy which are in force between the government or a governmental agency of any contracting party and the government or governmental agency of any other contracting party shall also be published. The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private [...]"

The Appellate Body in the EC-Poultry case interpreted "general application" of Article X⁹⁵⁷, as follows:

*"[...] Article X relates to the publication and administration of laws, regulations, judicial decisions and administrative rulings of 'general application' rather than to the substantive content of such measures [...]"*⁹⁵⁸

The EU obliged its member states to publish "*all laws, procedures and rules affecting imports, exports, and goods in transit, which includes administrative guidelines, decisions and rulings as well as customs and other government agencies' management plans relating to the implementation of WTO commitments*". This information has to be made available in a "*simple and accessible manner*",⁹⁵⁹ and expected to help traders gain more benefits.⁹⁶⁰

⁹⁵⁷ See Appellate Body Report. 1998. *European Communities –Measures Affecting the Importation of Certain Poultry Products*, (EC-Poultry), WT/DS69/AB/R, adopted 23 July 1998, par.115.

⁹⁵⁸ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹⁵⁹ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

⁹⁶⁰ See *Ibid.*

XV.c.2.3.2. The Article VIII of the GATT.

Article VIII governs about fees and formalities on export and import.⁹⁶¹ According to Zanamwe, “the language in Article VIII of GATT was drawn from a proposal submitted by the US in September 1946”. This proposal drafted based on the “*International Convention Relating to the Simplification of Customs Formalities*” 1923 and recommendations of the “*World Economic Conference*” 1927. Its purposed to reduce consular fees imposed on issuing visas for commercial travellers and consignment of goods.⁹⁶² The World Economic Conference 1927 recommend that the consular fees should be fixed in amount, not exceeds the cost of issue, and should not be used as a source of revenue. Various consular fees lead to unexpected increases in charges and cause uncertainty in trade.⁹⁶³

Provisions on Formalities connected with export and import laid down in Article 36 of the draft Havana Charter⁹⁶⁴. The essence of Article VIII of the GATT and Article 36 Havana Charter are commonly similar.⁹⁶⁵

XV.c.2.3.3. The Article V of the GATT.

Barcelona Convention regulates the requirement applied by a member state to the goods of another member states when passing through its territory to a third destination. The Freedom of Transit in international trade laid down in the Article 33 of the draft Havana Charter⁹⁶⁶. Paragraph 6 Article 33 of the draft Havana Charter, stipulated:

“[...] the Organization may undertake studies, make recommendations, and promote international agreement relating to the simplification of customs regulations concerning traffic in transit, the equitable use of facilities required for such transit and other measures designed to promote the objectives of this Article. Members shall cooperate with each other directly and through the Organization to this end [...]”.

Landlocked states or countries that do not have direct access to the sea have proposed this provision. The preparatory work on the Havana Charter can be helpful in understanding Article V. Hitherto, the real freedom of transit cannot be implemented completely.⁹⁶⁷

XV.c.3. The World Customs Organization.

The World Customs Organization (WCO) is an international organisation that supports international trade related to the customs system. The WCO plays a significant role in trade facilitation related to aspects of customs in national borders and trade procedures.⁹⁶⁸ The functions of the WCO are to maintain, support, and promote international instruments for the harmonisation and uniform application of simplified and

⁹⁶¹ See Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁹⁶² See *Ibid.*

⁹⁶³ See *Ibid.*

⁹⁶⁴ See United Nations Conference on Trade and Employment, Held at Havana, Cuba, From November 21, 1947, To March 24, 1948, Final Act and Related Documents Interim Commission for the International Trade Organization, Lake Success, New York, April, 1948, pp. 55-56, available at: http://www.wto.org/english/docs_e/legal_e/havana_e.pdf, last accessed : 10 November 2010.

⁹⁶⁵ See Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁹⁶⁶ See United Nations Conference on Trade and Employment, Held at Havana, Cuba, From November 21, 1947, To March 24, 1948, Final Act and Related Documents Interim Commission for the International Trade Organization, Lake Success, New York, April, 1948, pp. 55-56, available at: http://www.wto.org/english/docs_e/legal_e/havana_e.pdf, last accessed : 10 November 2010.

⁹⁶⁷ See Zanamwe, Gainmore, 2005; See Zanamwe, Gainmore, 2009.

⁹⁶⁸ See Grainger, Andrew., 2007.

effective customs systems and procedures. Trade facilitation concepts help customs administrations to carry out their tasks properly.⁹⁶⁹

The legal relationship between the WCO and WTO in trade facilitation is related to the technical interpretation of valuation rules under GATT (especially Article VII) and non-preferential origin rules under the WTO agreement on rules of origin. The framework of standards to secure and facilitate global trade was adopted by the WCO on 23 June 2005. This instrument provides “*an explicit commitment to the principles of trade facilitation*”.⁹⁷⁰

Pascal Lamy speech in Brussels 2011 highlighted about the contribution of WCO and its relationship with WTO in the framework trade facilitation program. WTO and WCO need to build close co-operation to support agreement on trade facilitation. The WTO focused to help countries obtaining better technical assistance and capacity building that appropriate to their needs. During DDA negotiations the WCO played important role related to preferential rules of origin. Related to the customs system, Mr. Lamy stated that Harmonized System (HS), customs valuation and rules of origin as other areas that extremely fruitful, considered as important instrument for the WTO. Further as Mr. Lamy said that :

“[...] the WCO has recently established a database of preferential rules of origin which covers only rules of origin of FTAs or other preferential schemes like the GSP and which I am told is simple and user friendly. This database allows users to compare different rules of origin of the same good. This has a significant potential to simplify the task of exporters in developing countries, particularly the least-developed. The latter have consistently called for a simplified system of rules of origin that would allow them to understand and comply with rules of origin requirements and this database is a positive step towards this goal. It is therefore our wish to see this database linked to the WTOs Non-Tariff Measures database being built [...]”.⁹⁷¹

With respect to the improvement of Article VIII of the GATT 1994, WCO recommend the application of technology, paperless administration and statistic data to support trade facilitation. For instance, establishment of the Single Window concept; standardization and simplification of customs and trade documents; simplification of governing trade procedures; and adherence to international customs conventions.

XV.c.4. Regional trade facilitation.

As mentioned above, one reason why developing countries refuse trade facilitations negotiations as a multilateral trade negotiation is because “*trade facilitation should be undertaken at the regional level*”. Moïse and Jean note that “*current regional trade agreements have gradually incorporated trade facilitation dimensions*”. The trade facilitation is commonly adopted or incorporated in regional trade integration agreements and regional cooperation agreements. Regional initiatives are considered to have strategic roles in the management of trade facilitation issues.⁹⁷²

According to Bin and Misovicova, and Jean, the number of regional agreements including trade facilitation has significantly increased. In addition, the number of agreements concerning trade facilitations in Asia and the Pacific has significantly increased

⁹⁶⁹ See *Ibid.*

⁹⁷⁰ See *Ibid.*

⁹⁷¹ See WTO News: Speeches — DG Pascal Lamy, WTO Trade Facilitation Deal To Reduce Trade Costs and Boost Trade, 24 June 2011, available at : http://www.wto.org/english/news_e/sppl_e/sppl197_e.htm, last accessed : 26 June 2011.

⁹⁷² See Christophe Maur, Jean., 2008.

in recent years. It has been shown that 34 out of the 102 countries to sign Regional Trade Agreements (RTAs) have incorporated trade facilitation provisions. The institutional setting of regional agreements is deemed appropriate to the implement of a trade facilitation agenda. In this regard, Jean noted that *“trade facilitation indeed requires not only the elimination of distortion and inefficient rules and practices, but mostly to carry on an ambitious and positive agenda of reform by implementing internationally compatible modern legislation, systems and skills”*.⁹⁷³

Regional approaches on trade facilitation also aim to improve the competitiveness of countries in trade. Trade facilitation at a regional level contributes to trade creation by helping to reduce the cost of trading and increase the availability of services to exporters and importers. According to the World Bank, customs cooperation committees established under the RTAs usually function to discuss enforcement issues and help solve disputes.⁹⁷⁴ The World Bank notes that trade facilitation within the RTAs is identified to give possible advantages to the improvement of the customs system and procedures. For instance the alignment of customs codes with international standards; simplification and harmonisation of procedures (e-documents and single document); alignment of tariff structures with the HS; transparency; effective implementation of the WTO valuation agreement; joint work towards customs integrity; establishment of joint border posts; and joint training centres.⁹⁷⁵

Trust is the basic foundation in international cooperation and international agreements. In addition, trust is also a vital aspect of trade facilitation cooperation. As argued by Schiff and Winters, and Jean, *“regional trade agreements act as a trust building mechanism, favouring interactions between officials and exchange of information”*. Trust in trade facilitation cooperation can help minimise risk and reduce tangible restraint *“on the transport of the goods such as examinations or requirements to abide to certain requirements such as compulsory routes”*. Trust can be manifested through increasing the sharing of information and systems.⁹⁷⁶ It has been proven that, recently, many RTAs include additional trade facilitation contents. The evidence was reported by Bin and Misovicova, and Jean, that *“regional agreements in Asia have included clauses covering transparency of laws and rulings, use of ICT and e-commerce, freedom of transit, mobility of business people, facilitation of transport and logistics, and facilitation of payment and trade finance”*.⁹⁷⁷ The most prominent progress on trade facilitation cooperation is through customs and trade procedures integration of the Association of Southeast Asian Nations (ASEAN) by Agreement on the single window systems (ASEAN 2005).⁹⁷⁸

The implementation of trade facilitation has multi-challenges that need to be addressed seriously especially inter-borders cooperation and coordination, and capacity building. It is important to design trade facilitation at the national, regional, and multilateral level based on efficiency to reduce cost transaction in international trade.⁹⁷⁹ Low and middle-income countries are mostly beneficiary countries of GSP, and generally

⁹⁷³ See *Ibid.*

⁹⁷⁴ See *Ibid.*

⁹⁷⁵ See *Ibid.*

⁹⁷⁶ See *Ibid.*

⁹⁷⁷ See *Ibid.*

⁹⁷⁸ See Grainger, Andrew., 2007.

⁹⁷⁹ See Christophe Maur, Jean., 2008.

lack capacity of technology, financial budget, institutions and human resources to participate equally in such cooperation.

The RTA has created new barriers to trade, such as preferential trade agreement. The existence of preferential and non preferential trade has increased the complexity on administration and formalities in the national borders, it requires more sophisticated trade facilitation measures.⁹⁸⁰

RTA has increased complexity on preferential rules of origin, such as application of cumulation preferential rules of origin. Most RTAs are focused on the application of the rules of origin in the trade facilitation aspect.⁹⁸¹ EU deems customs (and probably border processes in general) as an important instrument in favouring regional integration and promotion of preferential links. The special rules adopted in the union delivers benefit to the third countries. For instance, automatic reduction of transaction costs for traders when dealing with more than one customs union member.⁹⁸² According to the World Bank, capacity building of trading partners is an important factor for establishing trade facilitation at regional and international level:

“[...] one lesson that seems to emerge from regional cooperation on standards is that the nature of regional cooperation on standards depends on the specific capacity of the trade partners such as preparedness to perform conformity assessments, and the institutional setting of the agreement, where depending on how strong institutions are, more or less active harmonization or recognition routes can be followed [...].⁹⁸³

To strengthen capacity building at regional level needs stronger and permanent institutions. It is also required to establish better cooperation and coordination to attain harmonization and mutual recognition of rulings.⁹⁸⁴ Adequate RTA useful for the establishment of regional trade facilitation.⁹⁸⁵

XV.d. Trade facilitation: economic implication in GSP.

According to Butterly, trade facilitation covers political, economic, business, administrative, technical and technological issues.⁹⁸⁶ Trade facilitation is a concept to simplify, harmonise, standardise, and modernise trade procedures.⁹⁸⁷ It is designed to reduce transaction costs in international trade, mainly addressed to the relation between business actors or traders and government institutions at national borders.⁹⁸⁸

In 2007, the European Commission spent a budget of 133 million euros on customs modernisation. In 2013, it is going to increase the budget to 324 million euros for the customs programme. Trade facilitation is considered as the driving force for such

⁹⁸⁰ See *Ibid.*

⁹⁸¹ See *Ibid.*

⁹⁸² See *Ibid.*

⁹⁸³ See *Ibid.*

⁹⁸⁴ See *Ibid.*

⁹⁸⁵ See *Ibid.*

⁹⁸⁶ See Grainger, Andrew., 2007.

⁹⁸⁷ “[...] Simplification is the process of eliminating all unnecessary elements and duplications in formalities, process and procedures; harmonization is the alignment of national formalities, procedures, operations and documents with international conventions, standards and practices; and standardization is the process of developing internationally agreed formats for practices and procedures, documents and information [...]”. See Grainger, Andrew., 2007

⁹⁸⁸ See Grainger, Andrew., 2007.

programme.⁹⁸⁹ The reduction of bureaucratic costs in trade procedures has been estimated to give benefits equal to 300 billion euros of worldwide annual savings.⁹⁹⁰

As stated by Lamy, the WTO Director General, in a speech at the World Customs Organization in Brussels on 24 June 2011, stated that “*the trade facilitation deal is therefore one simple step to reduce the costs of trading and also to boost trade*”. He continued, “*according to OECD the implementation of the Trade Facilitation measures could reduce total trade costs by almost 10% [...] every extra day required to ready goods for import or export decreases trade by around 4%*.”⁹⁹¹ Furthermore, the success of the trade facilitation programme increases customs productivity, improves trade tax collections and attracts Foreign Direct Investment (FDI). It also has a positive impact on state income where several countries increase their revenues after introducing trade facilitation reforms.⁹⁹² According to this speech, trade facilitation has strong contributions regarding utilisation of GSP.

In addition, trade facilitation also plays a significant role for least developing countries (LDCs), developing countries, and smaller developed countries as “*a tool for economic development, especially for economic growth*”.⁹⁹³ Trade facilitation is also deemed as one of the important factors for the utilisation of the preferences scheme.

Trade facilitation has been acknowledged as an interface tool between traders and governments and faces major challenges to ensure and manage “*excessive transaction costs*” and simplify formalities of bureaucracy. As identified by the OECD and Grainger, excessive transaction costs can reduce economic benefits of trade liberalisation. Business costs are divided into direct and indirect costs. Direct business costs covers the collection of information and submitting of declarations or documents. While indirect business costs occur as an effect of border checks, in the form of delays and associated time penalties that cause losses of business opportunities and reduce competitiveness.⁹⁹⁴ It is concluded that country borders could create costly obstacles to international trade.⁹⁹⁵

The border delays is causing losses of business opportunities and reducing profits of traders, particularly small and medium enterprises (SME’s). Developing countries gained higher benefits from trade facilitation rather than the reduction or removal of tariff

⁹⁸⁹ See COM (2003)452 final; European Commission 2004; 2006a; Grainger, Andrew., Trade Facilitation: A Review, 25 June 2007, available at : http://www.tradefacilitation.co.uk/papers/AGrainger_TradeFacilitation_Review.pdf, last accessed : 15 May 2011.

⁹⁹⁰ See European Commission 2006b; Grainger, Andrew., 2007.

⁹⁹¹ See Pascal Lamy – Speeches : “[...] The scope for improvement is considerable for all parties involved. For OECD countries it currently takes on average about four separate documents and clearing the goods in an average often days at an average cost of about \$1,100 per container. By contrast, in sub-Saharan Africa almost double the number of documents are required and goods take from 32 days (for exports) to 38 days (for imports) to clear at an average cost per container of between \$2,000 (for exports) and \$2,500 (for imports). The overall world champion at trade facilitation is Singapore, where four documents are required and goods are cleared in, at most, five days at an average cost of around \$456 per container. At the other end of the scale are many of the low-income developing countries, in particular the landlocked developing countries, whose trade-processing costs can mushroom as a result of the effort required to move goods in transit by road or rail through their neighbours to their nearest international port. According to recent research, every extra day required to ready goods for import or export decreases trade by around 4% [...]”

⁹⁹² See WTO News: Speeches — DG Pascal Lamy, WTO Trade Facilitation Deal To Reduce Trade Costs and Boost Trade, 24 June 2011, available at : http://www.wto.org/english/news_e/sppl_e/sppl197_e.htm, last accessed : 26 June 2011.

⁹⁹³ See Sheikhan, Pegah., 2008.

⁹⁹⁴ See OECD 2001; 2003; Grainger, Andrew., 2007.

⁹⁹⁵ See Christophe Maur, Jean., 2008.

barriers.⁹⁹⁶ According to Sheikhan, that trade facilitation can generate more economic growth than tariff reductions.⁹⁹⁷ According to the OECD the Trade Transaction Costs (TTCs) is between 2% and 15% of the value of goods.⁹⁹⁸ The SMEs, that cannot afford “*high costs of compliance*” very helped by trade facilitation.⁹⁹⁹ The OECD study discovers that developing countries earn higher advantages from trade facilitation rather than developed countries. Better cooperation and coordination of trade facilitation can minimize the losses of business opportunities of traders.¹⁰⁰⁰

The positive impacts of trade facilitation had been studied through measuring its cost and benefits to the trade activities.¹⁰⁰¹ In 2003, OECD made a research to incorporate empirical characteristics of the border process into a model-based analysis to identify features that generate benefits from trade facilitation. This research discovered that “*1% reduction in Trade Transaction Costs (TTCs) would yield about US\$ 40 billions in gains to world income with no losers; more than 80% of benefits are estimated to come from reduction in indirect TTCs*”. Therefore, trade facilitation have important role in trade activities.¹⁰⁰² It is shown that benefit obtained through better trade facilitation measures is linear to the amount of Trade Transaction Costs (TTCs). Other studies estimated about the potential medium-term income obtained from trade facilitation is equal to 2-3 % of the total value of goods traded in the world.¹⁰⁰³

Further economic studies related to the positive impact of trade facilitation carry out by Wilson et. al, where he attempted to analyze “*the relationship between trade facilitation and trade flows in the Asia Pacific region*”. This research used gravity model analysis, including tariffs and some standard variables. Four variables applied in this research as indicators for measuring trade facilitation, consists of port efficiency, customs environment, regulatory environment, and e-business usage. The result of this study stated that :

“[...] improvement in port efficiency, custom environment, and improvements behind the border in regulatory harmonization and e-business usage are estimated to amount to gains of US\$ 117 billions, US\$ 22 billions and another US\$ 116 billions, respectively [...] the positive effects of enhanced port efficiency and regulations have a larger effect on trade flows than those resulting from improved customs efficiencies and usage of greater e-business [...] total gain in trade flows from improvements in trade facilitation is higher than that from reductions in tariff [...]”.¹⁰⁰⁴

XV.e. Trade facilitation and good governance.

It has been noted that trade facilitation has great importance in the reduction of non-tariff barriers in international trade. In this regard, non-tariff barriers cover “*excessive documentation requirements, lack of modernisation in required trade procedures, lack of*

⁹⁹⁶ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009. See also Wilson et. al (2003b); Weerakoon, Dushni, Thennakoon, Jayanthi., and Weeraratne, Bilesha.

⁹⁹⁷ See Sheikhan, Pegah., 2008.

⁹⁹⁸ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

⁹⁹⁹ See *Ibid*.

¹⁰⁰⁰ See Christophe Maur, Jean., 2008.

¹⁰⁰¹ See Wilson, J.S et al., 2003 and 2004; OECD, 2003; and Messerlin and Zarrouk, 2000; Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

¹⁰⁰² See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

¹⁰⁰³ See *Ibid*.

¹⁰⁰⁴ See Wilson et. al (2003b); Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha. See also Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

transparency in import and export requirements, and other bureaucratic provisions that unnecessarily increase the cost and hamper the efficiency of international trade".¹⁰⁰⁵ The roles of good governance in trade facilitation are linked through transparency, efficiency, and bureaucratic procedures. Good governance has to be implemented by the government trade institutions. In this regard, the government has a role as a public service provider in trade facilitation.

Transaction costs are influenced by government policies on the trade facilitation.¹⁰⁰⁶ Zanamwe noted improvement of trade facilitation could benefit the government itself:

"[...] the use of international standards and best practices to rationalise, simplify and harmonise customs procedures, formalities, documents, regulations and laws related to import, export and transit of goods, and making them transparent, efficient and predictable. The implementation of automation and the use of cutting edge information and communication technology to exchange trade facilitation related information [...]"¹⁰⁰⁷

There are two important components in the trade facilitation, i.e., public sector and private sector. The government as public sector is the regulator and administrator of the trade facilitation. Traders or business actors are private sector, deemed as government customers of public services. Government as the public service provider in trade facilitation entitled some competences, for instance customs administration, issuing certificate of origin, export import license, establishing international agreement and cooperation in trade facilitation.¹⁰⁰⁸

According to OECD, there are five principles that must be implemented in the trade facilitation, as follows:¹⁰⁰⁹

"[...] **Transparency** of relevant domestic regulations, procedures, and practices is critical for ensuring that regulatory objectives are achieved efficiently, while, at the same time, enhancing the benefits expected from trade and investment liberalization. By revealing the costs and benefits of administrative regulations and ensuring their purpose is clear and appropriately implemented, transparency plays an important role in making governments more effective and efficient. Greater transparency allows market participants and stakeholders to get better understanding of the conditions and constraints for entering and operating in a market, to assess more accurately the costs and returns of their involvement, to be better prepared to meet existing requirements and adjust to potential changes, and to deal with discriminatory or arbitrary decisions. It implies that information on border requirements and procedures are made available easily and systematically [...]"¹⁰¹⁰

"[...] **Consistency and predictability** in the application of rules and procedures is also important. Uncertainty can translate into unwarranted transaction costs in international trade, such as warehousing expenses, transport and insurance fees and financing charges. Smaller businesses are likely to be more vulnerable to such problems, given their relative lack of resources. It calls for standard policies and operating procedures that are applied consistently and without discrimination [...]"¹⁰¹¹

¹⁰⁰⁵ See Sidley Austin Brown & Wood LLP, 2002.

¹⁰⁰⁶ See Christophe Maur, Jean., 2008.

¹⁰⁰⁷ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

¹⁰⁰⁸ See Grainger, Andrew., 2007.

¹⁰⁰⁹ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

¹⁰¹⁰ See *Ibid.*

¹⁰¹¹ See *Ibid.*

"[...] **Non-discrimination** refers to uniform application of all border-related regulations, procedures, and practices. It goes beyond equal treatment between trading partner countries, to focus on the treatment of individual traders [...].¹⁰¹²

"[...] **Simplification of border procedures** is one means of increasing the efficiency of border administrations that can result in improved revenue collection and enhanced productivity. At the same time, simplifying procedures may also reduce unnecessary restrictions and burdens that add to transaction costs of international trade, including undue delays at borders. Measures to simplify border procedures include limiting unnecessary paperwork, upgrading regulations, technical capacity, etc [...].¹⁰¹³

"[...] **Due process** refers to the availability of appropriate mechanisms for reviewing and addressing administrative actions related to customs and border matters. General legal frameworks available may not always be sufficient to address the more highly technical customs and border matters. The quality of such mechanisms should be judged by their accessibility, impartiality, and efficiency in offering redress in accordance with national legislation [...].¹⁰¹⁴

According to Winter, trade policy has important role to combat against corruption, elaborated as follows:

"[...] The most important aspects are the simplest: the less restrictive is trade policy, the lower are the incentives for corruption while simpler more transparent and non-discretionary policies reduce the scope for corruption. Thus if tariffs or other barriers exist there are important benefits to their being uniform, stable and widely published. The rules of origin that accompany preferential trading arrangements are burdensome to be the honest trader and great opportunity for less honest ones [...].¹⁰¹⁵

The bureaucratic practices in the customs and port authorities potentially generate abuse of power and corruption. Many traders and business actors complaining about bureaucracy practice under customs authorities. *Rent-seeking behaviour* at government offices for facilitating clearance and other trade document increase the cost of exports, imports, and other related services. Weerakoon et. al, studied the case of corruption that often occurs in the bureaucracy:

"[...] about 85 percent of them were compelled to pay such bribes or gifts, since they could not clear goods without such transactions. Some stakeholders indicated that in the absence of paying 'speed money' to officials, goods could never be cleared, passing relevant stages [...].¹⁰¹⁶

Trade facilitation is not merely technical and technological issues but also includes some other aspects such as economic, business, administrative and political issues. Trade facilitation has wide scope that includes "*government regulations and controls, business efficiency, transportation, information and communication technology to the financial sector*".¹⁰¹⁷ The political will and adherence of good governance principles contributed in the improvement of trade facilitation.¹⁰¹⁸ Trade facilitation associated with corruptions eradication, creating friendly business environment and reducing transaction cost.¹⁰¹⁹

¹⁰¹² See *Ibid.*

¹⁰¹³ See *Ibid.*

¹⁰¹⁴ See *Ibid.*

¹⁰¹⁵ See *Ibid.*

¹⁰¹⁶ See *Ibid.*

¹⁰¹⁷ See Zanamwe, Gainmore, 2005; Zanamwe, Gainmore, 2009.

¹⁰¹⁸ See *Ibid.*

¹⁰¹⁹ See *Ibid.*

Beneficiary countries' trade facilitation identified as a constraint in optimizing GSP. The Commission Staff Working Paper Impact Assessment on GSP, noted *"that bureaucracy in the exporting countries cause of the preference utilization gap"*.¹⁰²⁰ CARIS assessment on *"Final Report Mid-term Evaluation of the EU's GSP"*, correlated the flexibility of rules of origin, bureaucratic costs in the exporting country and its impact on preference utilization.

"[...] the use of preferences is correlated with the size of the preferential margin, the flexibility of rules of origin and how large are bureaucratic costs in the exporting country... Furthermore, the results indicate that a positive impact on preference utilization, and as result on exports as indicated in, could be achieved by improving rules of origin and export procedures in export countries [...].¹⁰²¹

Porto studied about the effects of informal export barriers on poverty. Barriers to trade divided into formal trade barriers (tariff, quotas, export, and taxes) and informal trade barriers. Informal export barriers covers transport costs, cumbersome customs practices, bureaucracy, regulations and corruption.¹⁰²² When formal trade barrier is decreased, the informal trade barrier is increased. Improvement transport infrastructure, fighting corruption, and improving customs practices would have a significant impact on poverty alleviation.¹⁰²³

XV.f. Significance of e-trade in trade facilitation.

Globalisation and ICT development have caused evolutionary changes in techniques of trade from manual to digital. ICT developments have changed traders' attitude in their effort to expand markets and to increase production efficiency. ICT usage in international trade has helped to increase efficiency (reduction of time consumption and costs) of trade and increase profit traders (market expansion products). ICT has played a significant role in trade facilitation reforms through features such as e-trade, e-business, the single window concept, e-contract, and e-payment. In this regard, observably the ICT is vital in the development of world trade.¹⁰²⁴ Sheikhan notes that the rapid development of ICT is due to the need for "faster, cheaper and more efficient transport systems (for instance just in time-management and e-business)".¹⁰²⁵ In addition, the growth of Transnational Corporation (TNC) or Multinational Corporation (MNC) has led to the change from a manual to a digital environment.

Application of ICT brought consequences in the field trade facilitation such as preparedness of infrastructure, human resources, and operational budget. The application of ICT in trade facilitation has gives a lot of benefits but in the same time also creating some constraints to developing countries and LDC. Such constraint related to standards set out on e-trade and e-custom application where not all the developing countries well-prepared. It becomes main of the reasons of developing countries refused trade facilitation to be

¹⁰²⁰ See European Commission, Commission Staff Working Paper Impact Assessment: Proposal for a Regulation of the European Parliament and of the Council on applying a scheme of generalised tariff preferences.

¹⁰²¹ See Gasiorek, Michael, et.al, Mid-term Evaluation of the EU's Generalized System of Preferences: Final Report, Centre for the Analysis of Regional Integration at Sussex (CARIS), University of Sussex, p. 81, available at : http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146196.pdf, last accessed : 6 June 2011.

¹⁰²² See Porto, Guido G., Informal Export Barriers and Poverty, *Journal of International Economics* 66 (2005) 447-470, Development Research Group, MailStop MC3-303, The World Bank, 1818 H Street, Washington DC 20433, United States, 2004, p. 399. Winters, L. Alan., *Critical Perspective on the Global Trading System and the WTO : The WTO and Poverty and Inequality*, Volume I, An Elgar Reference Collection, UK , 2007.

¹⁰²³ See Porto, Guido G., 2004, *Op. Cit.*, p. 419. Winters, L. Alan., 2007.

¹⁰²⁴ See UN/CEFACT, available at : <http://www.unece.org/cefact/about.htm>, last accessed 29 May 2011.

¹⁰²⁵ See Sheikhan, Pegah., 2008.

included as a legal obligation under WTO law. According to Hellqvist *“human capital capacity in the form of computer literate work force, computerised systems, functioning telecommunication system, use of information and technology solutions, harmonised payment system and standardised transport facilities”*. These factors has strong correlation with the *“country’s overall level of development”*. To meet such requirements developing countries need helps on capacity building and technical assistants.¹⁰²⁶ The practitioners’ proposed trade facilitation concepts *“based on observation in the area of the application of information technology are covering standardization of documents and electronic data requirements, automation, Single Window and International electronic exchange of trade data”*.¹⁰²⁷

The ICT projects related to trade facilitation is the adoption of single windows systems by Association of Southeast Asian Nations’ (ASEAN).¹⁰²⁸ Singapore is one of the leading countries that succeed implement single window system. It made Singapore as the role model for other countries.¹⁰²⁹ The single window concepts set up based on *“a high use of electronic systems, eliminating requirements for paper and providing an infrastructure for greater integration among the many government agencies as well as between government and business actors”*.¹⁰³⁰

XV.g. European Union trade facilitation in optimising GSP utilisation.

The EU has provided a large budget for the customs modernisation programme through the *“electronic customs initiative”*¹⁰³¹. Where its goal is to enhance the trade facilitation programme. This programme is in line with the *“e-Europe”*¹⁰³² proposed by the Commission in 2005. The essence of the e-Europe programme is to create an information society for all in order *“to provide a favourable environment for private investment and for the creation of new jobs, to boost productivity, to modernise public services, and to give everyone the opportunity to participate in the global information society”*. The encouragement *“to participate in the global information society”* is consistent with the implementation of the transparency principle as stipulated in Article X of GATT 1994. The

¹⁰²⁶ See Weerakoon, Dushni., Thennakoon, Jayanthi., and Weeraratne, Bilesha.

¹⁰²⁷ See Grainger, Andrew., 2007.

¹⁰²⁸ See *Ibid.*

¹⁰²⁹ See Applegate, Neo et al. 1993; 1995; Wulf 2004; International Trade Institute of Singapore 2005; Grainger, Andrew., 2007.

¹⁰³⁰ See Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee a simple and paperless environment for Customs and Trade Communication from the Commission to the Council, European Parliament and the European Economic and Social Committee on the role of customs in the integrated management of external borders: Proposal for a Regulation of the European Parliament and Of The Council amending Council Regulation (EEC) No 2913/92 establishing the Community Customs Code, Brussels, 24.07.2003, COM(2003) 452 final, 2003/0167 (COD), available at : <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0452:FIN:EN:PDF>, last accessed : 6 June 2011; Grainger, Andrew., Trade Facilitation: A Review, 25 June 2007, available at : http://www.tradefacilitation.co.uk/papers/AGrainger_TradeFacilitation_Review%282007%29.pdf, last accessed : 15 May 2011.

¹⁰³¹ See *Ibid.*

¹⁰³² See Commission Of The European Communities, Communication from the Commission to the Council, the European Parliament, The Economic and Social Committee and The Committee of the Regions, eEurope 2005: an information society for all, Brussels, 28.5.2002, COM(2002) 263 final, an Action Plan to be presented in view of the Sevilla European Council, 21/22 June 2002, available at : http://www.etsi.org/WebSite/document/aboutETSI/EC_Communications/eEurope2005_actionPlan.pdf, last accessed : 7 June 2011.

government required the provision of the accessible publication of procedures and requirements of foreign trade.¹⁰³³

In accordance with Article VIII of GATT 1994 the “*electronic customs initiative*” proposes the usage of ICT, builds common data models, implements the use of risk management techniques, applies the single window concept, simplifies governing trade procedures, and standardises and simplifies customs and trade documents (for instance the application of e-trade and e-customs).¹⁰³⁴ Another programme to enhance trade facilitation is the adoption of documentation standards (such as the Single Administrative Document in the EU) in order to facilitate the access to information and cooperation between customs authorities for fact-finding.¹⁰³⁵

The e-Europe programs are covering e-Government, e-Learning, e-Health, and e-Business.¹⁰³⁶ It is part of the Lisbon strategy to improve the EU competitiveness. The e-Europe increase the number of businesses actors that utilize the ICT in their business activities. The e-Europe provide better and cheaper services driving efficiency and economic growth. The e-business designed to increase the competitiveness of European company, enhancing productivity, and growth through investment in ICT, human resources (notably e-skills) and new business models.¹⁰³⁷ The Commission and member states support the development of e-business solutions for cross-border business transactions for instance e-signature and e-payment.

Intensive use of ICT in public administrations improve transparency and efficiency economic in business activities, thus, reducing transaction costs, cut down administrative burdens and increased effectiveness.¹⁰³⁸ On 27 May 2011, the Council adopted conclusions on the European e-Government action plan for the period 2011-2015. The objectives of the action plan is to promote the application of e-Government (electronic government)

¹⁰³³ See Grainger, Andrew., 2007.

¹⁰³⁴ See *Ibid*.

¹⁰³⁵ See Christophe Maur, Jean., 2008.

¹⁰³⁶ See Barcelona European Council, Presidency Conclusions, paragraph 40&41, available at : (<http://ue.eu.int/en/Info/eurocouncil/index.htm>). The Barcelona European Council called upon “the Commission and the Member States to foster the use of open platforms to provide freedom of choice to citizens for access to applications and services of the Information Society, notably through digital television, 3G mobile and other platforms that technological convergence may provide in the future. “[...] It also invited the Commission to present “a comprehensive analysis of remaining barriers to: the achievement of widespread access to new services and applications of the information society through open platforms in digital television and 3G mobile communications, the full roll-out of 3G mobile communications, the development of e-commerce and e-government and the role that national electronic identification and authentication systems could play in this context [...]”.

¹⁰³⁷ See Commission Of The European Communities, Communication from the Commission to the Council, the European Parliament, The Economic and Social Committee and The Committee of the Regions, eEurope 2005: an information society for all, Brussels, 28.5.2002, COM(2002) 263 final, an Action Plan to be presented in view of the Sevilla European Council, 21/22 June 2002.

¹⁰³⁸ See Council of the European Union, Council conclusions on the European eGovernment Action Plan 2011-2015 3093rd Transport, Telecommunications and Energy Council meeting – telecommunication items only – Brussels, 27 May 2011, available at : http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/trans/122278.pdf, last accessed : 9 June 2011. See also Council of The European Union, Press Release, Transport, Telecommunications and Energy, Telecommunications items only, 10494/11 PRESSE 145, PR CO 33, 3093rd Council meeting, Brussels, 27 May 2011, available at : http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/trans/122294.pdf, last accessed : 9th 2011. See also Council of the European Union The European eGovernment action plan 2011-2015, Adoption of Council Conclusions, Brussels, 19 May 2011, 10308/11, available at : <http://register.consilium.europa.eu/pdf/en/11/st10/st10308.en11.pdf>, last accessed : 9 June 2011.

services at local, regional and EU level, to make them more accessible and available for citizens and businesses throughout the EU regardless of their country of origin.¹⁰³⁹

The Council Resolution on 30 May 2001, concerning *“strategy for the Customs Union”* invited the Commission *“to develop a broad-based programme for computerization of customs procedures and exchange of customs information, as well as a credible strategy for the development and use of information networks in customs activities”*. To facilitate creation of paperless environment it is important to review and simply existing regulations, systems, and formalities. It is important to take into account the *“latest developments in commercial logistic practices, the reduction of customs duties, and the forthcoming enlargement”*, because customs controls *“would become a part of the trade transaction, with optimised efficiency”*.¹⁰⁴⁰

Single automated access point of trade is very important in which traders only have single entry point to access all the relevant customs clearance and information systems. Traders provide data only once where efficiency of time and formalities enhanced through single entry point. To adhere transparency principle all information on customs procedures, simplifications, accreditation criteria, guidelines have to be available on the internet in a language widely understood in international trade. The cost of ICT application considered as long-term investment.¹⁰⁴¹

Traders allocate budget to provide the infrastructure in their company, for instance computer, software (client software), network/communications costs, training, and possible security measure. To operate the system necessary to provide maintainance costs. Traders gains the benefits¹⁰⁴² from e-customs due to improvement of customs clearance and release time, increasing of transparency, predictability, and flexibility of customs administration, cost reduction, and availability of single entry point.¹⁰⁴³

On the other hand, the authority to provide more budgets to finance the project, such as planning budget (includes seminars and meetings), infrastructure, research and development, human resources and technical assistance. The custom modernization improve collection of revenues (own resources).¹⁰⁴⁴ With respect to the earlier detection

¹⁰³⁹ See Council of the European Union, available at : <http://www.consilium.europa.eu/showFocus.aspx?id=1&focusid=608&lang=en>, last accessed : 9 June 2011.

¹⁰⁴⁰ See Proposal for a Regulation of the European Parliament and Of The Council amending Council Regulation (EEC) No. 2913/92 establishing the Community Customs Code, Brussels, 24.07.2003, COM(2003) 452 final, 2003/0167 (COD).

¹⁰⁴¹ See *Ibid.*

¹⁰⁴² “[...] Increased responsiveness of the customs administrations, particularly regarding reductions in the overall elapse time required to obtain customs clearance; Simplification and streamlining of compliance obligations and procedures to be followed, deriving specifically from the simplification and reduction of customs procedures, the Single European Authorization, and the possibility to use global guarantees; Increased transparency, predictability, co-operation and uniformity in interactions with customs administrations and systems; General reduction in the costs of doing business in the European Union via the automation of procedures and consequent replacement of paper-based procedures; Availability of a single automated entry point to the EU administrations, including the single window/one-stop-shop for customs and other agencies; Availability of lower cost customs software via the creation of an EU-wide market for a customs software following a unique set of specifications instead of 15 (or 25) markets of country-specific software; New business opportunities for customs agents and clearing houses in the area of bridging EU interfaces to private companies’ systems interfaces, and for representing traders established outside the Community regarding declaration and payment obligations; Increased flexibility in co-operation structures with customs administrations via expanded use of MOUs (Memoranda of Understanding); Better proof of export for tax purposes [...]”.

¹⁰⁴³ See Proposal for a Regulation of the European Parliament and of The Council amending Council Regulation (EEC) No 2913/92 establishing the Community Customs Code, Brussels, 24.07.2003, COM(2003) 452 final, 2003/0167 (COD).

¹⁰⁴⁴ *Ibis.*

of fraud and trade deflection, it would greatly influence the utilization of GSP by beneficiary countries and/the most need countries.¹⁰⁴⁵

With respect to the relationship between trade facilitation and the implementation of preferential rules of origin, Commission Regulation (EU) No. 1063/2010 requires the beneficiary countries to establish an electronic database of registered exporters.¹⁰⁴⁶ These databases will be used to facilitate targeted post-export controls, especially to issue the declaration of free circulation.¹⁰⁴⁷ The competent authorities of the beneficiary country must continue to update the electronic records of registered exporters located in the country or concern.¹⁰⁴⁸ The establishment of such database by beneficiary countries requires ICT infrastructure (e-trade)¹⁰⁴⁹, human resources, and operational costs. The database is protected under the data protection provisions of the EU and national law.¹⁰⁵⁰ Such database must be in line with export formalities in the beneficiary countries, procedures at the release of free circulation in the EU and methods of administrative cooperation.

The failure to fulfil the administration requirements of the preferential rules of origin and to provide administrative cooperation may lead to temporary withdrawal from the GSP scheme.¹⁰⁵¹ Administration cooperation refers to the implementation of the preferential rules of origin in order to obtain tariff reductions under the GSP scheme.¹⁰⁵²

Public participation considered as elements of transparency principle. The Commission held public consultation involving variety of stakeholders, consists of citizens, business associations, companies, no profit organizations and others elements.¹⁰⁵³ This activity is purposed to get proportional feedbacks from different range of groups in order to establish an improvement of the next GSP scheme. The public consultation held used online systems, known as “Interactive Policy Making”¹⁰⁵⁴. This system is established in line with the e-Europe programme in order to create information society, to enhance efficiency, to reduce the bureaucracy cost, and to cover the worldwide society.¹⁰⁵⁵

The DG of Trade provides e-service, called as “the export helpdesk” to facilitate developing countries accessing EU markets.¹⁰⁵⁶ The export helpdesk established in 2004, it is functioned as the point to access online information about exporting to Europe. This site is available in multilanguage languages: English, Spanish, French, Portuguese, Arabic and

¹⁰⁴⁵ “[...] Due to implementation of Generalized System of Preferences scheme which derogate from “Common Customs Tariff duties”, refer to duties specified in Part Two of Annex I to Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff (6), except those duties set up within the framework of tariff quotas [...]”; (6) OJ L 256, 7.9.1987, p. 1. Regulation as last amended by Commission Regulation (EC) No 360/2008 (OJ L 111, 23.4.2008, p. 9). See also Altomonte, Carlo., Nava, Mario., 2005. See also Gormley, Laurence W., 2009.

¹⁰⁴⁶ See Article 69 Paragraph 3 of the Commission Regulation (EU) No. 1063/2010 of 18 November 2010.

¹⁰⁴⁷ See Recitals 18 of the Commission Regulation (EU) No. 1063/2010.

¹⁰⁴⁸ See Article 91 Paragraph 1 of the Commission Regulation (EU) No. 1063/2010. See also Article 93 Paragraph 2 of the Commission Regulation (EU) No. 1063/2010.

¹⁰⁴⁹ See Recitals 23 of the Commission Regulation (EU) No. 1063/2010.

¹⁰⁵⁰ See Recitals 19, 20, 21, 22 and Article 69 Paragraph 4 of the Commission Regulation (EU) No. 1063/2010.

¹⁰⁵¹ See Article 16 Paragraph 1 Council Regulation (EC) No. 732/2008.

¹⁰⁵² See Article 16 Paragraph 2 (a) Council Regulation (EC) No. 732/2008.

¹⁰⁵³ See Public Consultation on the EU Generalised System Of Preferences (GSP), available at : http://trade.ec.europa.eu/doclib/docs/2010/september/tradoc_146463.edited.pdf, last accessed : 14 June 2011.

¹⁰⁵⁴ See <http://ec.europa.eu/yourvoice/ipm/forms/dispatch?form=NEXTGSPSCHEME&lang=en>.

¹⁰⁵⁵ See Public Consultation exercise on the revision and updating of the European Union's scheme of Generalised System of Preferences (the GSP scheme), available at : http://trade.ec.europa.eu/doclib/docs/2010/march/tradoc_145972.pdf, last accessed : 14 June 2011.

¹⁰⁵⁶ See The Export Helpdesk, available at : http://exporthelp.europa.eu/index_en.html, last accessed : 14 June 2011.

Russian. The export helpdesk provide guidance for exporters or traders from the third countries about trade opportunities, preferential arrangement, rules of origin, trade restriction, export-import formalities and procedures to EU, and provide import tariffs and taxes information. The export helpdesk provide trade statistics on EU trade with the rest of the world.¹⁰⁵⁷ On Customs and Tariffs, the EU established TARIC Consultation systems.¹⁰⁵⁸

In overall, EU trade facilitation improvement in line with Article X and Article VIII of GATT 1994. The transparency principles on publication and administration of trade regulations implemented by providing accessible information of export and import to the traders and other stakeholders, for instance the “*export helpdesk and interactive policy making programme*”. Trade facilitation open more access for beneficiary countries to optimizing utilization the EU GSP.

XVI. The proposal for new EU GSP regulations.

The EU GSP as the main instrument of trade and development was established under the framework of CCP. Trade preferences are considered as a tool to sustain development in beneficiary countries. It is clear that the EU GSP is dedicated to the assistance of developing countries to improve their economic development through increasing export earnings, alleviating poverty, promoting sustainable development and good governance and ensuring the enforcement of core human and labour rights in developing countries. However, the implementation of GSP always needs domestic sacrifices such as reducing the preference-granting country’s revenues because of tariff reductions. This invites debatable issues between the interest groups and stakeholders by taking into account the costs and benefits for its domestic industries.¹⁰⁵⁹ Hudec, states that “*preferences did more harm than good, they were something developed countries could give*”. GSP is interpreted as a voluntary contribution to help developing countries in the framework of development.

The Council Regulation (EC) No. 732/2008 applying a scheme of generalised tariff preferences expired on 31 December 2011.¹⁰⁶⁰ The proposal for new EU GSP is based on detailed impact assessment. The proposal was prepared by considering input from the public consultation held on 27 March to 4 June 2010.¹⁰⁶¹ This assessment studied the effect of different policies to enhance the utilisation of the GSP scheme for the countries most in need.¹⁰⁶² The new GSP scheme must take into account the significant changes in international trade relations and global economic development. The new GSP is designed to enhance it modalities on the eligibility criteria of beneficiary countries, preferential

¹⁰⁵⁷See About the Export Helpdesk, available at : http://exporthelp.europa.eu/display.cfm?page=intro/intro_HowToExportToEurope.html&docType=main&languageId=EN, last accessed : 14 June 2011.

¹⁰⁵⁸ Available at : http://ec.europa.eu/taxation_customs/dds2/taric/taric_consultation.

¹⁰⁵⁹ See Hudec, Robert E., 1987, *Op. Cit.*, p. 50.

¹⁰⁶⁰ See Council Regulation (EC) No. 732/2008 Amending Regulations (EC) No. 552/97, (EC) No. 1933/2006 And Commission Regulations (EC) No. 1100/2006 And (EC) No. 964/2007 (Officials Journals L 211/1, 6.8.2008)

¹⁰⁶¹ See Proposal For A Regulation Of The European Parliament And Of The Council Applying A Scheme Of Generalised Tariff Preferences, {SEC(2011) 536 Final},{SEC(2011) 537 Final}, Brussels, 10.5.2011, COM(2011) 241 Final, 2011/0117 (COD), p. 3.

¹⁰⁶² “[...] Global economic balances have shifted tremendously in the last decades. World tariffs are at all-time lows. If we grant tariff preferences in this competitive environment, those countries most in need must reap the most benefits. Trade and development go hand in hand and tariff preferences are a small part of our wide agenda to help poorer economies scale up their presence in global markets [...]” (European Union’s Trade Commissioner Karel De Gucht). See Focusing on needs: the EU reshapes its import scheme for developing countries, Brussels, 10 May 2011, available at: http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147894.pdf, last accessed: 12 May 2011.

rules of origin¹⁰⁶³, the withdrawal mechanism,¹⁰⁶⁴ and the graduation and de-graduation mechanism.¹⁰⁶⁵ Those elements are identified as the main core of the GSP to attain its goal in giving assistance to targeted countries.

In the new GSP regulation, beneficiaries who have enjoyed the GSP scheme will be reduced from 176¹⁰⁶⁶ to 80¹⁰⁶⁷ countries and territories.¹⁰⁶⁸ This policy was established based on economic criteria such as the increase of income per capita based on the World Bank Classification. In fact, some GSP beneficiaries have income similar or even higher than some member states of EU¹⁰⁶⁹, thus, the EU argues that the grants of the GSP scheme towards those countries with a higher income would go against the objectives of GSP, which is given as a favour to improve their economic development using tariff reductions. The beneficiary country concerned is considered as capable to compete in the EU market without any assistance of trade preferences. The beneficiary country that has a FTA or a

¹⁰⁶³See Recitals (22) by Commission Regulation (EU) No 1063/2010 (OJ L 307, 23.11.2010); See Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 8.

¹⁰⁶⁴ See Recitals (23) “[...] The reasons for temporary withdrawal of the three arrangements should include serious and systematic violations of the principles laid down in certain international conventions concerning core human rights and labour rights, so as to promote the objectives of those conventions [...]”.

“[...] Tariff preferences under the special incentive arrangement for sustainable development and good governance should be temporarily withdrawn if the beneficiary country does not respect its binding undertaking to maintain the ratification and effective implementation of the conventions or to comply with the reporting requirements imposed by the conventions, or if the beneficiary country does not cooperate with the European Union’s monitoring procedures as set out in this Regulation [...]”.

“[...] Recitals (24) due to the political situation in Myanmar and in Belarus, the temporary withdrawal of all tariff preferences in respect of imports of products originating in Myanmar and Belarus should be maintained [...]”. See Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 8.

¹⁰⁶⁵ See Recitals (21) “[...] Graduation based on criteria related to sections and chapters of the Common Customs Tariff. Graduation should apply in respect of a section or sub-section in order to reduce cases where heterogeneous products are graduated. The graduation of a section or a sub-section (made up of chapters) for a beneficiary country should be applied when the section meets the criteria for graduation over three consecutive years, in order to increase the predictability and fairness of graduation by eliminating the effect of large and exceptional variations in the import statistics. Graduation should not apply to the beneficiary countries of the special incentive arrangement for sustainable development and good governance and the beneficiary countries of the special arrangement for the least-developed countries as they share a very similar economic profile rendering them vulnerable because of a low, non-diversified export base [...]”. See Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 8.

¹⁰⁶⁶ See *Annex I* Beneficiary countries and territories of the Community’s scheme of generalised tariff preferences Council Regulation (EC) 732/2008.

¹⁰⁶⁷ See Annex I Eligible Countries of The European Union’s Scheme of Generalised Tariff Preferences Referred to in Article 3 Proposal for a Regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 29.

¹⁰⁶⁸ The decision to reduce the number of beneficiary of GSP needs to be finalized by co-decision mechanism referred to Paragraph 2 Article 188C The Treaty of Lisbon. See also Karel De Gucht, European Commissioner for Trade, Remarks at the press conference on the review of the Generalised System of Preferences, Press Conference on the GSP review, Strasbourg, 10 May 2011, available at: http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147895.pdf, last accessed : 12 May 2011. See also Article 5 Paragraph (3), Article 6 Paragraph (2), Article 9 Paragraph (2), Article 10 Paragraph (8), Article 11 Paragraph (2), Article 16, Article 17 Paragraph (3), Article 19 Paragraph (10) and (13), Article 22 Paragraph (4), Article 37 Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences.

¹⁰⁶⁹ Countries which have achieved a high or upper middle income per capita, according to the internationally accepted World Bank classification (such as Kuwait, Russia, Saudi Arabia and Qatar). See Focusing on needs: the EU reshapes its import scheme for developing countries, Brussels, 10 May 2011, available at: http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147894.pdf, last accessed: 12 May 2011. This achievement is such that their income is similar or even higher than that of some EU Member States. So, trade preferences did not make that much sense anymore. See also Karel De Gucht, European Commissioner for Trade, Remarks at the press conference on the review of the Generalised System of Preferences, Press Conference on the GSP review, Strasbourg, 10 May 2011, available at: http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147895.pdf, last accessed : 12 May 2011.

Special Autonomous Trade Regime with the EU would be removed from the list. Some beneficiary countries and territories also have alternative market access arrangement for developed markets, which means that they have greater market access for their products.

The modalities in the new GSP scheme must comply with Enabling Clause 1979 and correspond to the priorities of the United Nations for the combating of global poverty.¹⁰⁷⁰ The GSP is deemed as a policy that is coherent with economic development and that contributes to the eradication of poverty through opening affordable market access for developing countries and LDCs.¹⁰⁷¹ EU regulations under the CCP must be consistent with the principle laid down in Article 208 of the TFEU.¹⁰⁷²

Commitment of granting GSP caused losses to EU customs revenue due to zero tariff reductions. In 2009, the revenue losses caused by the implementation of the GSP scheme were estimated at 2.97 billion euros corresponding to a net amount of 2.23 billion euros after the deductions of member states' collection costs. The re-designed graduation mechanism and eligibility criteria of the beneficiary countries in the proposal of the new EU GSP scheme aims to minimise such losses. The estimation of annual loss of customs revenue from the coming GSP scheme is 1.87 billion euros (net amount 1.4 billion euros). The new regulation of the GSP is projected to reduce customs revenue losses.¹⁰⁷³ The estimation budget provided by the EU for the implementation of the GSP regulation 2011 is 16.6 billion euros¹⁰⁷⁴. Hence, the focal point of the proposed regulation is to reduce revenue losses through the graduation mechanism of the beneficiary country.

¹⁰⁷⁰ “[...] Generalized System of Preferences designed to increasing export earning and protecting infant industries in the beneficiary country. The assumption of increasing export quantity hoped also generates the employments, which directed to alleviate poverty and inequalities of economic development in the beneficiary country. The WTO is one of international organization, which supports the United Nations Millennium Development Goals (MDGs), in which covers eight international development goals that all 192 Members and a Number of International Organizations have agreed to achieve by the year 2015 to end poverty [...]”. (See The WTO And The Millennium Development Goals, available at : http://www.wto.org/english/thewto_e/coher_e/mdg_e/mdg_e.htm, last accessed : 14 May 2011; See <http://www.un.org/millenniumgoals/>, last accessed : 14 May 2011). Pascal Lamy, Director of WTO also stressed that “Open, Rules Based, Predictable and Non Discriminatory Trading System” can be a powerful engine for economic growth and development. For instance, Lamy said that there is a fact that the regions where most progress has been made in eradicating poverty are those that trade most, and there is a direct correlation between integration into the Multilateral Trading System and Economic Growth, between Growth and Poverty Reduction. (See Lamy Underlines WTO’s Role in Reducing Poverty, available at : http://www.wto.org/english/news_e/sppl_e/sppl170_e.htm, Last Accessed : 14 May 2011).

¹⁰⁷¹ See EU Contribution To The Millennium Development Goals: Some Key Results From European Commission Programmes 2010, available at : http://ec.europa.eu/europeaid/infopoint/publications/europeaid/documents/188a_Mdg_En.Pdf, last accessed : 14 May 2011.

¹⁰⁷² See Recital (4) “[...] The European Union’s common commercial policy is to be consistent with and consolidate the objectives of development policy, laid down in Article 208 of the Treaty on the Functioning of the European Union, in particular the eradication of poverty and the promotion of sustainable development and good governance in the developing countries. Compliance with WTO requirements, ‘Enabling Clause’, WTO Members may accord differential and more favourable treatment to developing countries. Recitals (7) By providing preferential access to the market of the Union, the scheme should assist developing countries in their efforts to reduce poverty and promote good governance and sustainable development by helping them generate additional revenue through international trade, which can then be re-invested for the benefit of their own development. The scheme’s tariff preferences should focus on helping developing countries having greater development, trade and financial needs [...]”. Proposal for a Regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, pp. 4-5.

¹⁰⁷³ See Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 3, available at : Http://Trade.Ec.Europa.Eu/Doclib/Docs/2011/May/Tradoc_147893.Pdf, last accessed : 12 May 2011.

¹⁰⁷⁴ See Legislative Financial Statement For Proposals Having A Budgetary Impact Exclusively Limited To The Revenue Side, Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 104.

Table 3. Estimation of customs revenue losses proposed by GSP regulation.¹⁰⁷⁵

Mio Euro	Pref. Imports	Loss of Revenue	Revenue of New Graduation	Total Loss
EBA	6,237	730	-	730
GSP+	2,835	307	-	307
GSP	31,066	1,066	231	835
Total	40,138	2,103	231	1,872

Table 4. Estimation¹⁰⁷⁶ of the loss of revenue to the EU budget (net amount).

Year	Loss of Revenue	25% Reduction "Member States Collection Costs"
2009	1,872	1,404
2010	1,966	1,474
2011	2,064	1,548
2012	2,167	1,625
2013	2,276	1,707
2014	2,389	1,792
2015	2,509	1,882
2016	2,634	1,976

Table 5. The European Union loss of revenue: example Indonesia.

Geonom Country Code	Beneficiary Country	GSP Scheme	Total Import per Euro 1,000	Eligible Imports per Euro 1,000	Preferential Imports per Euro 1,000	MFN Average	EBA Rate Average	EU Loss of Revenue per Euro 1,000
0700	Indonesia	General Arrangement	11,571,832.86	5,074,782.31	3,383,547.47	4.81	3.02	126,244.36

Table 6. Correlation of European Union loss of revenue and graduated section: example Indonesia.

Geonom Country Code	Beneficiary Country	Graduated Sections	Total Import x Euro 1,000	Eligible Imports per 1,000 euros	Preferential Imports per 1,000 euros	MFN Average	GSP rate Average	EU Loss of Revenue per 1,000 euros
0700	Indonesia	S-1a	15,538.24	13,989.51	13,989.51	0.58	-	895.33
0700	Indonesia	S-3	18,887,166.53	-	-	8	5.89	-

¹⁰⁷⁵ See Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 105.

¹⁰⁷⁶ Assuming an increase of imports of 5% per year and deducting 25% that are retained in the Member States to compensate for collection costs.

The proposed regulation laid down in Article 207 of the TFEU (Ex Article 133 TEC) as the legal basis of granting GSP. The new proposed regulations of GSP give more elaboration on the implementation of the “*non discriminatory principle of the enabling clause*” as interpreted by the Appellate Body in the EC Preferences Case.¹⁰⁷⁷ In this regard, the scheme of general arrangement will be granted to “*all those developing countries which share a common developing need and are in a similar stage of economic development*”.¹⁰⁷⁸ The wording “*share a common developing need*”¹⁰⁷⁹ and “*similar stage of economic development*” should be underlined, which set out the conditions known as “*similarly-situated*”. The Appellate Body stated that identical tariff preferences must be available for “*similarly-situated*” beneficiary countries.¹⁰⁸⁰ The general arrangement considers the fact that development, financial and trade needs are dynamic and assures that the arrangement remains open if the situation of a country changes.¹⁰⁸¹

On the other hand, beneficiary countries are defined as “not similarly situated”, where they do not share the same development, trade and financial needs, have different stages of economic development, and are categorised as developing countries that are more vulnerable. To prevent unjustified discrimination different needs should be granted to different treatments. Beneficiaries are classified by the World Bank as high-income or upper-middle income countries and successful completion of their migration from centralised to market economies is excluded from the general arrangement.¹⁰⁸²

With respect to the other PTAs established between developing countries and the EU, the proposed regulation clearly states that:¹⁰⁸³

“[...] the tariff preferences granted under the general arrangement should not be extended to developing countries which are benefiting from a preferential market access arrangement with the EU, which provides at least the same level of tariff preferences as the scheme for substantially all trade [...]”.

The Commission will monitor the implementation of special incentive arrangements and present the report to the European Parliament and the Council.¹⁰⁸⁴ The classification of

¹⁰⁷⁷ See *Appellate Body Report in EC-Preferences Case* paras. 153-154.

¹⁰⁷⁸ See Recitals (9) Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 5.

¹⁰⁷⁹ See also *Appellate Body Report in EC-Preferences Case* para. 153. “[...] The European Communities, however, appears to regard GSP beneficiaries as similarly-situated when they have “similar development needs”. Although the European Communities acknowledges that differentiating between similarly-situated GSP beneficiaries would be inconsistent with footnote 3 of the Enabling Clause, it submits that there is no inconsistency in differentiating between GSP beneficiaries with different development needs [...]”.

¹⁰⁸⁰ See *Appellate Body Report in EC-Preferences Case* para. 154.

¹⁰⁸¹ See Recitals (9) Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 5.

¹⁰⁸² See *Ibid.*

¹⁰⁸³ See *Ibid.*

¹⁰⁸⁴ See Recitals (14) “[...] The Commission should monitor the status of ratification of the international conventions and their effective implementation, by examining the conclusions and recommendations of the relevant monitoring bodies established under the respective conventions. Every two years, the Commission should present, to the European Parliament and the Council, a report on the status of ratification of the conventions, the compliance of the beneficiary countries with any reporting obligations under the conventions, and the status of the implementation of the conventions in practice; Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 7. The Commission should monitor the status of ratification of the international conventions and their effective implementation, by examining the conclusions and recommendations of the relevant monitoring bodies established under the respective conventions. Every two years, the Commission should present, to the European Parliament and the Council, a report on the status of ratification of the conventions, the compliance of the beneficiary countries with any reporting obligations under the conventions, and the status of the implementation of the conventions in practice [...]”.

sensitive and non-sensitive products in the general arrangement scheme will be maintained in order to protect domestic products of similar manufacturing sectors.¹⁰⁸⁵ In the current regulation non-sensitive products have been suspended,¹⁰⁸⁶ and will be maintained in the GSP proposal. While, sensitive¹⁰⁸⁷ products will be maintained to enjoy tariff reductions in order to increase GSP utilisation. Therefore, GSP tariff reductions are designed to attract traders to utilise the GSP scheme facility.¹⁰⁸⁸

Non-legislative acts¹⁰⁸⁹ will be applied in the amendments of the Annexes of the regulation and in temporary withdrawals from the special incentive arrangement. The aim is to create uniformity and detailed technical arrangements in the enforcement of the regulation. In addition, the Commission is obliged to hold appropriate consultations in the preparatory work of the “*non legislative act*”, which involves the relevant experts.¹⁰⁹⁰

¹⁰⁸⁵ See Recitals (17) “[...] As regards the general arrangement, the differentiation between tariff preferences for ‘non-sensitive’ products and tariff preferences for ‘sensitive’ products should be maintained, to take account of the situation of the sectors manufacturing the same products in the European Union [...]” Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 7.

¹⁰⁸⁶ See Common Customs Tariff duties on products listed in Annex V as non-sensitive products shall be suspended entirely, except for agricultural components. See Paragraph (1) Article 7 Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 7. See also Recitals (14) Council Regulation (EC) No 732/2008. See also Paragraph (1) Article 8 Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 7. See also Recitals (14) Council Regulation (EC) No 732/2008.

¹⁰⁸⁷ See Paragraph (2), (4), (6) Article 7 Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 7. See also Recitals (14) Council Regulation (EC) No 732/2008.

¹⁰⁸⁸ See Recitals (18) “[...] Common Custom Tariff duties on non-sensitive products should continue to be suspended, while duties on sensitive products should enjoy a tariff reduction, in order to ensure a satisfactory utilisation rate while at the same time taking account of the situation of the corresponding European Union industries [...]”; Recitals (19) “[...] Such a tariff reduction should be sufficiently attractive, in order to motivate traders to make use of the opportunities offered by the scheme. Therefore, the *ad valorem* duties should generally be reduced by a flat rate of 3.5 percentage points from the MFN duty rate, while for textiles and textile goods they should be reduced by 20 %. Specific duties should be reduced by 30 %. Where a minimum duty is specified, that minimum duty should not apply [...]”; Recitals (20) “[...] Duties should be suspended totally, where the preferential treatment for an individual import declaration results in an *ad valorem* duty of 1 % or less or in a specific duty of EUR 2 or less, since the cost of collecting such duties might be higher than the revenue gained [...]” Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, pp. 7-8.

¹⁰⁸⁹ See Article 290 of The Treaty on the Functioning of the European Union concerning “non legislative act”; see also Article 249 B Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, stipulated as follows :

1. A legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act. The objectives, content, scope and duration of the delegation of power shall be explicitly defined in the legislative acts. The essential elements of an area shall be reserved for the legislative act and accordingly shall not be the subject of a delegation of power.
2. Legislative acts shall explicitly lay down the conditions to which the delegation is subject; these conditions may be as follows:
 - (a) the European Parliament or the Council may decide to revoke the delegation;
 - (b) the delegated act may enter into force only if no objection has been expressed by the European Parliament or the Council within a period set by the legislative act.For the purposes of (a) and (b), the European Parliament shall act by a majority of its component members, and the Council by a qualified majority.
3. The adjective ‘delegated’ shall be inserted in the title of delegated acts.

¹⁰⁹⁰ See Recitals (25) “[...] In order to achieve a balance between the need for better targeting, greater coherence and transparency on one hand, and better promoting sustainable development and good governance through a unilateral trade preference scheme on the other hand, the power to adopt acts in accordance with Article 290 of the Treaty on the Functioning of the European Union should be delegated to the Commission in respect of due to failure to adhere to the principles of sustainable development and good governance, as well as procedural rules regarding the submission of applications for the tariff preferences granted under the special incentive arrangement for sustainable development and good governance, the conduct of a temporary withdrawal and safeguard investigations in order to establish uniform and detailed technical arrangements. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level. The Commission, when preparing

In addition, the GSP proposal has put forward regular assessment to review GSP scheme implementation every five years. The Commission will carry out such assessment and submit the report to the Council and European Parliament. The assessment covers the implications of the GSP scheme for the development, trade, and financial needs of beneficiary countries.¹⁰⁹¹

The proposal of GSP regulation consists of seven Chapters,¹⁰⁹² forty-two Articles, and nine Annexes.¹⁰⁹³ The proposed regulations have been maintained from the previous GSP scheme that consists of three arrangements.¹⁰⁹⁴ Article 2 of Chapter I of the proposed regulation contains a definition of terms.¹⁰⁹⁵ The eligibility criteria for general

and drawing up delegated acts, should ensure the simultaneous, timely and appropriate transmission of relevant documents to the European Parliament and Council [...]; Recitals (26) “[...] In order to ensure uniform conditions for the implementation of this Regulation, implementing powers should be conferred on the Commission [...]”. Those powers exercised in accordance with Regulation (EU) No 182/2011. The advisory procedure used for the adoption of decisions on suspension from the tariff preferences of certain GSP sections in respect of beneficiary countries and on the initiation of a temporary withdrawal procedure, taking into account the nature and impact of these acts. The examination procedure should be used for the adoption of decisions on safeguard investigations and on suspension of the preferential arrangements where imports may cause serious disturbance to European Union markets. Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 9. See also Recital 15, 16, 17 Council Regulation (EC) No 732/2008.

¹⁰⁹¹ See Recitals (27) “[...] The Commission should report regularly to the Council and the European Parliament on the effects of the scheme. Five years after its entry into force, the Commission should report on the operation of the Regulation and assess the need to review the scheme, including the special incentive arrangement for sustainable development and good governance and temporary withdrawal provisions of tariff preferences, taking into consideration the fight against terrorism and the field of international standards on transparency and exchange of information in tax matters. In reporting, the Commission should take into account the implications for development, trade and financial needs of beneficiaries. Where applicable, compliance with EU sanitary and phytosanitary rules should also be assessed. The report should also include an analysis of the effects of the scheme with regard to imports of biofuels and sustainability aspects [...]”; Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 9. See also Recital 15, 16, 17 Council Regulation (EC) No 732/2008.

¹⁰⁹² Chapter I (General Provisions), Chapter II (General Arrangement), Chapter III (Special Incentive Arrangement For Sustainable Development And Good Governance), Chapter IV (Special Arrangement For The Least-Developed Countries), Chapter V Temporary Withdrawal Provisions Common To All Arrangements, Chapter VI (Safeguard And Surveillance Provisions), Chapter VII (Common Provisions).

¹⁰⁹³ **Annex I** (Eligible countries of the European Union’s Scheme of Generalised Tariff Preferences referred to in Article 3; Eligible countries of the European Union’s Scheme of Generalised Tariff Preferences referred to Article 3 which have been temporarily withdrawn from this scheme, in respect of all or of certain products originating in these countries), **Annex II** (Beneficiary countries of the general arrangement referred to Article 1 (2) (A); Beneficiary countries of The general arrangement referred to Article 1 (2) (A) which have been temporarily withdrawn from this scheme, in respect of all or of certain products originating in these countries), **Annex III** (Beneficiary countries of the special incentive arrangement for sustainable development and good governance referred to Article 1 (2) (B); beneficiary countries of the special incentive arrangement for sustainable development and good governance referred to Article 1 (2) (B) which have been temporarily withdrawn from this scheme, in respect of all or of certain products originating in these countries), **Annex IV** (Beneficiary countries of the special arrangement for the LDC referred to Article 1 (2) (C); Beneficiary countries of the special arrangement for the LDC referred to Article 1 (2) (C) which have been temporarily withdrawn from this scheme, in respect of all or of certain products originating in these countries), **Annex V** (List of products included in the general arrangement referred to Article 1 (2) (a)), **Annex VI** (Modalities for the application of Article 8), Annex VII (Modalities for the application of Chapter III), **Annex VIII** (Conventions referred to in Article 9), **Annex IX** (List of products included in the special incentive arrangement for sustainable development and good governance referred to in Article 1(2)(b)).

¹⁰⁹⁴ See Articles 1 paragraph (2), Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 10. See also Recital (15), (16), (17) Council Regulation (EC) No 732/2008, stipulated as follows :

This Regulation provides for the following tariff preferences:

- (a) a general arrangement;
- (b) a special incentive arrangement for sustainable development and good governance; and
- (c) a special arrangement for the least-developed countries.

¹⁰⁹⁵ For the purposes of this Regulation:

arrangements are regulated in Paragraph 1 Article 4. General arrangement criteria are based on economic classification, and state income per capita of the World Bank.¹⁰⁹⁶ To implement and utilise the GSP facility the beneficiary country needs to prepare infrastructures such as administration support, human resources, and trade facilitations. However, not all the beneficiary countries are well prepared in such matters. Hence, the proposal of GSP regulation is to accommodate an adoption period for eligible beneficiary countries and economic operators in order to prepare the infrastructures concerned.¹⁰⁹⁷

-
- (a) 'GSP' means the Generalised Scheme of Preferences by which the European Union provides preferential access to the market of the European Union through the three separate preference regimes provided for in Article 1(2)(a),(b) and (c);
 - (b) 'eligible countries' means all developing countries as listed in Annex I;
 - (c) 'GSP beneficiary countries' means beneficiary countries of the general arrangement as listed in Annex II;
 - (d) 'GSP+ beneficiary countries' means beneficiary countries of the special incentive arrangement for sustainable development and good governance as listed in Annex III;
 - (e) 'EBA beneficiary countries' means beneficiary countries of the special incentive arrangement for least developed countries as listed in Annex IV;
 - (f) 'Common Customs Tariff duties' means the duties specified in Part Two of Annex I to Council Regulation (EEC) No 2658/87 of 23 July 1987, except those duties established as part of tariff quotas;
 - (g) 'section' means any of the sections of the Common Customs Tariff as laid down by Regulation (EEC) No 2658/87;
 - (h) 'Chapter' means any of the chapters of the Common Customs Tariff as laid down by Regulation (EEC) No 2658/87;
 - (i) 'GSP section' means a section listed in Annex V and established on the basis of sections and Chapters of the Common Customs Tariff;
 - (j) 'preferential market access arrangement' means preferential access to the European Union market through a trade agreement, either provisionally applied or in force, or through autonomous preferences granted by the European Union;
 - (k) 'effective implementation' means the integral implementation of all undertakings and obligations undertaken under the relevant conventions, thus ensuring fulfilment of all the principles, objectives and rights guaranteed therein.

¹⁰⁹⁶ See also Article 3 Council Regulation (EC) No 732/2008.

Council Regulation (EC) No 732/2008

- A beneficiary country shall be removed from the scheme when it has been classified by the World Bank as a high-income country during three consecutive years, and when the value of imports for the five largest sections of its imports covered by the GSP into the Community represents less than 75 % of the total GSP-covered imports from that beneficiary country into the Community.
- When a beneficiary country benefits from a preferential trade agreement with the Community which covers all the preferences provided for by the present scheme to that country, it shall be removed from the list of beneficiary countries.

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- An eligible country, as listed in Annex I, shall benefit from the tariff preferences provided under the general arrangement referred to in Article 1(2)(a) unless:
- It has been classified by the World Bank as a high-income or an upper-middle income country during three consecutive years immediately preceding the update of the list of beneficiary countries.
 - It benefits from a preferential market access arrangement which provides the same tariff preferences as the scheme, or better, for substantially all trade.

¹⁰⁹⁷ See Articles 5 paragraph (2), Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 10. See also Recital (15), (16), (17) Council Regulation (EC) No 732/2008, stipulated as follows :

By 1 January of each year following the entry into force of this Regulation the Commission shall review Annex II. To provide a GSP beneficiary country and economic operators with time for orderly adaptation to the change in the country's status under the scheme:

- (a) the decision to remove a beneficiary country from the list of GSP beneficiary countries, in accordance with paragraph 3 and on the basis of Article 4(1)(a), shall apply as from one year after the date of entry into force of the decision;
- (b) the decision to remove a beneficiary country from the list of GSP beneficiary countries, in accordance with paragraph 3 and on the basis of Article 4(1)(b), shall apply as from two years after the date of application of a preferential market access arrangement.

The criteria to grant special incentive arrangement for sustainable development and good governance in the proposal of GSP regulation elaborated more details, as follows:¹⁰⁹⁸

- (a) The beneficiary country must be considered as vulnerable due to a lack of diversification and insufficient integration within the international trading system.
- (b) The beneficiary country has ratified all the conventions listed in Annex VIII and the most recent available conclusions of the relevant monitoring bodies do not identify a serious failure to effectively implement any of these conventions.
- (c) The beneficiary country gives a binding undertaking to maintain ratification of the conventions listed in Annex VIII and to ensure their effective implementation.
- (d) The beneficiary country accepts without reservation the reporting requirements imposed by each convention and gives a binding undertaking to accept regular monitoring and review of its implementation record in accordance with the provisions of the conventions listed in Annex VIII.
- (e) The beneficiary country gives a binding undertaking to participate in and cooperate with the monitoring procedure referred to in Article 13.

To obtain facilities of the special incentive of GSP+ the eligible beneficiary countries must submit a written request to the Commission by providing “*comprehensive information regarding the ratification of the conventions and the binding undertakings*”.¹⁰⁹⁹ Upon such request, the Commission will notify the European Parliament and the Council.¹¹⁰⁰ The decision of whether to grant a special incentive arrangement will be informed to the applicant country after the Commission has examined the request.¹¹⁰¹ The beneficiary country will be excluded from the list of GSP+ if it no longer fulfils the criteria or withdraws from any of its binding undertakings of the listed international conventions.¹¹⁰² In order to implement the GSP+ scheme the Commission will adopt the delegated act.¹¹⁰³

The Commission will carry out the mechanism review of GSP+ implementation by considering the report from relevant monitoring bodies.¹¹⁰⁴ In this regard, the beneficiary countries have to cooperate with the Commission by providing the necessary information related to the implementation of the listed international conventions.¹¹⁰⁵ Every two years, the Commission should present the report before the European Parliament and European Council regarding the conclusions or recommendations of any relevant international monitoring body of each GSP+ beneficiary country. The report will also contain conclusions on whether each GSP+ beneficiary country undertakes the obligation to report and to cooperate with international monitoring bodies ensuring the effective implementation of the listed international conventions.

¹⁰⁹⁸ See Articles 9 paragraph (1), Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 13.

¹⁰⁹⁹ See Articles 10 paragraph (1) and (2), Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 14.

¹¹⁰⁰ See Articles 10 paragraph (3), *Ibid.*, p. 14.

¹¹⁰¹ See Articles 10 paragraph (4), *Ibid.*, p. 14.

¹¹⁰² See Articles 10 paragraph (5), *Ibid.*, p. 14.

¹¹⁰³ See Articles 10 paragraph (6) and (8), Articles 11 paragraph (2) *Ibid.*, p. 14. The delegated act will be implemented to establish and to amend Annex III in order to add or remove a country to or from the list of GSP+ beneficiary countries; to establish rules related to the procedure for granting the special incentive arrangement for sustainable development and good governance in particular with respect to deadlines and the submission and processing of requests; to amend Annex IX to take into account amendments to the Combined Nomenclature affecting the products listed in that Annex.

¹¹⁰⁴ See Articles 13 paragraph (1), *Ibid.*, p. 15.

¹¹⁰⁵ See Articles 13 paragraph (2), *Ibid.*, p. 15.

The eligible countries of LDC's arrangement are based on the classification United Nation.¹¹⁰⁶ The Commission continuing reviews the list of the LDC's beneficiary countries.¹¹⁰⁷ The temporarily withdrawal on LDC's arrangement will be applied under condition as follows :¹¹⁰⁸

- (a) Serious and systematic violation of principles laid down in the listed conventions as condition of LDC's arrangement.
- (b) Export of goods made by prison labour.
- (c) Serious shortcomings in customs controls on the export or transit of drugs n(illicit substances or precursors), or failure to comply with international conventions on anti-terrorism and money laundering.
- (d) Serious and systematic unfair trading practices including those affecting the supply of raw materials, which have an adverse effect on the Union industry and which have not been addressed by the beneficiary country.
- (e) Serious and systematic infringement of the objectives adopted by Regional Fishery Organizations or any international arrangements of which the European Union is a member concerning the conservation and management of fishery resources.

Upon temporarily withdrawal, the Commission will monitor and evaluate the situation in the beneficiary country concerned for six months from the date of publication of the notice from the *Official Journal of the EU*.¹¹⁰⁹ With respect to the Commission's findings, the beneficiary country concerned has the right to submit its comments on the report.¹¹¹⁰

Cases of fraud, irregularities or systematic failure to comply with or to ensure compliance with the rules of origin of the products and its procedures, or failure to provide administrative cooperation will lead to the temporarily withdrawal of all or of certain products originating from the beneficiary country.¹¹¹¹ However the temporarily withdrawal will only be taken if there is sufficient evidence.¹¹¹² The period of temporarily withdrawal will only be imposed for a period not exceeding six months, thereafter, the Commission will decide whether to terminate the temporary withdrawal or to extend the period of temporary withdrawal.¹¹¹³

In the proposed GSP regulation, the general safeguard clauses are regulated by Articles 22-28. Specifically the GSP proposal also provides safeguard clauses regarding the textiles, agriculture and fisheries sectors. The general safeguard clauses will be applied when imported products entering the Union market at a certain level will cause, or threaten to cause, serious difficulties to domestic producers of like or directly competing products. In this regard, normal CCT duties on that product will be re-imposed as safeguard measures.¹¹¹⁴ Like the products under the proposed regulation defined as "*a product which is identical, i.e. alike in all respects, to the product under consideration, or, in the absence of such a product, another product which, although not alike in all respects, has*

¹¹⁰⁶ See Articles 17 paragraph (1), *Ibid.*, p. 17.

¹¹⁰⁷ See Articles 17 paragraph (2), *Ibid.*, p. 17.

¹¹⁰⁸ See Articles 19, *Ibid.*, p. 19.

¹¹⁰⁹ See Articles 19 paragraph (4) sub paragraph a dan b, Proposal for a regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, p. 19.

¹¹¹⁰ See Articles 19 paragraph (7), *Ibid.*, p. 19.

¹¹¹¹ See Articles 21 paragraph (1), *Ibid.*, p. 20.

¹¹¹² See Articles 21 paragraph (3), *Ibid.*, p. 21.

¹¹¹³ See Articles 21 paragraph (6), *Ibid.*, p. 21.

¹¹¹⁴ See Articles 22 paragraph (1), *Ibid.*, p. 22.

characteristics closely resembling those of the product under consideration.”¹¹¹⁵ The proposed regulation sets out parameters regarding how to measure the “deterioration” or “serious economic injury” that occurs and causes EU producers to suffer. There are 10 parameters that will be used by the Commission in the examination of such deterioration. The parameters that should be taken into account consist of market share, production, stocks, production capacity, bankruptcies, profitability, capacity utilisation, employment, imports, and prices.¹¹¹⁶

XVII. General overview of New GSP Regulation Regulation (EU) No. 978/2012.

XVII.a. New beneficiary countries list.

The new GSP regulation was finally published on 31 October 2012; however, the tariff preferences provided under the preferential arrangements will be applied as of 1 January 2014.¹¹¹⁷ The new GSP regulation reduces the number of beneficiaries from 176 to 89 on the grounds of enhancing efficiency and focusing more on GSP for the countries most in need. This new regulation explicitly divides the developing countries into two groups, e.g. more advanced developing countries and developing countries. The more advanced developing countries are described as high-income or upper-middle income countries and those that have successfully completed the transformation of their centralised market-to-market economies. Application of “similarly situated” criteria of beneficiary countries that are eligible for general arrangement is identified by sharing a common developing need with a similar stage of economic development. More advanced developing countries are considered as having a different stage of development and do not share the same development, trade and financial needs.¹¹¹⁸ These advanced economies have successfully diversified their exports, have more resources to manage with their economic development, and have more access integrated into international trade. The existence of more advanced developing countries that enjoy GSP is distressing competition for poorer countries, particularly regarding the exports of similar products. In fact, almost 40% of preferential exports are dominated by more advanced developing countries. In order to avoid overlaps of the preferences granted by the EU, thus, the GSP beneficiaries will be excluded from the list if they benefit from another preferential market access arrangement with the EU. In this regard, the preferences provide at least the same level of tariff preferences as the GSP scheme.¹¹¹⁹ Therefore, GSP is more focused on beneficiaries that have no other preferential arrangement to penetrate the EU market.

The beneficiary countries that are excluded from the GSP list are divided into three groups:¹¹²⁰

1. Partners that are no longer eligible for GSP consist of 33 countries and territories that already have special market access to the EU or belong to developed countries. These countries consist of *Anguilla, The Netherlands, Antilles, Antarctica, American Samoa, Aruba, Bermuda, Bouvet Island, Cocos Islands, Christmas Islands, Falkland Islands, Gibraltar, Greenland, South Georgia*

¹¹¹⁵ See Articles 22 paragraph (2), *Ibid.*, p. 22.

¹¹¹⁶ See Articles 23, *Ibid.*, p. 23.

¹¹¹⁷ Article 43 paragraph 2 of the Regulation (EU) No. 978/2012.

¹¹¹⁸ Recitals 9 of the Regulation (EU) No. 978/2012.

¹¹¹⁹ The EU's new Generalised Scheme of Preferences (GSP), The European Commission, October 2012, available at : http://trade.ec.europa.eu/doclib/docs/2012/october/tradoc_150028.pdf, last accessed : 12 November 2012, p. 3.

¹¹²⁰ Regulation (EU) No 978/2012. The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 18. Highlights of the EU's New General Scheme of Preferences (GSP), The European Commission.

and South Sandwich Islands, Guam, Heard Island and McDonald Islands, British Indian Ocean Territory, Cayman Islands, Northern Mariana Islands, Montserrat, New Caledonia, Norfolk Island, French Polynesia, St Pierre and Miquelon, Pitcairn, Saint Helena, Turks and Caicos Islands, French Southern Territories, Tokelau, United States Minor Outlying Islands, Virgin Islands – British, Virgin Islands- US, Wallis and Futuna, Mayotte.

2. There are 34 partners that no longer benefit from GSP because they have been granted preferences through other channels, such as bilateral agreements, autonomous arrangements, and no longer benefit from GSP.

Euromed (6)	:	Algeria, Egypt, Jordan, Lebanon, Morocco, Tunisia.
Cariforum (14)	:	Belize, St Kitts and Nevis, Bahamas, Dominican Republic, Antigua and Barbuda, Dominica, Jamaica, Saint Lucia, Saint-Vincent and the Grenadines, Barbados, Trinidad and Tobago, Grenada, Guyana, Surinam.
EPAs Market Access Regulation (8)	:	Côte d'Ivoire, Ghana, Cameroon, Kenya, Namibia, Botswana, Swaziland, Fiji.
Eastern and Southern Africa (3)	:	Seychelles, Mauritius, Zimbabwe
Pacific (1)	:	Papua New Guinea
Other (2)	:	Mexico, South Africa.

3. At least 20 partners that are classified as high income and upper middle-income countries by the World Bank are excluded from the new GSP beneficiary list. High income countries and territories excluded from the EU GSP beneficiary list consist of 8 partners (7 countries and 1 territory), i.e., Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates, Oman, Brunei Darussalam, and Macao. While, the upper-middle countries consist of 12 partners, that is, Argentina, Brazil, Cuba, Uruguay, Venezuela, Belarus, Russia, Kazakhstan, Gabon, Libya, Malaysia, and Palau.

Yet, the new GSP regulation provides the possibility to re-introduce these more advanced developing countries into the GSP beneficiary list due to some requirements. It is stipulated that the development, trade and financial needs are subject to change and it is ensured that the arrangement remains open if the situation of a country changes.¹¹²¹ In this regard, if the country situation changes (if it is no longer classified as a high- or middle-upper income country) it will be included as a GSP beneficiary country.¹¹²² Therefore these groups of countries are included into Annex I concerning eligible countries into the scheme. In this regard, the re-introduction of these countries into the GSP list is regulated by Article 3 of Regulation (EU) No 978/2012.

There are 89 beneficiaries that are considered as the most in need countries in the new GSP regulation, which consist of 49 LDCs and 40 of these countries are classified as low income and lower middle-income countries by the World Bank. LDCs are granted EBA arrangement and developing countries are classified by the World Bank as low income and lower middle-income countries eligible for general arrangement and GSP+. The tariff preferences of Myanmar, one of the LDCs of the ASEAN member states, are being

¹¹²¹ Recitals 9 of the Regulation (EU) No. 978/2012.

¹¹²² The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 6.

temporarily withdrawn in the new GSP regulation due to serious and systematic violations of principles of core international labour conventions.¹¹²³ Until the new GSP regulation is published, the European Parliament and Council are still considering the Commission's proposal to reinstate this country into the EBA scheme.¹¹²⁴ The list of beneficiary countries of the general arrangement is set out in Annex II of the new GSP regulation. While, Annex IV of the new GSP regulation contains the list of beneficiary countries for the EBA arrangement. For the GSP+, the beneficiary countries who fulfil the eligibility criteria can apply to obtain additional benefit of such arrangement. The beneficiary countries listed in the current GSP+ must re-apply to obtain special incentives under the new GSP regulation.¹¹²⁵

XVII.b. Features of the preferential facilities under the new GSP regulation.

GSP provides exports facilities for its beneficiary countries through duty reduction, zero duty (GSP+), and full duty free and quota free (EBA).¹¹²⁶ The general arrangement is regulated under Chapter II (Articles 4-8) of the new GSP regulation. The eligibility criteria of the general arrangement are regulated under Article 4 of the regulation. Article 5 regulates the removal of the beneficiary countries from the general arrangement. The preference facilities of the general arrangement are regulated under Article 7. This facility provides CCT tariffs suspension for non-sensitive products, except for agricultural components. While sensitive products will be entitled to CCT *ad valorem* duties with 3.5% reduction, except for clothes and textiles (Section 11-a and 11-b of Annex V). With regard to the CCT, specific duties, other than minimum or maximum duties, on sensitive products will be reduced by 30%. In the case of CCT duties on sensitive products that include *ad valorem* duties and specific duties, the specific duties must not be reduced. Article 8 regulates section graduation of export products of GSP beneficiaries based on the threshold standard. Further, the threshold for section graduation is calculated based on the percentage of the total value of Union imports of the same products from all GSP beneficiary countries. As stipulated in the Annex VI of the new GSP regulation the section graduation threshold will be increased from 15% to 17.5%, especially for textile products it will be raised from 12.5% to 14.5%.

GSP+ on the special incentive arrangement for sustainable development and good governance is regulated in Chapter III (Articles 9-16) of the new GSP regulation. Section graduation will no longer be applied in the GSP+ of the new regulation. Beneficiary countries that fulfil the requirements of GSP+ may submit their formal written applications to the Commission. In the new GSP+, the application can be submitted at any time, while under the current regulation the application is submitted every 1.5 years. The new GSP regulation has maintained the number of core conventions that are similar with the current regulation.¹¹²⁷ The requirements to apply the GSP+ facility are regulated by Article 9 of the new GSP regulation. While, Article 10 regulates conditions to grant GSP+ tariff preferences. Annex IX contains products that grant the special incentive arrangement for

¹¹²³ Recitals 25 of the Regulation (EU) No. 978/2012.

¹¹²⁴ The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 19.

¹¹²⁵ Recitals 13 of the Regulation (EU) No. 978/2012.

¹¹²⁶ See Article 1 paragraph 2 of the Regulation (EU) No 978/2012. The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 2.

¹¹²⁷ Recitals 13 of the Regulation (EU) No. 978/2012. The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 8.

sustainable development and good governance.¹¹²⁸ Under the GSP+, beneficiary countries receive tariff suspension on CCT *ad valorem* duties and CCT specific duties (except for products for which the CCT duties include *ad valorem* duties).¹¹²⁹

The GSP+ scheme in the new regulation improves the monitoring mechanism to ensure the effective implementation of the principles and rights of the respective international conventions.¹¹³⁰ This monitoring is carried out by the Commission with scrutiny by the Council and the European Parliament. Monitoring will be performed every 2 years.¹¹³¹ The beneficiary countries of GSP+ have to cooperate fully with international monitoring bodies without reservation.¹¹³² To maintain the objectivity of monitoring or to withdraw processes, supplemented information from other sources would be included.¹¹³³ Temporarily withdrawal of the GSP+ is regulated under Article 15 of the new regulation.

Special arrangement for the LDCs (EBA) is regulated in Chapter IV (Articles 17-18). The EBA arrangement is maintained under the new GSP regulation as an open-ended scheme. The EBA provides facilities duty free, and quota free for all products to get access into the EU market, with the exception of arms and ammunition. The reduction of the number of GSP beneficiaries is expected to be able to enhance export opportunities for LDCs.¹¹³⁴

XVII.c. Comitology on the new GSP regulation.

A powerful institutional reason to change the instrument is the entry into force of the Lisbon Treaty. This requires the redesigning of the GSP Regulation to reflect the new institutional environment, with the reinforced role of the European Parliament in trade policy.¹¹³⁵

Regulation (EU) No. 978/2012 adopts the new institutional framework of the Treaty of Lisbon, which enhances the role of the European Parliament in trade policy. The new EU GSP scheme is a dynamic instrument equipped with some features to control the implementation of the regulation, such as the graduation mechanism, product coverage, change in the list of GSP+ beneficiary countries, safeguard mechanism, and temporary withdrawals. Successful GSP utilisation by beneficiary countries will be assessed periodically by the Commission. The assessment results may affect graduation of beneficiaries or temporary withdrawal and all other elements of the regulation, especially the annexes of the regulation. Therefore, the Commission is conferred power through delegated acts rather than ordinary legislative procedures to improve efficiency and to save time.

¹¹²⁸ Article 11 of the Regulation (EU) No. 978/2012. Annex IX — List of products included in the special incentive arrangement for sustainable development and good government.

¹¹²⁹ Recitals 12 and Article 12 of the Regulation (EU) No. 978/2012.

¹¹³⁰ Article 13 paragraph 1 of the Regulation (EU) No. 978/2012.

¹¹³¹ See Recital 14 of the Regulation (EU) No. 978/2012:

“[...] every two years, the Commission should present to the European Parliament and the Council a report on the status of ratification of the respective conventions, the compliance of the beneficiary countries with any reporting obligations under those conventions, and the status of the implementation of the conventions in practice [...]”

¹¹³² Article 13 paragraph 2 of the Regulation (EU) No. 978/2012. See also Article 9 paragraph 1 (e) of the Regulation No. 978/2012 :

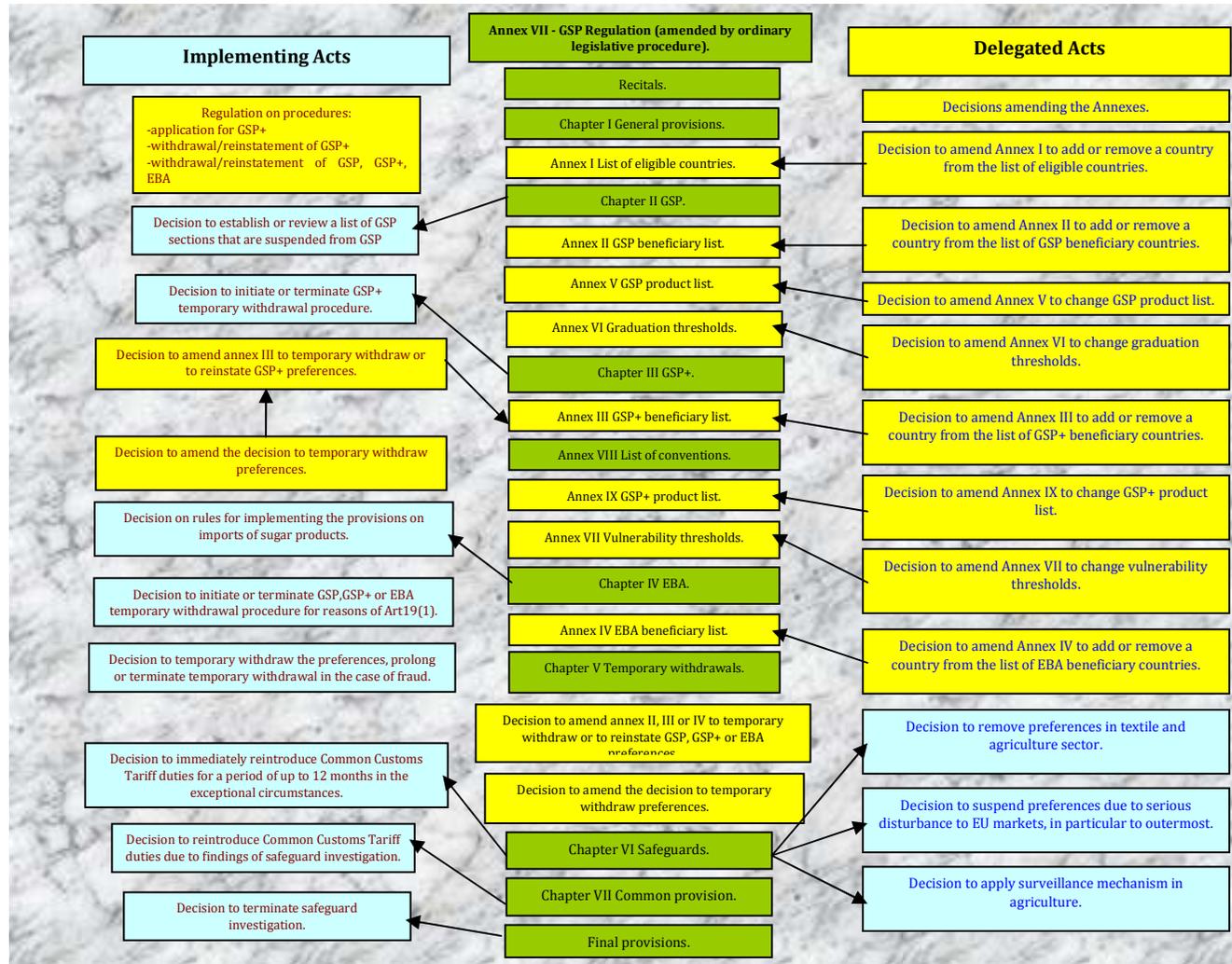
“[...] it accepts without reservation the reporting requirements imposed by each convention and gives a binding undertaking to accept regular monitoring and review of its implementation record in accordance with the provisions of the relevant conventions [...]”

¹¹³³ See Recital 15 of the Regulation (EU) No. 978/2012:

¹¹³⁴ The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 9.

¹¹³⁵ The EU's new Generalised Scheme of Preferences (GSP), The European Commission, 2012, *Op. Cit.*, p. 2.

Figure 50. The Comitology Procedures in the New GSP Regulation.



These new features of the institutional framework are needed to deliver speedy decisions, which are more business friendly due to the predictable and stable principles of the scheme guaranteed. Following the basic GSP regulation the EU will issue some legal acts, which include the list of graduated sectors, procedures regarding GSP+ entry, withdrawals and safeguards, and adjustment of the GSP beneficiary due to the graduation mechanism.¹¹³⁶

The implementation mechanism of the delegated acts in the new GSP regulation is regulated under Articles 36 and 27. Delegated acts would be implemented in thirteen articles of the new GSP regulation, i.e. Articles 3, 5, 6, 8, 9, 10, 11, 15, 16, 17, 19, 20 and 22.¹¹³⁷ However, the delegation power may be revoked at any time by the European Parliament or by the Council.¹¹³⁸ Delegated acts enter into force only if no objection has been expressed by either the European Parliament or the Council within a period of two months of notification of that act to the European Parliament and the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object.¹¹³⁹ To ensure uniform conditions for the implementation of the new GSP regulation the Commission is attributed with implementing powers in accordance with Regulation (EU) No. 182/2011.¹¹⁴⁰ The new GSP regulation has adopted the new features of Comitology in the Article 39 and is elaborated as follows:

“[...] The advisory procedure should be used for the adoption of implementing acts on suspension from the tariff preferences of certain GSP sections in respect of beneficiary countries and on the initiation of a temporary withdrawal procedure, taking into account the nature and impact of those acts [...]”.¹¹⁴¹

“[...] The examination procedure should be used for the adoption of implementing acts on safeguard investigations and on suspension of the preferential arrangements where imports may cause serious disturbance to Union markets [...]”.¹¹⁴²

“[...] In order to ensure the integrity and orderly functioning of the scheme, the Commission should adopt immediately applicable implementing acts where, in duly justified cases relating to temporary withdrawals due to non-compliance with customs-related procedures and obligations, imperative grounds of urgency so require [...]”.¹¹⁴³

Overall, the preferences scheme in the new GSP regulation is not very different, yet, it enhances some of its modalities due to the change in the institutional framework of the Treaty of Lisbon.

¹¹³⁶ Recitals 26 of the Regulation (EU) No. 978/2012 :

“[...]the power to adopt acts in accordance with Article 290 TFEU should be delegated to the Commission in respect of amendments to the Annexes to this Regulation and temporary withdrawals of tariff preferences due to failure to adhere to the principles of sustainable development and good governance, as well as procedural rules regarding the submission of applications for the tariff preferences granted under the special incentive arrangement for sustainable development and good governance, the conduct of a temporary withdrawal and safeguard investigations in order to establish uniform and detailed technical arrangements [...]”.

¹¹³⁷ Article 36 paragraph 2 of the Regulation (EU) No. 978/2012.

¹¹³⁸ Article 36 paragraph 3 of the Regulation (EU) No. 978/2012.

¹¹³⁹ Article 36 paragraph 5 of the Regulation (EU) No. 978/2012.

¹¹⁴⁰ See Recitals 28 of the Regulation (EU) No. 978/2012.

¹¹⁴¹ See Recitals 29 of the Regulation (EU) No. 978/2012.

¹¹⁴² See Recitals 30 of the Regulation (EU) No. 978/2012.

¹¹⁴³ See Recitals 31 of the Regulation (EU) No. 978/2012.

Chapter IV

The role of EU Generalised System of Preferences to discover trade relationships between ASEAN-EU

The EU's Generalised System of Preferences is commonly recognised as having been the only trade preferences system operating among the European Union and ASEAN member states for 40 years. As such, it seems that Southeast Asian countries have been placed at a low-priority level within the framework of EU foreign trade policies. Such circumstances were influenced by the political and economic context, due to the regional dominant power of the US and Japan in the Southeast Asian market. The establishment of AFTA and membership enlargement has increased ASEAN bargaining power in international trade. Due to the various levels of economic developments, ASEAN member states are granted different arrangements in the EU GSP scheme. Most ASEAN member states are able to utilise EU GSP at a utilisation rate of up to 75%. In the end of 2012, the EU issued a new GSP basic regulation, which is intended to be in effect by January 2014. There are some crucial changes in the new regulation in order to improve the GSP scheme, compared with the previous one. First, the application of an open-ended system review, replacing the annual review, is aimed to develop a more stable and predictable GSP scheme. Second, GSP would be given based on the considerations of the country most in need. Consequently, based on such policy, the EU would cut down the number of beneficiary countries from the current 176 to 89 countries. Such reduction has the purpose of increasing the efficiency of GSP utilisation.

I. ASEAN: The long road to becoming an economic community.

The history of Southeast Asia in international trade can be traced back to the 5th century AD when the Strait of Malacca started to become one of the major international sea-lanes that connected the India Ocean and the Southeast coast of Sumatra. The earlier role of the Strait of Malacca was the major channel to expand networks of long distance trade between India, China, and Southeast Asia.¹ Southeast Asia has a strategic geographic position² as the main road of world trade, which has significant advantages to the economic development of the region. After the arrival of European traders in Asia, the Strait of Malacca was monopolised under the era of colonisation.³

¹ See Leifer, Michael, *International Straits of the World : Malacca Singapore and Indonesia*, Edited by Mangone, Gerard J., Volume II, Sijthoff & Noordhof International Publisher BV Alphen aan den Rijn, The Netherlands, 1978, p. 6.

² “[...] For instance the existences of Malacca Strait which located between the Malaysia Peninsula and the Indonesia island of Sumatra is deemed as the most important maritime passage in the world, especially for commercial shipping. Malacca strait is the main shipping channel between the Indian Ocean and the Pacific Ocean, linking major Asian economies such as India, China, Japan and South Korea. The 900-km long (550 miles) Malacca Strait is vital channel of Asia with the Middle East, Africa and Europe, carrying about 40 percent of the world's trade. More than 50,000 merchant ships ply the waterway every year. Since the 1950's the straits have become of vital importance to the carriage of ever increasing amounts of fuel oil between the Persian Gulf and Japan in tankers known as Very large Crude Carriers (VLCCs). Indeed, more than eighty percent of Japan's oil supply was conveyed in such tankers in 1977 and a considerable portion of them passed through the Strait of Malacca and Singapore. Oil also been shipped through the straits from the East Sumatra terminals of Dumai and Sungai Pakning [...]”. (See Leifer, Michael, *Op. Cit.*, p. 52. See also *Malacca Strait is a strategic 'chokepoint'*, available at : <http://in.reuters.com/article/2010/03/04/idINIndia-46652220100304>, last accessed : 14 October 2011.)

³ “[...] The conquest of Malacca, in 1641, had given the VOC (the Verenigde Oostindische Compagnie) a great advantage. Dutch East Indiamen could safely use the strait, and thus Malacca became rendezvous in the network of the Company Shipping. The conquest had made the Dutch a powerful nation in the region, but they were by no means the only influential nations, and their hopes of monopolizing the Malayan tin trade were never fulfilled. Instead of monopolization and exclusion of foreign trade, the VOC could try to develop Malacca as a centre for Asian trade for Indian merchants or even for Dutch free traders. Dutch applied duties and customs system in Malacca strait was complex. VOC has absolute monopoly, for instance imports of tin and pepper were exempt from duty, but these products had to be sold exclusively to the VOC. Import of gold and silver were taxed at 10%

Due to its important role in international trade, from the 17th to 18th century, the Strait of Malacca was a rivalry object between Britain and the Netherlands. Leifer notes that in the dynamics of contemporary international relations of the region of Southeast Asia, the strait has become an important issue for the great maritime powers. The US and USSR are competed in the economic and politic sector to infuse their influence on Southeast Asia. In addition, Japan and Korea also have interests in the Strait of Malacca. East Asian countries import oil from the Middle East through the Strait of Malacca. The Strait of Malacca is the route of international commerce for many countries in the world.⁴

Due to its strategic location, many traders from all over the world have crossed the Southeast Asia region. According to Lim, it has formed ethnic diversity as traders have migrated and settled across the region.⁵ Colonisation in Southeast Asia has continued the legacy of internationalisation by linking conquered land with its conqueror country. Most Southeast Asian countries were colonised by European powers, for instance Myanmar, Malaysia, Singapore and Brunei by Britain; Vietnam, Laos and Cambodia by France; Indonesia by the Netherlands; the Philippines by Spain and then the US. Independence came to some by the late 1940s (Indonesia, the Philippines, and Myanmar) and to most of the other countries by the 1950s (Cambodia, Laos, Malaysia, and Singapore). The last was Brunei Darussalam that finally got its independence in 1984.⁶

In the early postcolonial era, Southeast Asia was surrounded by internal conflicts, civil wars, and territorial disputes between countries. This raised political tension in the region. Communism spread largely in Indochina, such as Cambodia, Laos and Vietnam. The communist system was seen as an ideological threat to other Southeast Asian countries that had developed the market economic model backed by the US.⁷ The US had the important role of re-shaping economic development in Southeast Asia after the Second World War. The key interest of the US was to restrain communism from spreading across Southeast Asia. It was fully committed through “*high levels of aid and military spending*”. This included the establishment of an open international economy with rapid growth and trade expansion.⁸

In the Cold War era, the US and USSR were in competition regarding taking control of Southeast Asia. In the mid-1950s, the USSR provided aid to Southeast Asia. At the same time, the US also started to distribute regular economic and military assistance missions to the region. For instance, in order to prevent communism from

of the value, but were free in case of delivery to the company. Ships under European flag were asked to call at Malacca, but if the masters of these ships, despite urgent requests, refused to do so, then they could sail unmolested. Portuguese merchants were obliged to pay a toll for their passage, while Spaniards were not allowed to pass at all. Asian ships were forced to go to Malacca for control the passes but if Asian merchants did not want to carry on any trade at Malacca, they could sail through the strait without making any payment [...]”. (Gaastra, Femme S., *Competition or collaboration? Relations between the Dutch East India Company and Indian Merchants around 1680*: Chaudhury, Sushil, and Morineau, Michel, *Studies in Modern Capitalism : Merchants Companies and Trade (Europe and Asia in the Early Modern Era*, Cambridge University Press, UK, 1999, p. 195-197)

⁴ See Leifer, Michael, 1978, *Op. Cit.*, p. VIII.

⁵ In the past Malacca strait was passed by traders from Arabia, Africa, Persia, and Southern Indian for trading with Chinese. Such trading environment has brought so much influenced to the Southeast Asia especially on the politic, economic, culture and religion, which colorized the landscape of the regions until today.

⁶ See Lim (1995); M. Dent, Christopher., *The European Union and East Asia : An Economic Relationships*, Routledge, Taylor & Francis Group, London and New York, 2002, p. 37.

⁷ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 37.

⁸ See Bowie, Alasdair., and Unger, Danny., *The Politics of Open Economies : Indonesia, Malaysia, the Philippines, and Thailand*, The Press Syndicate of The University of Cambridge, Cambridge University Press, United Kingdom, 2002, p. 25.

spreading in Indochina, by 1954 the US had increased its aid to 800 million US dollars, mainly in the form of military supplies.⁹ Unfortunately, the majority of US aid and institutional effort towards Southeast Asia focused on “security institutions”, such as the Southeast Asia Treaty Organization. In fact, the US was not so eager to encourage the establishment of “*regional economic institutions*”, which were by far the most needed by Southeast Asian countries to promote regional cooperation in economic development, such as boosting regional intra- and extra-trade, reducing transaction costs, improving technology transfers and increasing infrastructure development.¹⁰

In order to secure US economic and security interest through open development policies, the US campaigned the doctrine of economic liberalism. This doctrine directly influenced decision-makers in developing countries and the US backed them up through the provision of capital, technology and managerial skills, and access to the US market.¹¹ After the US defeated Japan in the Second World War it became known as the “regional dominant power”. Its control was directly linked to Southeast Asia's markets and raw materials. The US also played a key role in the nurturing of the international economic institutions that facilitated the expansion of an open international economy. According to Bowie and Unger, “*the economic choices of Southeast Asian decision-makers was supposed to be seen, in the first instance, as responses to the security concerns and geopolitical considerations of the United States and their regional consequences*”.¹²

In the 1960s, territorial disputes rose into critical situation due to the confrontation between Malaysia, the Philippines, and Indonesia. Followed Singapore separation from the Malaysian Federation in August 1965. ASEAN established initially is to prevent the wider spread of communism within Southeast Asia. In other words, ASEAN used as a septum to divide Southeast Asia based on ideology. At the beginning of its establishment ASEAN used to maintain political stability in the south east asian region.¹³

The ASEAN Chapter was signed on August 8, 1967, in Bangkok. US as the dominant regional power in the region, welcomed ASEAN establishment. Japan with ambivalence attitudes gradually supporting the establishment ASEAN.¹⁴ In 1977, Japanese officials attended the first meeting of the ASEAN-Japan forum, at the same year, Prime Minister Fukuda attended the ASEAN Summit in Kuala Lumpur.¹⁵ Japan established some programs to foster ASEAN economic development, these includes, providing \$ 1 billion USD in loans for ASEAN regional projects, driving ASEAN export earning, and re-examine its tariff policies conformed with Tokyo Round negotiation.¹⁶ ASEAN develops without any direct participation from Japan or the United States.¹⁷

ASEAN have five initial member states consists of Indonesia, Malaysia, Philippines, Singapore, and Thailand, but along with its development some Southeast Asia countries are joining into the membership. Brunei Darussalam is the sixth member

⁹ See Amry Vandenbosch and Richard Butwell, *The Changing Face of Southeast Asia*, Lexington: University Press of Kentucky, 1966, pp. 368-369; Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 30.

¹⁰ See Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, pp. 31-32.

¹¹ See *Ibid.*, p. 26.

¹² See Richard Stubbs, *Geopolitics and the Political Economy of Southeast Asia*, International Journal 44 (1989), pp. 519-520; Bowie, Alasdair., and Unger, Danny., 2002, *Loc. Cit.*, p. 26.

¹³ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 37.

¹⁴ See Masahide Shibusawa, *Japan and the Asian Pacific Region*, New York: St. Martin's Press, 1984, pp. 101-3; Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 32.

¹⁵ See *Ibid.*, pp. 104; *Ibid.*, p. 32.

¹⁶ See Sueo Sudo, “*The Road to Becoming a Regional Leader: Japanese Attempts in Southeast Asia, 1975-1980*,” *Pacific Affairs* 61 (1988), 27-5; Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 32.

¹⁷ See Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 32.

states, joined on 8 January, 1984. Followed by Vietnam joined on 28 July, 1995, Laos and Myanmar joined on 23 July, 1997, and Cambodia joined on April 30, 1999. ASEAN main purpose is promoting intra-regional trade by reducing tariffs between member states. In the 1960s and early 1970s, the share of intra-ASEAN trade in the total trade value of its member states was between 12% and 15%.¹⁸

Facing globalization, many regions are integrating their economy into regional organization, such as PTA and FTA. In Cold War era, regional organization is designed to create and to keep politic stability and security of the region. Regionalism is developed to have a better bargaining position with other regional group such as the EU, NAFTA and East Asian countries. As regional organisation ASEAN has two main objectives, i.e., :

1. to accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian nations, and
2. to promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter.

According to Bangkok Declaration ASEAN is represented the collective will of the Southeast Asia nations to bind themselves together in friendship and cooperation, and through joint efforts and sacrifices to secure the blessings of peace, freedom, and prosperity for their peoples and their posterity.¹⁹

ASEAN never intended used as an instrument of integration with supranational authority. ASEAN used as an instrument to manage intra-regional conflicts, and to maintain and to strengthen national sovereignty.²⁰ *Raison d'être* of ASEAN is explicitly stated in the founding declaration, that is "[...] to ensure their stability and security from external interference . . . in order to preserve their national identities [...]". This explains why from the very beginning ASEAN choose the model of "state-to-state cooperation where diplomacy used as the main instrument". For that reason, regional economic integration is not mentioned as ASEAN objective in the founding declaration.²¹ In this regard, Aekaputra stated that Bangkok Declaration "[...] is simply a political instrument that designed to show the political good intention of the signatory states to cooperate more closely with one another mainly in the fields of economic, political and social cooperation [...]".²²

ASEAN early economic development based on "export-oriented principal". It started in the mid-1960s, when Singapore's implemented "export-oriented industrialisation (EOI)" and it had demonstrated positive development. Singapore gained successful in implementing EOI, which making them becomes the role model for other ASEAN member states. In the late 1960s, Malaysia, Thailand and Philippines are following by implementing EOI strategy. While, Indonesia started to implement EOI in the early 1980s. At that time, USA is a prime export market for the ASEAN member states, and Japan served as an essential source of imports.²³

¹⁸ See <http://www.aseansec.org>. See also Welfens, Paul J.J., Ryan, Cillian., Chirathivat, Suthipand., and Knipping, Franz., *EU-ASEAN : Facing Economic Globalisation*, Springer-Verlag, Berlin, Heidelberg, 2009, pp. 76-77.

¹⁹ See Welfens, Paul J.J., et.al., 2009, *Op. Cit.*, p. 137.

²⁰ See Balme, Richard., and Bridges, Brian., *Europe – Asia Relations : Building Multilateralism*, Palgrave Macmillan, New York, 2008, p. 84.

²¹ See *Ibid.*, p. 91.

²² See Herrmann, Christoph., and Terhechte, Jorg Philipp., *European Yearbook of 2011*, Springer Heidelberg Dordrecht London New York, 2011, p. 376.

²³ See Ariff and Hill 1985; M. Dent, Christopher., 2002, *Op. Cit.*, p. 38.

During the first two decades following its establishment in 1967, development of ASEAN as a regional organisation was considered to be very slow. Few “concrete integrative efforts” were performed and only limited economic cooperation was noted among the ASEAN states. According to Balme and Brian, in order to expand the market and invite foreign investment, ASEAN started to open up to international economic cooperation, for instance with the EU. ASEAN market access expansions increased export revenues and rapidly stimulated economic growth. In the late 1980s, the ASEAN socioeconomic landscape changed. Significant improvement in interdependency factors between ASEAN member states encouraged the establishment of closer economic cooperation. In 1992, the path of closer economic integration was embodied through the establishment of the ASEAN Free Trade Agreement (AFTA). The AFTA was considered as a milestone in the perception of shifting economic development from a national to a regional approach.²⁴

According to Nischalke, the model of ASEAN integration is “particularly ASEAN”, also known as the “ASEAN Way”. Model integration of the ASEAN Way is based on respect for sovereignty and non-interference in internal affairs, peaceful resolution of conflicts, and non-use of force. The ASEAN Way is a way to describe integration in ASEAN and to distinguish it from EU integration. Since two mechanisms exist in EU integration, consisting of intergovernmentalism and supranationalism. Supranationalism or the executive in the organisational level does not exist in ASEAN, such as the EU Commission. There is no delegation of power establishing laws and regulations to one specific body in ASEAN. As previously mentioned, ASEAN was never designed as an instrument of integration with a supranational authority.

According to Tay and Estanislao, there is no need for ASEAN to establish a supranational authority similar to the EU Commission, but what it needs is to develop “[...] sufficient authority to regional mechanisms and institutions to enable it to review and coordinate between the different countries [...]”.²⁵ ASEAN consists of various, large ethnic groups, languages and cultures. However, such characteristic has been identified as having a two sided effect that can be taken as an advantage and a challenge to strengthen integration. Even though the ASEAN group consists of a diverse collection of nation states²⁶, there are also noteworthy similarities within the members’ assemblage.²⁷

A unique feature of the ASEAN Way is the adoption of the Southeast Asian society’s local wisdom of elements and customary norms in organisational practice. Such feature is reflected through “privilege informalism and non-confrontational behaviour” that are implemented within the concept of *musyawarah* (consultation) and *mufakat* (consensus).²⁸ However, features of informality, flexibility, and pragmatism of ASEAN are considered as a weakness to go further for deeper integration. For instance, the ASEAN Way has failed to handle the economic crisis that hit Southeast Asia in 1997 and it has drowned some ASEAN member states in prolonged and severe economic crisis. The crisis has challenged the norms and procedures of regional cooperation. Thus, it leads to the serious re-thinking of institutionalisation and the development of

²⁴ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 91.

²⁵ See Tay and Estanislao, 2001, p. 19; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 92.

²⁶ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 37.

²⁷ For instance Singapore and Brunei are both rich ‘microstates’ which more techno-industrial base compares to other member states. Most members are resource-rich with many being oil and gas producers since the late 1970s (Brunei, Malaysia, Indonesia, Thailand).

²⁸ See Nischalke, 2000, *Op. Cit.*, p. 90-93; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 91.

new regional mechanisms to go for further integration development.²⁹ Therefore, after the Asian financial crisis, ASEAN started to look to the EU experience on integration.³⁰ According to Tay and Estanislao, “[...] the long-standing EU–ASEAN relations did not contribute directly to a policy shift in approaches to regional cooperation by the ASEAN countries, EU provides itself if not as a model, at least as a subject for study and for lessons-drawing [...]”. The example of the adoption of EU norms and organisational works to ASEAN strengthens the ASEAN Secretariat.³¹

The EU’s concrete contribution to encourage the strengthening of the institutional capacity of the ASEAN Secretariat was given through aid and assistance in the “*ASEAN Programme for Regional Integration Support (APRIS)*”. In the Regional Indicative Programme for ASEAN, the Commission stated that APRIS addressed the need for closer economic integration between ASEAN countries after the Asian financial crisis struck.³² APRIS gives facilitation to the ASEAN Secretariat to obtain flexible and responsive technical assistance from the EU. It includes the know-how and shared-experience on aspects of regional cooperation that are relevant to ASEAN’s integration, primarily focusing on strategic planning.³³ For instance, the delivery of policy papers, work programmes, institutional capacity building, and training.³⁴ It cannot be denied that the ASEAN-EU relationship has significantly influenced the evolution of ASEAN integration.³⁵

Back to the earlier development of ASEAN, according to Welfens et al., the share of intra-ASEAN trade from the total trade of member states amounts to 12% to 15%. This indicates that trade among the ASEAN member states in its earliest era was not so significant. Initially, ASEAN economic cooperation schemes focused on the increase of intra trade.³⁶ In 1977, ASEAN introduced the first Preferential Trading Agreement (PTA)³⁷ that contractually accorded tariff preferences in the form of tariff reductions for trade among ASEAN economies. After ten years, at the 3rd ASEAN Summit in Manila, the enhancement of the PTA Programme was adopted to increase intra-ASEAN trade.³⁸ During the 4th ASEAN Summit in Singapore, two Agreements were signed, i.e., the Agreement on the Common Effective Preferential Tariff Scheme (CEPTS) for the ASEAN Free Trade Area and Framework Agreements on Enhancing ASEAN Economic Cooperation.³⁹

In 2005, in order to cope with international economic competition, ASEAN established AFTA based on the CEPTS agreement. In 2003, almost 95% of manufactured goods and services had been included in AFTA.⁴⁰ In the investment sector, the ASEAN Investment Area (AIA) was established in order to induce more Foreign Direct Investment (FDI) into the region.⁴¹ To support traders or business actors in how to solve problems related to trade and investment, the ASEAN Consultation to Solve Trade and Investment Issues (ACT) was established. The

²⁹ See *Ibid.*, p. 90-93; *Ibid.*, p. 91.

³⁰ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 91-92.

³¹ See Tay and Estanislao, 2001, p. 19; Balme, Richard., and Bridges, Brian., 2008, *Loc. Cit.*, p. 92.

³² See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 92.

³³ See *Ibid.*, p. 92.

³⁴ See *Ibid.*, p. 92.

³⁵ See *Ibid.*, pp. 92-93.

³⁶ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 137.

³⁷ See ASEAN Preferential Trading Arrangements signed in Manila on 24 February 1977.

³⁸ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 137.

³⁹ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, pp. 76-77. See also Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 86.

⁴⁰ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 48.

⁴¹ See *Ibid.*, p. 48.

objective of ACT is to support the creation of a business friendly environment in ASEAN. Through ACT, traders and business actors have the opportunity, within the long bureaucracy chain, to get speedy settlements regarding cross border operational problems related to the implementation of ASEAN agreements, especially in trade and investment. The legal basis of the establishment of ACT is the Bali Concord II Declaration and the recommendations of the High Level Task Force. ACT is an ICT based service that provides online problem solving for business actors. The problem settlements of ACT are considered as a non-legal and non-binding mechanism. Business actors or traders who have encountered operational problems related to a given member state's implementation of the ASEAN agreement are invited to highlight such problems through the ACT.⁴²

According to Welfens et Al., ASEAN-EU economic cooperation has produced a positive effect marked by significant improvement in trade volumes and investment grades in both regions. Further new areas of cooperation need to be explored in order to strengthen the relationship between ASEAN and EU. The establishment of AFTA and AIA aims to provide a secure and conducive environment for EU direct investments.⁴³

The CEPTS⁴⁴ contains removal of tariff and non-tariff barriers between member states in order to promote greater economic efficiency, productivity, and competitiveness. AFTA has the strategic objective to increase the ASEAN region's competitive advantage as a single production unit. Therefore, the final goal of AFTA is to improve the competitiveness of ASEAN goods and products. It has been noted that three years after the launch of AFTA, the share of intra-regional trade in ASEAN's total trade volume rose from 20% to 25%.⁴⁵

In 1993, the exports among ASEAN countries increased from \$43.26 billion USD to \$80 billion USD. In 1996, ASEAN average annual growth is 28.3%.⁴⁶ The CEPTS agreement identified as a factor in lowering intra-regional tariffs. In 2003, ASEAN adopted the *Protocol to Amend the CEPT-AFTA Agreement for the Elimination of Import Duties* to encourage closer integration and realizing ASEAN Economic Community (AEC). This Protocol contains the commitment of ASEAN-6 to eliminate tariffs on 60% of their products that listed in the *CEPT Inclusion List (IL)*.

"[...] more than 99% of the products in the *CEPT Inclusion List* of ASEAN-6 had been brought down to the 0-5% tariff range. The average tariff for ASEAN-6 under the CEPT Scheme was cut from 12.76% in 1993 to its current level of 1.51%. ASEAN's newer members or ASEAN-4, consists of Cambodia, Laos, Myanmar and Vietnam, are not far behind in the implementation of their *CEPT* commitments. Almost 80% of their products are included in their respective *CEPT IL*. Of these items, about 66% already have tariffs within the 0-5% band. Vietnam is expected to bring down tariffs on products in the IL to no more than 5% duties by 2006, while Laos and Myanmar are to follow in 2008 and Cambodia in 2010 [...]"⁴⁷

In 1995, the 5th ASEAN Summit held in Bangkok adopted the *Agenda for Greater Economic Integration*, which included acceleration timetable for the launch of AFTA

⁴² See ASEAN Consultation to Solve Trade and Investment Issues (ACT), available at : <https://act.aseansec.org/act/login/about.do>, last accessed : 16 January 2012.

⁴³ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, pp. 48-49.

⁴⁴ "[...] CEPT means the Common Effective Preferential Tariff, and it is an agreed effective tariff, preferential to ASEAN, to be applied to goods originating from ASEAN Member States, and which have been identified for inclusion in the CEPT Scheme [...]". See Article 1 of the Agreement on the CEPTS for the AFTA, available at : <http://www.asean.org/12375.htm>, last accessed : 14 October 2011.

⁴⁵ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 86.

⁴⁶ See *Ibid.*, p. 138.

⁴⁷ See *Ibid.*, pp. 77-78.

from a 15 years timeframe into 10 years. In 1997, the ASEAN leaders have adopted the ASEAN Vision 2020 that called for ASEAN *Partnership in dynamic development*. It is purposed to promote closer economic integration in the region. ASEAN Vision 2020 also purposed to create stable, prosperous, and highly competitive economic region. ASEAN Vision 2020 is branded by free flows of goods, services, investments, and capitals. The deeper integration expected could stimulate economic development to reduce poverty and narrowing socio-economic disparities.⁴⁸

Framework Agreements on Enhancing ASEAN Economic Cooperation has the objective to strengthen and enhance ASEAN economic co-operation, covering five major areas of cooperation that consist of cooperation in trade, cooperation in industry, minerals, and energy, cooperation in finance and banking, cooperation in food, agriculture, and forestry, and cooperation in transportation and communications. It also includes other areas of cooperation related to economics, such as intellectual property rights, tourism promotion⁴⁹, and human resources development.⁵⁰

In the external cooperation, the Framework Agreement has laid down “*extra-ASEAN economic cooperation*” to encourage member states to establish and/or strengthen cooperation with other countries, including regional and international organisations, for instance the ASEAN-EU relationship.⁵¹

The shifting of EU external policies towards Asia was reflected through the EU Commission’s Communications, issued in July 1994, with titles “*Towards a New Asia Strategy (NAS)*” and “*Creating a New Dynamic in EU-ASEAN relations*”.⁵² Welfens et al., note this as “*the cornerstone of the new partnership that Europe would seek in Asia*”.⁵³ Unfortunately none of those polices were ever implemented into real policies until the enlargement of the ASEAN memberships. Thus, it has slowly changed the perspectives of the EU in its relationship with ASEAN.⁵⁴

ASEAN enlargement has made the EU consider building further cooperation. In fact, ASEAN has growth as the “*key player*”⁵⁵ in the region of Southeast Asia. It has a large population reaching almost 500 million people and covers 10 countries in Southeast Asia. It is assumed that the EU sees ASEAN as a large market to be penetrated. Shifting of EU policy was proved in the 11th AEMM, which was held in Karlsruhe, Germany, in September 1994. ASEAN became the upper hand in determining the topics, styles, and procedures of the meeting.⁵⁶ ASEAN enlargement and EU enlargement increased the importance of the ASEAN-EU trade relationship.⁵⁷

⁴⁸ See *Ibid.*, pp. 76-77.

⁴⁹ “[...] tourists from ASEAN countries themselves have been representing an increasingly important share of tourism in the region. Of the 28.6 million tourist arrivals in ASEAN during 1996, 11.2 million or almost 40% came from within ASEAN itself [...]”. (See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 138.)

⁵⁰ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 87-88.

⁵¹ See Framework Agreements on Enhancing ASEAN Economic Cooperation, available at : <http://www.asean.org/12374.htm>, last accessed : 14 October 2011. See also Article 5 of the Agreement.

⁵² See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 49.

⁵³ See *Ibid.*, p. 49.

⁵⁴ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 87-88.

⁵⁵ “[...] ASEAN Integration which covers 10 countries (Indonesia, Malaysia, Singapore, Thailand, Philippines, Brunei Darussalam, Vietnam, Myanmar, Cambodia, and Laos Peoples Democratic Republic) integrating a region which has a population of about 549 million, a total area of 4.5 million square kilometres, a combined gross domestic product of US \$800 billion, and a total trade of US \$1047 billion (as of 2004). This will have a great impact on the region, not only economically but with respect to other aspects as well [...]”. (See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, pp. 138-139)

⁵⁶ See Rueland, J. (1996). “*The Asia-Europe Meeting (ASEM): Towards a New Euro-Aseam Relationship*. Universität Rostock (Rostock Information zu Politik und Verwaltung.5); Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 49.

⁵⁷ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 49.

In September 2001 the Commission presented a communication, regarding “*Europe and Asia: A Strategic Framework for Enhanced Partnerships*”, where ASEAN was identified as the major economic and political partner of the EU. The Commission’s Communication on “*A New Partnership with Southeast Asia*”, presented in July 2003 reiterated the previous communication.⁵⁸ Since 1977, the dialogue relations between ASEAN and EU were formalised in the 10th ASEAN Foreign Ministers Meeting (AMM) attended by the Council of Ministers of the EEC, the Permanent Representative of the EEC countries and the EEC Commission. Hence, both regions agreed to establish a formal cooperation and relationship.⁵⁹

II. ASEAN Economic Community⁶⁰.

The ASEAN Vision 2020⁶¹ aims to encourage closer economic integration of the region. In 1998, the Hanoi Plan of Action was adopted. It was designed as the first series of plans of action leading up to the realisation of the ASEAN vision.⁶² Liberalisation of trade and investment are believed to have driven the realisation of AEC. Regional economic integration is being pursued through the development of trans-ASEAN infrastructures such as transportation, ICT, and energy.

The Trans-ASEAN transportation network consists of major inter-state highway and railway networks, principal ports, and sea-lanes for maritime traffic, inland waterway transport, and major civil aviation links. ASEAN has been promoting interoperability and interconnectivity of the national telecommunications equipment and services. In the area of energy, ASEAN is developing trans-ASEAN energy networks that consist of the ASEAN Power Grid and the Trans-ASEAN Gas Pipeline Projects.⁶³

An initiative for ASEAN Integration (IAI) was launched in November 2000. IAI gives direction and focus to collective efforts, narrowing the development gap among ASEAN member states and between ASEAN and other parts of the world. Currently, IAI covers some priority areas such as infrastructure, human resources development, ICT, capacity building for regional economic integration, energy, investment climate, tourism, poverty reduction, and improvement of quality of life.⁶⁴

ASEAN is an important regional actor and driving force for trade liberalisation in Southeast Asia. In this regard, ASEAN should be able to integrate itself into the global economy. It is undeniable that ASEAN operates in the global environment with interdependent markets and globalised industries. Hence, it is very important for ASEAN to “*look beyond the borders of AEC*” by taking into account external rules and regulations in developing trade policies.⁶⁵

Integration acceleration into the global market would enable ASEAN traders and business actors to compete in the international environment. Integration into the global market would also enhance the capability and capacity of ASEAN as part of the

⁵⁸ See <http://www.delkhm.cec.eu.int/eu/asean/relations.htm>; Joint Co-Chairmen’s Statement Of The 15th ASEAN–EU Ministerial Meeting Jakarta, 10.3.2005, available at : <http://www.aseansec.org/17355.htm>; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 70.

⁵⁹ See Overview of ASEAN-EU Dialogue Relations, available at : <http://www.asean.org/23216.htm>, last accessed 14 October 2011.

⁶⁰ ASEAN Community consists of three pillars, ASEAN Security Community, ASEAN Economic Community and ASEAN Socio-Cultural Community.

⁶¹ One Vision, One Identity and One Community.

⁶² See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 138.

⁶³ See *Ibid.*, p. 138.

⁶⁴ See *Ibid.*, p. 138.

⁶⁵ See Ministers Discuss Implementation Progress of AEC Blueprint, Jakarta, 7 May 2011, available at : <http://www.asean.org/26240.htm>, last accessed 17 October 2011.

global supply chain and attract more foreign investment in the internal market. The ASEAN external economic relationship is based on the “ASEAN Centrality” approach, where a system has been established to enhance coordination in a regional and multilateral sphere. The 18th ASEAN Summit Jakarta emphasised the importance of ASEAN’s centrality in developing the architecture of regional cooperation with external partners. ASEAN’s centrality also reiterated basic principles and modalities and the commitment of the East Asia Summit (EAS) as outlined in the Kuala Lumpur Declaration 2005.⁶⁶ The Secretary-General of ASEAN, Dr Surin Pitsuwan, stated that “ASEAN needs to be fully integrated to remain competitive, strong and attractive to ensure ASEAN centrality in the evolving regional architecture.”⁶⁷

The success story of the EU in establishing a single market and single currency (Economic and Monetary Union) has motivated ASEAN to go further into economic integration. During the ASEAN Summit in Bali 2003, all ASEAN member states agreed to establish what is known as the “ASEAN Economic Community (AEC)”. According to the ASEAN Vision 2020, it is deemed as the realisation and final goal of economic integration. AEC is designed to achieve the ASEAN single market and production base by managing the diversity of the region into business opportunities. The AEC blueprint aims to make ASEAN more dynamic and stronger in terms of global competition.⁶⁸

The ASEAN Community consists of three pillars, that is, the ASEAN Economic Community, the ASEAN Security Community and the ASEAN Socio-Cultural Community. These three pillars must work in harmony with each other as a single unity. The 38th ASEAN Economic Ministers Meeting (AEM) 2006 agreed to develop a single and coherent blueprint for advancing the AEC by identifying the characteristics⁶⁹ and elements of the AEC by 2015 consistent with the Bali Concord II with clear targets and timelines for implementation of various measures with pre-agreed flexibilities to accommodate the interests of all ASEAN member states. In addition, the Ministers have agreed to recommend the ASEAN leaders to accelerate ASEAN economic integration from 2020 to 2015.⁷⁰

Declaration on the AEC Blueprint was signed at the 13th ASEAN Summit 2007 that took place in Singapore.⁷¹ The AEC structure building should be based on an “[...] open, outward-looking, inclusive, and market driven economy that is consistent with multilateral rules and adherence to rules based systems for effective compliance and implementation of economic commitments [...]”.⁷²

The ASEAN single market and production base include five core elements, i.e., free flow of goods, free flow of services, free flow of investment, freer flow of capital, and free flow of skilled labour. It also includes two other important components that consist of the priority of the integration sectors, and food, agriculture and forestry.⁷³

⁶⁶ See The ASEAN Secretariat, Chair’s Statement of the 18th ASEAN Summit Jakarta, “ASEAN Community in a Global Community of Nations” 7 - 8 May 2011, available at : http://www.asean.org/Statement_18th_ASEAN_Summit.pdf, last accessed 17 October 2011.

⁶⁷ See Ministers Discuss Implementation Progress of AEC Blueprint, Jakarta, 7 May 2011, available at : <http://www.asean.org/26240.htm>, last accessed 17 October 2011.

⁶⁸ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 138.

⁶⁹ “[...] Key characteristics and elements of AEC consists of : (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy [...]”.

⁷⁰ See Joint Media Statement of the Thirty-Eight ASEAN Economic Ministers’ (AEM) Meeting Kuala Lumpur, 22 August 2006, available at : <http://www.asean.org/18692.htm>, last accessed 17 October 2011.

⁷¹ See Declaration on the ASEAN Economic Community Blueprint, available at : <http://www.asean.org/21081.htm>, last accessed 17 October 2011.

⁷² See *Ibid*,

⁷³ See *Ibid*.

In order to facilitate free movement of business actors, and skilled labour, it is important to set up cooperation in human resources development and capacity building, and in the recognition of professional qualifications. Concerning free flow in the area of investment, capital, goods, and services there is the need for a “[...] *closer consultation on macroeconomic and financial policies; trade financing measures; enhanced infrastructure and communications connectivity; development of electronic transactions through e-ASEAN; integrating industries across the region to promote regional sourcing; and enhancing private sector involvement for the building of the AEC [...]*”.⁷⁴

In the framework of the AEC, external trade of ASEAN is considered as the significant factor driving economic growth. Of the other five elements of AEC, free flow of goods is a principal instrument in the establishment of a single market and production base unit. Single markets for goods serve as a facilitation to develop production networks and improve ASEAN’s capacity as a global production centre. Honourable Dato’ Seri Abdullah Ahmad Badawi, the Prime Minister of Malaysia, emphasised the importance for ASEAN to continue engaging and expanding linkages with major trading partners in his opening speech. In addition, the Ministers also agreed that the free flow of goods is considered as the main key of the AEC. The free flow of goods can be achieved through trade facilitation development to transaction cost and the cost of doing business in ASEAN.⁷⁵

To ensure the free flow of goods within AEC, agreements and policies must be established to remove the barriers of free flow and facilitation to make sure such flow is established. The most important component to establish the free flow of goods is the removal of tariff barriers and non-tariffs barriers to trade. ASEAN has achieved significant progress in removing tariff barriers through AFTA.⁷⁶ Elimination of tariffs from all intra-ASEAN goods has to comply with the schedules and commitments set out in the CEPTS-AFTA Agreement and other relevant Agreements/Protocols.

NTBs play an important role since there are many obstacles that inhibit the free flow of goods. NTBs often inhibit trade flow such as excessive and long chain formalities and procedures, long bureaucracy chains, corruption, and lack of facilities and infrastructures. Trade facilitation measures are provided to eliminate NTBs and to facilitate the free flow of goods. Trade facilitation measures make up some essential components, such as integrating customs procedures, establishing the ASEAN Single Window (ASW), continuously enhancing the CEPTS rules of origin including its operational certification procedures, and harmonising standards and compliance procedures. The focus of ASEAN to realise AEC in 2015 is the full elimination of NTBs.⁷⁷

Establishing regional cooperation on the trade facilitation mechanism is deemed as a strategic issue under the framework of AEC. The objective of trade facilitation is to

⁷⁴ See *Ibid.*

⁷⁵ See Joint Media Statement of the Thirty-Eight ASEAN Economic Ministers’ (AEM) Meeting, Kuala Lumpur, 22 August 2006, available at : <http://www.asean.org/18692.htm>, last accessed : 17 October 2011.

⁷⁶ “[...] ASEAN Member Countries have made significant progress in the lowering of intra-regional tariffs through the Common Effective Preferential Tariff (CEPT) Scheme for AFTA. More than 99 percent of the products in the CEPT Inclusion List (IL) of ASEAN-6, comprising Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand, have been brought down to the 0-5 percent tariff range. ASEAN’s newer members, consists of Cambodia, Laos, Myanmar and Viet Nam, are not far behind in the implementation of their CEPT commitments with almost 80 percent of their products having been moved into their respective CEPT ILS. [...]” (See ASEAN Free Trade Area (AFTA) Council, available at : <http://www.asean.org/19585.htm>, last accessed 17 October 2011).

⁷⁷ The schedule of removing all NTBs comply with the agreed Work Programme on NonTariff Barriers (NTBs) elimination, whereas, for ASEAN-5 by 2010, for the Philippines by 2012, and for ASEAN-4 with flexibilities by 2015 to 2018.

reduce transaction costs in ASEAN to improve export competitiveness and accelerated ASEAN integration into a single market for goods, services and investments and a single production base. Generally, trade facilitation covers simplification, harmonisation, and standardisation of trade and customs, procedures and formalities related to the flow of information. The focal point of trade facilitation is to promote the transparency and visibility of all actions and interventions that are carried out by all stakeholders within international trade transactions.

In the framework of AEC, trade facilitations are divided into two major components. The first component is related to physical infrastructures such as cooperation on transportations and infrastructure development. Transportation infrastructures include maritime, land, and air transport to ensure the free flow of goods, services, and capital.⁷⁸ ASEAN transportation infrastructures are designed to provide links and connectivity to facilitate distribution between ASEAN with Northeast and South Asian countries. Providing efficient, secure, and integrated transport networks in ASEAN is crucial to manage the full potency of AFTA. Moreover, such infrastructures could improve the attractiveness of the region as a single production, tourism and investment destination and reduce development gaps. The second component is integrated under ASW, which covers ICT infrastructures, e-customs, e-trade or e-commerce, and automation rules of origin. The establishment of ASW is considered as the stepping-stone to accelerate the realisation of AEC by 2015. ASW systems stress the use of ICT applications for efficiency in trade facilitation. ASW is also defined as a comprehensive system involving private and public stakeholders from a wide range of areas to cooperate by creating an environment that enhances trade efficiency and competitiveness.

ASEAN is the third largest trading partner of the EU. Most ASEAN member states are listed as EU GSP beneficiary countries, except for Singapore that has been graduated and Myanmar that has been suspended due to its non-compliance with human rights. Under GSP preferential rules of origin, ASEAN has been given a facility known as cumulative origin. Cumulative origin is considered as an opportunity to improve GSP utilisation among ASEAN countries. It is carried out through production networking and enables comparative advantages of ASEAN member states to improve production quality, efficiency and to generate job opportunities. In other words, the cumulative origin could facilitate trade and investment among ASEAN member states, promote a regional production network, encourage growth of Small and Medium Enterprises (SMEs), reduce economic development gaps, and promote the use of the AFTA CEPTS. Hence, it is important for ASEAN to enact the rules of origin (ROO) that are responsive to the dynamic changes of global production processes. ASEAN continuously reforms and enhances its CEPT ROO to respond to such changes in the regional production processes. Including making necessary adjustments such as the introduction of advance rulings and improvements to the ROO, simplifying the operational certification procedures for the CEPT ROO, introducing electronic processing of certificates of origin, and harmonising national procedures as much as possible.

ASEAN customs integration is an essential component to increase the collection of revenues and reduce transaction costs for traders. ASEAN has established a “*strategic plan of customs development*”, which was implemented from 2005 to 2010. This

⁷⁸ The ASEAN Transport Action Plan (ATAP) 2005-2010 covers maritime, land and air transport, and transport facilitation. The Plan outlines 48 action measures.

programme had seven goals consisting of a) *integration of customs structures*; b) *modernisation of tariff classification*; c) *customs valuation and origin determination and establishment of ASEAN e-Customs*; d) *enhancement of customs clearance*; e) *improvement of human resources development*; f) *promoted partnership with relevant international organisations to reduce the development gaps in customs*; and g) *adoption of risk management techniques and audit-based control for trade facilitation*. Custom integration is carried out through the modernisation of custom techniques, simplification, and harmonisation of procedures and formalities aligned with international standards and best practices.

Secure and connected ICT infrastructures must be provided urgently in order to sustain the region's economic growth and competitiveness. ICT networks need to be developed at the national level, and then integrated into the regional infrastructure system. It is crucial to facilitate interconnectivity and technical interoperability among ICT systems within ASEAN. Some effort has been made at the national and regional level under the National Single Window (NSW) and ASW. In order to promote e-commerce, it is vital to lay down policies and legal infrastructures for electronic commerce, by enabling on-line trade in goods (e-commerce) within ASEAN through the implementation of the e-ASEAN Framework Agreement and based on common reference frameworks. It is also important to encourage internet use for electronic transactions, payments, and settlements among traders and business actors.

Establishing Standards and Technical Barriers to Trade is equally important to attain greater transparency, improved quality of conformity assessment and active participation of the private sector. Standards and Technical Barriers to Trade are defined as “[...] a system of standards, quality assurance, accreditation, and measurement [that is] crucial to promote greater efficiency and enhance cost effectiveness of production of intra-regional imports/exports [...]”. Standards, technical regulations and conformity assessment procedures will be harmonised through the implementation of the ASEAN Policy Guidelines on Standards and Conformance.

In the 4th AEC Council Meeting August 2010, which took place in Da Nang, Vietnam, the Ministers noted that 80% of deliverables under the AEC Blueprint for 2008-2009 have been achieved. There are some significant progresses related to the initiative programme that supports the realisation of AEC, such as the ASEAN Trade in Goods Agreement⁷⁹, and finalises the ASEAN connectivity master plan.⁸⁰

The ASEAN connectivity master plan covers the Master Plan on ASEAN Connectivity⁸¹, ASEAN Strategic Transport Plan (ASTP) 2011-2015, Information Communications Technology (ICT) Master Plan 2011-2015⁸², and ASEAN Tourism Strategic Plan (ATSP) 2011-2015. It involves cross-sectorial coordination to enhance physical and institutional connectivity through cost reductions of investment and international trade in goods and services.⁸³ During the 5th AEC Council Meeting May

⁷⁹ See The ASEAN Trade in Goods Agreement, available at : <http://www.asean.org/22223.pdf>, last accessed 17 October 2011.

⁸⁰ See The ASEAN Secretariat, Chair's Statement of the 18th ASEAN Summit Jakarta, “*ASEAN Community in a Global Community of Nations*” on 7 - 8 May 2011, available at : http://www.asean.org/Statement_18th_ASEAN_Summit.pdf, last accessed 17 October 2011.

⁸¹ See The Master Plan on ASEAN Connectivity, available at : <http://www.asean.org/documents/MPAC.pdf>, last accessed 17 October 2011.

⁸² See The ASEAN ICT Masterplan 2015, available at : <http://www.asean.org/documents/ASEAN%20ICT%20Masterplan%202015.pdf>, last accessed 17 October 2011.

⁸³ See Joint Media Statement of the 4th ASEAN Economic Community (AEC) Council Meeting, available at : <http://www.asean.org/25107.htm>, last accessed 17 October 2011.

2011, which took place in Jakarta, agreements were made to achieve further AEC progress, greater concerns on the implementation of the AEC pillar and equitable economic development. It was particularly stressed to encourage the growth of SMEs and to reduce the development gap in ASEAN.⁸⁴ The 18th ASEAN Summit in Jakarta reiterated that SMEs should benefit from AEC. Therefore, it is necessary to facilitate a free market system that encourages competition. In this regard, ASEAN SMEs must have better access to technology, and the market.⁸⁵

III. ASEAN-EU trade relationship.

III. a. An international political economic theory.

The trade relationship between ASEAN and the EU has been influenced by so many factors. In the 1970s-1980s both regions went through a stagnation period in their trade relationship. After the Asian economic crisis struck, the trade relationship between the two regions became more intimate. Economic and political factors were considered as the main factors shaping the relations between both regions. From the geo-politic perspective, Welfens et al. studied the factors influencing the development of trade relations between ASEAN and the EU. It is important to note that during the nine years after its establishment, “[...] the ASEAN relation with the EU has not developed more than it has [...]”.⁸⁶

Initially, ASEAN-EU cooperation was purely related to economic interest.⁸⁷ The main motivation was rooted in fears of Japanese economic domination. In the late 1960s Japanese products were flooding into Thailand and Indonesia, while at the same time Japanese investments were dominating all ASEAN states. This raised anti-Japanese campaigns throughout the region. Governments of the ASEAN states responded to such situation by exploring options that might reduce their economic dependence on Japan. In this regard, the ASEAN started “*considering*” the EU as a potential partner. In November 1971 ASEAN representatives began to consider the possibility of closer relations. In February 1972 the European Commissioner, represented by Ralf Dahrendorf, visited the region to examine the prospects for European investment.⁸⁸

In 1975, a special coordination committee of ASEAN was formed with the purpose of creating new economic links with the EU. The committee would meet alternately in the EU and ASEAN. The committee had the responsibility to examine all aspects of economic cooperation between the two groups. This was followed by the creation of the ASEAN-EU joint study group with the task to foster talks on economic cooperation and trade. In 1978, a conference on ministerial cooperation was held in Brussels and representatives from both sides were present. Unfortunately, no significant decisions arose from this. However, there were exchanges of views on issues such as capital transfer and technical assistance.⁸⁹

According to Grilli and Welfens, there are three reasons why the EU needed to build cooperation with ASEAN. First, the entry of the United Kingdom into the EU made it essential to provide alternative arrangements for states such as Malaysia and

⁸⁴ See Ministers Discuss Implementation Progress of AEC Blueprint, Jakarta, 7 May 2011, available at : <http://www.asean.org/26240.htm>, last accessed 17 October 2011.

⁸⁵ See The ASEAN Secretariat, Chair’s Statement of the 18th ASEAN Summit Jakarta, “ASEAN Community in a Global Community of Nations” 7 - 8 May 2011, available at : http://www.asean.org/Statement_18th_ASEAN_Summit.pdf, last accessed 17 October 2011.

⁸⁶ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 68.

⁸⁷ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 84.

⁸⁸ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 68.

⁸⁹ See Kesavan, K. V. (1981). Japan, and the EEC. In K. V. Lall & H. S. Chopra (Eds.), *The EEC and the third world*. New Jersey: Humanities Press; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 68.

Singapore that had lost Commonwealth preferences. The EU saw Southeast Asia as former colonies and new-potential markets. Second, US evacuation from Indochina following its failure in the Vietnam War left ASEAN countries vulnerable to external threats from the new potential regional hegemonic power, such as communism of North Vietnam. In fact, some EU countries did have commercial interest in the region. Particularly, the United Kingdom and the Netherlands had strong investment interests in ASEAN countries such as Singapore, Malaysia, and Indonesia. Hence, the EU needed to keep its interest in Southeast Asia through some aids to support the economic development of the region.⁹⁰

In the area of security and politics, the ASEAN Regional Forum (ARF) was established at the Post-Ministerial Conference. It was held immediately after the annual ASEAN Foreign Ministers Meetings. It functioned as a forum of dialogue to strengthen ASEAN's strategic position as the key player in the Asian Region.⁹¹ After being hit by economic crisis, ASEAN rose up and gained its confidence to build its reputation as the strategic regional organisation. It was known as the period of recovery for ASEAN economics. To prevent economic and political disruptions within the region, ASEAN tended to use cooperation and informal approaches rather than institutions and rules.⁹²

Some scholars have studied the relationship between ASEAN and the EU in different perspectives. Referring to Hudec, it is difficult to separate economic and legal issues in GSP policy, since it was established to accommodate legal equality in inequalities of economic development. In respect of the issues discussed in this research, which cover international trade issues on EU GSP, we used the *"international political economy"* perspective. This goes back to the notion of GSP as the *"gift"* or *"grant"* from the preference-granting country to the beneficiary country in which the policy of the GSP scheme is considered as an autonomous right. ASEAN member states comprise developing countries where most are beneficiary countries of EU GSP. Except Singapore that has been graduated from the scheme since 1997, together with Hong Kong. The international political economic perspective is the suitable approach to analyse the relation of EU-ASEAN in the context of international trade. Because both of these entities have been recognised as international organisations that have their own characteristic in international relations. At first we should define what international political economy is. According to Frieden and Lake (1995:1), international political economy is:

*"[...] the interaction of economics and politics in the world arena, where the economy can be defined as the system of producing, distributing, and using wealth and politics as the set of institutions and rules by which social and economic interactions are governed [...]."*⁹³

In this regard we have seen that GSP was established based on the political and economic relationship between developed countries and developing countries in which both parties have different political interests, different economic development, but are interdependent on one another to enhance international trade liberalisation. According to Christopher, there are three main theories of international political economy that are used to study the ASEAN-EU relationship, consisting of *"Neo-realism, Neo-liberalism and Marxism"*.

⁹⁰ See Grilli, E. R., 1993. *The European community and the developing countries*. Cambridge: Cambridge University Press; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, pp. 68-69.

⁹¹ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 48.

⁹² See *Ibid.*, p. 52.

⁹³ See Frieden and Lake (1995:1); M. Dent, Christopher., 2002, *Op. Cit.*, p. 1.

III. a.1. The application of neo-realism theory in the EU-ASEAN relationship.

Neo-realism derives from the realism theory that was developed by “*Thucydides and Machiavelli*”. In the perspective of realism theory, “nation-states” are considered as the only important actors in international relations while the other actors are considered as subordinates. According to realism theory, anarchy is something that usually occurs in international relations since there is no supra authority or “global governing authority” that influences states to act in a certain way when establishing their relations with another state. States are free to decide their international policy and their international relations. Neo-realism believes that the anarchic structure of the international system as a whole could lead to inevitable competition between states. Naturally, every state would struggle to have an advanced position and status in the international community. Some states might bind themselves into alliances to attain certain goals. However, in some cases, such alliances would not be stable and would not be permanent due to the different interests of member states.⁹⁴ Therefore, neo-realism argues, “[...] the balance of power between states can change quite rapidly with the frequent shift in interstate alliances [...]”.⁹⁵

Neo-realism believes that the central power of the international economic system could influence state behaviour. In conclusion, neo-realism concerns states and systemic structure, where advanced economics of a state can improve the status of states in the international community.⁹⁶ The more advanced a state in its economic development the more significant its role and status within the international community.

In the “*anarchic*” international relationship between states, hegemonic issues will be present. Hegemony prevails between states to increase their economic development through market expansion overseas. The trade liberalisation system forces the states to comply with international rules. There are certain international actors that have an important role in the establishment of an international system and rules should be applied by member states, for instance the WTO.⁹⁷

On the topic of hegemonic roles in international trade, Robert Pahre wrote a book with the title “*Leading Questions: How Hegemony Affects the International Political Economy*”. According to his book, the hegemony theory has a crucial role and can be applied across a wide scope of theoretical perspectives, from Realism to Marxism.⁹⁸ According to realists, a hegemon persuades other states to create an open international economy, even in a world of power-seeking states that find themselves in an anarchic international system.⁹⁹ Marxists perceive hegemony as a recurring feature of the world-system by which the capitalist class at the core of the world economy exploits both its own workers and the peoples of other countries through its control of international finance, money, trade, and ideological production.¹⁰⁰ While according to the liberal view, the hegemony is considered as a guarantor of international cooperation and as a state that can help other states to solve their problems through

⁹⁴ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 2.

⁹⁵ See Waltz 1979; Gilpin 1984; M. Dent, Christopher., 2002, *Op. Cit.*, p. 3.

⁹⁶ See *Ibid*; *Ibid*; *Ibid*, p. 3.

⁹⁷ See Kindleberger 1973; Krasner 1976; Lake 1991; Strange 1994; M. Dent, Christopher., 2002, *Op. Cit.*, p. 3.

⁹⁸ See Keohane 1984, 1986b; Organski 1968: 355-76; Sylvan 1981; Pahre, Robert., *Leading Questions : How Hegemony Affects the International Political Economy*, Michigan Studies in International Political Economy, Ann Arbor, The University of Michigan Press, USA, 2002, p. 4-5.

⁹⁹ See Gilpin 1981; Keohane 1984; Krasner 1976; Lake 1983, 1984, 1988; Rapkin and Avery 1982; Stein 1984; Pahre, Robert., 2002, *Op. Cit.*, p. 4-5.

¹⁰⁰ See Braudel 1979; Chase-Dunn 1981, 1982; Wallerstein 1974, 1979, 1989; Pahre, Robert., 2002, *Op. Cit.*, p. 4-5.

coordinated collective action.¹⁰¹ To understand the relationship between international trade policy and hegemony theory, it usually begins by identifying the existence of a single dominant state or hegemonic power. The hegemonic state due to its political, economic, and military power would make it possible to provide many services for the international economy, for example, guaranteeing freedom of the seas, encouraging trade cooperation, and managing the world's monetary system.¹⁰² The hegemonic power is also seen as a driving force to encourage open trade policy.

In the conceptual relationship between ASEAN-EU, the dynamic change of world hegemony shifted EU policy towards ASEAN. In the 1970s US hegemony strongly influenced ASEAN. The EU did not want to compete with US interests over ASEAN, which might have disturbed US hegemonic stability.¹⁰³ US hegemony in ASEAN was due to its commitment to provide an open market for developing country products. It also became the means to keep US domination over ASEAN.¹⁰⁴

As the dominant regional power in Asia in the post Second World War, US shaping constellation of economic and politic on the region. Some strategies are made by the "dominant state" to influence the development process of countries in the region. First, it is carried out by reducing transaction costs in order to create wider international environment and generate opportunities of economic growth. Expansion of market access to the dominant power (developed countries) deemed could stimulate the growth and increased gains from trade.¹⁰⁵ Second, using political power to encourage government of the countries in the region implementing public policies aligns with the dominant power, which is aimed to stimulate rapid economic growth. The dominant power may employ ideological tool, or use the demonstration effect of its economy to encourage pro-growth policies. Third, using the tool of direct influence that involving trade, the provision of capital, transfers of technology, technical assistant, capacity building, and expansion of market access.¹⁰⁶

In 1990s, the hegemonic of the Southeast Asia region shifted from politic to economic. It is starting the gold era for ASEAN member states develop their economy before the hit of 1997 economic crisis. ASEAN growth to be one of the EU major trading partners and shifting the pattern of dependency relationship into interdependency relationship.¹⁰⁷

In the neo-realism theory, relationship between ASEAN and EU is seen as an economic relations between two regions, or regional groups of states. As a regional organization, EU has more advanced organizational organs and deeper integration, which implemented through the Union's competences and EMU system. The supranational level, in this regard, the EU Commission represent Union's interest in the external trade relation under CCP.¹⁰⁸

After gained their independency, ASEAN member states continuously produce efforts to develop theirs' industrializations, to build the nation's confidence, and to improve their status in the international community. In order to accelerate the economic development during post war these new states encourage themselves to

¹⁰¹ See Keohane 1984; Kindleberger 1973, 1976, 1981; Pahre, Robert., 2002, *Op. Cit.*, p. 4-5.

¹⁰² See Pahre, Robert., 2002, *Op. Cit.*, p. 7.

¹⁰³ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 73.

¹⁰⁴ See Stubbs, "Geopolitics," 538; Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 43.

¹⁰⁵ See Ronald Rogowski, *Commerce and Coalitions: How Trade Affects Domestic Political Arrangements*, Princeton: Princeton University Press, 198; Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 26.

¹⁰⁶ See Bowie, Alasdair., and Unger, Danny., 2002, *Op. Cit.*, p. 26.

¹⁰⁷ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 73.

¹⁰⁸ See *Ibid.*, pp. 5-6.

build international relationship with developed countries.¹⁰⁹ On the other hand, the EU that consists of developed countries, have to compete with US and Japan as the post war economic power and strong industrial countries. Neo-realists argued the similarity of interest to deal with industrial rivalry increase the alliance endurance of regional organization.¹¹⁰

In the context of the ASEAN and EU relationship, neo-realists argued that the internal structures of each region had influenced their external relationships. First, neo-realists argued that the EU's international agenda under CCP was seen as a manifestation of inter-state bargaining within the Union. It is argued that the more powerful member states would significantly influence the policymaking and decisions in the Union. In other words, EU CCP was often influenced by specific national interest of powerful member states.¹¹¹ Second, according to Regelsberger, post-colonial ties significantly influenced the differences of foreign policy interests of EU member states in Southeast Asia.¹¹² On the other hand, the variance of national interests within ASEAN also explained why consensus on matters relating to the EU was often vague.¹¹³

Furthermore, in the neo-realist perspective ASEAN is identified as a regional organisation that has many weaknesses. This has made its bargaining position in trade diplomacy less powerful. Since there are no compromises of national sovereignty in ASEAN to establish supranationalism like in the EU, thus, it gives greater space for nation-state objectives to be pursued. Such organisational conception is considered counterproductive to achieve common interests of the group because there will be a fragmented policy. The common interest is needed for the group to gain welfare. Thus, uniform policy is necessary to ensure that the common interest is attained properly. In fact, to implement uniform policy a condition is required where economic development disparities are not too wide. While ASEAN member states are in the process of narrowing such disparities, therefore, ASEAN still needs more time and learning to adjust and reach such level.¹¹⁴

Due to such organisational structure, this could explain ASEAN failures to impose greater collective pressure upon the EU, especially regarding trade policy. According to Indorf, in the early 1980s “[...] *the complexity of their organisations, the lack of procedural mobility, and the stagnating effects of diverse national standpoints [...]*” in general hampered the ASEAN-EU relationship. Along with the dynamic change of the international trading system, the organisational behaviour tended to change in order to meet the economic demand.¹¹⁵

III. a. 2. The application of neo-liberalism theory in the EU-ASEAN relationship.

The neo-liberalism theory stems from the classic liberal theory that is based on the “*notion of individual self-determination and utility-maximising rationality*”. In the later development it has contributed to the existence of *laissez-faire* principles of free trade and comparative advantage. Both of these principles are the basis of market economy where the government should not interfere with the market except when there is a threat to public interest.¹¹⁶

¹⁰⁹ See *Ibid.*, p. 6.

¹¹⁰ See *Ibid.*, p. 6.

¹¹¹ See *Ibid.*, p. 6.

¹¹² For example, Spain has given strong support to Portugal's stance against Indonesia over the East Timor issue.

¹¹³ See Regelsberger 1989; M. Dent, Christopher., 2002, *Op. Cit.*, p. 72.

¹¹⁴ See Indorf, 1983, *Op. Cit.*, p.105; M. Dent, Christopher., 2002, *Loc. Cit.*, p. 72.

¹¹⁵ See *Ibid.*, p. 105; *Ibid.*, p. 72.

¹¹⁶ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 7.

Neo-liberalists have placed the individual as the most important actor in the international economic systems. In this term, individual actors usually refer to a company or firm. Therefore, neo-liberalists are more focused on inter-company competition rather than inter-state competition. Based on *laissez-faire* principles of free trade, neo-liberalists support trade without borders by placing the superiority of markets over the states.¹¹⁷

Neo-liberalism takes into account the significant role of Non-State Actors (NSA) in international economic relations. In this term, NSAs are trans-national actors whose existences were produced from the globalisation system. Trans-national actors usually refer to the representatives of non-governmental organisations (NGOs). This includes industry associations, officials from supranational or international agencies, or business executives employed by multinational Companies (MNCs).¹¹⁸

In the context of the ASEAN-EU relationship, neo-liberalism has emphasised the importance of NSA in the economic relationship, especially in the era of the 1990s when the rapid expansion of EU-ASEAN economic exchanges turned a dependency relationship into an interdependency relationship. In the period of diplomatic deadlock, business representatives and other trans-national, NSAs bore the burden of greater responsibility to maintain ASEAN-EU economic relations. However, both parties were criticised for their failures in not involving NSAs effectively, particularly business representatives, to promote the formalisation of the ASEAN-EU economic relationship.¹¹⁹

Interconnected issues relate to trade that also influences the ASEAN-EU economic relationship. Those issues have broadened the EU-ASEAN economic agenda to include technology, the environment, human resources development, labour standards, and other issues related to trade, investment, and financial assistance. In the area of trade, the EU gives support to ASEAN in the establishment of trade facilitation through APRIS I and II with the purpose to increase trade flows between ASEAN and the EU.¹²⁰ On the other hand, inevitably the “*value-system friction*” has perpetually become part of the interface in the EU-ASEAN relationship. In this regard, most ASEAN states apparently distrust the policies of EU to include non-trade conditions such as environmental, human rights issues and social clauses in the GSP scheme.¹²¹

III. a. 3. The application of the Marxist doctrine in the EU-ASEAN relationship.

The Marxist doctrine was developed in the nineteenth-century by political economist Karl Marx. The basic theoretical position of Marxism is to divide the dominant actors' class in the international political economy. Therefore, the Marxist doctrine contends that international economic relations are essentially “*conflictual*”. Marxism recognises that states, societies and various NSAs operate as part of the world capitalist system. The Marxist doctrine argues that the notion of inter-class friction occurs within a capital and labour relationship, where capitalists exploit and suppress their labour in order to maximise the benefits of their firm. According to Marxism, hierarchy in the international economic system is determined by the patterns of production and exchange is established by multinational corporation (MNC). The

¹¹⁷ See *Ibid.*, p. 7.

¹¹⁸ See *Ibid.*, p. 7.

¹¹⁹ See *Ibid.*, p. 73.

¹²⁰ See *Ibid.*, pp. 73-74.

¹²¹ See *Ibid.*, p. 74.

Marxist doctrine also emphasises the economic objectives as the main key in the agenda of foreign policy of the states.¹²²

Marxism stresses the relationship between the expansion of internationalised capital interests and imperialism. Imperialism occurs from the exploitation of labour-intensive countries by their capital-intensive counterparts. In the past, in order to protect the trade interests of their indigenous firms the states colonised other countries. Inter-state competition also occurred between capitalist countries to control the colonial territories. The post colonialism era brought a new imperialism where “*trans-national class conflict*” took place, for instance competition between MNC to obtain global market shares.¹²³ The new-imperialism practices also covered multinational Foreign Direct Investment (FDI) in which MNC extended their control over factors of production in other countries.¹²⁴ According to Frobel et al., MNC used their market power to play off workforces against each other within international production networks in their endeavour to drive down labour costs and maximise economic rents. For instance, MNC fragmented their production in some countries in order to maximise their firm profit with low labour cost. Thus leading to competition between workforces from developed and developing country locations where MNC exploit them for their own advantage.¹²⁵ Therefore, the Marxists doctrine puts strong emphasis on the dependency theory to explain the persisting gap between developed and most developing countries. Capital, technology, finance, and trade are considered as dependent factors that sustain the economic relationship between industrialised regions and under-developed regions. The dominant capitalist supports such relationship pattern¹²⁶ in order to maintain the status quo.¹²⁷

New imperialism has an influence on the ASEAN-EU economic relationship, with many EU companies establishing their MNC in ASEAN. For instance, Malaysia and Singapore are strongly dependent on EU FDI flows. EU governments are concerned with protecting the foreign investment interests of their indigenous MNC in those countries.¹²⁸

The EU MNC has a significant influence in determining the role of ASEAN economy. The dependency factor of developing countries to developed country has contributed to this matter. Over the last three decades, ASEAN has continued to depend highly on European companies as important sources of imports, investment, finance, technology, and capital.¹²⁹ However, the ASEAN industry revival that started in the 1980s¹³⁰ migrated such dependency relationship into an interdependency relationship. ASEAN has evolved from the recipient state to a potential EU trading partner. With respect to the EU GSP scheme, Marxists criticise the motives of the non-trade conditionality application, for instance new environmental and social clauses and the graduation mechanism. Marxists argue that less developed ASEAN member states

¹²² See *Ibid.*, p. 12.

¹²³ See *Ibid.*, p. 12.

¹²⁴ See *Ibid.*, p. 13.

¹²⁵ See Frobel *et al.* 1980; M. Dent, Christopher., 2002, *Loc. Cit.*, p. 13.

¹²⁶ For example state policymakers from developed countries, MNE executives and capital-orientated international organisations such as the IMF and World Bank.

¹²⁷ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 13.

¹²⁸ See *Ibid.*, p. 14.

¹²⁹ See *Ibid.*, p. 74.

¹³⁰ “[...] In the 1980’s the EU and ASEAN witnessed a gradual rise in their mutual trade flows. Over the 1980–85 period, EU exports to ASEAN increased by 84.4% from Ecu5.32bn to Ecu9.81bn, while ASEAN exports to the EU increased by 44.7% from Ecu6.89bn to Ecu9.97bn [...]”. (See M. Dent, Christopher., M. Dent, Christopher., 2002, *Op. Cit.*, pp. 51-53)

would have difficulty complying with such conditions.¹³¹ Such conditionality will not significantly contribute to the economic development of the less developed country.

III.b. A legal and historical review of the ASEAN-EU trade relationship.

The first direct commercial linkages between Europe and Southeast Asia date back to the fifteenth century when the European maritime powers started their eastward expeditions. Then due to economic and trade interests, a series of colonial relationships were developed that lasted until after the Second World War. Over this period, European firms dominated many aspects of Southeast Asia's economy.¹³²

Before the establishment of ASEAN, the relationship between Europe and Asia were embodied as a state-to-state relation, or mother state and former colony, and trade ventures.¹³³ The first Europeans who came to Asia were Portuguese. They came as traders for political, religious, strategic, and economic motives. After the routes to the new Asia were founded, other European countries started to come to Asia for similar reasons such as the British, French, Dutch, Spanish, and Portuguese. When they first came to Asia, the motivation of the Europeans was to trade and to find new market and production resources. However, the need to strengthen political and economic power in order to compete with other European states turned this into an era of colonisation. For instance, the Dutch came to Indonesia and started establishing Vereenigde Oostindische Compagnie (VOC) in 1602, which had been backed up by the Dutch Kingdom. Based on the permission of the Dutch Kingdom, VOC was given absolute monopoly to colonise Indonesia.

In the late 1940s some Asian countries obtained their independence, for instance the UK renounced its sovereign over Burma in 1947, India in 1948, Singapore in 1956, Malaysia in 1957, and Hong Kong in 1997. While Indonesia gained independence from the Netherlands in 1945.¹³⁴ According to Sung-Hoon Park and Heung-Chong Kim, the relationship between Asia and Europe is "ambivalent". First, the two continents have maintained a long-standing relationship in trade since Marco Polo "discovered" Asia. Second, some Asian countries are former colonies of European states. However, history has increased Asia's ignorance and distrust of Europe.¹³⁵ In the post-Second World War period, Asia's trade largely went to the US and Japan.

In the 1990s, the relationship between Asia and Europe was largely shaped by bilateral relations, country-to-country negotiations. It caused a low degree of congruence and weak focus from the European perspective.¹³⁶ In fact, Asia needed Europe to avoid "absolute dependency" on the US and Japan. Asia also needed to expand its market access to the western world.¹³⁷

Establishment of ASEAN has transformed the relationship Southeast Asian countries and the EU, from state to state relation into region to region relation. Yeo Lay Hwee, defined the relationship of ASEAN – EU "as one of the oldest group-to-group relationships". From the perspective of ASEAN, trade relationship with the EU is aimed to achieve greater market access and price stabilization scheme for ASEAN's primary commodities. While from the EU perspective, ASEAN is an important sources for raw

¹³¹ See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 74-75.

¹³² See *Ibid.*, p. 45.

¹³³ See Godement, 1997; Gregory, 2003; Hobson, 2004; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 2-3.

¹³⁴ See Balme, Richard., and Bridges, Brian., 2008, *Loc. Cit.*, pp. 2-3.

¹³⁵ See Sung-Hoon Park and Heung-Chong Kim, *The Asia Strategy of the European Union and Asia-EU Economic Relations: History and New Developments*; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 66.

¹³⁶ See *Ibid.*, p. 66.

¹³⁷ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 28.

materials, beside the hidden political interest. In this point, ASEAN is a peaceful non-communist area and potential economic partner.¹³⁸

The Bangkok Declaration 1967 is the umbrella to establish ASEAN external relationship with another regional group, where it is stipulated that the purpose of the association is “[...] to maintain close and beneficial cooperation with existing international and regional organizations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves [...]”. The EU is advanced role model for the regional integration, which successfully developed Economic and Monetary Union system.¹³⁹ ASEAN external’s relationship’s with EU primarily focused to boost trade and investment between two regions. The cornerstone of the ASEAN international relations is the Bali Economic Minister meeting in 1976, which laid down the common approaches to international problems.¹⁴⁰

The relationship between ASEAN and the EU begun in 1972. It is started with informal dialogue between ASEAN ministers and the Vice-President and Commissioner of the European Commission. Dialogue is focused on trade and market access issues.¹⁴¹ The EU is ASEAN the first regional partner dialogue.¹⁴² Dynamic changes of economic and political situation extending dialogue to political area and functional cooperation.¹⁴³ These issues are uniting two regions that have different economic development.

The relationship between ASEAN and EU has been evolved during four decades and it has been influenced by so many factors such as economic, political, and security. This evolution is divided into four stages of period. According to Welfens et.al, first stage is taken from the period 1972 to 1980, which so-called as exploration of cooperation. Second stage is taken from period 1980 to 1991, namely consolidation periods. Third stage is taken from period 1991 to 2001, which identified as unstable situations due to security problems, international conflict, and economic crisis.¹⁴⁴ Fourth stage is associated with re-discovery and re-building relationship along with the dynamic change of global situations including Eurozone crisis.¹⁴⁵ It has to be noted that during more than forty-four years ASEAN never intended to be an instrument of integration with supranational authority.¹⁴⁶

Three informal meetings were held between the EU Commission and ASEAN between 1972-1974.. The first meeting was held in Brussels on 16th June 1972, the second was held in Bangkok on 5th-6th September 1973, and the third meetings was held in Jakarta on 24-25 September 1974. As stated in the *“Joint Statement the Informal Meeting of ASEAN Ministers and Vice-President and Commissioner of the EC Commission, 1974”*, the third meetings was more focused on some trade topics. These topics are

¹³⁸ See Yeo Lay Hwee, *EU-ASEAN Relations and Policy-Learning*; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 83.

¹³⁹ See EMU: A Historical Documentation, available at : http://ec.europa.eu/economy_finance/emu_history/index_en.htm, last accessed : 26 September 2011.

¹⁴⁰ See Kesavan, K. V., 1981. Japan, and the EEC. In K. V. Lall & H. S. Chopra (Eds.), *The EEC and the third world*. New Jersey: Humanities Press; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 68.

¹⁴¹ The informal dialogue was exclusively focused in order to achieve greater market access for ASEAN’s exports and a price stabilization scheme for ASEAN’s primary commodities.

¹⁴² See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 84.

¹⁴³ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 45. See also Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 83-84.

¹⁴⁴ “[...] The political relations, however, took a turn for the worse in the early 1990s due to the East Timor incident in 1991 when differences emerged over how to treat Burma in the midst of its ruling junta’s violent suppressions of pro-democracy movements. It was also the time of the triumphant mood in the West following the collapse of the Berlin Wall and the break-up of the Soviet Union and the wave of democratization movements in the former Communist countries in Central and Eastern Europe [...]”. (See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 48).

¹⁴⁵ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 45.

¹⁴⁶ See *Ibid.*, p. 46.

covering issues on trade promotion and regional integration projects, the world economic situation, ASEAN development, the Multilateral Trade Negotiations (MTN), and the Generalized System of Preferences (GSP).¹⁴⁷

The third informal meeting stressed the importance of effective implementation of GSP¹⁴⁸ and it has been included into the cooperation agenda of both regions. In 1971, the EU became the first pioneer that extended their GSP scheme to ASEAN member states. In the ASEAN-EU Ministerial Meetings (AEMMs) 1978 until 1994, the GSP is deemed as an effective tool to boost exports earnings and helping improve economic development of ASEAN member states. Yet after the establishment of WTO both regions shifted their focus into cooperation on trade liberalization through trade aid, capacity building, and trade facilitation project. The ASEAN-EU cooperation to maximize utilization of GSP scheme is moderately successful and it has been proven by the full graduation and sector graduation given to some ASEAN member states. In 1997, Singapore has been graduated from the list of GSP beneficiary countries because of classified as the high-income country by World Bank. In 2008, five out of ten ASEAN member states, consists of Thailand, Vietnam, Indonesia, Malaysia and Philippines, included into the 20 top exporters countries under EU GSP Scheme.¹⁴⁹

Back to the 10th ASEAN Foreign Ministers Meeting (AMM), held on 5th – 8th July 1977, ASEAN and EU have agreed to formalise their “*dialogue relation*” into “*formal cooperation*”. This agreement named as “*ASEAN’s formal cooperation and relationship with the European Economic Community (EEC)*”. Formalisation of cooperation has involved “*the Council of Ministers of the EEC, the Permanent Representative of the EEC countries and the EEC Commission*”. This cooperation stage is covering some areas such as political and security, economic and trade, social and cultural, and development cooperation.¹⁵⁰

In 1975, during several informal meetings, ASEAN and EU established the Joint Study Group¹⁵¹ that focused on trade sectors. According to Luhulima and Welfens et al., this Joint Study Group was used to appraise other possible areas of cooperation, such as joint ventures in the exploration of ASEAN resources, the prospect of encouraging some

¹⁴⁷ Paragraph 3 of the Joint Statement The Informal Meeting of ASEAN Ministers and Vice-President and Commissioner of the EU Commission, Jakarta, 24-25 September 1974, available at : <http://www.asean.org/5615.htm>, last accessed : 22 September 2011.

¹⁴⁸ “[...] Noting the dangers of possible disruptions to the orderly functioning of the world economic system, it was agreed that both developed and developing countries had a role to play in the context of their increasing economic interdependence. Emphasis was laid on the contribution which the GSP and the Multilateral Trade Negotiations should make to improving the world trading system and to promoting a better balance in international economic relations. The importance of an effective implementation of generalized System of Preferences by all developed countries was stressed [...]”. (See Paragraph 5 Joint Statement The Informal Meeting of ASEAN Ministers and Vice-President and Commissioner of the EU Commission, Jakarta, 24-25 September 1974, available at : <http://www.asean.org/5615.htm>, last accessed : 22 September 2011).

¹⁴⁹ See Generalized System of Preferences 2008 statistics 20 top countries, available at : http://trade.ec.europa.eu/doclib/docs/2010/march/tradoc_145946.pdf, last accessed : 26 September 2011.

¹⁵⁰ See Overview of ASEAN-EU Dialogue Relations, available at : <http://www.asean.org/23216.htm>, last accessed : 21 September 2011.

¹⁵¹ “[...] The Joint Study Group will also serve as the mechanism through which to explore together all possible areas where cooperation could be broadened, intensified, diversified giving special considerations to the development needs of the ASEAN countries and bearing in mind the situations in the EEC [...]”. (Paragraph 6 of the Joint Statement The Informal Meeting of ASEAN Ministers and Vice-President and Commissioner of the EU Commission, Jakarta, 24-25 September 1974, available at : <http://www.asean.org/5615.htm>, last accessed : 22 September 2011).

extent of EU participation in ASEAN manufacturing activities and the mobilisation of capital for financing ASEAN projects.¹⁵²

In 1978, the ASEAN–EU Ministerial Meetings (AEMMs) had greater political significance and improved cooperation between both regions. During the second ASEAN–EC Ministerial Meeting, which was held in Kuala Lumpur in March 1980, the ASEAN–EU Cooperation Agreement was formulated. This agreement started the new era of cooperation between the two regions.¹⁵³ The provisions of the agreement covered trade and development cooperation, the promotion of investments, joint ventures and other miscellaneous economic issues such as technological transfers.¹⁵⁴

The 1980 cooperation agreement was considered as positive progress in the trade relations between the two regions. The EU had extended its GSP to ASEAN to enhance market access for ASEAN exports, but EU investment in ASEAN was limited. Through GSP, ASEAN's finished, semi-finished manufacture and agricultural products were allowed to enter the EU market at lower tariffs. However, ASEAN considered that the GSP did not go far enough and there were demands for more concessions. Welfens et al., also note that the "[...] basic (preferential) export regime unilaterally extended by the EU in 1971 to non-associated developing countries, including those in ASEAN, was not altered in any way by the 1980 Cooperation Agreement [...]".¹⁵⁵

The rise of ASEAN manufactured exports, stimulated by Japanese investments, caused the EU to grant ASEAN a low priority development status. Not surprisingly, the EU proved unwillingly to grant ASEAN member states trade preferences other than GSP status.¹⁵⁶ On the other hand, these were advantageous during the 1980s as ASEAN manufactured exports began to develop.¹⁵⁷

The Joint Cooperation Committee (JCC) was established as a monitoring device in ASEAN–EU cooperation. The ASEAN–EU Cooperation Agreement constitutes of the Framework Agreement that is considered as the milestone that institutionalised the relationship between ASEAN-EU. Since, the major focus of the agreement was on economic cooperation and development, it consequently opened up an exclusive channel for the exchange of information and requests that paved the way for EU assistance in several development projects. Hence, this agreement also included technical assistance cooperation.¹⁵⁸

Ruelend and Welfens et al. comment on the existence of the unequal relationship between ASEAN and EU, wherein the ASEAN countries certainly had a weaker bargaining position. From the beginning of cooperation, ASEAN was economically far behind the EU. At that time the EU did not consider ASEAN as its priority compared to African, Caribbean & Pacific (ACP) and Latin American countries which received more favourable trade benefits covered by the Lomé Convention. In addition, the irregular

¹⁵² See Luhulima, C.P.F., *Asean-European Community Relations: Some Dimensions of Inter-regional cooperation*, paper presented at International Conference on ASEAN and European Community, 1992, Singapore ; " Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 46. See also Luhulima, 1993; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 84.

¹⁵³ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 84-85. See also Rueland, J., *The Asia-Europe Meeting (ASEM): Towards a New Euro-Aseam Relationship*, Universität Rostock (Rostock Information zu Politik und Verwaltung.5), 1996; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 47.

¹⁵⁴ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 48.

¹⁵⁵ See K. V. Lall & H. S. Chopra (Eds.), *The EEC and the third world*, Humanities Press New Jersey, 1981; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 69.

¹⁵⁶ See Grilli, E. R., *The European community and the developing countries*, Cambridge, Cambridge University Press, 1993; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 69.

¹⁵⁷ See Welfens, Paul J.J., et. al., 2009, *Loc. Cit.*, p. 69.

¹⁵⁸ See *Ibid.*, p. 47.

attendance of the AEMM by the EU ministers apparently showed that the ASEAN–EU relationship was a donor-recipient relationship.¹⁵⁹

In the post-Cold War period, the EU started to introduce “*conditionality policy*” that linked trade preferences to issues on human rights, democratisation, and environmental protection. The EU argued that such policy was designed to improve economic development and democratisation in developing countries by means of trade preferences. The politicisation of the trade preferences policy raised tensions between the EU and ASEAN member states. Some ASEAN leaders saw it as neo-colonialism in trade because the beneficiary has no bargaining power to negotiate the conditions and is obliged to comply with the conditions, otherwise it will be excluded from the beneficiaries list. Dr Mahathir Muhammad, the Prime Minister of Malaysia, complained that the conditionality policy seemed to burden the beneficiary country since some of the non-trade conditions had no significance in the increasing of trade volumes.¹⁶⁰

The polemics of the “*conditionality policy*” in obtaining trade preferences were brought onto the negotiating table during the 9th and 10th AEMMs, which were held in 1991 and 1992. The major agenda of the AEMMs was considered as a very sensitive topic for both parties as it involved exchanges over East Timor and the new conditionality of EU aid and cooperation policy.¹⁶¹ Significant economic growth of ASEAN and East Asia nurtured self-confidence in diplomatic relations. In other words, the economic achievements of ASEAN have been translated into the ability to confront and challenge the decision or intervention action of western countries in order to defend their self-interest for development.¹⁶²

In the 1990s, the relation between ASEAN-EU was extremely tense, where both regions were involved in international trade disputes. ASEAN criticised the EU’s Common Agricultural Policy (CAP) that imposed higher tariffs on oleo chemicals such as palm oil and dry fruit products. In 1995, other disputes were raised by Thailand when submitting a request for WTO consultations with the EU over its import duties on rice.¹⁶³

Some persisting trade disputes arose as the EU protectionist regimes¹⁶⁴ had become an obstacle for ASEAN exports such as the treatment of ASEAN exports within the GSP scheme.¹⁶⁵ The original EU GSP granted facility of free duty for selected products of beneficiary countries but subject to quantitative restriction or quantitative limitation. After 1994, the policy of quantitative restriction under the GSP scheme radically changed and was replaced by tariff modulations, where tariff cuts of the GSP product coverage were divided into four categories according to the import sensitivity of the products related to the EU market. “Product sensitivity” had four categories consisting of a 15% preferential margin for very sensitive products; a 30% preferential margin for sensitive products; a 65% preferential margin for semi-sensitive products; and duty-free entry for non-sensitive products, for instance a 100% preferential

¹⁵⁹ See Welfens, Paul J.J., et. al., 2009, *Loc. Cit.*, p. 47. See also Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 84-85.

¹⁶⁰ See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 48.

¹⁶¹ See Welfens, Paul J.J., et. al., 2009, *Loc. Cit.*, p. 48. See also Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 85.

¹⁶² See Welfens, Paul J.J., et. al., 2009, *Loc. Cit.*, p. 48. See Balme, Richard., and Bridges, Brian., 2008, *Loc. Cit.*, p. 85.

¹⁶³ See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 61-62.

¹⁶⁴ EU Member states protectionist measures that were permissible under Article 115 of the Treaty of Rome and thus outside the CCP, where EU member states could invoke the escape clause and imposes own protectionist measures if the imports in question were having an injurious effect upon domestic producers.

¹⁶⁵ See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 51-53

margin.¹⁶⁶ In the ASEAN perspective, such scheme was seen as too rigid and complicated, and may have created obstacles for GSP utilisation.¹⁶⁷

The GSP Scheme 2002-2004 simplify products sensitivity into two categories that is “*non-sensitive products*” and “*sensitive products*”. Simplification of product sensitivity maintained under current scheme, where eligible non-sensitive products continue enjoying preferential tariff at zero rate. While, sensitive products are eligible enjoying a reduction of 3.5 percentage points at the full *ad valorem* rate of customs duty.¹⁶⁸

In the middle of 1990's, the EU GSP launched open policy on graduation mechanism, to set out criteria for country-sector graduation and country graduation. Country graduation mechanism is granted based on economic criteria when the beneficiary country included as high-income country's based on the World Bank classification. On 1 January 1998, the EU GSP introduced special incentive arrangements that operated on the basis of additional margin of preference and it is granted to beneficiary countries that comply with certain requirements related to labour standards and environmental norms.¹⁶⁹ Most of ASEAN member states are major beneficiaries of the EU GSP that has large export's volume and covering wide range of product's. In 2010, ASEAN is the biggest region trading partner that shared 10.6% of export to EU market under GSP scheme.¹⁷⁰ The comparative advantages of ASEAN member states that combined with the opportunity granted under GSP scheme, it offers greater advantages to expand market share and improving competitiveness of developing countries producers. GSP schemes are expected to be an effective instrument for ASEAN producers to penetrated EU “sensitive” and “semi-sensitive” products market.¹⁷¹

Both of organizations agreed to improve their cooperation through adoption of “*Nuremberg Declaration on EU-ASEAN Enhanced Partnership in 2007*”. Nuremberg Declaration contains long-term vision and commitment to cooperate achieving common goals and covering wide range of areas.¹⁷² In order to implement the Nuremberg Declaration effectively, both of parties agreed to adopt “the ASEAN-EU Plan of Action 2007”. The Plan of Action promoting exchanges information on trade rules and regulation between both parties. It is important for traders to have open information and to understand trading partner rules and regulations on trade and investment, such as anti-dumping, subsidies, and tariff and non-tariff measures.¹⁷³ The

¹⁶⁶ See United Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the European Community, 2008, *Op. Cit.*, p. 9. See also See United Nations Conference on Trade and Development, Generalized System of Preferences : Handbook on the GSP scheme of the European Community, Trade Laws and Preferences UNCTAD/ITCD/TSB/Misc.25 March 1998, UNCTAD Technical Cooperation Project on Market Access, INT/97/A06, p. 6, available at : <http://www.unctad.org/en/docs/poitcdtsbm25.pdf>, last accessed : 13 October 2011.

¹⁶⁷ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 53.

¹⁶⁸ See *Ibid.*, p. 53.

¹⁶⁹ See United Nations Conference on Trade and Development, Generalized System of Preferences, Handbook on the Scheme of the European Community, 2008, *Op. Cit.*, p. 9. See also See United Nations Conference on Trade and Development, Generalized System of Preferences : Handbook on the GSP scheme of the European Community, Trade Laws and Preferences, 1998, *Op. Cit.*, p. 6.

¹⁷⁰ See EU GSP Statistic, available at : http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147291.pdf, last accessed : 14 October 2011.

¹⁷¹ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 53.

¹⁷² Nuremberg Declaration covers Political and Security Cooperation, Economic Cooperation, Cooperation in the field of Energy Security and Climate Change/Environment, Socio-Cultural Cooperation, and Development Cooperation. ASEAN - EU agreed to utilise the Trans Regional EU-ASEAN Trade Initiative (TREATI) as the foundation for economic cooperation. In the development cooperation both of EU put their commitment on alleviate poverty, narrow the development gap, and promote sustainable development and integration in ASEAN. Nuremberg Declaration on an EU-ASEAN Enhanced Partnership in 2007 was signed in 15 March 2007 in Germany.

¹⁷³ See Paragraph 2.10 The Plan of Action (PoA) to implement Nuremberg Declaration 2007.

Plan action is encouraging cooperation of the enhancement and modernization of customs clearance and transit regime in ASEAN, through strengthening the capacity of the Customs Administrations and the ASEAN Secretariat.¹⁷⁴ The Plan of action initiated concrete steps and activities to develop further ASEAN-EU dialogue relations.¹⁷⁵

In the area of economic cooperation, the Plan of Action is driving implementation of ASEAN Programme for Regional Integration Support (APRIS II) and Regional EC-ASEAN Dialogue Instrument (READI) as a key instrument to support ASEAN closer integration.¹⁷⁶ The Plan of action also emphasized the significant role of statistical data modernisation in order to build integrated economic region and support further integration measures.¹⁷⁷

With respect to the improvement of trade and investment, a programme called "*Trans Regional EU-ASEAN Trade Initiative (TREATI)*" was established. TREATI functioned as a channel to promote dialogue and cooperation on regulatory issues, to improve two-way trade and to enhance investment flows between ASEAN-EU. For instance, practical improvements in ASEAN-EU trade through expert dialogues and seminars/workshops on the priority sectors.¹⁷⁸ TREATI was established in order to promote trade and investment flows between the two regions through the dialogue mechanism, covering issues on economics and trade such as capacity building and technical assistance.¹⁷⁹ TREATI was also considered as an important initiative to strengthen cooperation on trade facilitations between ASEAN and EU.¹⁸⁰

The trade relationship between ASEAN and EU focused on the development strategy on export growth. It has to be noted that ASEAN exports to all parts of the world saw dramatic rises in the last decade but the region was particularly successful in developing trade with the EU.¹⁸¹

Furthermore, the trade relationship between ASEAN and EU entered a new era when the First Business Summit was organised on 5 May 2011 and took place in Jakarta, Indonesia. The ASEAN-EU Business Summit resulted from the mutual agreement reached in the 9th Consultation meetings between the ASEAN Economic Ministers (AEM) and the EU Commissioner for Trade, which was held in Vietnam on 27 August 2010. The Summit served as an opportunity for ASEAN and EU leaders to discuss ways in which the private sector can exchange views and contribute on ASEAN-EU trade and investment relations with governmental decision makers.¹⁸² This Summit

¹⁷⁴ See Paragraph 2.13 The Plan of Action (PoA) to implement Nuremberg Declaration 2007.

¹⁷⁵ The Plan of Action (PoA) to implement Nuremberg Declaration aimed to serve as the master plan for enhancing ASEAN-EU relations and cooperation in the medium term (2007-2012) in a comprehensive and mutually beneficial manner.

¹⁷⁶ See Paragraph 2.4 The Plan of Action (PoA) to implement Nuremberg Declaration 2007.

¹⁷⁷ See Paragraph 2.5 The Plan of Action (PoA) to implement Nuremberg Declaration 2007.

¹⁷⁸ See Paragraph 2.7 The Plan of Action (PoA) to implement Nuremberg Declaration 2007.

¹⁷⁹ Overview of ASEAN-EU Dialogue Relations, available at : <http://www.asean.org/23216.htm>, last accessed : 21 September 2011.

¹⁸⁰ See Paragraph 2.8 The Plan of Action (PoA) to implement Nuremberg Declaration 2007.

¹⁸¹ "[...] From 1990 to 1998, ASEAN exports to the EU trebled to reach some €45 billion Euro. In 2001, the EU is ASEAN's second largest export market and the third largest trading partner after the United States and Japan. The EU exports to ASEAN are estimated at €42.2 billion Euro, while EU imports from ASEAN are valued at €65.7 billion Euro. It is, demonstrating that the EU maintained its commitment to keeping its market open to ASEAN after the 1997 Asian financial crisis. As a region, ASEAN has benefited significantly from the EU's GSP. ASEAN member states such as Thailand and Indonesia become ultimately very competitive in several sectors during the last few years. European investment was high in the region before the crash of 1997. However, the trend is rising again even higher than what it has been achieved [...]" (See Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, pp. 69-70).

¹⁸² See The 1st ASEAN-EU Business Summit 2011, available at : <http://asean-eubizsummit.com/index.php/about> and <http://asean-eubizsummit.com/index.php/about>.

provided a solid foundation to strengthen cooperation and partnerships between the two regions.¹⁸³

IV. The European Union Generalised System of Preferences and ASEAN.

The intention to develop and improve EU GSP that was granted to the ASEAN member states was the focus of the Ministerial Meetings between the two regions. In trade relations with EU, ASEAN's position is as the mutual trading partner and the recipient of the EU GSP. The rapid economic development of ASEAN has increased the volume of trade between ASEAN and EU, significantly creating interdependency factors between the two regions.

Since ASEAN is not included in any other PTA, such as the Lomé Agreement, GSP is the only trade preferential scheme granted by EU to ASEAN member states. Currently the Lomé Agreement has been replaced by the EPA's regime covering ACP (Africa, Caribbean and Pacific) countries. Originally, this PTA was based on colonial ties. Since the beginning of its implementation, other countries have expressed disagreement due to the breach of the non-discrimination principle under GATT 1947. As mentioned before, earlier developments of ASEAN were not so fast, thus, they were placed as low priority for the granting of a preferential trade scheme. Therefore, GSP has played an important role in its contribution to strengthen cooperation between the two regions.

GSP was first discussed in the AEMM in Brussels on November 1978. The meeting was attended by five ASEAN member states (Indonesia, Malaysia, the Philippines, Singapore and Thailand), and eight EU Member States (Belgium, Denmark, Germany, France, Ireland, Italy, Luxembourg, and the Netherlands). It included the President of the Council and the President of the Commission of the EU. During the meeting, the EU explicitly expressed its awareness of the special needs of developing countries, particularly ASEAN. Therefore, the EU reiterated its intention to meet the special needs of developing countries using "legal" agreements in international trade principles.¹⁸⁴

In the sphere of their economic relationship, ASEAN and EU affirmed their mutual interest to stimulate economic cooperation between the two regions.¹⁸⁵ In trade matters, ASEAN focused on measures adopted by the EU. ASEAN argued that some of those measures were considered as exports constraints. On the other hand, the EU argued that such measures would not significantly influence trade flows between the two regions. Furthermore, the EU stated that such measures were taken based on the special situation in a few sectors and were applied temporarily.¹⁸⁶

In the AEMM in 1978, ASEAN expressed its needs to improve access to EU markets. ASEAN needed to expand the market for its manufactured, semi-manufactured, and primary product exports and EU responded positively towards the request.¹⁸⁷ In respect of trade facilitations, ASEAN demanded the EU to remove or relax

¹⁸³ See The ASEAN Secretariat, Chair's Statement of the 18th ASEAN Summit Jakarta, "ASEAN Community in a Global Community of Nations" 7 - 8 May 2011, available at : http://www.asean.org/Statement_18th_ASEAN_Summit.pdf, last accessed 17 October 2011.

¹⁸⁴ See Paragraph 18 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978, available at : <http://www.asean.org/5617.htm>. "[...] ASEAN and the Community agreed on the necessity to maintain free trade conditions in order to promote a recovery in the world economy through expanding international trade. They confirmed their readiness to cooperate constructively to achieve satisfactory results in the MTN negotiations. The Community expressed its awareness of the special needs of the developing countries and particularly of ASEAN and reaffirmed its intention to seek provisions which would satisfy these needs [...]".

¹⁸⁵ See Paragraph 20 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978, available at : <http://www.asean.org/5617.htm>.

¹⁸⁶ See Paragraph 21 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

¹⁸⁷ See Paragraph 23 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

tariff and NTB and to streamline its administrative procedures.¹⁸⁸ ASEAN requested efficiency improvements and excessive bureaucracy reductions that were imposed on ASEAN's export products. The relaxation of tariff and NTB to trade could help ASEAN products compete in the EU market. Since EU GSP significantly contributed to the economic development of the ASEAN member states, therefore, ASEAN asked the EU to improve its GSP scheme, formalising it into a permanent policy.¹⁸⁹

It should be noted that before the Enabling Clause was enacted in 1979, the EU GSP was established based on the Waiver of GSP 1971. According to the Waiver of GSP, Article I of GATT 1947 waived for a period of ten years, thus, allowing developed contracting parties to come to an agreement on the preferential tariff treatment on products originating from developing countries based on generalised, non-reciprocal, and non-discriminatory principles.¹⁹⁰

The EU responded to such positive opportunity and expressed its intention to extend such GSP "*beyond the initial decade foreseen at its establishment*". Furthermore, the EU considered the request of "*favourably to the fullest possible extent for improvements*" that would significantly favour the economic development of ASEAN member states.¹⁹¹ Before the legalisation of GSP into the Enabling Clause, the EU intended to formalise the GSP scheme as its permanent policy and to improve the scheme as part of its commitment to favouring the economic development of developing countries.

Some identified factors have caused low utilisation of GSP by beneficiary countries. For instance, Corbet and Ariff criticise the EU GSP scheme for its restrictive rules on origin, low quota provisions, and high administrative costs incurred upon beneficiaries. They consider that such factors do not allow the utilisation of GSP to be maximised. However, ASEAN member states were constantly seeking better access for particular products through the scheme (e.g. tapioca, palm oil, and plywood). In the late 1980s, the GSP scheme reforms started to be introduced through limiting the scope of benefits enjoyed by ASEAN, especially on the provisions that limited GSP concessions to non-sensitive sectors. As a result, ASEAN exports to the EU that enjoyed GSP status, decreased by 70% in 1989.¹⁹²

The Cooperation Agreement between the "*Member Countries of ASEAN and European Community in 1980*" is considered as the cornerstone of ASEAN-EU cooperation. The Cooperation Agreement did not specifically mention the EU GSP, but the provisions of the agreement supported the implementation of GSP, especially Article 2 (Commercial Cooperation) and Article 3 (Economic Cooperation). For instance, Paragraph 3 Article 2 contains provisions on Commercial Cooperation. Where both parties should accommodate trade facilitation in their policy in compliance with national legislation. First, both parties must use their best endeavours to grant each other the widest facilities for commercial transactions. Second, both parties must take into full account their respective interests and needs for improved access for manufactured, semi-manufactured and primary products as well as the further processing of resources. Third, there must be cooperation between the economic operators in both regions with the aim of creating new trade patterns. Fourth, a study must be carried out to recommend trade promotion measures that are likely to

¹⁸⁸ See Paragraph 24 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

¹⁸⁹ See Paragraph 24 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

¹⁹⁰ See Waiver of Generalized System of Preferences, Decision of 25 June 1971, BISD 18S/24.

¹⁹¹ See Paragraph 25 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

¹⁹² See M. Dent, Christopher., 2002, *Op. Cit.*, p. 54.

encourage the expansion of imports and exports. The Cooperation Agreement has laid down the fundamental basis of trade facilitations that is useful to help improve GSP implementation in ASEAN.¹⁹³

The Cooperation Agreement reflects mutual trade cooperation between two regions that have very different economic development levels. In 1981, the ASEAN Ministers and the EU Commission had a meeting that was held in Brussels, where EU “reiterated its strong support for ASEAN’s endeavours towards closer regional economic cooperation”.¹⁹⁴ Both parties agreed to undertake cooperation and carry out positive roles in international trade organisation in order to establish a new international economic order.¹⁹⁵

Following the success of the 3rd Meeting of the Joint Cooperation Committee in 1982, thus, in 1983 the 4th AEMM was held in Bangkok, with the aim to increase cooperation between the industrial and business sectors between the two regions. During the 4th AEMM, the importance of economic and technical cooperation among developing countries was explicitly recognised as a means to promote the efficient use of human capital, material, financial, and technological resources that are available within the region for the individual and collective welfare of the people of ASEAN and other developing countries. In later development, the importance of technical cooperation among developing countries is very useful to enhance trade facilitation and to improve utilisation of EU GSP.¹⁹⁶

During the 5th AEMM, the EU has reiterated its commitment to implement the basic principles of the GSP. The EU also agreed to take into account the interests and needs of the ASEAN countries in the second phase of its GSP scheme improvement to ensure utilisation of the GSP economic benefit.¹⁹⁷

Thus, in the AEMM on Economic Matters, which was held in Bangkok in October 1985, ASEAN and EU agreed, “that the EU GSP is the effective tool to expand trade between ASEAN and EU”. Since 1975, the EU has applied “cumulative rules of origin provisions” to ASEAN imported products under the GSP scheme. The cumulative origin has promoted trans-national export-oriented production within the regions to facilitate closer economic integration, particularly to attain a single market and production base.¹⁹⁸

In addition, the EU also emphasised the importance of making further improvements particularly in respect of product coverage, preferential margins, and quantitative limitations of preferential imports in the GSP scheme.¹⁹⁹ The EU policy on reforming its GSP scheme has answered the demand of ASEAN expressed in AEMM 1978. During the first five years of the cooperation agreement the EU increased its development aid to ASEAN.²⁰⁰

¹⁹³ See Paragraph 3 Article 2 of the Cooperation Agreement between Member Countries of ASEAN and European Community, Kuala Lumpur, 7 March 1980, available at : <http://www.asean.org/1501.htm>.

¹⁹⁴ See Paragraph 4 of the Joint Press Statement The ASEAN Ministers and the Commission of the European Community Brussels, 15 October 1981, available at : <http://www.asean.org/5626.htm>.

¹⁹⁵ See Paragraph 7 of the Joint Press Statement The ASEAN Ministers and the Commission of the European Community Brussels, 15 October 1981.

¹⁹⁶ See Paragraph 30 and 31 of the Joint Declaration The Fourth ASEAN-EC Ministerial Meeting Bangkok, 25 March 1983, available at : <http://www.asean.org/5628.htm>.

¹⁹⁷ See Paragraph 25 of the Joint Declaration The Fifth ASEAN-EC Ministerial Meeting Dublin, 15-16 October 1984, available at : <http://www.asean.org/5630.htm>.

¹⁹⁸ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 51. Its has emerge the establishment of multinational company in ASEAN.

¹⁹⁹ See Paragraph 10 of the Joint Statement The ASEAN-EC Ministerial Meeting on Economic Matters, Bangkok, 17-18 October 1985, available at : <http://www.asean.org/5631.htm>.

²⁰⁰ See Paragraph 11 of the Joint Statement The ASEAN-EC Ministerial Meeting on Economic Matters, Bangkok, 17-18 October 1985.

The EU and ASEAN agreed to maintain open trading systems and improve market access in both regions. In the 6th AEMMs the EU GSP scheme regarded as the effective instrument to penetrated EU market. In other words, EU GSP still played significant role to expand ASEAN market access in EU. Therefore, ASEAN is keen “welcomed” the EU intention to make further improvement on their GSP scheme.²⁰¹

Single European Act (SEA) entered into force by 1 July 1987 with aimed to create single market by 1992. SEA has brought the Union into closer integration and created an internal market of 360 million populations. The completion of the EU single market provides larger opportunities and greater market access for EU trading partners’.²⁰² Enlargement of EU enhance ASEAN market shares, yet elimination of NTB is still needed to have better market access. The EU GSP has significant contribution of increasing ASEAN exports’, especially in manufactured goods in which constitute 50% of ASEAN total exports to the EU, therefore, the EU Ministers agreed to examine the possibility of improving the EU GSP scheme further.²⁰³ In the early of 1990s the trade flows between two regions have significantly increased, especially for industrial products.²⁰⁴

The 8th AEMMs is prioritized on the “*Market Access and Trade Promotion*”, for instance ASEAN requested EU to provide better market access and *vice versa*. Both of the parties made focus on tariffs reduction, removal of non-tariff barriers, and minimizing tariff increases in order to improve the market access for their export products’. The EU needs market access improvement in respect of products such as motor cars, personal computers, paper, textiles and clothing, fertilisers, pharmaceuticals, and chemical products. While ASEAN tends to demand market access improvement for agricultural products and strongly criticized the EU common agricultural policy (CAP).²⁰⁵

Important improvement is made in the EU GSP Scheme 1989 and 1990, which include sensitive products under its’ product coverage. Accordingly, the beneficiary countries including ASEAN member states are given market access improvement in the EU sensitive sectors, which had never been opened under previous scheme. At the same time, the EU GSP cumulative rules of origin contributes positive progress to enhance GSP utilization.²⁰⁶ In addition, the EU also giving aid and technical assistance

²⁰¹ See Paragraph 19 of the Joint Declaration The Sixth ASEAN-EC Ministerial Meeting Jakarta, 20-21 October 1986, available at : <http://www.asean.org/5633.htm>.

²⁰² See Paragraph 26 of the Joint Declaration The Eighth ASEAN-EC Ministerial Meeting Malaysia, 16-17 February 1990, available at : <http://www.asean.org/5637.htm>.

²⁰³ See Paragraph 45 and 46 of the Joint Declaration The Seventh ASEAN-EC Ministerial Meeting, in Duesseldorf on 2 and 3 May 1988, available at : <http://www.asean.org/5636.htm>.

²⁰⁴ See Paragraph 26 of the Joint Declaration The Eighth ASEAN-EC Ministerial Meeting Malaysia, 16-17 February 1990.

²⁰⁵ See Paragraph 30 and 32 of the Joint Declaration The Eighth ASEAN-EC Ministerial Meeting Malaysia, 16-17 February 1990. “[...] The ASEAN Ministers request the EU to provide better market access and a more open trade policy for textiles and clothing, tropical vegetable oils, cocoa products, canned pineapple, timber products, tapioca products, pulp, and fuel wood through reduction of tariffs, elimination of non-tariff barriers and elimination of tariff escalation. The ASEAN Ministers also request the EU to take into account agricultural products of export interest to ASEAN in its implementation and review of the CAP. The EU Ministers requested ASEAN to sign the MTN agreements (technical barriers, government procurement, etc.) and to provide improved market access for products such as motor cars, personal computers, paper, textiles and clothing, fertilisers, pharmaceuticals and chemical products through reduction of tariffs and elimination of non-tariff barriers [...]”

²⁰⁶ See Paragraph 35 of the Joint Declaration The Eighth ASEAN-EC Ministerial Meeting Malaysia, 16-17 February 1990. See also paragraph 47 of the Joint Declaration The Ninth ASEAN-EU Ministerial Meeting Luxembourg, 30-31 May 1991, available at : <http://www.asean.org/5638.htm>. “[...] The Minister agreed that the EU GSP Scheme was an important tool by which ASEAN’s exports to the EU could be diversified and increased. They welcomed the significant increase in benefits arising from the use of GSP. The ASEAN Ministers noted that the EU is revising the GSP Scheme in order to make it simpler and more transparent. They urged the EC to take into account ASEAN interests inter alia the inclusion of the donor country content [...]”.

on ASEAN trade promotion programmes. This program designed to improve ASEAN exports to the EU and third countries.²⁰⁷

In the beginning of 1990s ASEAN-EU's trade grown significantly. ASEAN exports to EU are continuing to improve faster than its exports to any other market. EU nowadays is the second largest market for ASEAN's manufactured products. The EU's exports to ASEAN is increasing at a higher rate than to any other region in the world. According to the ASEAN secretariat, the implementation of two-way trade has exceeded amount of \$50 billion USD. During the 10th AEMMs it is agreed some important points with purposed to enhance cooperation between two regions, i.e.:²⁰⁸

1. Each side would continue to improve access to its market to maintain these high rates of growth in two-way trade.
2. Both sides would continue to improve access and enhance rapid information networks linking business operators in the two regions, for example, through the establishment of business information centres and networks of European Chambers of Commerce in ASEAN.
3. The EU would provide more systematic information on the Single European Market with the view to assisting ASEAN to adjust to changes and market opportunities arising there from.

In the early of 1990s, the EU was on the process of ratifying Treaty of Maastricht that very crucial for the establishment of what we called now as "*Treaty on European Union*",²⁰⁹ At the same time, the fall of the Berlin wall has encouraged the enlargement of the EU to the East Europe. While, on 28th January 1992, took a place in Singapore, the "*Agreement on the CEPTS for the AFTA*" was signed by ASEAN member states to apply effective tariff preferential to the goods and products originating from its' members.²¹⁰ According to this agreement , ASEAN member states are obliged to implement tariff reduction under the CEPT Scheme.²¹¹

In the 10th AEMMs the EU GSP Scheme still included in the main menu of discussion, because it is deemed as an important tools to diversify and to increase ASEAN's exports to EU. ²¹² The meeting was took a note about the important role of cumulative rules of origin in the ASEAN economic integration.

"[...] The Ministers recognized that the General System of Preferences (GSP) has contributed to the growth in exports from ASEAN to the EU. More than one third of ASEAN's exports to the EU enjoy tariff concessions under the GSP.²¹³ The Ministers

²⁰⁷ See Paragraph 36 of the Joint Declaration The Eighth ASEAN-EC Ministerial Meeting Malaysia, 16-17 February 1990. See also paragraph 49 of the Joint Declaration The Ninth ASEAN-EU Ministerial Meeting Luxembourg, 30-31 May 1991, available at : <http://www.asean.org/5638.htm>. "[...] The ASEAN Ministers expressed their appreciation to the EU for its assistance in ASEAN's trade promotion programmes which were found to be an important element in the process towards the diversification of exports [...]"

²⁰⁸ See Joint Declaration The Tenth ASEAN-EC Ministerial Meeting Manila, 29-30 October 1992, available at : <http://www.asean.org/5639.htm>.

²⁰⁹ See Joint Declaration The Tenth ASEAN-EC Ministerial Meeting Manila, 29-30 October 1992.

²¹⁰ See Paragraph 1 Article 1 Agreement on the CEPTS for the AFTA.

²¹¹ See Paragraph 1 Article 2 Agreement on the CEPTS for the AFTA.

²¹² See Joint Declaration The Tenth ASEAN-EC Ministerial Meeting Manila, 29-30 October 1992.

²¹³ "[...] Changes made by the EU to its GSP scheme during the mid-1990s were another cause of concern for the ASEAN beneficiaries. The group still enjoyed considerable advantages from participating in the scheme, receiving around 30% of its total concessions in value terms in 1993. However, in 1995 the system of fixed and flexible quota restrictions on industrial products was replaced by preferential CCT duty concessions granted according to 'sensitivity' classification. Unlimited market access was also offered to GSP imports, although safeguard measures were still applicable under certain circumstances. These revisions meant that GSP imports were no longer eligible for automatic zero-CCT rates, but attracted a Modulated Preferential Duty (MPD) commensurate with the degree of sectoral sensitivity associated with the products in question. Four types of classification are exist. Very sensitive with MPD equivalent to 85% of the CET. Its mainly includes textiles and ferro-alloys. Sensitive with 70% MPD rate. Its covering a wide range of products such as chemicals, consumer electronics, cars and footwear. Semi-sensitive with 35% MPD rate, its covers diverse range of products in less sensitive

noted that the EU envisages a revision and updating of the GSP for the next decade. In this context, the Ministers recognised that the Cumulative Rules of Origin (CRO) provision has contributed to ASEAN's regional integration and would further assist ASEAN in achieving its objectives of an ASEAN Free Trade Area. . The ASEAN Ministers stressed their concerns about certain elements such as "Social Incentives" in the Commission proposals on the review of the GSP. The ASEAN Ministers asked that the proposed scheme should take into account the need for smooth industrial development in the ASEAN countries and the multilateral principles. The EU Ministers took note of these remarks while stressing the development aspects of the proposed scheme [...].²¹⁴

In the early of 1990s, the EU announced about their plan to apply new features of GSP scheme that enter into force in 1994. The EU provide opportunities for further discussions of the new features of GSP with ASEAN. In respect of trade promotion assistance, the EU considers it did increased two-way trade and significantly contributing to ASEAN's exports diversification. Therefore, both of parties were agreed to continue such programmes. ²¹⁵

In 1993, the ASEAN secretariat noted that trade flows between EU and ASEAN exceeded 49 billion ECU²¹⁶. This is equal to four times the volume of trade in 1980 when the ASEAN-EU started formalising their trade cooperation into an agreement.²¹⁷ According to Christopher, in 1980 EU15 represented ASEAN's third biggest external trading partner with 14.1% of its total export and import trade. While ASEAN shared only 3.0% of extra-EU15 exports and 2.7% of extra-EU15 imports.²¹⁸

Continuously the value of trade between ASEAN and the EU reached 86 billion USD in 1995. This proved that the trade flow of ASEAN-EU increased significantly with remarkable progress.²¹⁹ Both parties agreed that there should be mutual efforts to improve market access, promoting, and facilitating the free flow of goods and services between the two regions, in this regard referring to the establishment of the FTA.²²⁰

In 1996, the Asia-Europe Meeting (ASEM) took place in Bangkok and was officially launched as an interregional forum dialogue. ASEM was seen as a new dynamic parallel with the AEMMs. The central role of the AEMMs was policy-formulating and coordinating organs of the ASEAN-EU dialogues.²²¹ In 1997, the relationship between ASEAN and EU entered its third decade since ASEAN was

sectors than the above, e.g. jewellery, calculators, watches. Non-sensitive with zero MPD rate is applied to products deemed to not to possess any degree of sectoral sensitivity [...]. (See M. Dent, Christopher., 2002, *Op. Cit.*, p. 58).

²¹⁴ See Paragraph 10 of the Joint Declaration The Eleventh ASEAN-EU Ministerial Meeting, Karlsruhe, 22-23 September 1994, available at : <http://www.asean.org/5642.htm>.

²¹⁵ See Joint Declaration The Tenth ASEAN-EC Ministerial Meeting Manila, 29-30 October 1992.

²¹⁶ "[...] ECU is standfor European Currency Unit (symbol ₤). The name of the currency used in the European Community before the Euro applied. The ECU by the EU member states as the internal accounting unit. The ECU was begin to be applied in the European Economic Community (EU) on 13 March 1979. Hence, ECU considered as the precursor of the euro introduced on 1 January 1999 [...]. See European Currency Unit, available at : <http://fx.sauder.ubc.ca/ECU.html>, , last accessed : 12 January 2012.

²¹⁷ See Paragraph 8 and 9 of the Joint Declaration The Eleventh ASEAN-EU Ministerial Meeting, Karlsruhe, 22-23 September 1994.

²¹⁸ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 49.

²¹⁹ See Subparagraph 5 Paragraph 12 of the Joint Declaration The Twelfth ASEAN-EU Ministerial Meeting, Singapore, 13-14 February 1997, available at : <http://www.asean.org/5643.htm>.

²²⁰ See Subparagraph 5 Paragraph 12 of the Joint Declaration The Twelfth ASEAN-EU Ministerial Meeting, Singapore, 13-14 February 1997.

²²¹ See Paragraph 4 of the Joint Declaration The Twelfth ASEAN-EU Ministerial Meeting, Singapore, 13-14 February 1997.

established as a regional organisation in Southeast Asia and covered so many areas of cooperation.²²²

The establishment of WTO in 1995 significantly influenced the current relationship between ASEAN and EU since all their members states had WTO Membership including the EU itself. Therefore, they were obliged to carry out the entire obligations laid down in the WTO Agreements. Accordingly, the ASEAN and EU trade relationship had to be governed by fair and equitable principles based on open trade rules of the international trading system. The pattern of the trade relationship between ASEAN and EU shifted into an “*equal economic partnership*”, since economic development and industrialisation in Asia was rapidly growing. In a multilateral context and at a global level, the WTO establishment developed consciousness of globalisation. The post-Cold War *détente* also influenced “the anomaly” of international relations between states from geo-politics into geo-economics.

Nowadays, either ASEAN or the EU is considered as the most dynamic economic region in the world. The EU is the world’s largest trading entity, while ASEAN is one of the fastest growing regions in the world. Accordingly, this provides a sound basis for dynamic economic cooperation between ASEAN and EU.²²³ Christopher briefly outlines the reasons that explain changes in the EU mind-set and policies in its relationship with ASEAN, which is based on economic interest.²²⁴

²²² See Paragraph 9 of the Joint Declaration The Twelfth ASEAN-EU Ministerial Meeting, Singapore, 13-14 February 1997. “[...] Since 1977, ASEAN and EU have established a strong network of mechanisms to drive ASEAN-EU cooperation. These mechanisms include the ASEAN-EU Ministerial Meeting, the Post-Ministerial Conference, the ASEAN Regional Forum, the ASEAN-EU Senior Officials Meeting (SOM) and the Joint Cooperation Committee (JCC) [...]”.

²²³ See Subparagraph IV Paragraph 12 of the Joint Declaration The Twelfth ASEAN-EU Ministerial Meeting, Singapore, 13-14 February 1997.

²²⁴ “[...] The European perception of ASEAN as a minor economic partner was to change over the course of the 1980s. Southeast Asia’s dynamic industrial development during the decade had made the EU increasingly aware of the growing interdependent economic relationship that was evolving between itself and ASEAN. In this context, a number of trends are worth noting. By 1990, ASEAN’s share of extra-EU-15 exports had risen to 4.8%, thus becoming a larger export market than the whole of Latin America, while its share of extra-EU imports had increased to 4.0%, making it a more important source of imports than Canada and Australia combined. The acceleration of ASEAN-EU trade flows was especially apparent from the late 1980s onwards. EU imports from ASEAN has increased by 66.8% over 1987–1990. It was rising from 10.0 billions ECU to 16.8 billions ECU by the end of the period [...]”. (See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 65-66).

“[...] Meanwhile, EU exports to ASEAN had increased even faster at 80.5 %, rising from 8.9 billions ECU to 16.1 billions ECU. Furthermore, the EU-15’s position as ASEAN trade partner had improved slightly, with its share of total ASEAN imports and exports standing at 15.5 % and 15.9 % respectively by 1990. A growing interdependence was also manifest in sectoral trade trends with ASEAN manufacture exports to the EU as a share of the group’s total EU exports increasing from 54.4 % in 1980 to 58.4 % by 1987. Among the ASEAN member states, the highest individual rates were attained by Singapore (86.4 %), Malaysia (83.7 %) and the Philippines (83.0 %). The EU’s imports from ASEAN rose from 16.8 billions ECU in 1990 to 45.7 billions ECU by 1997, and its exports from 16.1 billions ECU to 45.5 billions ECU [...]”. (See M. Dent, Christopher., 2002, *Loc. Cit.*, pp. 65-66).

“[...] Over the 1985–1989 period, the stock of FDI from EU firms in the ASEAN increased by 57.2 % from \$7.7 billions to \$12.1 billions, thus maintaining the EU’s position as the second largest inward investor in Southeast Asia after Japan. Moreover, in the structure of EU financial assistance to ASEAN there was a notable switch of emphasis towards economic co-operation and away from development co-operation and humanitarian assistance over the 1980s, a further reflection of ASEAN being perceived by the EU as a more capable economic partner. Thus by the end of the 1980s, there were calls for a more equal partnership to be established within the institutionalised framework of EC-ASEAN economic relations. This was to set the tone for a new phase of EU-ASEAN economic relations in the 1990’s [...]”. (See M. Dent, Christopher., 2002, *Op. Cit.*, p. 59).

“[...] At the industrial level, we have already commented on how Southeast Asia’s continued rapid industrialisation had brought about significant structural changes to EU-ASEAN economic exchange by the end of the 1980s. In the early 1990s, manufactured goods share of ASEAN’s exports to the EU rising from 58.4 % in 1987 to 78.6 % by 1993. The intra-industry trade ratios of ASEAN country trade with the EU had all risen over the 1989–1994 period: Indonesia from 11.7 % to 26.3 %; Malaysia from 42.2 % to 46.2 % ; the Philippines

EU GSP has evolved since it was first launched in 1971. The EU Commission reviews the implementation of the GSP annually to ensure that the benefits of GSP are delivered properly to the beneficiary countries. The section graduation mechanism that is applied in the GSP has allowed the EU to gradually reduce or eliminate GSP benefits from certain products that exceed the quota restrictions or from countries that successfully diversify their exports. Section graduation is determined based on the criteria that represent the development level and product specialisation of the beneficiary countries. However, the EU also provided a mechanism for the beneficiary countries that have been granted sector graduations to re-apply for the product concerned to get GSP facility.²²⁵

There are five ASEAN countries that have been granted sector graduations. They consist of Thailand, Malaysia, Indonesia, Brunei Darussalam, and the Philippines. In May 1998, Singapore as the most advanced economy of ASEAN, totally graduated from the EU GSP. Christopher notes, “[...] *these changes did have some significant impact on Southeast Asia’s less advanced economies whose dependence upon the EU GSP concessions was naturally more pronounced [...]*”. In addition, the non-trade conditionality that applied in the GSP seemed to be a burden for the developing countries thereof the ASEAN member states were dubious of the new social and environmental clauses that had been incorporated into the scheme in 1998.²²⁶

The pattern of the ASEAN-EU relationships had changed from dependence into interdependence, where at the beginning the relationship of ASEAN-EU started from historical factors such as colonial ties. After the Second World War, the relationship between Southeast Asian and European countries was established as a relationship between developed and developing countries (north and south relation). In the framework of the GSP, the relationship pattern that exists is the relationship between beneficiary countries and preference-granting countries. In other words, the relationship pattern under the GSP scheme apparently works as “*dependency*” of recipient countries and donor countries.

In the early years of the ASEAN-EU relationship, the concept of their relationship was based on donor (rich) countries and recipient (poor) countries. The rapid development of some ASEAN member states changed the EU trade policy by considering ASEAN as “*equal trading partners*”. ASEAN started feeling more confident to be able to criticise the EU CCP related to trade and development issues.²²⁷

While in the north and south relation concept the character of the relationship traditionally existed based on “*comparative advantage*”. ASEAN was exporting labour-intensive products and receiving EU capital-intensive products. Hence, this reflected Southeast Asia’s technological dependency on European companies. In the beginning of the 1980s more intra-industry development was emerging in ASEAN. In 1973, ASEAN manufacture exports to the EU as share of its total EU exports was 25.5%, thus, in 1980 it had risen by 54.4%. Obviously, it reflected the rapid industrialisation achieved by the ASEAN states, which to some extent depended on imported technology and capital goods supplied by European companies.²²⁸

The increased trade and investment flows between ASEAN and EU made ASEAN one of the largest exporters and importers to the EU. The rise in ASEAN economic

from 28.9 % to 44.7 %; Singapore from 45.3 % to 47.1 %; Thailand from 32.1 % to 34.1 % [...]”. (See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 64-65).

²²⁵ See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 64-65.

²²⁶ See *Ibid.*, pp. 64-65.

²²⁷ See *Ibid.*, p. 49.

²²⁸ See *Ibid.*, p. 49.

development placed this region as a potential market for EU products. The ASEAN member states as the beneficiary countries of the EU GSP scheme were either involved to give contributions towards the scheme reform through the forum of discussion in the AEMM or through public consultation held by the EU Commission. At the 12th AEMM, both parties recognised “*mutually beneficial economic cooperation*”, in this regard, it can be interpreted that the EU started to consider ASEAN as its important trading partner.²²⁹

The Joint Declaration of the EU and the ASEAN in 1994 brought concern regarding the conditionality of labour rights in the EU GSP, but ASEAN did not challenge its legality under the Enabling Clause. The language of the Declaration is as follows:²³⁰

“[...] The ASEAN Ministers stressed their concerns about certain elements such as “Social Incentives” in the Commission’s proposals on the review of the GSP. It is clear that although the ASEAN Ministers had “concerns” about some conditions in GSP that differentiated between different developing countries, *these concerns did not lead to the least hint of questioning the legality of the EC GSP scheme under the GATT Enabling Clause*. Moreover, it is clear that there is no agreement between the EC and the ASEAN Ministers that such incentives were disciplined in any legal sense by WTO rules [...]”

Regarding conditionality and selectivity in the GSP scheme, Howse notes that over 30 years no legal instrument had ever been promulgated to elevate the elements of non-discrimination or non-reciprocity to a legal condition standard for the granting of preferences otherwise it would be inconsistent with Article I.²³¹ Since the nature of GSP is a “*grant*” from a developed country to a developing country, obviously it is the autonomous right of the preference-granting country. Therefore, it has been considered as an unstable preferences system.

ASEAN would never be a European Union, even though its integration originally derived from the EU model of regional co-operation.²³² Some studies have compared the emergent Asian-style regionalism with European-style regionalism. The differences identified were mainly due to politico-cultural differences. Both organisations have their unique institutional structures and mechanism, and a distinctive policy to carry out international relations.²³³

Additionally, Christopher briefly elaborates the distinction of regionalism between ASEAN and the EU. First, the EU approach is essentially based on contract or is treaty based and managed with the assistance of supranational institutions. Second, ASEAN is founded on a consensus-building, inter-governmental model of regionalisation. ASEAN member states consist of a heterogeneous composition of politics, economy, and culture. Many obstacles and difficulties have been created in the attempt for deeper integration.²³⁴

ASEAN, as the regional organisation where most of its member states are developing countries that receive GSP facilities, must be able to facilitate its members in order to utilise the GSP properly to increase its extra-trade. In addition, the improvement of the EU GSP scheme also requires the support of regional stakeholders, especially in providing trade facilitation, increasing awareness of business opportunities, and minimising impediments to inter-regional trade.

²²⁹ See Paragraph 12 of the Joint Declaration The Twelfth ASEAN-EU Ministerial Meeting, Singapore, 13-14 February 1997.

²³⁰ See Robert, Howse., 2003.

²³¹ See *Ibid.*, 2003.

²³² See Rajendran 1985; Rieger 1991; M. Dent, Christopher., 2002, *Op. Cit.*, pp. 50-51.

²³³ See Palmer 1991; Langhammer 1997; Palmujoki 1997; M. Dent, Christopher., 2002, *Loc. Cit.*, pp. 50-51.

²³⁴ See M. Dent, Christopher., 2002, *Loc. Cit.*, pp. 50-51.

In 2010, the EU was the second largest trading partner for ASEAN after China. ASEAN and the EU have a total trade value of 11.2% of the total trade among the top ten trading partners. However, the trade relationship between ASEAN and the EU is asymmetric due to the gap between exports and imports. Based on the population, ASEAN has a population of 600 million, which is a larger market than the EU. However, based on the situation of the economic level of the population, the EU has a greater potential market to absorb more goods or products. ASEAN exports to the EU in 2010 were \$92,999.9 million USD or a 11.5% share of the total value of exports among the top ten export trading partners. The EU was the first destination for ASEAN exports. The second destination for imports was the US with a total value of exports of \$82,201.8 million USD or a 10.1% share of the total value among the top ten export trading partners. China is the third destination for ASEAN exports with the total value of \$81,591.0 million USD or a 10.1% share of the total value. Japan is the fourth destination for ASEAN exports with the total value of \$78,068.6 million USD or a 9.6% share of the total value. Hong Kong is in the fifth rank with the total value of exports at \$56,696.7 million USD.

While the biggest import partner in ASEAN is China with the total value of imports reaching \$96,594.3 million USD or a 13.3% share of the total value among the top ten import trading partners. The second biggest import partner is Japan with total value of imports \$82,795.1 million USD or a 11.4% share of the total value. Followed by the EU in the third position with a total value of imports of \$78,795.0 million USD or a 10.8% share of the total value. There is an unbalance in trade between ASEAN and the EU due to the gap between exports and imports in ASEAN. ASEAN exports to the EU are larger than ASEAN imports from the EU. This shows that ASEAN largely depends on exports to the EU. It has placed the EU as the important market for ASEAN exports. Despite the GSP scheme being the only trade preferences given by the EU in the last 40 years.

ASEAN has established a free trade agreement with some countries in East Asia and the Pacific. Five agreements have been established by ASEAN in FTA consisting of AANZFTA (ASEAN-Australia-New Zealand), ASEAN-Republic Korea, ASEAN-Japan, ASEAN-China (ACFTA), and ASEAN-India. In 2003, China was the fourth biggest trading partner with ASEAN and the EU was placed as the third biggest trading partner.²³⁵ Thus, in November 2004 ASEAN and China signed the Agreement on Trade in Goods (TIG) of the Framework Agreement on Comprehensive Economic Cooperation.²³⁶ The TIG agreement contains the non-maintenance of quantitative restrictions and the elimination of non-tariff barriers with the purpose of lowering the costs of trade transactions, to increase ASEAN-China trade, and to enhance economic efficiency. This agreement generates low-cost imports and boosts real income in both ASEAN and China.²³⁷ The ACFTA is divided into two different schedules of tariff reduction and elimination. ASEAN 6 and China completed the removal of their tariff barriers in 2010. While ASEAN CMLV countries have been given the schedule to reach zero tariff by

²³⁵ See Raul L. Cordenillo, *The Economic Benefits to ASEAN of the ASEAN-China Free Trade Area (ACFTA)*, Studies Unit Bureau for Economic Integration, ASEAN Secretariat, 18 January 2005, available at : <http://www.aseansec.org/17310.htm>, last accessed : 02 February 2012.

²³⁶ See ASEAN-CHINA Free Trade Agreement (ACFTA) available at : http://www.mtib.gov.my/repository/woodspot/website_acfta_23july09.pdf, last accessed : 02 February 2012.

²³⁷ See Raul L. Cordenillo, 2005.

2025.²³⁸ China also joined ASEAN Plus Three (APT) Cooperation with Japan and the Republic of Korea. APT covers cooperation in areas of finance and economic and social cultural.²³⁹ The trade between ASEAN and China has grown quickly, thus, it has placed China as the first biggest trading partner of ASEAN. Even replacing the US position in the first rank, skipping the Japanese position in the second rank and EU position in the third rank. ASEAN total trade values to China have reached \$81,591.0 million USD or a 11.6% share of the total value among the top ten trading partners.

²³⁸ See Chia Siow Yue, *ASEAN-China Free Trade Area*, Singapore Institute of International Affairs, Paper for presentation at the AEP Conference, Hong Kong, 12-13 April 2004, available at : <http://www.hiebs.hku.hk/aep/chia.pdf>, last accessed : 02 February 2012.

²³⁹ See ASEAN Plus Three Cooperation, available at : <http://www.aseansec.org/16580.htm>, last accessed : 02 February 2012.

Table 7. Top ten export markets and import origins, 2009²⁴⁰

as of 15 July 2010

value in million USD; share in per cent

Export market			Import origin		
Country of destination ^{1/}	Value of exports	Share to total	Country of origin ^{1/}	Value of Imports	Share to total
ASEAN	199,587.3	24.6	ASEAN	176,620.1	24.3
European Union-27	92,990.9	11.5	China	96,594.3	13.3
USA	82,201.8	10.1	Japan	82,795.1	11.4
China	81,591.0	10.1	European Union-27	78,795.0	10.8
Japan	78,068.6	9.6	USA	67,370.3	9.3
Hong Kong	56,696.7	7.0	Republic of Korea	40,447.4	5.6
Republic of Korea	34,292.9	4.2	Saudi Arabia	17,901.7	2.5
Australia	29,039.3	3.6	Australia	14,810.8	2.0
India	26,520.3	3.3	United Arab Emirates	13,797.0	1.9
United Arab Emirates	10,569.5	1.3	India	12,595.5	1.7
Total top ten destination countries	691,558.3	85.3	Total top ten origin countries	601,727.1	82.8
Others ^{2/}	118,930.9	14.7	Others ^{2/}	124,626.9	17.2
Total	810,489.2	100.0	Total	726,354.1	100.0

Source: ASEAN Merchandise Trade Statistics Database (compiled/computed from data submission, publications and/or websites of ASEAN Member States' national ASEAN Free Trade Area (AFTA) units, national statistics offices, customs departments/agencies, or central banks)

²⁴⁰ Cited from ASEAN External Trade Statistics, available at : <http://www.asean.org/18137.htm>, last accessed : 16 November 2011.

Table 8. Top ten ASEAN trade partner countries/regions, 2009²⁴¹

as of 15 July 2010

value in million USD; share in per cent

Trade partner country/region ^{1/}	Value			Share to total ASEAN trade		
	Exports	Imports	Total trade	Exports	Imports	Total trade
ASEAN	199,587.3	176,620.1	376,207.3	24.6	24.3	24.5
China	81,591.0	96,594.3	178,185.4	10.1	13.3	11.6
European Union-27	92,990.9	78,795.0	171,785.9	11.5	10.8	11.2
Japan	78,068.6	82,795.1	160,863.7	9.6	11.4	10.5
USA	82,201.8	67,370.3	149,572.1	10.1	9.3	9.7
Republic of Korea	34,292.9	40,447.4	74,740.3	4.2	5.6	4.9
Hong Kong	56,696.7	11,218.6	67,915.2	7.0	1.5	4.4
Australia	29,039.3	14,810.8	43,850.1	3.6	2.0	2.9
India	26,520.3	12,595.5	39,115.8	3.3	1.7	2.5
United Arab Emirates	10,569.5	13,797.0	24,366.5	1.3	1.9	1.6
Total top ten trade partner countries	691,558.3	595,044.0	1,286,602.3	85.3	81.9	83.7
Others ^{2/}	118,930.9	131,310.1	250,241.0	14.7	18.1	16.3
Total	810,489.2	726,354.1	1,536,843.3	100.0	100.0	100.0

Source: ASEAN Merchandise Trade Statistics Database (compiled/computed from data submission, publications and/or websites of ASEAN Member States' national ASEAN Free Trade Area (AFTA) units, national statistics offices, customs departments/agencies, or central banks)

²⁴¹ Cited from ASEAN External Trade Statistics, available at : <http://www.asean.org/18137.htm>, last accessed : 16 November 2011.

Table 9. ASEAN Member States Trade with China, 2004-2008²⁴²

(Value in million USD)

Country Name	2004	2005	2006	2007	2008
Brunei Darussalam	243	234	174	201	0
Cambodia	12	15	13	11	13
Indonesia	4,605	6,662	8,344	8,897	11,637
Lao PDR	1	4	1	35	15
Malaysia	8,634	9,465	11,391	15,443	18,422
Myanmar	75	119	133	475	499
The Philippines	2,653	4,077	4,628	5,750	5,467
Singapore	15,321	19,770	26,472	28,925	29,082
Thailand	7,098	9,083	10,840	14,873	15,931
Vietnam	2,711	2,828	3,015	3,336	4,491
ASEAN Export	41,352	52,258	65,010	77,945	85,558
Brunei Darussalam	87	94	120	157	171
Cambodia	337	430	516	653	933
Indonesia	4,101	5,843	6,637	8,616	15,247
Lao PDR	89	185	23	43	131
Malaysia	11,353	14,361	15,543	18,897	18,646
Myanmar	351	286	397	564	671
The Philippines	2,659	2,973	3,647	4,001	4,250
Singapore	16,137	20,527	27,185	31,908	31,583
Thailand	8,183	11,116	13,578	16,184	19,936
Vietnam	4,416	5,322	7,306	12,148	15,545
ASEAN Import	47,714	61,136	74,951	93,173	107,114

Source: ASEAN Trade Statistics Database (Data as of July 2009)

²⁴² ASEAN Member States Trade Data with China, available at : <http://www.asean.org/23752.htm>, last accessed : 02 February 2012.

V. ASEAN Trade Facilitations.

V.a. Trade Facilitations at a regional dimension.

Over the years, trade facilitation has established mainly at a regional level and developed along with regional institutions and trade organisation. Establishment of trade facilitation at a regional level has played a key role in the encouragement of closer integration. Regional trade facilitation usually has special characteristics based on the uniqueness of each region. It is influenced by so many factors such as the political and security situation, economic development, culture, population (demography), and geographical locations. Therefore, adopting an individualised approach to each region is indispensable.²⁴³ According to Kerr and Gaisford, trade analysis must extend beyond neoclassical-based welfare analysis and incorporate political economy elements such as rent seeking behaviour, and political decision-making.²⁴⁴

In order to establish regional trade facilitation with a global approach, it is also important to build collaboration with international organisations and international financial institutions such as the WTO, WCO, United Nations regional economic and social commissions, UNCTAD, regional development banks, and trade promotion organisations. Further Carol Cosgrove-Sacks has explained, “[...] *global standards and technical co-operation projects, for example, can be implemented in practice through existing regional structures, while regional knowledge and experience can be realised through global co-operation in the elaboration and harmonisation of standards [...]*”. The network of regional institutions can play an important role in the future building of trade facilitation. Its strategy is through extracting local experience and best practice around the world and then implementing it into the local setting of trade facilitation. Such strategy would increase efficiency of regional trade facilitation through global knowledge building and high quality standards. In the perspective of international trade, regional trade facilitation can be further developed related to the existing work done within the WTO DDA. The WTO strategy for technical co-operation and capacity building includes a regional approach. It has focused on the delivery of technical assistance on regional platforms, and assembled to the needs of the particular regions of the world.²⁴⁵

The business community significantly contributed to the establishment and improvement of trade facilitation. According to Julian Oliver, the Director General of the IECC, there are three important elements in trade facilitation, i.e. “*cooperation, modernisation and reformation*”.

“[...] Cooperation for trade facilitation, or else see their business migrate to those who do; customs modernisation or else see their revenues decline as trade migrates elsewhere; and governments reformation or else see other countries attract trade and foreign direct investment away from them [...].”²⁴⁶

Furthermore, the business community can contribute to attain a common goal of trade facilitation through dialogue with the government agencies. The dialogue can be

²⁴³ See Cosgrove-Sacks, Carol and Apostolov, Mario, *Trade Facilitation: The Challenges for Growth and Development*, United Nations Economic Commission for Europe, United Nations New York and Geneva 2003, ECE/TRADE/299, United Nations Publication, Sales N°. E.03.II.E.10, ISBN 92-1-116824-4, p.13, available at: http://www.unece.org/cefact/publica/ece_trade_299.pdf. Carol Cosgrove-Sacks, Director, UNECE Trade Division and Mario Apostolov, Coordinator, International Forum on Trade Facilitation, UNECE, *How to Achieve Efficient and Open Collaboration for Trade Facilitation?*.

²⁴⁴ See Kerr, William A., and Gaisford, James D., *Handbook on International Trade Policy*, Edward Elgar Publishing, Inc., Massachusetts, USA, 2007, p. 4.

²⁴⁵ See Cosgrove-Sacks, Carol and Apostolov, Mario, 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 13.

²⁴⁶ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 15.

carried out when new regulations are introduced and old ones reviewed (and this is the key to compliance), providing expertise, and participating in training programmes. The business community demanded that government regulations should be adapted to the modern technology solutions and be more practical and efficient. Solutions can be found through harmonisation regulations across borders and the elimination of excessive formalities and procedures such as the implementation of the single window. Application of ICT on risk management is indispensable to overcome global trade volume growth. To determine the risk factor involved in trade transactions it is necessary to assess selective issues²⁴⁷ in international trade. It is very important to maintain efficiency in customs modernisation through regular validation and updating the system.²⁴⁸

Trade facilitation is very complex because all of its elements are interrelated. Therefore, there is the need for an integrated system and synergic cooperation among the parties involved. Each state has to ensure that its trade facilitation strategy is integrated into its national and regional trade policy and its economic development plans. At a regional level, trade facilitation gives advantages to promote competitiveness and market integration. Improving transparency and speedy procedures is considered as a crucial element to establish successful competition in the global market.²⁴⁹

According to Carol Cosgrove-Sacks, trade facilitation is defined as “*public goods*” that deliver benefits for all parties (including the public and private sector). In an economic perspective, public goods are defined as goods that are *non-rivalrous* and *non-excludable*,²⁵⁰ which means it should be free and common and enjoyed by all citizens. Therefore, trade facilitation should deliver benefits for all parties. It is delivered either directly or indirectly to business actors, traders, other stakeholders, governments and common citizens.²⁵¹

Trade facilitation has the potential of saving billions of dollars for world economic growth and development. It enables trade liberalisation as an important tool for development based on predictable rules, openness, and lack of discrimination.²⁵² Carol Cosgrove-Sacks includes predictable rules and logistical infrastructures as a part of public goods. The government is considered as not fulfilling its major tasks to citizen when public goods are not provided, in this term, trade facilitations, based on predictable rules.²⁵³

The demands for the government to provide trade facilitation have increased since the rapid development in the area of ICT, which has a significant influence. In fact, trade facilitation faces so many challenges. As mentioned above, trade facilitation is very complicated because it covers a wide range of areas, for instance government regulations, business practices, international trade law, ICT and other areas related to it.²⁵⁴

In order to provide trade facilitation as public goods collaboration is needed between the private and public sector to agree on concrete acts, commitments, and payments. Therefore, trade facilitation would be realised as long as the sum of the

²⁴⁷ For example documentary requirements, valuation, checks of quality, brand or origin.

²⁴⁸ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Loc. Cit.*, p. 15.

²⁴⁹ See *Ibid.*, p. 15.

²⁵⁰ See Public good, available at : <http://are.berkeley.edu/courses/EEP101/spring05/Chapter07.pdf>.

²⁵¹ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 11.

²⁵² See *Ibid.*, p. 11.

²⁵³ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 19.

²⁵⁴ See *Ibid.*, p. 19.

willingness of all stakeholders to contribute goes beyond the cost of the product.²⁵⁵ However, to elaborate the interest of all parties into one vision is not an easy job.

The governments of developing countries face problems related to the extra-cost that trade facilitation would impose. On the other hand, they do need trade facilitation to boost their exports. Demands from the business community have encouraged the government to establish trade facilitation. For example the Philippines, it claims that the implementation of trade facilitation measures was not based on WTO or regional trading arrangements, but due to demands from its business community.²⁵⁶

As mentioned above, trade facilitation should deliver benefits to all parties. In this regard, the benefits do not only go to business actors, traders, or stakeholders but are also distributed for the welfare of society through the improvement of economic development. To deliver benefits for all, there is the need for collaboration of political will²⁵⁷, good government and good governance, and private sector participation. Pasca Lamy emphasises that political pressure from the top down is crucial to establish and run trade facilitation as it should be. In other words, the lack of “*political will*” hampers the correct running of trade facilitation.²⁵⁸

Such collaboration goes beyond price, where in the long run building a dynamic system reduces the extra-cost of trade facilitation. Collaboration works in the complementary system that covers simplification, harmonisation, automation of trade procedures (e-trade and e-business), the guarantee of secure information, reduction of excessive bureaucratic procedures, and the removal of other obstacles to trade.

In line with the idea “*that trade facilitation should deliver benefit for all*”, hence, ASEAN prescribes principles on trade facilitation²⁵⁹ in order to give guidance for the member states to carry out trade facilitation measures, i.e.:

- a. **Transparency principle**, means that all information on policies, laws, regulations, and administrative rulings, related to the trade have to be made available to all parties concerned, consistently, and at reasonable cost.
- b. **Communications and Consultations principle**, means the authorities must carry out facilitation and promoting effective mechanisms to the business community, including opportunities of consultation when formulating, implementing and reviewing rules related to trade.
- c. **Simplification, practicability and efficiency principle**, means that rules and procedures relating to trade must be simplified to ensure no more constraints to achieve its legitimate objectives.
- d. **Non-discrimination principle**, means that is rules and procedures relating to trade have to be applied in non-discriminatory manner and be based on market principles.
- e. **Consistency and predictability principle**, means that rules and procedures related to trade have to be applied in consistent, predictable, and uniform manner so as to minimise uncertainty and corruption. In this regard, rules and procedures related to trade has to be provided with clear and precise, having standard operating procedures, and to be applied with non-discretionary.
- f. **Harmonisation, standardisation and recognition principle**, means the rules between member states has to be harmonised accordance to international standards.

²⁵⁵ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, pp. 19-20.

²⁵⁶ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 20.

²⁵⁷ See Alexander Arevalo, also argued that trade facilitation needs “highest-level support”, in this point, its interpreted as political will. It is not purely involve government functions, it is also necessary to mobilize private and public sectors participation and support.

²⁵⁸ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, pp. 13-14.

²⁵⁹ See Article 47 ASEAN Trade in Goods Agreement.

- g. **Modernisation and use of new technology principle**, means that's rules and procedures related to trade has to be reviewed and updated if necessary. Its due to changes of situation such as development of ICT.
- h. **Due process principle**, means as an access to adequate legal appeal procedures, adding greater certainty to trade transactions, in accordance with the applicable laws of member states.
- i. **Co-operation principle**, means member states must undertake to work closely with private sector through opening channels of communication and co-operation.

According to “doing business organization”, there are three elements that important in the export trade facilitation, consists of the number of all documents needed by traders to export, time to export, and cost to export. Documents of export are covering clearance document by government ministries, customs authorities, port and container terminal authorities, health and technical control agencies, and banks. The time to export is calculated starting from procedure of export initiated and runs until it is completed. The cost to export covering all the fees paid until the completion procedures to export the goods such as costs for documents, administrative fees for customs clearance and technical control, customs broker fees, terminal handling charges and inland transport.²⁶⁰

ASEAN member states requires four to ten documents to completed export formalities. Singapore and Thailand are the ASEAN member states that requires less documents than others. Cambodia and Laos are the ASEAN member state that requires more documents compared to others. Indonesia in the third position as ASEAN member states that requires less document after Thailand and Singapore. Exports document has been identified as one of the barriers to the utilization of GSP

Table 10. Time to do exports procedures (days)²⁶¹

Countries	2007	2008	2009	2010	2011
Brunei Darussalam	27	27	27	25	19
Cambodia	37	22	22	22	22
Indonesia	18	18	18	17	17
Malaysia	17	17	17	17	17
Lao PDR	50	50	50	48	44
The Philippines	17	16	16	15	15
Thailand	17	14	14	14	14
Vietnam	24	24	22	22	22
Myanmar	..	..	..	..	..
Singapore	5	5	5	5	5

The average time to carry out export procedures in ASEAN is fifteen days. Singapore is the leader with the shortest time to export compared to other ASEAN member states. While among the other nine ASEAN member states, Laos is nominated as a country with the longest times to carry out export procedures and is also the most expensive country that has imposed the highest cost to export. It takes 48 days to completed export procedures in Laos. While in Indonesia, it takes 20 days to complete

²⁶⁰ Trading Across Border, available at : <http://www.doingbusiness.org/methodology/trading-across-borders>, last accessed : 20 January 2013.

²⁶¹ Available at : <http://databank.worldbank.org/ddp/html>, last accessed : 21 January 2012.

the export procedures. The gap between the shortest periods and the longest periods is too wide. Such gap in the time to export and the cost to export between ASEAN member states is one of the obstacles of AEC realisation and ASW implementation. It is also one of the significant obstacles for a trader to maximise the utilisation of GSP.

Table 11. Document to export (Number)²⁶²

Countries	2007	2008	2009	2010	2011
Brunei Darussalam	6	6	6	6	6
Cambodia	10	10	10	9	9
Indonesia	4	4	4	4	4
Malaysia	6	6	6	6	6
Lao PDR	9	9	9	9	9
The Philippines	7	7	7	7	7
Thailand	7	5	5	5	5
Vietnam	6	6	6	6	6
Myanmar	..	..	..	..	..
Singapore	4	4	4	4	4

Table 12. Cost to export (USD per container)²⁶³

Countries	2007	2008	2009	2010	2011
Brunei Darussalam	515	630	630	630	680
Cambodia	722	732	732	732	732
Indonesia	607	644	644	644	644
Malaysia	432	450	450	450	450
Lao PDR	1750	1860	1860	1860	1880
The Philippines	755	771	771	630	630
Thailand	615	625	625	625	625
Vietnam	468	533	555	555	580
Myanmar	..	..	..	..	..
Singapore	416	456	456	456	456

V.b. ASEAN Single Window

For sixty-four years, the great achievement of the GATT was the significant reduction of tariffs and quotas to encourage further trade liberalisation. Unfortunately, it was followed by the increase of non-tariff barriers (NTBs) which have now become the largest obstacles to trade. NTBs allegedly serve as trade protectionism, which off course distorts fair trade competition and discourages trade liberalisation. In recent decades, the role of trade facilitation has increased to reduce NTBs. Trade facilitation is more effective to enhance trade liberalisation than tariff barrier removal. In the tight international trade competition, NTBs have been transformed and become a protectionism tool. This situation could create new protectionism in the international community. With respect to such matters, in Pascal Lamy's speech, he states that:

²⁶² Available at : <http://databank.worldbank.org/ddp/html>, last accessed : 21 January 2012.

²⁶³ Available at : <http://databank.worldbank.org/ddp/html>, last accessed : 21 January 2012.

“[...] it is understandable that at a time of suffering, people want protection. But the irony is that trade protectionism does not protect. One country’s exports are another country’s imports, and vice versa. One country’s protectionism will lead to another country’s protectionism. This is even more true in today’s world of global value chains where protectionism hurts not only consumers but also upstream domestic producers importing low valued-added input to focus on higher technology-oriented tasks – hence endangering highly paid, export-oriented jobs. To turn to protectionist trade measures in the current circumstances would be a huge mistake – one that could send the slowing global economy back into deep recession [...]”²⁶⁴

There are several factors that have made trade facilitation grow rapidly, such as ICT evolution, public participations, and infrastructure development. First, the rapid development of information society has driven the creation of sophisticated tools for trade, for instance e-business. Accordingly, positive opportunities are created from this digital revolution. The ICT development is utilised within trade facilitation to reduce NTBs.²⁶⁵

Second, to provide trade facilitation governments would not be able to work alone. In this regard, participation of the private sector (business community/traders) and NGOs are urgently needed. Therefore, the government as a policy maker needs to involve the active participation of all stakeholders concerned, particularly the most vulnerable groups in society. Previously, the task of establishing standards on trade facilitation was the domain area of the public sector. Currently the private sector also plays an active role in such field and its contributions have increased. Even though the roles of public policy have changed, but remain of great importance. The government has several main tasks, for instance to disseminate best practice, promote market access, and maintain fair competition in the market.²⁶⁶

Third, trade facilitation is recognised as an essential component of the basic infrastructure of the market economy and of democracy. Inherently, it is related to availability of the tangible and intangible public infrastructures of a state. Tangible infrastructures include transportation, energy, customs services, and telecommunications. Intangible infrastructures cover knowledge, networking, education, training, capacity building of institutions, and good governance. Therefore, it requires a broad and comprehensive approach to trade policy.²⁶⁷

Trade facilitation could stimulate trade creation between regions. In the regional dimension, trade facilitation plays a positive role in the exploitation of all the comparative advantages that belong to the region. Regional trade facilitation is supposed to play “*a unique role*” in promoting consistency and co-operation among many relevant players at the regional level. Regional trade facilitation also contributes to the integration of economic, social, and environmental aspects for sustainable development.²⁶⁸

Single windows have become a global trend due to the significant reduction in transaction costs of trade. Singapore is the pioneer single window in ASEAN, while

²⁶⁴ See WTO News: Speeches – Directorate General Pascal Lamy: Lamy makes a strong plea for global co-operation, 6 October 2011, available at http://www.wto.org/english/news_e/sppl_e/sppl208_e.htm?utm_source=dlvr.it&utm_medium=twitter, last accessed : 6 October 2011.

²⁶⁵ See Cosgrove-Sacks, et.al., 2003; Paolo Garonna, Deputy Executive Secretary, *UNECE : The Policy Debate on Trade Facilitation*, pp. 6-7.

²⁶⁶ See *Ibid.*, pp. 6-7.

²⁶⁷ See *Ibid.*, pp. 6-7.

²⁶⁸ See *Ibid.*, p. 7.

Africa is led by Senegal and Kenya. Australia is currently undergoing preparations for the establishment of their National Single Window.²⁶⁹

The ASEAN Single Window (ASW) was established as part of a step to realise AEC. During the 9th ASEAN Summit 2003, the ASEAN member states committed to deepening and broadening their internal economic integration and links with the world economy through a “*bold, pragmatic, and unified strategy*”.²⁷⁰ In the context of the ASW’s wording of a bold, pragmatic, and unified strategy, this was described as the process of developing infrastructures of trade facilitation, especially ICT connectivity through e-ASEAN. Furthermore, Alexander M. Arevalo²⁷¹ elaborates the importance of the “[...] *adoption of the single window approach including the electronic processing of trade documents at national and regional level [...]*,” to accelerate ASEAN economic integration 2010.

As the follow up of the Bali Concord II Declaration, the Informal ASEAN Economic Ministers (AEM) Meeting was held in January 2004. During the meeting eleven sectors²⁷² were discussed that were identified for priority integration. In this regard, the Ministers considered that such priority sectors were crucial to accelerate the realisation of the AEC. To facilitate the establishment of the ASW, the Ministers agreed to set up “*the ASEAN inter-agency Task Force*”. It comprises representatives from relevant government agencies, such as, trade, health, agriculture, customs, and those who are responsible for standards and the conformance of the ASW design.²⁷³ In short, the ASEAN inter-agency Task Force was given the task of designing an appropriate model for the ASW. Members of the ASEAN inter-agency Task Force consist of Customs Authorities of 10 ASEAN member states, including the Ministry of International Trade, ASEAN Secretariat, ASEAN-EU Programme for Regional Integration Support (APRIS) and other government agencies (OGA) involved in cargo clearance processing such as permit/license processing and cargo inspection.

APRIS is a programme that is co-financed by the ASEAN Secretariat and the European Commission Co-operation Office.²⁷⁴ It is directly used to support ASEAN accelerate realisation of AEC. Practically, it helps establish the ASEAN single market and production base. It has the further goal of strengthening the relationship between ASEAN-EU. There were two phases of APRIS that are known as APRIS I and APRIS II.²⁷⁵ APRIS II is the successor of APRIS I that ended in September 2006. APRIS I made a successful contribution to help ASEAN integration. APRIS II started on 20 November 2006, for a period of 3 years, and ended in 2010. The next successor of APRIS II was the ASEAN Economic Integration Support Programme (AEISP) that started in 2011 with a

²⁶⁹ See Alvin C.K, *ASEAN Single Window*, Head of Company Dagang Net Commerce, Presented in Asian Forum for Information Technology (AFIT) Tokyo, Japan, 22-23 October 2007, available at: http://www.cicc.or.jp/japanese/kouenkai/pdf_ppt/pastfile/h19/afit/presentation_2.pdf

²⁷⁰ See The Declaration of ASEAN Concord II (Bali Concord II), available at: <http://www.asean.org/15159.htm>.

²⁷¹ See Chairman, Inter-Agency Task Force on the ASEAN Single Window.

²⁷² See ASEAN Framework Agreement for the Integration of Priority Sectors, Vientiane, 29 November 2004, available at: <http://www.asean.org/16659.htm>. The priority sector according to paragraph Article 2 of this agreement is covering agro-based products, air travel, automotives, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparels, tourism; and wood-based products.

²⁷³ See Media Statement, Informal Asean Economic Ministers Meeting, 19-20 January 2004, Yogyakarta, Indonesia, available at: <http://www.asean.org/15661.htm>.

²⁷⁴ See ASEAN-EU Programme for Regional Integration Support (APRIS) - Phase II, available at: <http://www.asean.org/apris2/index.htm>.

²⁷⁵ See APRIS Phase I and Phase II have been operating for the last eight years with EU grant support of €10 million (approximately IDR 120 billion).

total budget of approximately €15 million Euro. The AEISP is directly used to assist ASEAN realise its targets for the creation of a single market by 2015.²⁷⁶

The APRIS II successfully assisted the initial establishment of ASW.²⁷⁷ The APRIS II Team was given the task of designing a fully computerised ASEAN Customs Transit System (ACTS). This system provides electronic messages that are used for communications between traders and customs. The communications include the submission of transit declarations, discharge of completed transit movements, and exchange of transit movement data between customs authorities based on risk assessment. The EU computerised transit system is designed with the purpose to prevent fraud in exports and imports.²⁷⁸

In the 7th ASEAN Economic Ministers Meeting, it was stated that “[...] ASW is the most important initiative of customs that will ensure the expeditious clearance of goods and reduce the cost of doing business in ASEAN [...]”. ASW facilitates the speedy clearance of ASEAN extra-trade through the electronic processing of trade documents at a national and regional level.²⁷⁹ The major goal of ASW is to develop harmonious collaboration and partnership between governmental agencies and economic operators²⁸⁰ within the framework of the international supply chain.²⁸¹ The first pilot project of ASW was operated by Thailand and the Philippines. ASW was fully implemented by ASEAN 6²⁸² (The Philippines, Thailand, Indonesia, Singapore, Brunei Darussalam, and Malaysia) in 2008. Thus, it will be followed by the ASEAN 4 (Cambodia, Lao PDR, Vietnam and Myanmar) in 2012.²⁸³ According to the schedule of the establishment, the first phase of the ASW has to be completed by 2012 when all the National Windows of the ten ASEAN member states are ready to operate.

²⁷⁶ See Press Release European Commission Provides € 7.2 million to Support ASEAN Integration Process, Jakarta, 5 June 2007, <http://www.asean.org/20649.htm>.

²⁷⁷ “[...] During four-year period (2006-2010), APRIS II focused its support on developing key agreements and implementation mechanisms leading to trade facilitation and removal of non-tariff barriers between the ASEAN members. This had led to tangible successes including the simplification of customs procedures across borders, harmonisation of administrative documents, and standardisation of technical requirements. As stated by the Secretary-General of ASEAN, Dr Surin Pitsuwan that “over the last eight years, the APRIS support from the EU has been successful and helpful to ASEAN. The new phase of support opens a new and exciting chapter for economic cooperation with the EU. I look forward to working in closer partnership with the EU in advancing economic integration [...]”. See Joint Press Release ASEAN and EU: Family matters, available at : http://www.delmys.ec.europa.eu/en/pdf%20files/Press_Release_APRIS_II_28_02_11_clear.pdf.

²⁷⁸ See ASEAN-EU Programme for Regional Integration Support (APRIS) - Phase II, A Modern Regional Transit Transport System: Asean Customs Transit System (ACTS) To Ensure ASEAN Economic Community Trade Facilitation, available at : http://www.asean.org/apris2/file_pdf/result/%20trade%20facilitation.pdf.

²⁷⁹ See Paragraph 14 of the Joint Media Statement of the Thirty Seventh ASEAN Economic Ministers’ (AEM) Meeting, Vientiane, 28 September 2005, available at : <http://www.asean.org/17780.htm>. See also Joint Media Statement of the Thirty-Eight ASEAN Economic Ministers’ (AEM) Meeting, in Kuala Lumpur, 22 August 2006, available at : <http://www.asean.org/18722.htm>. See also Article 5 Agreement to establish and implement the ASEAN Single Window., stipulated as follows : “[...] Member Countries shall develop and implement their National Single Windows in a timely manner for the establishment of the ASEAN Single Window. Brunei Darussalam, Indonesia, Malaysia, Philippines, Thailand and Singapore shall operationalise their National Single Windows by 2008, at the latest. Cambodia, Lao PDR, Myanmar, and Viet Nam shall operationalise their National Single Windows no later than 2012 [...]”.

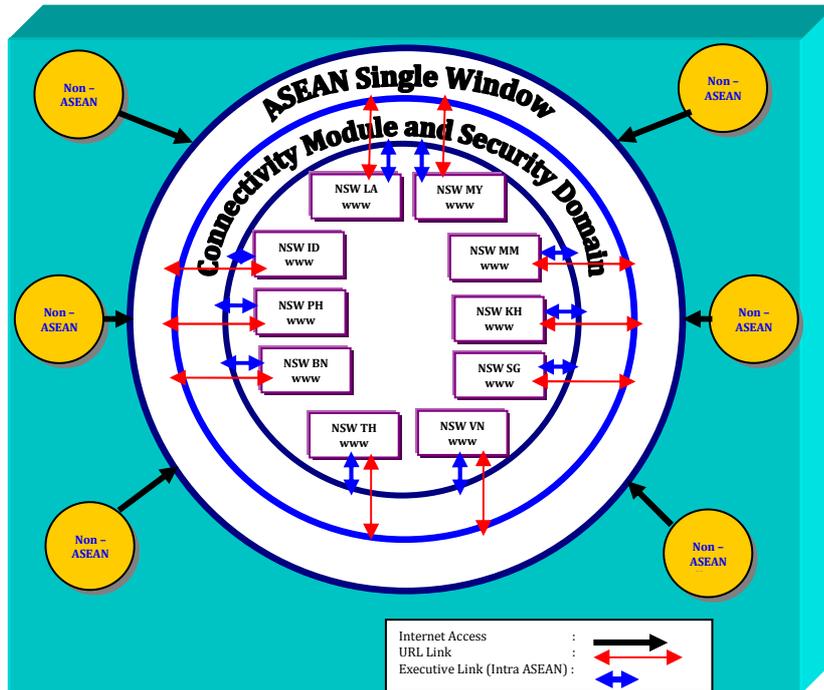
²⁸⁰ Such as importers, exporters, transport operators, express industries, customs brokers, forwarders, commercial banking entities and financial institutions, insurers, etc.

²⁸¹ See Technical Guide of ASW and NSW Version 3/2006.

²⁸² See Paragraph 3 Article 2 of ASEAN Framework Agreement for the Integration of Priority Sectors.

²⁸³ See Paragraph 14 of the Joint Media Statement of the Thirty Seventh ASEAN Economic Ministers’ (AEM) Meeting. See also Joint Media Statement of the Thirty-Eight ASEAN Economic Ministers’ (AEM) Meeting. See also Article 5 Agreement to establish and implement the ASEAN Single Window., which stipulated as follows : “[...] Member Countries shall develop and implement their National Single Windows in a timely manner for the establishment of the ASEAN Single Window. Brunei Darussalam, Indonesia, Malaysia, Philippines, Thailand and Singapore shall operationalise their National Single Windows by 2008, at the latest. Cambodia, Lao PDR, Myanmar, and Viet Nam shall operationalise their National Single Windows no later than 2012 [...]”.

Figure 3. Phase 1 ASEAN Single Window in 2012²⁸⁴



In the 11th ASEAN Summit 2005, ASEAN member states signed an “*agreement to establish and implement the ASEAN Single Window*”. ASEAN leaders are agreed adopting the single window to accelerate realization of AEC. Recommendation to implement ASW mentioned under Paragraph f Article 8 of the “*ASEAN Framework Agreement for the Integration of Priority Sectors*”, it is stipulated as follows:

“[...] the member states be necessary to develop the single window approach including the electronic processing of trade documents at national and regional level by 31 December 2005 [...]”.

ASW defined as the environment where National Single Windows of member states operate and integrate.²⁸⁵ ASW is “[...] *trade-facilitating environment that operated on the basis of standardized information, procedures, formalities, and international best practices to the release and clearance cargoes at entry points of ASEAN under any particular customs regime (imports, exports, and others) [...]*”.²⁸⁶ The basic concept of ASW is to achieve better economic efficiency through trade facilitation.²⁸⁷ ASW has been used to support the flow of intra-trade and extra-trade of ASEAN as part of the global supply chain. There are three layers institutions that playing crucial roles

²⁸⁴ Cited from ASEAN Single Window for Trade Facilitation and ASEAN Integration by 2015, SPECA-ASEAN UneDOCS Seminar, April 2007, available at : http://www.unescap.org/tid/projects/unedocs_s3_le.pdf, last accessed : 3 July 2011.

²⁸⁵ See Paragraph 1 Article 2 Agreement to establish and implement the ASEAN Single Window, available at : <http://www.asean.org/18005.htm>.

²⁸⁶ See Technical Guide of ASW and NSW Version 3/2006.

²⁸⁷ One of the objective of ASW agreement is to strengthen the coordination and partnership among ASEAN Customs Administrations and relevant line ministries and agencies, and economic operators (importers, exporters, transport operators, express industries, customs brokers, forwarders, commercial banking entities and financial institutions, insurers, and those relevant to the international supply chain) to effectively and efficiently implement the ASEAN Single Window.

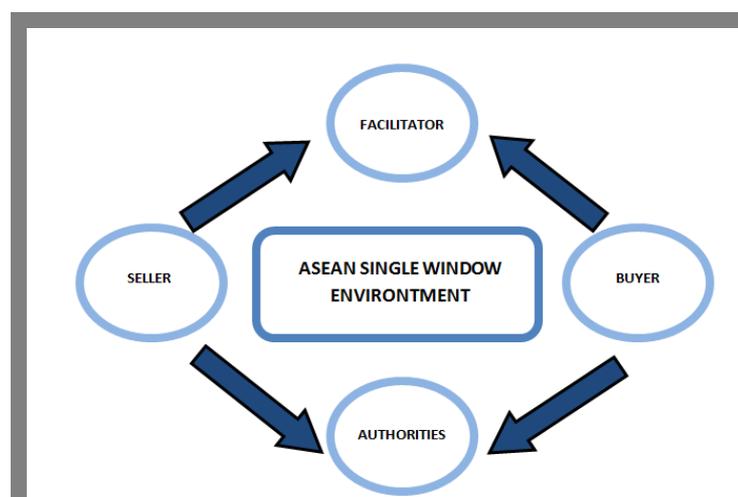
in the implementation of ASW consists of “custom administration²⁸⁸, lead agency²⁸⁹ and line ministries and agencies”²⁹⁰.

While National Single Window (NSW) defined as “[...] a single entry and a single decision making under the concept of single submission of data and information, a single and synchronous processing of data and information, a single decision making for customs release and clearance of cargo[...]”.²⁹¹ NSW is functioned as the international supply chain, which serves movement of goods and commodities crossing national borders. In order to enhance trade facilitation NSW has been designed with modern features. These features are including internationally aligned standards and information parameters, appropriate modernized methods of information administration and processing, and streamlined decision-making by a customs administration.²⁹²

ASW and NSW are established based on the provisions and best practices as set forth in the Revised Kyoto Convention (RKC) and in other related international conventions. ASW and NSW are designed in accordance with numerous international recommendations and standards established by UNCTAD, UNECE, and UNCITRAL.²⁹³

Establishment of ASW and NSW contributes tremendously to “just in time trade” through e-trade facilities. ASW and NSW serve and connect all parties involved in trade between borders. The principle of “just in time trade” considerably influences the international supply chain flow. The implementation of “just in time trade” could reduce transaction costs, maximise the firm benefits, boost import and export earnings, and prevent losses of state revenues from customs duties.

Figure 4. The role of ASW in the international supply chain.²⁹⁴



²⁸⁸ Referring to the government agency, which is responsible for the administration of Customs law and related national legislation.

²⁸⁹ Referring to the government agency that appointed by Member Countries to take the leading role in the establishment and the implementation of the ASEAN Single Window.

²⁹⁰ Referring to the government agencies, which are responsible for the administration and enforcement of trade laws and regulations as relevant to the release and clearance of cargo.

²⁹¹ See Paragraph 2 Article 2 Agreement to establish and implement the ASEAN Single Window, available at : <http://www.asean.org/18005.htm>.

²⁹² See Technical Guide of ASW and NSW Version 3/2006.

²⁹³ See *Ibid*.

²⁹⁴ Cited from ASEAN Single Window for Trade Facilitation and ASEAN Integration by 2015 SPECA-ASEAN UNeDOCS Seminar, April 2007, available at : http://www.unescap.org/tid/projects/unedocs_s3_le.pdf.

There are four main principles that have to be applied in the implementation of ASW. Those principles consist of consistency, simplicity, transparency, and efficiency.²⁹⁵ Consistency principles provide predictability rules and assure legal certainty for traders. In some countries, so many trade rules and policies are frequently changed, thus, creating insecurity in doing business. The simplicity principle is applied to reduce the processing time of documents or to simplify import-export procedures. In most countries in the world, complex bureaucracy chains and excessive documents are common obstacles for traders. In the context of developing countries, transparency principles are implemented to reduce corruption in bureaucracy. The purpose of efficient procedures is to transform the procedure into a more affordable and speedy system, which is supported by the implementation of a ICT system.

V.b.1. The concept and implementation of ASW.

To provide a legal and technical framework of the ASW, in the 8th Meeting of the Task Force, *“the Protocol to establish and implement the ASEAN Single Window”* was issued. The adoption of this Protocol is based on Article 6 of the ASW Agreement.²⁹⁶ The ASW Agreement is the hard law in the implementation of ASEAN Single Windows. Therefore, Paragraph 2 Article 1 explains the position of the Protocol towards the ASW Agreement, as follows:

“[...] the Protocol shall be read and interpreted in accordance with the ASW Agreement. In the event of any inconsistency between this Protocol and the ASW Agreement, the provisions of the ASW Agreement shall take precedence [...]”

The member states issued *“the technical guide of ASW and NSW implementation”*, with the purpose of providing technical, functional, and operational guidance for the implementation of the single window. It contains a compilation of relevant international accepted standards, procedures, documents, glossary, and technical details as deemed appropriate to be adopted in the NSW. In this regard, the ASEAN member states have been given the freedom to make necessary modifications or updates related to the ASW and NSW implementation with the idea to improve efficiency.

To achieve the planned target *“the Action Plan of ASW implementation”* was issued and contains the schedule of the ASW implementation activities. ASW operation requires linkages between economic operators and governments. To assemble NSW into ASW, strong cooperation and technological compatibility are required. The conceptual model of ASW connects all NSWs through secure connectivity. In this regard, the transactions among the NSW and ASW systems have to be carried out under a secure infrastructure as described below:

²⁹⁵ See Article 4 Agreement to establish and implement the ASEAN Single Window.

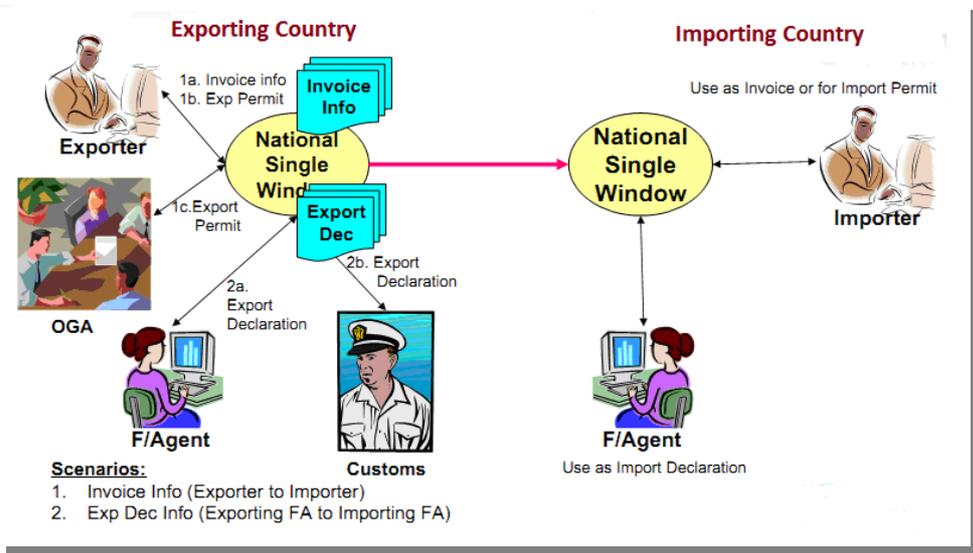
²⁹⁶ See Article 6 of the Agreement to Establish and Implement the ASEAN Single Window, concerning “Technical Matters of the ASEAN Single Window”, stipulated that “[...] Member Countries shall, by means of a Protocol to be agreed upon, adopt relevant internationally accepted standards, procedures, documents, technical details and formalities for the effective implementation of the ASEAN Single Window [...]”.

Figure 5. The conceptual model of a secure infrastructure.²⁹⁷



ASW applies the most advanced development of information processing (ICT), and integrates this into the secure networking environment.²⁹⁸ Transactions covered under the ASW system include “Government to Business, Business to Business, Government to Government and others transactions with such nature”. The process of transaction business to business under ASW system is described as follows:

Figure 6. The ASW process flow in the form business to business.²⁹⁹



²⁹⁷ Cited from Technical Guide of ASW and NSW Version 3/2006.

²⁹⁸ See Technical Guide of ASW and NSW Version 3/2006.

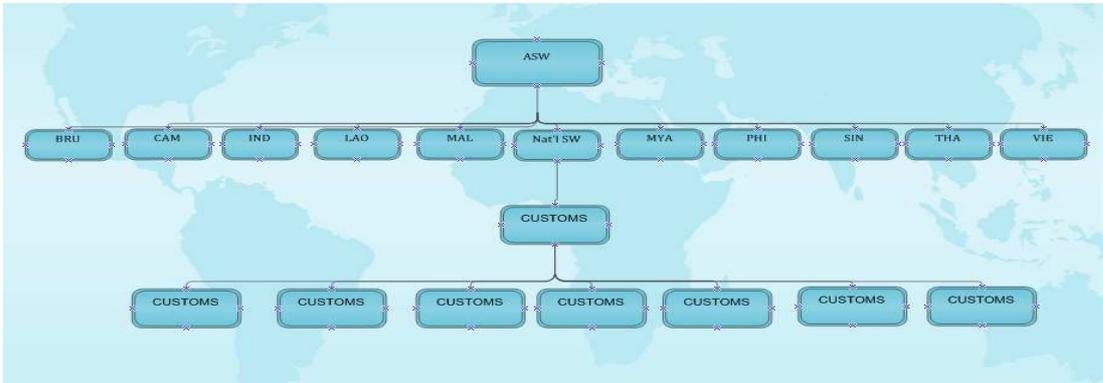
²⁹⁹ Cited from SPECA-ASEAN UneDOCS Seminar, *ASEAN Single Window for Trade Facilitation and ASEAN Integration by 2015*, April 2007,

The protocol of the ASW emphasises three crucial technical aspects in the single window implementation. It consists of documents and formalities³⁰⁰, data and information, and ICT application. Such aspects are important to synchronise the implementation of single windows among member states. ASW establishes the environment where ten NSWs operate and integrate to expedite customs release and clearance in order to reduce transaction costs and reduce bureaucracy chains.³⁰¹

The application and standardisation of ICT is deemed as “the backbone” of the single window. As mentioned above, ASW and NSW operation requires compatibility and interoperability of national systems, such as data and information from customs administrations, ministries, and other government agencies. These components become crucial once member states use the ICT application in their NSW system. Adoption of commercial formalities, standards and documents is used to ensure synchronous processing. Relevant ministries and other government agencies have an essential role in the maintenance of steady coordination among the different components of the single window system.³⁰² Adoption of the single window requires simplification, standardisation, and harmonisation of the following elements:³⁰³

- a. Documentation and processes undertaken by line ministries and agencies;
- b. Information requirements of line ministries and agencies; and
- c. Format of the data for ICT applications.

Figure 7. Conceptual model of integration 10 NSWs into ASW.³⁰⁴



³⁰⁰ “[...] The documents and formalities that used in the ASW systems consist of : a) ASEAN Customs Declaration Document as endorsed by ASEAN Directors-General of Customs; b) commercial and transport documents for the release and clearance of goods and commodities by Customs Administrations as stipulated in national laws and regulations of Member Countries; c) formalities and documents required by national laws and regulations for the release and clearance of goods and commodities by Customs Administrations as stipulated in national laws and regulations of Member Countries; and d) other formalities as stipulated by national laws and regulations and international conventions where relevant. With respect to the format of document and formalities will be determine by the respective national competent authorities compliance with international standards [...]”.

³⁰¹ See Technical Guide of ASW and NSW Version 3/2006.

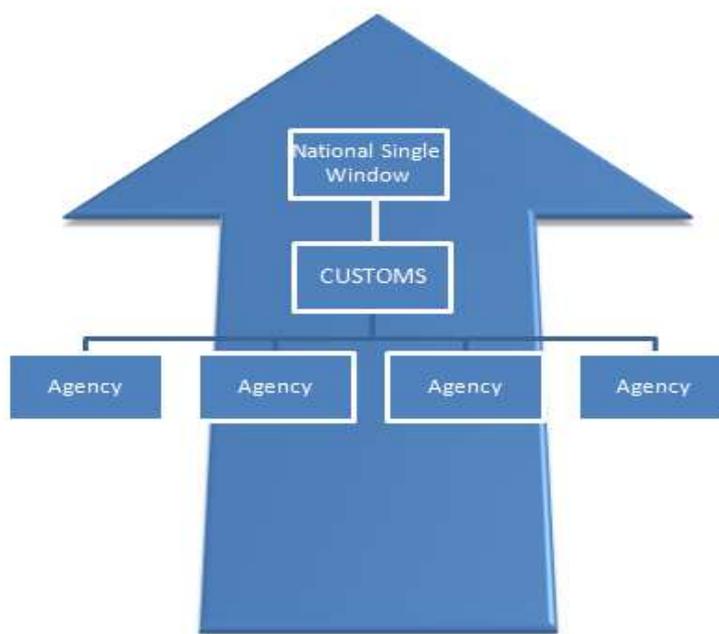
³⁰² See *Ibid.*

³⁰³ See *Ibid.*

³⁰⁴ Cited from Arevalo, Alexander M., *Development of the Asean Single Window*, Chairman Inter-Agency Task Force on the ASEAN Single Window, Chairman ASEAN CUSTOMS I.C.T., Heads Chairman, ASEAN CUSTOMS I.C.T., Heads Deputy Commissioner, Management Information System and Technolog, Deputy Commissioner Management Information System and Technology Group Bureau of Customs, Philippines, Presented on BIMP-EAGA CIQS Task Force Meeting & Seminar Discovery Suites – 21 to 22 August 2006, available at : <http://www.adb.org/documents/others/ogc-toolkits/anti-money-laundering/documents/ASEAN-Trade-Single-Window.pdf>.

According to Alexander Arevalo, “trade facilitation is not a purely government function”, in this regard, the government is not able to implement trade facilitation without support from other stakeholders. Further, he emphasises that collaborations and partnerships with stakeholders at the national, regional, and international level is indispensable. It is important for developing countries to use the bottom-to-top approach in NSW implementation.³⁰⁵ Such approach is supposed to eliminate certain constraints³⁰⁶ in trade facilitation.³⁰⁷

Figure 8. Bottom-to-top strategy (integration of National Single Windows).³⁰⁸



There are three technical pillars in the ASW.³⁰⁹ The first pillar consists of functions and processes. The second pillar comprises of standardisation and synchronisation. The third pillar is the ultimate goal known as “integration”. Each of these pillars are operated by a sophisticated ICT interface through e-customs, e-trade and other e-government facilities that link all the parties in the ASW. In a broad concept, ASW is operated in the environment that has features comprising progressive synchronisation and integration with standardised information connecting governments and the business community.³¹⁰ The functional linkage within ASW is based on relationships between government authorities and economic operators.

³⁰⁵ See *Ibid.*

³⁰⁶ Constraints of trade facilitation includes of excessive documentation requirements; the lack of automation and transparency; unclear import and export requirements; inadequate procedures (especially concerning the lack of audit-based controls and risk-assessment techniques); and lack of modernisation and co-operation among customs and other government agencies.

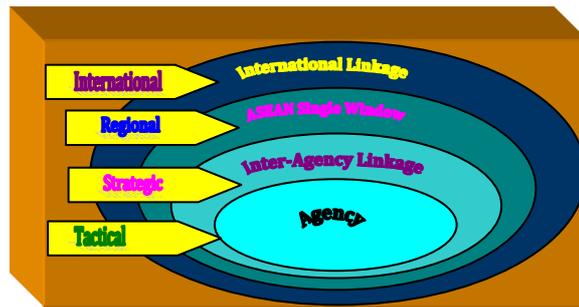
³⁰⁷ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 17.

³⁰⁸ See Arevalo, Alexander M., 2006.

³⁰⁹ See SPECA-ASEAN UNeDOCS Seminar, April 2007.

³¹⁰ See Technical Guide of ASW and NSW Version 3/2006.

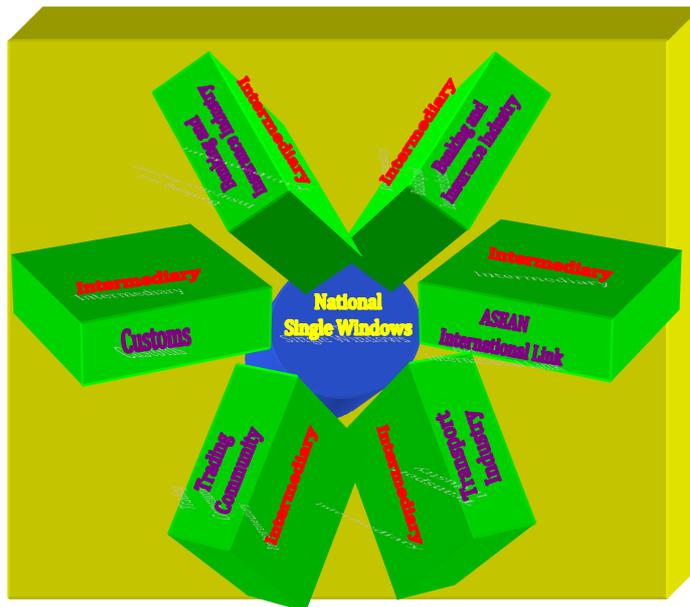
Figure 9. The ASW strategy approach.³¹¹



The focal point of the ASW is to streamline operational linkages and procedures in foreign trade. It is designed to facilitate a seamless flow of regulatory information among ministries and other government agencies at national level. Intra-agency cooperation plays a key role in streamlining management and enhancing just in time services.³¹²

NSW should be the common, neutral, secure, and trusted connection for business actors, industries, traders, and governments to communicate, exchange and process trade or related information.³¹³ The wording of a “*common, neutral, secure and trusted connection*”, describes that the NSW should be easy to operate by users, have a friendly user interface, and give assurance of user data protection. The scope of NSW transactions comprise of customs administration, governmental agencies, and economic agents.³¹⁴

Figure 10. The conceptual model of a NSWs.³¹⁵



³¹¹ Cited from Arevalo, Alexander M., 2006.

³¹² See Technical Guide of ASW and NSW Version 3/2006.

³¹³ See Technical Guide of ASW and NSW Version 3/2006.

³¹⁴ Economic agent and operator, includes e.g. importers, exporters, transport operators, express industries, customs brokers, forwarders, commercial banking entities and financial institutions, insurers, and the like), and the completion of procedures by management authorities in the respective arenas (trade management, duty and tax management).

³¹⁵ Cited from Technical Guide of ASW and NSW Version 3/2006.

The conceptual model of NSW comprises activities and interactions among six major components. Those components are described on the diagram above and consist of: “trading community, customs administration, other government agencies, transport operators, banking and insurance industry, and their linkages to ASEAN/international systems”.³¹⁶ It enables ASEAN member states to enhance their capability to be more competitive and efficient in global competition. It also helps traders and producers of ASEAN, especially SMEs, to compete in the global market through reductions of transactions cost, cutback bureaucracy chains and time efficiency.

VI.b.2. The role of e-customs, e-trade and e-government in the ASW.

Many studies have identified that delays, unclear and/or redundant documentation requirements, and lack of adequate customs automation lead to costly trading procedures. In many cases excessive tariff costs can cause business losses. Providing effective and accessible trade facilitation is considered a smart solution with plus values such as a multiplayer effect on increasing trade and promoting economic growth.³¹⁷ According to Carol Cosgrove-Sacks, ICT has a significant role in trade facilitation to eliminate the “invisible” barriers to trade.³¹⁸ Corruption can be considered as an invisible barrier of trade.

Inherently, in the world there is no such thing as a “sterile country” from corruption. The Corruption Perceptions Index (CPI) organisation has ranked 183 countries in the world. In its assessment, CPI uses the scale of 0 to 10 to measure the level of corruption in those countries. Extremely corrupt countries are indicated by the scale 0 and very clean countries are indicated by the scale 10. According to corruption perception index 2011, the top three cleanest countries in the world are New Zealand, Denmark, and Finland, where these countries were given a corruption index above 9. While the most corrupt countries in the world are Somalia, North Korea, and Myanmar, which have a corruption index below 1.5. Singapore is one of the countries in ASEAN that is included in the top five clean countries with a corruption index of 9.2 and Myanmar is ranked as the most corrupt country in ASEAN with a corruption index of 1.5.³¹⁹

³¹⁶ See Technical Guide of ASW and NSW Version 3/2006.

³¹⁷ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 17.

³¹⁸ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, pp. 18-19. “[...] in a rapidly changing global economy, increasingly characterised by electronic business, using advanced ICT and global supply chains, government and business leaders should adopt trade facilitation as a key tool for economic development. ICT should be used to address issues of integrity, accountability, and transparency, for example by enhancing the free flows of information between customs administrations and the business community. One of the objectives would be to promote economic integration within the existing regional blocs. Finally, the “invisible” barriers to trade, which are mostly administrative in nature and simply add costs to trade, should be removed. The standards and projects for trade facilitation, which are administered by the United Nations and the other international organisations, are based on the principle of open access to all. Various countries and agents may value the products of trade facilitation differently (as is the case with UN/EDIFACT), they may have different capacity to contribute to providing them, yet at the end they have equal access to these products. Inefficient trade procedures are a troublesome externality for those involved in international trade, yet the products of trade facilitation can also be seen as an externality – available to everyone, no matter whether some parties want more or less of them than others [...]”

³¹⁹ See Corruption Perceptions Index (CPI), available at : <http://cpi.transparency.org/cpi2011/results/#CountryResults>, last accessed : 14 January 2011.

Table 13. ASEAN Member States Corruption Index 2011. ³²⁰

No.	Country	Rank	Corruption Index
1.	Singapore	5	9.2
2.	Brunei Darussalam	44	5.2
3.	Malaysia	60	4.3
4.	Thailand	80	3.4
5.	Indonesia	100	3
6.	Vietnam	112	2.9
7.	The Philippines	125	2.6
8.	Laos	154	2.2
9.	Cambodia	164	2.1
10.	Myanmar	180	1.5

These data show the significant gap between ASEAN member states in the implementation of good governance and good government, especially the application of transparency and excellent services in public service. The ASEAN member states need to address such gap by encouraging the “*vulnerable member states*” with the low corruption index scale to make more effort to combat corruption and implement good governance in their public service. This gap creates obstacles in the implementation of ASW since ASW is an integrated system.

Principally, the use of the ICT application in the single window is part of a strategy to combat corruption. Infrastructures and applications of ICT must be based on the international standard and international best practices. Standardisation of ICT aims to avoid the creation of new “*barriers*” to trade and to provide an accessible and affordable ICT application to traders in ASEAN and traders from ASEAN trading partners. However, the differences between countries to provide trade facilitation cannot be neglected, due to their capacity and ability. In this regard, the situation of a country depends on its state income, economic development, human resources, and the capacity of its institutions to influence its infrastructure building on trade facilitation.

Trade facilitation is not simply about technical standards, rules, or procedures but covering wide range of aspects. Each elements on trade facilitation needs to be seriously implemented in appropriate manner to produce “*good practice*” on trade services. Trade facilitation has to be formulated and evaluated in the context of policy strategies for economic reform, stabilisation, and growth. As mentioned before that trade facilitation supposed to be public goods, therefore, its implementation should give contribution to the society welfare.³²¹

Trade facilitation also used for “*developing comprehensive national strategies*”, therefore, it has to be integrated into the national development strategy. Commonly, countries integrating trade facilitations into theirs national development strategy as part of trade liberalisation policy. It believed giving positive impact for the developing countries to “*achieve financial stability and growth, attracting foreign direct investment, improving governance and competitiveness*”. Thereby generating jobs, alleviating poverty, and increase standards of living. With respect to the correlation between trade

³²⁰ See *Ibid.*

³²¹ See Cosgrove-Sacks, et al., 2003; Paolo Garonna, Deputy Executive Secretary, UNECE : The Policy Debate on Trade Facilitation, pp. 7-9.

facilitation and development, Paolo Garonna emphasized about the role of “good government” in the establishment of trade facilitation.³²²

“[...] sound policies in trade, customs, taxation, education, public services, etc. are both a condition and an outcome of trade facilitation. When the public administration is corrupt, customs are inefficient and unskilled, tax evasion and the black economies flourish, and there is no technical standard, software or magic bureaucratic formula that can facilitate trade. Trade facilitation presupposes, above all, “good government”, accountable democracies and sound and bold policies of economic and social reform [...]”³²³

Application and standardization of the ICT is functioned to linking and integrating the e-trade and e-customs service. E-trade and e-customs is including into e-government system. Within single window system, the relationship between traders and customs administrations commenced when traders submitted required data and information to the customs. Its followed by processes of declaration, communication, and dialogue of declared information to customs administrations according to the national laws and regulations.³²⁴

When trader submitted the customs declaration document and other related documents to the customs administrations (customs office), they are entering into legal engagement based on the national law and regulations.³²⁵ Custom administration will issued receipt and validation of the submitted information by traders. Thus, proper communication will be established with the relevant agencies and concerned parties/operators in the processing of clearance and release. Process completed upon the final decision by customs administration for physical release of shipment.³²⁶

Integration of e-customs into the ASW system has the purpose of enhancing trade competitiveness through the implementation of good governance in trade services. The application of ICT is used to ensure transparency through the modernisation of techniques for efficient customs release and clearance. It is also part of the ASEAN customs administration strategy plan to migrate into e-customs. It is important to secure the connectivity and interoperability of systems dealing with customs clearance and release through the development of common protocols and standards of communication and messaging.³²⁷ One of the goals of ASW is to accelerate the customs clearance of goods and commodities to achieve higher economic efficiency through streamlining and simplifying related procedures.³²⁸

ASW is also described as an integrated environment of the collective effort of all stakeholders, which are integrated as a major function of the international supply chain, such as transportation, commercial transactions, and cargo movement.³²⁹ In conclusion, ASW and NSW are part of a more comprehensive program of e-government in improving the efficiency and effectiveness of trade transactions. Overall, they do not merely contribute to the custom services for public users but also to the promotion of good governance.

³²² See *Ibid.*

³²³ See *Ibid.*

³²⁴ See Technical Guide of ASW and NSW Version 3/2006.

³²⁵ See *Ibid.*

³²⁶ See *Ibid.*

³²⁷ See *Ibid.*

³²⁸ See Alvin C.K, 2007.

³²⁹ See Alvin C.K, 2007.

Figure 11. NSWs ICT environment.³³⁰

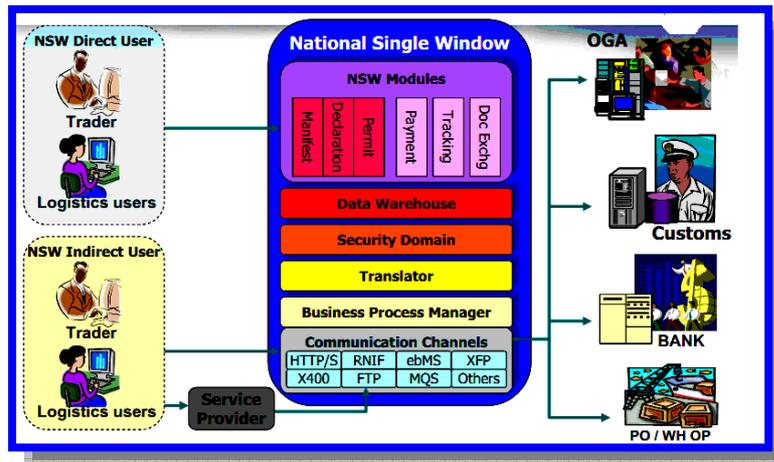
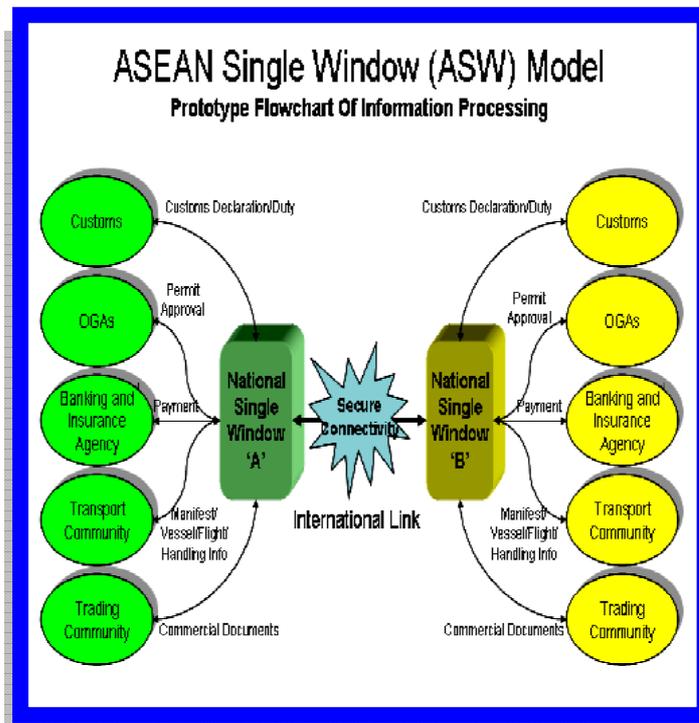


Figure 12. Information process of ASEAN Single Windows.³³¹



In July 2010 the US-ASEAN Business Council conducted a survey regarding the applications and features of ASW and NSW. The survey aimed to find out users' opinion on what features or services they most need to be included in the ASW. This survey took into account both national and regional dimensions. In the end, the survey results were communicated to the ASEAN officials concerned. It was expected to be considered as an input for the design and implement of ASW.³³²

³³⁰ Cited from SPECA-ASEAN UneDOCS Seminar, 2007.

³³¹ See SPECA-ASEAN UNeDOCS Seminar, 2007.

³³² See USABC (US-ASEAN Business Council Inc.), Analysis of Results : Survey on ASEAN Single Window, August 2010, available at : http://www.usasean.org/ASEAN/ASW_Survey_Aug242010.pdf. (This survey and report were a

The survey revealed that two-thirds of respondents had not heard about ASW, and almost 90% would like to receive more information about it. Import and export declarations, certificates of origin, electronic payment of customs duties and taxes, and express consignments, were the most frequently used in the clearance procedures and processes. Most respondents generally thought that the processing of import and export declarations, electronic payment of duties and taxes and processing of certificates of origin were not all automated or processed electronically. Therefore, ASEAN should enhance its efforts to implement electronic certificate of origin processing. ASEAN also needs to ensure that the efforts of NSW focus on the improvement of electronic submission, processing, and decision-making. This is associated with import-export declaration and electronic payment of duties. The possibility of exchanging data among ASEAN member states must be realised in the short term.³³³

Practically, all respondents thought that they would derive either substantial or reasonable benefits from the full automation of the fifteen cargo clearance procedures listed on the survey.³³⁴ Particularly the automation of import-export declarations, certificates of origin, electronic payment of duties/taxes, port operations, and express consignments, where they are most often engaged with those processes. According to the survey, on average two-thirds of respondents thought that all potential features of NSW were important. In order to ensure these features run properly each ASEAN state member needs to provide good ICT infrastructures and secure connectivity.³³⁵

According to the analysis of the survey, it has been recommended that ASEAN focus on its efforts to ensure that import-export declarations, certificates of origin, electronic payment of customs duties/taxes, and express consignments can be submitted and fully processed electronically. The data related to these transactions can be exchanged between member states to speed up cargo clearance. In addition, ASEAN also needs to accelerate the implementation of electronic processing and the exchange of certificates of origin in ASEAN.³³⁶

V.b.3. The roles of ASW and NSW in the implementation of good governance and eradicating corruption.

EU GSP has been changed and improved throughout the 40 years of its implementation. It is aimed to respond to the development needs of beneficiary countries. Despite the fact that many beneficiary countries deal with difficulties to utilise such preference benefit, utilisation of GSP is influenced by so many factors, which cover a wide range of areas at a local, national, regional, and international level. In the last two decades, trade facilitation measures have been considered as an important factor that could promote optimum utilisation of GSP. According to Luzius Wasescha, trade facilitation is “[...] *an essential component of the basic infrastructure of the market economy and of democracy [...]*”. He argues that it is basically connected to

joint effort of the U.S. ASEAN Business Council and the U.S. Agency for International Development-funded ASEAN Single Window Project, which is part of the ADVANCE Program supported by USAID and the U.S. Department of State).

³³³ See *Ibid.*

³³⁴ Import declaration, Export declaration, Transit, Transshipment, Express consignments, Financial Settlement (EFT Payment of customs duties/taxes), Certificate of origin, Health certificates/permits/licenses, Agriculture (sanitary and phytosanitary) certificates/permits/licenses, Other Government Agencies' requirements (not agriculture or health-related), Temporary admission or duty-drawback schemes, Bonded, Warehousing, Port operations, and Free zones.

³³⁵ See USABC (US-ASEAN Business Council Inc.), 2010.

³³⁶ See *Ibid.*

the tangible and intangible public infrastructures of a state, for instance covering transport, energy, customs services and telecommunications, knowledge, networks, education and training (human resources development), and good governance. In this regard, “a broad and comprehensive approach to trade policy” is needed.³³⁷

According to Alexander M. Arevalo, a single window is not just trade facilitation but also governance.³³⁸ Bill Maruchi propounded three factors that are considered important in the promotion of stable trade facilitations. They consist of “[...] good governance and accountability, border controls, and governmental procedures and infrastructural development [...]”. Good governance consists of three essential elements namely “transparency, accountability, and human resources”.³³⁹

The single window as a public website portal provided by the government is supposed to be the most efficient, fastest, and most affordable tool to implement transparency. Since it is a public portal, therefore, it will contain rules and regulations, policies, fees, forms, and other official information about all countries concerned.³⁴⁰ Transparency implementation not only reduces and prevents the irregularities of conduct, such as corruption, but also enhances the performance and efficiency of public services. This also includes the availability of convenient services that are easily accessible everywhere and at any time by traders and of the enforcement of legal certainty.

The single window is based on an integrated ICT system enabling accountability in the trade process. For instance, the transaction flow and goods consignment can be tracked, and legally accountable to prevent trade deflection or trade fraud. The availability of competent human resources is indispensable in order to operate, sustain, and enhance the single window system at the national and regional level. Such professional capacity can be built using a system of which the processes require internationally approved best practices³⁴¹ with professional training and workshops.

While Milner, Morrissey, and Zgovu, argue that in trade facilitation, the automation of customs procedures are combined with the availability of skilled, competent and professional customs officials (human resources), it can enable controls of government functions, reduce administrative costs, eliminate technical constraints, and thus minimise opportunities for corruption. It also promotes a culture of cooperation between the government and business community.³⁴²

According to Luzius Wasescha, high cost trade could injure governments, taxpayers, economic operators, and consumers. It is necessary for the government to implement good governance, and provide better regulation, prompt service and enhancement of ICT facilities. Trade facilitation has the potential to improve state revenues especially from customs duty collections. To increase such revenues governments need to improve the enforcement of regulations, improve customs integrity and low cost trade for traders. The improvement of customs integrity significantly eradicates “invisible barriers” such as rent seeking behaviour and bribery,

³³⁷ See Cosgrove-Sacks, et.al., 2003; Ambassador Luzius Wasescha, Delegate of the Swiss Government for Trade Agreements, *The Way Forward to Facilitate Trade*, p. 321.

³³⁸ See Arevalo, Alexander M., 2005.

³³⁹ See Cosgrove-Sacks, et.al., 2003; Bill Maruchi, Chief Operating Officer, TATIS S.A., *Addressing the Implementation Challenges*, p. 227.

³⁴⁰ See *Ibid.*

³⁴¹ See *Ibid.*

³⁴² See Chris Milner, Oliver Morrissey and Evious Zgovu, *Trade Facilitation in Developing Countries*, Credit Research Paper, No. 08/05, Center for Research in Economic Development and International Trade, University of Nottingham, available at : <http://www.nottingham.ac.uk/credit/documents/papers/08-05.pdf>, p. 9.

which is usually conducted by some “*corrupted officials*”.³⁴³ According to UNECE and UN/CEFACT, implementation of the single window delivers a lot of benefits for economic growth such as reduction of bureaucratic processes, modernisation of participant entities, better control of exports, less corruption in customs and participant entities, increase in the reliability of statistics, increase in exports and investment, and increase in job opportunities.³⁴⁴

To provide considerable benefits to developing countries, particularly SMEs, it is necessary to create a conducive climate for foreign investment, trade, and economic activity. Trade facilitation is an infrastructural asset that can give positive contributions to sustainable development, including encouraging the SMEs in developing countries to develop and expand their markets. For instance, Tom Butterly argues, “[...] *trade facilitation can help reduce the burdens of bureaucracy for companies, broaden market access, increase the participation of small and medium-sized enterprises in international trade, reduce corruption, and help all countries obtain benefits from global trade development [...]*”.³⁴⁵ In addition, according to Butterly, trade facilitation could bring “*direct benefits to both governments and the business community*”. Trade facilitation measures can deliver extra benefit for business i.e. decrease transaction costs³⁴⁶ and increase business opportunities.³⁴⁷

International trade scholars also consider that trade facilitation is necessary to boost the export earnings of countries. According to Anthony Kleitz “[...] *trade facilitation can even so bring benefits to the public sector through more efficient implementation of customs and related regulations [...]*”. In this regard, Anthony Kleitz emphasises the “*greater efficiency*” produced from trade facilitation, for instance the increase of public revenue and minimisation of corruption in the bureaucracy.³⁴⁸

Corruption and trade deflection have an extremely negative impact on economic development. It also creates obstacles that hinder the main purpose of the EU GSP. Michael, Ferguson and Karimov, elaborate the motivations and methods of corruption related to the fraud occurring in customs collection. They believe that traders generally pay bribes (*corruption trigger factors*)³⁴⁹ for three reasons. First, to obtain favourable classification for their goods so they will be allowed to pay lower taxes. Second, to receive more favourable conditions during clearance. Third, to avoid inspections since the traders knowingly committed trade fraud regarding their goods or products.³⁵⁰

³⁴³ See Cosgrove-Sacks, et.al., 2003; Ambassador Luzius Wasescha, *Op. Cit.*, p. 321

³⁴⁴ See Economic Commission For Europe, United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT), Case Studies on Implementing a Single Window to enhance the efficient exchange of information between trade and government, Working Draft United Nations, p. 29.

³⁴⁵ See Cosgrove-Sacks, et.al., 2003; Tom Butterly, Trade Facilitation, UNECE, Trade Facilitation in a Global Trade Environment, p. 60.

³⁴⁶ The efficiency of trade facilitation measures will covers compliance costs (producing and transmitting required documents); service charges (banking, insurance, cargo handling, transport); time-costs (processing time, procedural time); business opportunities cost (lost business or business not considered); complex and time-consuming trade process; personal opportunity cost which is particularly severe for SMEs; and costs related to unpredictability and corruption.

³⁴⁷ See Cosgrove-Sacks, et.al., 2003; Tom Butterly, *Op. Cit.*, p. 37.

³⁴⁸ See Cosgrove-Sacks, et.al., 2003; Anthony Kleitz, Head, Trade Liberalisation and Review Division, Organisation for Economic Cooperation and Development (OECD), Costs and Benefits of Trade Facilitation, p. 168.

³⁴⁹ Michael, Ferguson, and Karimov., elaborated how the corruption in the customs related to trade could collapse states economy, “[...] bribes to customs (and tax) comprise the two main types of bribes paid by companies to government agencies. Firms pass through these extra taxes bribes, partly to their customers and partly to their workers and creditors causing lower demand and higher costs of production which hurts the conomy [...]”. (See Michael, Bryane., Ferguson, Frank., and Karimov, Alisher., Do Customs Trade Facilitation Programmes Help Reduce customs-Related Corruption, available at : <http://corruptionresearchnetwork.org/marketplace/resources/Abu%20Dhabi%20Combined.pdf>, p. 15).

³⁵⁰ See Ferreira et al., 2007; Michael, Bryane., Ferguson, Frank., and Karimov, Alisher., *Op. Cit.*, p. 8.

Pomfret and Sourdin have analysed the existence of some unexplained variables that influence trade costs.³⁵¹ They consider that the corruption index³⁵² and inefficient trade process contribute to a higher cost to trade.³⁵³ While, Kunio Mikuriya considers that corruption is “*a major obstacle to economic and social development*”.³⁵⁴ Liliana Annovazzi-Jakab, argues that “*corruption and fraud*” need to be eradicated and prevented in order to provide a climate of confidence, stability and security in trade.³⁵⁵ Leonid Lozbenko, also argues that corruption endangers security and hampers the economic development of every country.³⁵⁶ Baroness Symons, argues that the trade facilitation measures and efficient procedures of customs can eradicate corruption and deliver wider benefits to boost the country’s economy.³⁵⁷

The customs process is part of the single window project that plays a significant role in delivering the benefit of EU GSP to the countries most in need. Michael, Ferguson, and Karimov deem “*customs work as a big business*”, since customs regulate between 20%-100% of the value of an economy.³⁵⁸ Leonid Lozbenko stresses that the main task of the customs service is to control over compliance with tariff and non-tariff regulation of foreign economic activity by taking into account international commitments. Further Leonid Lozbenko elaborates, the control function of customs that could promote trade, improve national economic and social development, eradicate corruption, and serve as a filter for cutting off illegal trade flows or trade fraud. On the other hand, the ineffective customs service can be seen as a barrier of international trade.³⁵⁹ While, Kunio Mikuriya considers that the customs process in international trade is “*vulnerable*” to corruption due to “*its wide range of discretionary powers to discharge its multipurpose function*”.³⁶⁰

According to Michael, Ferguson, and Karimov, “[...] *corruption costs state treasuries roughly \$2.0 billion USD world-wide in lost trade taxes (not counting value-added-taxes and excise taxes), though about 8 countries account for the bulk of such losses [...]*”.³⁶¹ Serfaty de Madieros studied the impact of corruption on bilateral exports between countries. She found that corruption in both importer and exporter countries has a negative effect on trade between those two countries. She concludes that corruption has an effect on international trade much more than other factors.³⁶² In

³⁵¹ “[...] Anderson and Marcouiller (2002) argue that corruption adds a security cost to trade costs. The relationship may be more complex if corruption imposes uncertainty and possible delays, so that traders concerned about time select a mode of transport that avoids hold-ups. Nordas et al. (2006) find that corruption-associated delays reduce the level of trade in a set of time-sensitive goods. Sequiera and Djankov (2008) report evidence of traders paying a premium to use routes that avoid corruption-ridden ports in southern Africa [...]”.

³⁵² The Transparency International Corruption Perceptions Index.

³⁵³ See Sourdin, Patricia., and Pomfret, Richard., *Trade Facilitation and The Measurement of Trade Cost*, Journal of International Commerce, Economics and Policy, Vol.1, No. 1 (2010) 145-163, World Scientific Publishing Company, available at : http://www.relooney.info/0_New_7428.pdf, p. 9.

³⁵⁴ See Cosgrove-Sacks, et.al., 2003; Kunio Mikuriya, Deputy Secretary General, WCO, *The Challenges of Facilitating the Flow of Commerce in a Heightened Security Environment*, pp. 156-157.

³⁵⁵ See Cosgrove-Sacks, et.al., 2003; Liliana Annovazzi-Jakab, UNECE Trade Division, *Landlocked Countries: Opportunities, Challenges and Recommendations*, p. 127.

³⁵⁶ See Cosgrove-Sacks, et.al., 2003; Leonid Lozbenko, Head of the Russian Customs Academy, Major-General of Customs Service, *Fight against Corruption in the Sphere of Customs as a Trade Promoting Factor*, p. 158.

³⁵⁷ See Cosgrove-Sacks, et.al., 2003; Baroness Symons, UK Minister of State for International Trade and Investment, *Trade Facilitation - everyone wins!*, p. 141

³⁵⁸ See Michael, Bryane., Ferguson, Frank., and Karimov, Alisher., *Op. Cit.*, p.9. “[...] Malaysia and the Slovak Republic imported in 2009 over 100% of their GDP. Brazil and Japan imported about 16% of their (extremely large) GDP. Indian Excise and Customs handled roughly \$8.3 billion whereas China Customs handled about \$5.6 in trade revenues [...]”.

³⁵⁹ See Cosgrove-Sacks, et.al., 2003; Leonid Lozbenko, *Op. Cit.*, p. 159.

³⁶⁰ See Cosgrove-Sacks, et.al., 2003; Kunio Mikuriya, *Op. Cit.*, pp. 156-157.

³⁶¹ See Michael, Bryane., Ferguson, Frank., and Karimov, Alisher., *Op. Cit.*, p.9-10

³⁶² See *Ibid.*

addition, Staples also argues that “[...] *high levels of corruption continue to plague many administrations causing loss of tax revenue and economic costs of countries [...]*”.³⁶³ Therefore, trade facilitation should urgently be addressed in order to reduce such state losses and improve economic efficiency.

Declaration on Customs Co-Operation Council Concerning Good Governance and Integrity in Customs (The Revised Arusha Declaration) was adopted in 1993. The Arusha Declaration aimed to strengthen international cooperation in customs cross border in order to combat corruption in the customs process of international trade and to implement good governance. Carol Cosgrove-Sacks³⁶⁴ and Ambassador Luzius Wasescha³⁶⁵ stress that cooperation between relevant institutions of governments, the business community, NGOs and international organisations is necessity to eradicate corruption in the international trade process. In addition, Leonid Lozbenko, also argues that the “[...] *key to success of combating corruption is co-operation and interaction between all international organisations, regional unions, national governments, and businesses [...]*”, since one country, on its own, cannot successfully control corruption.³⁶⁶ Therefore, in order to prevent and eradicate corruption in international trade there is the need for “[...] *comprehensive, systematic, and coordinated work of all international and regional organisations and national governments [...]*” and an inter-governmental programme. It has already been carried out in the regional level of Southeast Asia through the ASEAN Single Window project.³⁶⁷

Member states agreed establishing ASEAN Customs Code of Conduct³⁶⁸ and ASEAN Agreement on Customs³⁶⁹, which aimed to ensure the smooth cross-border flow of goods and services, facilitating implementation of ASEAN economic agreements, and preventing distortion or misuse of power on custom service that potentially injured economy and caused high cost economic. Both of these agreements are enabling six principles, which endeavour good customs conduct:

1. **Transparency principle**, means that member states will make all laws, regulations, administrative guidelines and policies pertaining to Customs administration in their economies publicly available in a prompt, transparent and readily accessible manner;
2. **Consistency principle**, means that member states will ensure the consistent application of Customs determinations to different traders, and in different cities, regions or states of ASEAN;
3. **Appeals and Challenges principle**, means that member states will ensure the availability to traders of readily accessible means of review or challenge of Customs determinations in ASEAN;
4. **Efficiency principle**, means that member states will ensure the efficient and effective administration and expeditious clearance of goods to facilitate intra-ASEAN trade and investment;

³⁶³ See Brian Rankin Staples, *Trade Facilitation*, October 1998, p. 29, available at : <http://www.acp-eu-trade.org/library/files/Staples%20-%20October%201998%20-%20Trade%20Facilitation.pdf>.

³⁶⁴ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, Director, UNECE Trade Division and Mario Apostolov, Coordinator, International Forum on Trade Facilitation, UNECE, *How to Achieve Efficient and Open Collaboration for Trade Facilitation?*, p. 27.

³⁶⁵ See Cosgrove-Sacks, et.al., 2003; Ambassador Luzius Wasescha, *Op. Cit.*, p. 321.

³⁶⁶ See Cosgrove-Sacks, et.al., 2003; Leonid Lozbenko, *Op. Cit.*, pp. 158-159.

³⁶⁷ See *Ibid.*, p. 163.

³⁶⁸ See ASEAN Customs Code of Conduct 1995 amended Customs Code of Conduct 1983, available at : <http://www.asean.org/2165.htm>, last accessed : 30 October 2011.

³⁶⁹ See ASEAN Agreement on Customs, 1997 available at : <http://www.aseansec.org/1905.htm>, last accessed : 30 October 2011.

5. **Simplicity principle**, means that member states will strive to ensure the simplification and harmonisation of trade transactions and customs procedures within ASEAN;
6. **Mutual Assistance and Cooperation principle**, means that member states will endeavour their utmost cooperation and mutual assistance between Customs Authorities.

One of the objectives of ASEAN Agreement on Customs is to ensure consistency, transparency, and fair application of the customs regulations. It is very crucial to support implementation of good governance and good government in the ASW and NSW. These principles is affirmed under Article 54 of ASEAN Trade in Goods Agreement concerning customs procedures and control. It is stipulating that each member state have to ensure that their customs procedures and practices should be predictable, consistent, and transparent including speedy clearance of goods. Member states are requested accordance to their respective national customs law adopting and complying the standards and recommendation practices provides by the WCO and other international organisations related to customs. Article 65 of ASEAN Trade in Goods Agreement, emphasized regarding transparency principle. It is implemented through “[...] the timely publication, dissemination of statutory and regulatory information, decisions, and rulings on customs matters [...]”.

To build a strong cooperation in the trade facilitation, Tom Butterly, emphasized about the importance of “*political will*”. Trade facilitation is not merely about technical issues but rather to political and economic issues due to its goal improving economic development and competitiveness of trade. In practices trade facilitation, needs harmonization and standardization in the operation, mandate, and orientation of various governmental agencies at both the national and international level.³⁷⁰ The open cooperation between public and private organisations is necessary to achieve common economic objective. The essence of trade facilitation is government/business partnership where both parties obtained mutual benefits. The active participation and commitment of the business community in the trade facilitation initiatives is paramount to their success.

At the national level, political will is a crucial instrument, particularly, dealing with the corruption issues in the trade administration’s processes and promoting implementation good governance and good government. Political will is essential to establish further cooperation between various national, regional, and international organisations, which involving in the trade facilitation project. The benefits of trade facilitation must be seen to be reasonable for all countries in order to encourage government leaders to embrace such project.³⁷¹

In the ASEAN perspective, political will in trade facilitation, has been set forth in the e-ASEAN Framework Agreement and the ASEAN Agreement on Customs. These agreements are considered to have a strong contribution to the development of ASW and NSW. The e-ASEAN Framework Agreement is designed to facilitate the establishment of the ASEAN information infrastructure, promoting electronic commerce, and promoting the applications of e-government.³⁷² With respect to the facilitation of e-commerce development, member states have to adopt electronic commerce regulatory and legislative frameworks. It aims to create trust and confidence

³⁷⁰ See Cosgrove-Sacks, et.al., 2003; Tom Butterly, *Op. Cit.*, pp. 47-48.

³⁷¹ See *Ibid.*, pp. 47-48.

³⁷² See Article 3 of the e-ASEAN Framework Agreement, sign in Singapore November, 2000 available at : <http://www.aseansec.org/6267.htm>, last accessed : 30 October 2011.

for consumers. It also facilitates the transformation to e-business based on international norms.³⁷³

E-government has been acknowledged as one of the tools to apply good governance and good governance principles. E-government enables public control over public services and reduces bureaucracy chains. It automatically eliminates the opportunity for corruption, increasing efficiency of public services in terms of time and costs, and enforces transparency and accountability principles. Therefore, in the e-ASEAN Framework Agreement member states must improve ICT utilisation in the delivery of public services. In order to promote transparency, the member states must provide a wide range of government services and transactions using ICT applications. ICT applications are also important to enhance inter-governmental cooperation, which includes facilitating the freer flow of goods.³⁷⁴

V.b.4. The role of ASW and NSW for GSP utilisation.

GSP is the result of the Uruguay Round, which forms part of multilateral trade negotiations that brought developed countries and developing countries to negotiate at the one table. GSP provides special tariff reductions for developing countries and LDCs. GSP was proposed to encourage the full participation of developing countries in trade liberalisation. It is granted to bridge the economic gap between developed countries and developing countries by increasing the export earnings of developing countries. It is supposed to generate employment, reduce poverty, and increase NI (Gross National Income)³⁷⁵ and GDP (Gross Domestic Product).³⁷⁶

GNI is calculated on a per capita basis to demonstrate the “*consumer buying power*” of an individual from a particular country, and estimate average wealth, wages, and ownership distribution in a society. When the GNI of a country increases it is assumed that “*consumer buying power*” of its nationals also increases. Increasing “*consumer buying power*” creates a new market access for foreign country products in the domestic market and indicates the increase of its national welfare and prosperity. Hence, when a beneficiary country, according to the World Bank, has been classified as a high-income country for three consecutive years it is automatically excluded from the GSP list.³⁷⁷

Practically, GNP and GDP are used to describe a country’s economic development. Direct comparison between GDP and GNP can be used to observe the correlation between a country’s export and its local economy. GNP could be used to measure the overall economic strength of a country and the size of its local economy. Both of these parameters can be used to analyse the distribution of wealth throughout a society, or

³⁷³ See Article 5 of the e-ASEAN Framework Agreement.

³⁷⁴ See Article 9 of the e-ASEAN Framework Agreement.

³⁷⁵ See World Bank, available at : <http://data.worldbank.org/about/country-classifications>. See also http://www.diffen.com/difference/GDP_vs_GNP. With regard to operational and analytical purposes, the World Bank’s main criterion for classifying economies is gross national income (GNI) per capita (it was named as GNP (Gross National Product)). According GNI there are three classification of economic rank low income, middle income (subdivided into lower middle and upper middle), or high income. GNI calculates the total income of all nationals of a country, therefore, GNI could give accurate description of a nation’s yearly economy. The formulation to calculate $GNI = GDP(\text{Gross Domestic Product}) + NR(\text{Net income from assets abroad (Net Income Receipts)})$.

³⁷⁶ See http://www.diffen.com/difference/GDP_vs_GNP, GDP of a country is defined as the total market value of all final goods and services produced within a country in a given period of time (usually a calendar year). The most common formula to calculate GDP is the expenditure method: $GDP = consumption + investment + (\text{government spending}) + (\text{exports} - \text{imports})$, or, $GDP = C + I + G + (X - M)$.

³⁷⁷ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 20.

the average purchasing power or consumer buying power of the individual.³⁷⁸ The relationship between GDP and GNP can be defined as follows:

“[...] an increase in exports of a country will lead to an increase in both GDP and GNP of the country, correspondingly, an increase in imports will decrease GDP and GNP [...]”.

Nowadays, as studied by many experts in international trade, tariff reductions have a less significant contribution to boost the export income of a country. It was argued that trade facilitation gave a significant contribution to the export influence of a country. Expanding market access is considered as one of the main keys to development of a country. Trade facilitation in line with the principles and goals of the United Nations to achieve faster economic growth and eliminate poverty.³⁷⁹ Trade facilitation has to “pro-develop” and provide more favour for LDCs.³⁸⁰

In the framework of GSP, the concept relationship between developed countries and developing countries was based on a dependency relationship between a donor country and a recipient country or between a rich country and a poor country. During the GSP improvement process, the EU involved beneficiary countries to evaluate obstacles that hampered beneficiary countries from utilising GSP. Beneficiary countries and related stakeholders participated through public consultation that was held by the European Commission.

The procedures and formalities applied in exports impose long bureaucracy, require excessive documents and have very complicated regulations, significantly obstacles for traders have been created, especially for developing countries that lack trade facilities. Such circumstances could hamper utilisation of GSP. Thus, to obtain tariff facilities of the GSP scheme the EU has applied some requirements to the import formalities and procedures such as a certificate of origin document. Exporters from a beneficiary country who are allowed to obtain GSP facility are only authorised exporters or registered exporters. The EU also requires beneficiary countries to apply custom modernisation. The lack of trade facilitation could create barriers for trade and hinder the purpose of GSP. The success of GSP utilisation is not only the single responsibility of the preference granting country. It is the shared responsibility of the preference granting country and beneficiary country. The beneficiary country has the responsibility to provide trade facilitation for their traders in order to utilise the GSP scheme properly.

It has been mentioned that ASW and NSW could provide better trade efficiency and competitiveness. The target of ASW is to enhance competitive transactions of regional economies through the standardisation of the trading process. Implementation of ASW and NSW is achieved through collective efforts by related ministries and government agencies. ASW and NSW also function to promote closer regional integration to realise AEC. It is carried out through better compatibility and interoperability of functional systems of international trade transactions, and trade management of the respective stakeholders. In conclusion, the ASW and NSW are the main engine of trade facilitation in ASEAN.³⁸¹

³⁷⁸ See *Ibid.*, p. 20.

³⁷⁹ See *Ibid.*, pp. 11-12.

³⁸⁰ See *Ibid.*, p. 20.

³⁸¹ See Technical Guide of ASW and NSW Version 3/2006.

V.b. ASEAN and cumulation preferential rules of origin.

V.b.1. Cumulation preferential rules of origin.

In its early development, the preferential rules of origin were commonly used in the “*autonomous tariff preferential*” such as in the GSP scheme. Moreover, the establishment of the European Free Trade Area (EFTA), requested the EU to develop a system of rules of origin. Rules of origin is recognised as a crucial component within the FTA aiming to avoid trade deflection and trade fraud, so as to enable to deliver its advantage among the contracting parties.³⁸² Thus, according to Falvey, Rod and Reed, and Geoff, the rules of origin have rapidly developed along with the “increase” in numbers of PTA and FTA.³⁸³ In fact, until the beginning of the 1990s there were only a few preferential rules of origin.³⁸⁴ According to WTO data, in January 2012 there were 511 RTAs notified to the WTO. Those RTA notifications consisted of 370 RTAs under Article XXIV of the GATT 1947 or GATT 1994, 36 under the Enabling Clause, and 105 under Article V of the GATS. From those RTA notifications, 319 agreements were put in force.³⁸⁵ For example, Indonesia as one of the ASEAN member states was involved in 8 RTAs of trade in goods. The table of the RTAs enforced by ASEAN members states in the area of trade in goods can be seen below:³⁸⁶

³⁸² See Inama, Stefano., *Rules of Origin in International Trade*, Cambridge University Press, New York, USA, 2009, p. 174. See also See Falvey., Rod and Reed, Geoff., *Rules of Origin as Commercial Policy Instruments*, Research Paper 2000/18, Centre for Research on Globalisation and Labour Markets, School of Economics, University of Nottingham, available at : http://www.nottingham.ac.uk/Research_Papers/2000/00_18.pdf, last accessed : 9 April 2011. “[...] In the context of preferential trade, where partner exports face a lower tax, the ROO has the ostensible purpose of reducing the revenue loss from trade deflection. We have shown that the importing country may gain from lower priced imports as well [...]”.

³⁸³ See Falvey., Rod and Reed, Geoff., 2000.

³⁸⁴ See Inama, Stefano., 2009, *Op. Cit.*, p. 174.

³⁸⁵ See Regional Trade Agreements, available at : http://www.wto.org/english/tratop_e/region_e/region_e.htm, last accessed : 18 January 2012. See also Cheng Xin-xuan, *The Impact of Preferential Rules of Origin On The Relationship of Free Trade Area and The Multilateral Trading System*, available at : <http://www.cscanada.net/index.php/mse/article/viewFile/1614/1884>, last accessed : 9 April 2011.

³⁸⁶ See RTA WTO available at : http://www.wto.org/rta_participation_map_e.htm?country_selected=MMR&sense=g, last accessed : 18 January 2012.

Table 14. RTAs of ASEAN member states

No.	Country	RTA in goods sector
1.	Indonesia	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea; 6) ASEAN Free Trade Area (AFTA); 7) Global System of Trade Preferences among Developing Countries (GSTP); and 8) Japan – Indonesia.
2.	Singapore	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea; 6) ASEAN Free Trade Area (AFTA); 7) China – Singapore; 8) EFTA – Singapore; 9) Global System of Trade Preferences among Developing Countries (GSTP); 10) India – Singapore; 11) Japan – Singapore; 12) Jordan – Singapore; 13) Republic of Korea – Singapore; 14) New Zealand – Singapore; 15) Panama – Singapore; 16) Peru – Singapore; 17) Singapore – Australia; 18) Trans-Pacific Strategic Economic Partnership; and 19) US – Singapore.
3.	Malaysia	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; ASEAN – Republic of Korea; 5) ASEAN Free Trade Area (AFTA); 6) Global System of Trade Preferences among Developing Countries (GSTP); 7) India – Malaysia; Japan – Malaysia; and 8) Pakistan – Malaysia.
4.	Thailand	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea; 6) ASEAN Free Trade Area (AFTA); 7) Global System of Trade Preferences among Developing Countries (GSTP); 8) Japan – Thailand; 9) Lao People's Democratic Republic – Thailand; 10) Thailand – Australia; and 11) Thailand - New Zealand.
5.	Philippines	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 4) ASEAN – India; 5) ASEAN – Japan; 6) ASEAN – Republic of Korea; 7) ASEAN Free Trade Area (AFTA); 8) Global System of Trade Preferences among Developing Countries (GSTP); 9) Japan – Philippines; and 10) Protocol on Trade Negotiations (PTN).
6.	Brunei Darussalam	1) ASEAN – Australia - New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea ; 6) ASEAN Free Trade Area (AFTA); 7) Brunei Darussalam – Japan; and 8) Trans-Pacific Strategic Economic Partnership.
7.	Cambodia	1) ASEAN – Australia - New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea; 6) ASEAN Free Trade Area (AFTA).
8.	Vietnam	1) ASEAN – Australia - New Zealand; 2) ASEAN – China; ASEAN – India; 3) ASEAN – Japan; 4) ASEAN – Republic of Korea; 5) ASEAN Free Trade Area (AFTA); 6) Global System of Trade Preferences among Developing Countries (GSTP); and 7) Japan – Vietnam.
9.	Laos	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea; 6) ASEAN Free Trade Area (AFTA); 7) Asia Pacific Trade Agreement (APTA); 8) Asia Pacific Trade Agreement (APTA) – Accession of China; and 9) Lao People's Democratic Republic – Thailand.
10.	Myanmar	1) ASEAN – Australia – New Zealand; 2) ASEAN – China; 3) ASEAN – India; 4) ASEAN – Japan; 5) ASEAN – Republic of Korea; 6) ASEAN Free Trade Area (AFTA); and 7) Global System of Trade references among Developing Countries (GSTP).

With regard to cumulation of origin, preference granting countries that have not yet done so should give serious consideration to adopting appropriate forms of "cumulative origin" treatment in their respective schemes.³⁸⁷ The increasing of various types and the contents of preferential rules of origin are influenced by some factors. First, the absence of a non-binding multilateral agreement in the preferential rules of origin causes a lack of international harmonisation and uniformity of such regulation.³⁸⁸ Second, the increased RTA, for instance FTAs or PTAs, usually applies tariff preferences through reducing tariff and/or eliminating tariff until 0% on imports from their trading partners (the contracting parties). In the RTAs, they use a different set of rules to determine the origin of products to grant preferential tariff treatment, namely the "*contractual rules of origin*". The essential roles of preferential rules of origin were to ensure that only the goods and products originating from contracting

³⁸⁷ See Commentaries on the ILC's Draft Articles, 1978, *Op. Cit.*, p. 64.

³⁸⁸ See Inama, Stefano., 2009, *Op. Cit.*, p. 174.

parties can enjoy tariff or other preferences. In addition, a preferential rules of origin in the RTAs is designed to prevent trade deflection or trade fraud. For instance, “*simple trans-shipment*”, “[...] whereby goods or products from non-participating countries (non-RTA members) are redirected through any RTA partner in order to avoid the payment of customs duties [...]”.³⁸⁹ Third, the notion of GSP as an autonomous right of preference-granting countries, has led to the establishment of various “*unilateral preferential rules of origin*”.³⁹⁰

Contractual rules of origin under the FTA function to regulate the trade pattern between members, and minimise trade deflection. It should be noted that FTA is different from customs union, where “*common external tariff*” between members does not exist. Without the contractual rules of origin the existence of preferences among contracting parties could be distorted. For example, trade deflection might happen when a product is destined for a high tariff member-country and is first imported into a lower-tariff member country and then re-exported to the main export destination country. The objective of trade deflection conduct is to earn maximum gain through law circumventions. Such modus is generally used to escape high tariffs and take advantage of the FTA facility.³⁹¹

Broadly speaking, there are two kinds of preferential rules of origin, namely “*unilateral preferential rules of origin*” and “*contractual rules of origin*”. However, in certain cases of preferential agreement a combination of “*unilateral preferential rules of origin*” and “*contractual rules of origin*” have been implemented, such as the previous Lomè Convention and the Cotonou Partnership Agreement. It has the character of a non-reciprocal and contractual agreement. Unilateral and contractual preferential rules of origin have the main function to ensure tariff preferences are granted exclusively to the goods originating from beneficiary countries or member states of the PTA.³⁹²

GSP rules of origin have two main tasks related to their legal nature. First, they work as an “*integral part*” of the GSP system that has the purpose of boosting export earnings, promoting industrialisation, and economic development of beneficiary countries. It is important to ensure that the beneficiary country gets the real benefits from the GSP scheme to accelerate its economic growth. Second, GSP rules of origin are set up for specific trade policy objectives such as “*the allocation of preferences to products included in the GSP product coverage genuinely produced in beneficiary countries*”. Inherently GSP rules of origin have derived an autonomous character that are not from the negotiation process.³⁹³

The existence of various sets of rules of origin are caused by the different schemes of GSP that are granted by developed countries. According to the Enabling Clause, developed countries are asked to recognise some “*unilateral obligation*” to respond positively to the development needs of developing countries. The various schemes of GSP cannot be separated from its legal history when preference-granting countries decide to implement their national schemes independently. Consequently, each GSP scheme established has its own rules of origin. Thus, beneficiary countries are obliged to comply with such rules in order to take benefits of the GSP preferential tariff. On the other hand, the technical nature and the diversity of the rules of origin have

³⁸⁹ See Rajan Sudesh Ratna, *Rules of Origin: Diverse Treatment and Future Development in the Asia and Pacific Region*, p. 69, available at : http://www.unescap.org/tid/artnet/pub/tipub2469_chap3.pdf, last accessed : 28 October 2011.

³⁹⁰ See Inama, Stefano., 2009, *Op. Cit.*, p. 176.

³⁹¹ See *Ibid.*, p. 174.

³⁹² See *Ibid.*, p. 175.

³⁹³ See *Ibid.*, p. 175.

brought some additional complexities to the GSP. It has been analysed that more complex and rigid rules of origin cause lower utilisation of the GSP.³⁹⁴

According to the UNCTAD Secretariat, the use of preferential rules of origin by preference granting countries is divided into two broad categories. First, the GSP rules of origin based on percentage criterion, implemented by Canada, United States, and Russia. Second, the GSP rules of origin based on combination of criteria such as change of tariff heading (CTH) criterion, percentage criterion, and specific working or processing requirements. The “*product specific requirements*” that including in the list called as “*single list*”.³⁹⁵ EU, Norway, Switzerland, and Japan used the combination of criteria. The application of “*percentage criterion*” brings consequences of different calculation methods of local content's and minimum amount of local content's required.³⁹⁶

Under the EU GSP rules of origin, product exported originating from beneficiary country are divided into two categories:³⁹⁷

1. Products wholly obtained in that beneficiary country, means as products that have been entirely grown, extracted from the soil, or harvested within the exporting country, or manufactured there exclusively from any of these products, qualify as having been of GSP origin by virtue of the total absence of the use of any imported components or materials, or such of unknown origin.
2. products obtained in that beneficiary country incorporating materials which have not been wholly obtained there, provided that such products that are made from imported materials, parts, or components, that is, products that are manufactured wholly or in part from materials, parts or components imported into the beneficiary country or that are from unknown origin. These products, which are termed “products with import content,” qualify only if they have undergone “sufficient working or processing” (as defined under the individual rules of origin of preference granting countries) in the beneficiary country. Consequently, GSP scheme regulates detailed rules or definitions of “sufficient working or processing” that have to be fulfilled if goods are to be granted GSP tariff treatment.

Cumulative rules of origin purposed to encourage trade amongst members of developing countries group or among developing countries in general. From the economic perspective, cumulative rules of origin could generate trade diversion and trade creation.

GSP rules of origin are based on a “*single country origin*”, which means that the “*origin requirements*” must be fully complied by one beneficiary country. The development of RTA has influenced some preference-granting countries to adopt cumulation of origin. There are four types of cumulation of origin in the preferential rules of origin, consisting of “(a) *bilateral cumulation or donor-country content*; (b) *diagonal or partial cumulation*; (c) *regional cumulation*; (d) *full cumulation*”.³⁹⁸

Bilateral cumulation is applied between two countries that are bound under a FTA or autonomous arrangement. The provisions allowing them to cumulate origin are contained in their arrangement. Hence, according to such agreement only products or materials originating from the contracting parties can benefit from it.³⁹⁹ Preference-granting country “*content*” rules of origin are defined as the rule that allows products

³⁹⁴ See *Ibid.*, p. 177.

³⁹⁵ See *Ibid.*, p. 179.

³⁹⁶ See *Ibid.*, p. 179.

³⁹⁷ See Article 72, 75 and 76 Commission Regulation (EU) No. 1063/2010. See also Inama, Stefano., 2009, *Op. Cit.*, p. 179.

³⁹⁸ See Inama, Stefano., 2009, *Op. Cit.*, p. 190.

³⁹⁹ See http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_774_en.htm

(materials, parts, and components) of their manufactures when supplied to a beneficiary country and used there in a process of production, to be regarded as of that beneficiary country's origin for determining whether the finished product qualifies for GSP treatment. For example, products originating in the EU that are subject to sufficient working or processing in a beneficiary country are to be considered as originating in that beneficiary country.⁴⁰⁰

Diagonal or partial cumulation provides liberalisation allowing a product to be manufactured and finished in a beneficiary country using imported materials, parts, or components from other beneficiary countries. Such material could be considered as originating in the beneficiary country claiming the preferential tariff treatment or where the last working or processing operation took place. EU diagonal cumulation is applied between the EU and the countries included in the "Pan-Euro-Mediterranean cumulation zone".⁴⁰¹

Regional cumulation is considered as another form of diagonal or partial cumulation. Regional cumulation can be applied by more than two countries under FTA, which contains identical origin rules and provisions for cumulation between them. According to the EU GSP preferential rules of origin, regional cumulation is defined as:

"[...] a system whereby products originate in a country which is a member of a regional group and are considered as materials originating in another country of the same regional group (or a country of another regional group where cumulation between groups is possible) when further processed or incorporated in a product manufactured there [...]"⁴⁰²

Regional cumulation is provided under the EU GSP that is applied for four separate regional groups.⁴⁰³ Besides the EU, Japan, Norway, Switzerland, and the US are preference-granting countries that apply regional cumulation to certain regional groups.⁴⁰⁴

The basic philosophy of regional cumulation is economic complementarities.⁴⁰⁵ The benefits can be maximised when countries with "*identical rules of origin*" work together for the purpose of manufacturing products that are eligible for preferential tariff treatment. In this regard, regional cumulation can also be considered as trade facilitation to strengthen regional economic cooperation among the member states within the groups. However, there are complexities in regional cumulation because of different levels of economic development between countries in the regional group. In this regard, some countries in the regional groups can have different facilities of EU GSP arrangements. For example, some ASEAN member states are granted general arrangements and some members who are classified into LDCs are granted EBA arrangements. There are some provisions that should be made to exclude certain sensitive products from regional cumulation. In the context of regional cumulation for a country that has been fully graduated, such as Singapore, it is still considered as part of regional cumulation.⁴⁰⁶ In other words, the withdrawal of certain countries or territories from the list of GSP beneficiaries due to the country graduation mechanism does not affect the possibility of using products originating in that country under the regional cumulation rules.⁴⁰⁷

⁴⁰⁰ See Inama, Stefano., 2009, *Op. Cit.*, p. 189.

⁴⁰¹ See http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_774_en.htm

⁴⁰² See Article 66 paragraph h Commission Regulation (EU) No 1063/2010.

⁴⁰³ See Article 86 paragraph h Commission Regulation (EU) No 1063/2010.

⁴⁰⁴ See Inama, Stefano., 2009, *Op. Cit.*, pp. 191-193.

⁴⁰⁵ See Falvey., Rod and Reed, Geoff., 2000.

⁴⁰⁶ See Recitals 10 and 11 See Article 86 paragraph h Commission Regulation (EU) No 1063/2010.

⁴⁰⁷ See Inama, Stefano., 2009, *Op. Cit.*, p. 196.

Full cumulation is the most liberal scheme of cumulation origin. Full cumulation origin allowing cumulation of material, working and processes or value added of more than one beneficiary country to be added together to comply with origin requirements. All the working process must be carried out in the non-originating materials where the final product obtained origin. Therefore, in the full cumulation “*all operations carried out in the participating countries are taken into account*”.⁴⁰⁸

Canada is the GSP preference granting country that applying full and global cumulation. In addition, Canada also applying donor-country content requirement to all of GSP’s beneficiary countries. According to the Canada GSP scheme, all beneficiary countries are deemed as “*one single area for determining origin*”. Therefore, the full and global cumulation, described, wherein all “[...] *value-added and/or manufacturing processes performed in the area may be added together to meet the origin requirements for products to be exported to any of therefore mentioned preference granting country [...]*”.⁴⁰⁹

With respect to the concept of full and global cumulation, as recently WTO has launched a new brand, namely “*made in the world*” initiatives in the framework of accelerating trade liberalization.⁴¹⁰ Gradually “*the concept country of origin for manufactured goods*” is being eroded. The vast development of trans-national or multinational company across the world supposed as the background of “*made in the world*” launching initiatives, as stated by Mr. Pascal Lamy :

“[...] the concept of country of origin for manufactured goods has gradually become obsolete as the various operations, from the design of the product to the manufacture of the components, assembly and marketing have spread across the world, creating international production chains [...]”⁴¹¹

Further, Inama explained that the full cumulation of origin allows more scattered job opportunities and dividing labour operations among the beneficiary countries in order to fulfil the origin criteria. The distribution of manufactures can be performed based on the business demand of the member regional grouping. For instance, according to cost/benefit analysis working process may start in Country A, continue in Country B, and finished in Country C. Full cumulation in line with the globalization and interdependency of production, where developed countries might be attracted to farming out technology or labour intensive production processes in low-cost countries.⁴¹² Inama described the distinction between full and partial regional cumulation that applied between EU, Japan and US :

“[...] the EU grants what is called partial or diagonal regional cumulation as opposed to the full regional cumulation accorded under the schemes of the United States and Japan. Partial or diagonal regional cumulation means that inputs imported from another member of the regional association and utilized for further manufacturing or incorporated in the final exporting country must already have originated there to be considered as domestic content. This limitation does not exist under the regional cumulation option of the schemes of Japan and the United States, which consider the members of a regional association as one single customs territory. Any working or processing operations may be counted as domestic content in compliance with rules of origin requirements [...]”

⁴⁰⁸ See http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_774_en.htm

⁴⁰⁹ See Inama, Stefano., 2009, *Op. Cit.*, pp. 190-191.

⁴¹⁰ See Made in the World, available at : http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.htm.

⁴¹¹ See WTO News : speeches - Director General Pascal Lamy speech to the French Senate in Paris on 15 October: Lamy says more and more products are “Made in the World”, 15 October 2010, available at : http://www.wto.org/english/news_e/sppl_e/sppl174_e.htm, last accessed : 28 October 2011.

⁴¹² See Inama, Stefano., 2009, *Op. Cit.*, p. 193.

Under full regional cumulation, which is applied by Japan and the United States, all ASEAN member states are considered as one single customs territory.⁴¹³ Therefore, all processing or manufacturing carried out in ASEAN member states, regardless of whether it acquires origin or not, it is counted as local content. In the partial regional cumulation applied under EU GSP scheme, the materials counted as domestic content only if acquiring origin in one of the member states of the regional association. In the partial regional cumulation only those products that already originate in other countries of ASEAN could be counted as local content when utilized for further manufacturing or incorporated into the finished product manufactured in the final member states.⁴¹⁴ The EU rules for partial and regional cumulation explained that :

“[...] materials or parts imported by a member country of one of these four groupings from another member country of the same grouping for further manufacture are considered as originating products of the country of manufacture and not as third-country inputs, provided that the materials or parts are already originating products of the exporting member country of the grouping [...]”.

Thus, the originating products are those products that obtained origin by fulfilling the individual origin requirements under the EU rules of origin for the GSP objective. In this regard, Article 86 paragraph 4 Commission Regulation (EU) No 1063/2010 has stipulated:

“[...] where the condition laid down in the first sub-paragraph is not fulfilled, the products shall have as country of origin the country of the regional group which accounts for the highest share of the customs value of the materials used originating in other countries of the regional group [...]”.

The “*proof of originating status good*” regulated under Article 72a paragraph 4 and 5 Commission Regulation (EEC) No 2454/93. It is stipulated that :

“[...] proof of the originating status of goods exported from a country of a regional group to another country of the same group to be used in further working or processing, or to be re-exported where no further working or processing takes place, shall be established by a certificate of origin Form A issued in the first country [...]”.

Based on the first certificate a further certificate of origin Form A or invoice declaration is made in the country that establish proof of the originating status of the goods to be re-exported to the EU from a country belonging to a regional group.⁴¹⁵

⁴¹³ Except Singapore and Brunei which has been graduated from United States GSP Scheme.

⁴¹⁴ See Inama, Stefano., 2009, *Op. Cit.*, pp. 193-194. Inama visualized an example for regional cumulation under the EU rules of origin. For instance cars production which classified under heading HS 8702 must not incorporate more than 40 percent of imported inputs. In this example a car manufactured in Malaysia, may incorporate the following inputs (all prices are in US\$):

Inputs originating in Singapore	4,500
Inputs originating in the Philippines	1,400
Inputs originating in Japan	1,500
Value added in Malaysia (local content, labor costs, profits)	2,600

Total (ex-works price)	10,000

According to the partial cumulation provision of the EU, to calculate the percentage of imported inputs, the materials imported from Singapore and the Philippines will not be considered imported materials if they originate in these countries. Materials originating in other ASEAN member countries will not be considered as imported inputs. Therefore, only the components imported from elsewhere are to be considered as imported inputs. As the amount of the input from Japan is US\$1,500, equal to 15 percent of the export price, and as this is less than 40 percent, the car will be considered as originating. Since, the value of inputs originating in Singapore is greater than the value added in Malaysia the car will be considered as originating in Singapore.

⁴¹⁵ See Inama, Stefano., 2009, *Op. Cit.*, p. 198. The example in proof of origin status, elaborated as follows: A trader/exporter in Indonesia wishes to export a finished product which contains imported inputs originating from Thailand and Philippine, where these countries are belonging to the same regional grouping (ASEAN). The

Since the first time launched, developing countries have challenged the rules of origin as the main obstacle to the utilization of GSP. Nevertheless, rules of origin is the “*trade policy instrument*” used to achieve the objective of GSP scheme.⁴¹⁶ Developed countries used the rules of origin as the tools to discriminate the import products or goods based on the production processes related to the social clauses such as the labour standard, human right and environment protection.⁴¹⁷ Preferential rules of origin hold important role on the trade preferences, especially to promote trade creation and trade diversion.⁴¹⁸

In broad outline it can be summed, innately “*unilateral rules of origin*” under GSP serve as the instrument to prevent trade deflection and trade fraud. It is also worked as a tool to ensure benefits of GSP scheme granted appropriately to the goods or products originating manufactured in the beneficiary countries. Trade fraud often occurs takes a form as tariff circumvention operation. The modus operandi of tariff circumvention happened when the goods simply trans-shipped or produce the object by minimal working or processing in the beneficiary countries just to take advantage of the trade preferences. The misuse the “*origin of goods*” of beneficiary country by traders or producers from non-beneficiary countries hindered achievement of the GSP final goal.⁴¹⁹

Experts in international trade law assessed the strong correlations between preferential rules of origins and utilization of GSP. Its concluded that too rigid and details rules of origins could undermining the utilization of GSP. Too complex GSP rules of origin creates obstacles for developing countries and LDCs to obtain facility of preferential tariff, because it would burden extra cost on formalities and procedures to comply with the regulations. For instance, Carrère et. al noted that “...*benefiting from market access requires proving origin which itself is costly and reduces the benefits from that market access...*”⁴²⁰. While, Inama has written regarding “*assessing the impact of rules of origin in the utilization of trade preferences under the GSP*”.⁴²¹

“[...] Preferences are conditional on the fulfilment of an array of requirements related to rules of origin that in many instances, *beneficiary countries may not be able to comply with*. Recent literature, driven by the flourishing of unilateral and contractual preferential trading, has increasingly indicated rules of origin as *prime suspects of underutilization of trade preferences and distortion in FTA*. In spite of the evidence contained in various UNCTAD reports and related studies, since the last decade, part of this literature is still discussing the empirical foundation of the relation between rules of origin and low utilization rates as a new finding rather than acknowledged reality. Nevertheless, the fact that *utilization rate is strictly linked to origin requirements* is very clear to beneficiary countries.....*In some cases, exporters may have not submitted the necessary documentation (such as a certificate*

trader/exporter must submit to the competent authority two certificate of origin Form A relating to the inputs originating from Thailand and Philippine, respectively, and issued by the competent authorities in each of these countries. On the basis of these two certificates, the competent authority in Indonesia will then issue the final certificate of origin Form A relating to the finished product to be exported.

⁴¹⁶ See Inama, Stefano., 2009, *Op. Cit.*, pp. 341-342.

⁴¹⁷ See Falvey., Rod and Reed, Geoff., 2000. “[...] Yet one should also recognise that developed countries in particular are increasingly likely to employ policies that discriminate amongst imports on the basis of how they have been produced. This is equivalent to employing a ROO, and may be justified on the grounds of protecting the environment or discouraging the use of child labour [...]”.

⁴¹⁸ See Inama, Stefano., 2009, *Op. Cit.*, pp. 341-342.

⁴¹⁹ See *Ibid.*, pp. 341-342.

⁴²⁰ See Cèline Carrère, Jaime de Melo, and Bolormaa Tumurchudur, Disentangling Market Access Effects of Preferential Trading Arrangements with an Application for ASEAN Members under an ASEAN – EU FTA, EUDN/WP 2008 – 04, 17 November, 2008.

⁴²¹ See Inama, Stefano., 2009, *Op. Cit.*, pp. 360-361.

of origin or through bill of lading) to get preferential treatment because of lack of knowledge or incorrect information [...].⁴²²

Since GSP facilities are granted based on the origin of the goods or products, thus, the goods must fulfil the conditions to be originating from the beneficiary country. It has to be remembered that trade preferences given under GSP are directed for a certain target country with the objective to help improve the economic development of that country. Therefore, the rules of origin have become a crucial technical requirement to obtain GSP facility, however, from the perspective of the beneficiary countries, they have caused some obstacles for exporters to obtain GSP facility. For instance in the EU GSP, regarding “*not wholly obtained products*” or products obtained in the beneficiary country incorporating materials which have not been wholly obtained in that country. In this case, such products “*have undergone sufficient working or processing*”,⁴²³ certain conditions are applied based on the “*list of working or processing operations*”.⁴²⁴ The set of products that accumulated from originating and non-originating materials would be deemed as “*originating*” if the content of non-originating materials does not exceed 15% of the ex-works price of the products.⁴²⁵ According to the EU GSP rules of origin, there are four different types of rules to grant originating status to the not wholly obtained product:

1. through working or processing a maximum content of non-originating materials is not exceeded;
2. through working or processing the 4-digit Harmonised System heading or 6-digit Harmonised System sub-heading of the manufactured products becomes different from the 4-digit Harmonised System heading or 6-digit sub-heading respectively of the materials used;
3. if a specific working and processing operation is carried out; and
4. if working or processing is carried out on certain wholly obtained materials.

The beneficiary country is obliged to demonstrate evidence to obtain originating status of its products. That evidence should be in compliance with the standards applied by the EU. In addition, the beneficiary country is also required to provide “*administrative structures and systems*” to comply with the rules and procedures determined by the regulation including building an integrated system to support the implementation of “*accumulation of origin*”, such as ASW. More details and complex rules of origin create more difficulties for exporters to demonstrate evidence in order to obtain certificate of origin.

As highlighted by Inama, another problem is the “*lack of knowledge or incorrect information*” regarding certificate of origin. The roles of government trade institutions in the beneficiary countries become crucial to ensuring that their traders have sufficient information to obtain tariff facilities under the GSP scheme. Dissemination of GSP information in the beneficiary country is crucial since not all traders are aware of the tariff reductions given under the GSP scheme. Therefore, trade institutions in the beneficiary country are deemed as the core engine to drive GSP utilisation. The preference-granting country has designed its policy to simplify and relax GSP rules of origin, however, the roles of the beneficiary country institutions to deliver information, public services, and assistantship to traders to access GSP facility is much more significant. Lack of knowledge or incorrect information is the common problem faced by local companies (SMEs) or local traders when they are located away from the centre

⁴²² See *Ibid.*, pp. 360-361.

⁴²³ See Article 72 and Article 75 of the Commission Regulation (EU) No. 1063/2010.

⁴²⁴ See Article 82 of the Commission Regulation (EU) No. 1063/2010.

⁴²⁵ See Annex 13a of the Commission Regulation (EU) No. 1063/2010.

of the central government institutions. Generally, beneficiary countries lack infrastructures in transportation and communication that cause the high cost of fees for producers and traders to obtain documents of rules of origin.

The minimum content of non-originating materials is not allowed to exceed 15% of the ex-works price of the final exported product, and has caused difficulties for the beneficiary country producers to manage their productions with limited choices. In this regard, producers of the beneficiary country cannot maximise their profits to choose the low cost materials from different sources. For LDCs, Commission Regulation (EU) No. 1063/2010 provides “*maximum content of non-originating*⁴²⁶ *materials up to 70%*” since LDCs are considered as not having enough resources to do production by themselves.

As previously noted that GSP is settled under UNCTAD, in this regard, UNCTAD carries out tasks to ensure the general non-reciprocal system of preferences delivers benefit to all developing countries.⁴²⁷ According to Resolution 21(II) 1968, the Special Committee on Preferences⁴²⁸ was established under UNCTAD with the task of reviewing the operation and effects of the GSP. According to the Agreed Conclusion the tasks of the Special Committee to evaluate the effect of the GSP scheme “*on exports and export earnings, industrialisation and the rate of economic growth of the beneficiary countries.*”⁴²⁹ UNCTAD conducting analysis on GSP utilisation is based on the trade data notified by preference-granting countries. Therefore, trade data submitted by preference-granting countries have been internationally accepted as “*reliable sources*” to analyse the utilisation rate of GSP.⁴³⁰

In practice, the task of the Special Committee working with the UNCTAD Working Group on rules of origin is to review the “*performance criteria of the GSP*”. In the assessment of GSP performance UNCTAD has special methodologies that have been used for forty years. Three methodologies have been used by UNCTAD to assess the GSP performance, that is, product coverage⁴³¹, utilisation rate⁴³² and utility rate⁴³³.⁴³⁴ Among those methodologies, the utilisation rate is used to measure the utilisation of the GSP related to the implementation rules of origin. The degree of rigidity and difficulties of rules of origin include its additional criteria determining higher and lower utilisation rates of GSP. The utilisation rate is measured based on the ratio between the actual import that is granted preference and the covered import. The utilisation rate is

⁴²⁶ See Paragraph 1 (o) Article 67 of the Commission Regulation (EU) No. 1063/2010, defined “[...] maximum content of non-originating materials as the maximum content of non-originating materials which is permitted in order to consider a manufacture as working or processing sufficient to confer originating status on the product. It may be expressed as a percentage of the ex-works price of the product or as a percentage of the net weight of these materials used falling under a specified group of chapters, chapter, heading or sub-heading [...]”.

⁴²⁷ See Commentaries on the ILC’s Draft Articles 1978, p. 60.

⁴²⁸ See Yusuf, Abdulqawi., 1982., *Op. Cit.*, p.143.

⁴²⁹ See Robert, Howse., 2003, *Op. Cit.*, p. 393.

⁴³⁰ See Inama, Stefano., 2009, *Op. Cit.*, pp. 360-361.

⁴³¹ “[...] **Product coverage** defined as the ratio between imports that are covered by a preferential trade arrangement and total dutiable imports from the beneficiaries’ countries. The higher the percentage, the more generous the preferences may appear, depending on the structure of dutiable imports of the beneficiary countries. Coverage does not automatically mean that preferences are granted at the time of customs clearance [...]”. (See Inama, Stefano., 2009, *Loc. Cit.*, p. 361).

⁴³² “[...] **Utilization rate** defined as the ratio between imports actually receiving preference and covered imports. This rate is based on the customs declaration made by the importer at the time of importation [...]”. (See Inama, Stefano., 2009, *Loc. Cit.*, p. 361).

⁴³³ “[...] **Utility rate** defined as the ratio of imports actually receiving preference and all dutiable imports (covered or not), refers to the percentage of total dutiable imports that receive preferences. A low level of this ratio means that a large part of dutiable imports (either covered or not) pay the MFN rate [...]”. (See Inama, Stefano., 2009, *Loc. Cit.*, p. 361).

⁴³⁴ See Inama, Stefano., 2009, *Op. Cit.*, pp. 360-361.

calculated based on the customs declaration made by the importer at the time of importation.

The EU has used the utilisation rate to evaluate the performance of its GSP scheme. According to the midterm evaluation on utilisation rates of EU GSP, 61 beneficiary countries have high utilisation rates up to 100%. Then, 21 beneficiary countries have utilisation rates up to 75%. This is followed by 3 beneficiary countries with utilisation rates up to 50% and 2 beneficiary countries with utilisation rates up to 25%. Then finally, there are 26 beneficiary countries that have utilisation rates up to 10%. Based on this data, almost 54% of beneficiary countries under GSP have maximum utilisation rates and 23% of the beneficiary countries have utilisation rates less than 10%.

Table 15. Utilisation Rates under EU GSP.⁴³⁵

No.	Utilisation of GSP (%)	Number of Countries
1.	<10 %	26
2.	<25 %	2
3.	<50 %	3
4.	<75 %	21
5.	<100%	61

The EU evaluates the performance of the EBA GSP scheme using utilisation rates. According to the midterm evaluation of EU28 countries, 49 beneficiary countries have utilisation rates up to 100%. Followed by 8 countries with utilisation rates up to 75%, 3 countries with utilisation rates up to 50%, 1 country with utilisation rates up to 25% and 9 countries have utilisation rates less than 10%. Based on data of the evaluation almost 57% of beneficiary countries under EBA have utilisation rates up to 100%.

Table 16. Utilisation rates under EBA.⁴³⁶

No.	Utilisation of GSP (%)	Number of Countries
1.	<10 %	9
2.	<25 %	1
3.	<50 %	3
4.	<75 %	8
5.	<100%	28

Singapore is the only countries of ASEAN that has been graduated from GSP since 1997. Under general arrangements of EU GSP five countries of ASEAN have utilisation rates up to 75% and 1 country has utilisation rate less than 10%. In this regard, ASEAN needs to upgrade its efforts to facilitate the utilisation of the GSP scheme. As pointed out earlier, the utilisation rates are correlated to the rules of origin, where the obstacles not only come from the conditions of the rules of origin under GSP but also from the

⁴³⁵ Cited from Gasiorek, Michael, Mid-term Evaluation of the EU's Generalized System of Preferences: Final Report, Centre for the Analysis of Regional Integration at Sussex (CARIS), University of Sussex, pg. 70, available at : http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146196.pdf, last accessed : 6 June 2011.

⁴³⁶ Cited from Gasiorek, Michael, 2010, *Op. Cit.*, p. 69.

facilitation provided by the trade institutions in the developing countries to issue the supporting documentation.

Table 17. Utilisation rates of GSP by ASEAN member states.⁴³⁷

No.	Utilisation of GSP (%)	ASEAN Countries
1.	<10 %	Brunei Darussalam
2.	<25 %	-
3.	<50 %	-
4.	<75 %	Malaysia Philippines Thailand Indonesia Vietnam
5.	<100%	-

V.b.2. The Rules of Origin within CEPT-AFTA and ASEAN trade in good agreement.

The concept of “contractual rules of origin” is to prevent trade deflection within FTA or PTA. Trade deflection is deemed to hinder the benefit of regional integration that should be distributed among the contracting parties. According to Inama, FTA as a contractual obligation is intended to serve as a “discrimination instrument” against “unlawful imports” or trade fraud conduct of non-member FTA countries. Thus, contractual rules of origin functions to ensure that preferential market access will only be granted to the goods that have actually been “substantially transformed” within the area of FTA, and not to goods that are produced elsewhere and simply trans-shipped through one of the member countries.⁴³⁸ Generally, the *modus operandi* of trade deflection within FTA is conducted by exploiting its weaknesses. Within FTA each member state maintains its own external tariff and commercial policy in its relationship with outside third country trading partners. Consequently, the tariffs and commercial policies are different related to the third country trading partners. Commonly, FTA reduces the customs duty tariffs between its members until 0%. Therefore, tariff circumvention operations can be conducted by some “opportunists traders or producers”. Those opportunists penetrate FTAs by means of minimal transformation in one of the FTA members in order to re-export the goods to the countries with the higher tariffs or to the member countries of FTA which offered 0% of custom duty tariffs.

Trade deflection does not have *per se*⁴³⁹ a negative economic effect. In the economic perspective, trade deflection is considered as a positive effect to improve economic efficiency. Economically speaking, it is “[...] equivalent to a reduction in the tariff of the country having the higher tariff of the FTA to the country having the lower tariff [...]”.⁴⁴⁰ But, Falvey, Rod and Reed, and Geoff, argue that “it doesn't matter what rules of origin effects the trade preferences practice, such policies will distort trade”.⁴⁴¹ While, from the legal perspective it is not aligned with the objectives of the agreement

⁴³⁷ Cited from Gasiorek, Michael, 2010, *Op. Cit.*, p. 72.
⁴³⁸ See Inama, Stefano., 2009, *Op. Cit.*, p. 340.
⁴³⁹ Means that inherently trade deflection does not absolutely caused negative effect from the economic efficiency perspective.
⁴⁴⁰ See Inama, Stefano., 2009, *Op. Cit.*, p. 234.
⁴⁴¹ See Falvey., Rod and Reed, Geoff., 2000.

that has been agreed between the FTA contracting parties. For that reason, rigorous contractual rules of origin must be established within FTA as a traditional remedy of trade deflection.⁴⁴² Related to the comparative advantages theory, the origin compliance and administrative costs bring effect to stimulate trade diversion and trade creation within FTA.

While Cheng Xin-xuan considers preferential rules of origin under PTA as “*internal protection and external discrimination*”. In internal protection, rules of origin are used as tools to protect the contracting parties from trade deflection conducted by third parties. In external discrimination, rules of origin serve as a discrimination instrument to determine types of treatment granted to the products originating from contracting parties and non-contracting parties. The level of discrimination is influenced by two factors, that is, the coverage of regional trade agreements and the different degree between the free trade area and multilateral trade agreements. In this regard, the more extensive coverage of RTA, the higher the level of foreign discrimination is based on the rules of origin.⁴⁴³

The legal basis of ASEAN cumulative rules of origin is contained in the Agreement on ASEAN Preferential Trading Arrangements that was signed in 1977. ASEAN PTA facilitates the member states to utilise the most resources available in the region to broaden the complementarities of each member’s respective economies and expand production opportunities within regions. ASEAN PTA covers areas of basic commodities, particularly food and energy, products of the ASEAN industrial projects, expansion of intra-ASEAN trade and increase in the utilisation of raw materials available in the member states. Enhancement of utilisation of raw materials, complementarities, and expanding production opportunities among member states is considered as the driving factors of trade creation and trade diversion. In order to maintain and to ensure that the benefits of ASEAN PTA are delivered and utilised properly by member states, the Agreement provides provisions, stating that eligible products under PTA should comply with the PTA rules of origin.⁴⁴⁴ ASEAN has acknowledged that cumulative rules of origin given under EU GSP have a significant role in ASEAN economic integration and AFTA. It was stated in the Joint Declaration of the EU and ASEAN in 1994, as follows:

“[...] The Ministers recognised that the General System of Preferences (GSP) has contributed to the growth in exports from ASEAN to the EU. More than one third of ASEAN’s exports to the EU enjoy tariff concessions under the GSP. The Ministers noted that the EU envisages a revision and updating of the GSP for the next decade. In this context, the Ministers recognised that the Cumulative Rules of Origin (CRO) provision has contributed to ASEAN’s regional integration and would further assist ASEAN in achieving its objectives of an ASEAN Free Trade Area [...]”⁴⁴⁵

ASEAN PTA had contributed significantly to support the extra-ASEAN trade by establishing basic regulations related to cumulation rules of origin as set out in Annex 1⁴⁴⁶ and Annex 2⁴⁴⁷ of the Agreement. ASEAN PTA rules of origin consist of eight (8)

⁴⁴² See Inama, Stefano, 2009, *Op. Cit.*, p. 234.

⁴⁴³ See Cheng Xin-xuan quoting Bonade. Haldeman and Michael.KeStecchi, stated that “*the liberalization of FTA depended on its rules of origin.*”

⁴⁴⁴ See Article 2, 4, and 15 of the Agreement On ASEAN Preferential Trading Arrangements Manila, 24 February 1977, available at : <http://www.aseansec.org/1376.htm>, last accessed : 30 October 2011.

⁴⁴⁵ See Robert, Howse., 2003, *Op. Cit.*, p. 393..

⁴⁴⁶ See Annex 1 Rules of Origin for the ASEAN referential Trading Arrangements, available at : <http://www.aseansec.org/1376.htm>, last accessed : 30 October 2011.

⁴⁴⁷ See Annex 2 Operational Certification Procedures for the Rules of Origin of the ASEAN Preferential Trading Arrangements, available at : <http://www.aseansec.org/1376.htm>, last accessed : 30 October 2011.

rules, which are important to determine the origin of products eligible for preferential concessions. Rule 1 elaborates the definition of “*originating product*” that covers products wholly produced or obtained and products not wholly produced or obtained in the exporting members states.

According to the Rule 4, products not wholly produced or obtained in the exporting member states, applies to the requirement that the total value of the materials from non-ASEAN countries or undetermined origin used does not exceed 50% of the FOB value of the products produced, except for Indonesia, regarded it does not exceed 40%. In this regard, Indonesia only allows certain manufactured products of non-ASEAN content up to a maximum limit of 50%. For the purpose of accelerating industrialisation in certain sectors, the rules on maximum limits of non-ASEAN content may be waived. In order to acquire origin under ASEAN PTA, the final process of manufacture of not wholly produced or obtained products should be carried out within the territory of the exporting contracting states.⁴⁴⁸

With respect to the certificate of origin, rule 7 regulates that the government authority appointed by the exporting member state should accept a claim that the product is eligible for preferential concession, thus, it has to be notified to the other member states. The certification procedures need approval from the Committee on Trade and Tourism. Rule 4 of Annex 1 specially regulates “*cumulative rules of origin*”, stipulated as follows:

“[...] products which comply with or requirements provided for in Rule 1 and which are used in a contracting state as inputs for a finished product eligible for preferential treatment in another contracting state/states shall be considered as a product originating in the contracting state where working or processing of the finished product has taken place provided that the aggregate ASEAN content of the final product is not less than 60% [...]”

In 1987, the Protocol on Improvements on Extension of Tariff Preferences under the ASEAN PTA, amended the regulation related to regional content requirement, as follows:

“[...] The ASEAN content requirement in the rules of origin shall be reduced from 50% to 35% on a case-by-case basis for a period of five years. With respect to Indonesia, the ASEAN content requirement will be reduced from 60% to 42%. After the said period of reduction it shall be reviewed with a view to revert to original levels [...]”.⁴⁴⁹

According to value content (VC), the criteria of a product or goods to have origin require a certain minimum local value in the exporting country. Value content can be calculated by three methods. First, the minimum percentage of value that must be added in the exporting country, known as domestic or regional value content (RVC). Second, the difference between the value of the final goods and the costs of the

⁴⁴⁸ “[...] products worked on and processed as a result of which the total value of the materials, parts or produce originating from non-ASEAN countries or of undetermined origin used does not exceed 50% of the FOB value of the products produced or obtained and the final process of manufacture is performed within the territory of the exporting contracting state ...in respect of Indonesia, the percentage referred to subparagraph (i) above is 40%. On certain categories of manufactured products to be agreed upon from time to time, the requirement of 50 of non-ASEAN content may apply...in respect of the ASEAN industrial projects, the percent criterion of Rule 3(a) may be waived...The value of the non-originating mates, parts or produce shall be: (1) The CIF value at the time of importation of the products or importation can be proven; or (2) The earliest ascertainable price paid for the products of undetermined origin in the territory of the Contracting State where the working or processing takes place [...]”.

⁴⁴⁹ See Section V Protocol on Improvements on Extension of Tariff Preferences under The ASEAN Preferential Trading Arrangements, signed on Manila, 15 December 1987, available at : <http://www.aseansec.org/1380.htm>, last accessed : 29 October 2011.

imported inputs, known as import content (MC). Third, the value of parts (VP), whereby originating status is granted to a product that meets a minimum percentage of originating parts out of the total.⁴⁵⁰

Further, ASEAN rules of origin evolved along with the signing of CEPT-AFTA in 1992⁴⁵¹, wherein the rules of origin (ROO) for CEPT-AFTA was also adopted. This agreement applies a 40% requirement for “ASEAN Value Content” or the “Regional Value Content (RVC)” of goods to be deemed originating in the member state.⁴⁵² Furthermore, ROO for CEPT-AFTA introduces two formula for calculating ASEAN Value Content or RVC, that is, direct and indirect methods.

a. Direct method:

$$\text{RVC} = \frac{\text{ASEAN Material Cost}^{453} + \text{Direct Labour Cost}^{454} + \text{Direct Overhead Cost}^{455} + \text{Other Cost}^{456} + \text{Profit}}{\text{FOB price}^{457}} \times 100\%$$

b. Indirect method:

$$\text{RVC} = \frac{\text{FOB Price} - \text{Non-Originating Materials, Parts or Produce}}{\text{FOB price}} \times 100\%$$

According to the regulations of the ROO CEPT AFTA, each member state is only allowed to choose and apply one of the calculating methods. Member states are given the flexibility to change their calculation methods by notifying the AFTA council at least six month before adoption.⁴⁵⁸ Cumulative ASEAN rules of origin are regulated in Article 5 Paragraph 1⁴⁵⁹. It stipulates that goods originating in a member state used in another member state as materials for finished goods are eligible for preferential tariff treatment. It is deemed to be originating in the latter member state where working or processing of the finished good has taken place. In other words, under the ASEAN cumulative rules of origin the goods that are entitled under CEPT-AFTA to acquire their origin depend on where the finished goods are processed. Partial cumulation is regulated in Article 5 Paragraph 2⁴⁶⁰, goods entitled partial cumulation, if at least 20% of the RVC of the good originates in the member state where working or processing of the goods has taken place.

Rules of origin are regulated under the ASEAN Trade in Goods Agreement (ATIGA) almost similar with the regulation of rules of origin in ROO CEPT-AFTA. ATIGA

⁴⁵⁰ See Estevadeordal, Antoni., Harris, Jeremy., and Suominen, Kati., *Multilateralising Preferential Rules of Origin around the World*, IDB Working Paper Series # IDB-WP-137, Inter-American Development Bank, 2009, p. 9, available at: <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1803029>, last accessed : 9 April 2011.

⁴⁵¹ See Agreement on the CEPTS for the AFTA. See also Rules of Origin for the Agreement on the CEPTS for the AFTA (ROO CEPT-AFTA), available at : <http://www.aseansec.org/17293.pdf>, last accessed : 29 October 2011.

⁴⁵² See Paragraph 1 (4) Article 4 of the ROO for CEPT-AFTA, stipulates as follows : “[...] a good shall be deemed to be originating in the Member State where working or processing of the good has taken place: (a) if at least 40 percent of its content (hereinafter referred to as “ASEAN Value Content” or the “Regional Value Content (RVC)”) originates from that Member State or it has undergone a change in tariff classification at four-digit level (change in tariff heading) of the Harmonised System [...]”

⁴⁵³ See Paragraph 3 (a) Article 4 of the ROO for CEPT-AFTA.

⁴⁵⁴ See Paragraph 3 (b) Article 4 of the ROO for CEPT-AFTA.

⁴⁵⁵ See Paragraph 3 (c) Article 4 of the ROO for CEPT-AFTA.

⁴⁵⁶ See Paragraph 3 (d) Article 4 of the ROO for CEPT-AFTA.

⁴⁵⁷ See Paragraph 3 (e) Article 4 of the ROO for CEPT-AFTA.

⁴⁵⁸ See Paragraph 4 Article 4 of the ROO for CEPT-AFTA.

⁴⁵⁹ See Paragraph 5 Article 1 of the ROO for CEPT-AFTA.

⁴⁶⁰ See Paragraph 5 Article 2 of the ROO for CEPT-AFTA. See also Appendix B concerning implementing guidelines for partial cumulation under asean cumulative rules of origin.

was established to facilitate the establishment of the single market and the production base to attain AEC. Article 28 ATIGA regulates the criteria applied to not wholly obtained or produced goods. The goods deemed to be originating in the member state where working or processing of the goods has taken place. The goods must have a regional value content of not less than forty per cent (40%) calculated using one of the "ASEAN Value Content" formulae (direct or indirect methods). Accumulation of rules of origin is regulated under Article 30 of ATIGA in which the content of the article is similar to Article 5 of CEPT-AFTA. ATIGA is established to tackle economic development gaps and to facilitate the participation of member states in the AFTA, through technical and development co-operation.⁴⁶¹

According to Article 5 of the ASEAN Framework (Amendment) Agreement for the Integration of Priority Sectors, member states should establish rules of origin that are more transparent, predictable, standardised (compliance with international best practice) and trade-facilitating. Implementation of those principles is used to improve application of the rules of origin in the CEPT-AFTA.⁴⁶²

Some experts who observed and studied the development of regional rules of origin, have criticised the development of regional rules of origin. For example Inama criticises that "[...] *the drafting of the original AFTA rules was rather ambiguous and contained a number of provisions and wording, leaving too much space to interpretation and little guidance to the various actors of customs or the private sector who must implement this rule [...]*". Further, he gives criticism on RVC, where it is stipulated that "[...] *a product is originating if at least 40% of its content originates from any members state*". According to Inama, this provision "*does not further specify what the criteria are for determining and calculating such 40% of local content [...]*". He considers that, "[...] *there is no definition of what could be considered local content that is a very vague concept unless properly defined [...]*".⁴⁶³

In the end, the efforts taken by ASEAN to develop "*regional rules of origin*" are considered as a tool to develop industrialisation and increase economic development in the region. Rules of origin also have the role to overcome the economic development gap among the member states. It is also deemed as positive progress in the framework of international trade facilitation. Enhancement of the rules of origin system, particularly related to the accumulation of origin, gives a positive impact to generate trade creation and trade diversion under PTA. Of course, in this discourse, it is also positive to improve the utilisation of EU GSP by ASEAN member states.

⁴⁶¹ See ASEAN Framework (Amendment) Agreement for the Integration of Priority Sectors, 2006.

⁴⁶² See ASEAN Framework (Amendment) Agreement for the Integration of Priority Sectors, 2006.

⁴⁶³ See Inama, Stefano., 2009, *Op. Cit.*, p. 459.

Table 18. Utilisation of the Certificate of Origin ASEAN Trade in Goods Agreement (ATIGA) on export to other ASEAN member countries 2010.

YEAR	No.	ASEAN Member Countries Exports Destinations	Total Number of Certificate of Origin ATIGA	FOB USD
2010	1	Brunei Darussalam	430	20,712,615
2010	2	Cambodia	258	8,677,917
2010	3	Lao PDR	43	1,165,160
2010	4	Malaysia	32,856	3,063,156,406
2010	5	Myanmar	333	43,887,567
2010	6	Philippines	16,046	1,506,621,068
2010	7	Singapore	8,392	705,527,320
2010	8	Thailand	26,237	1,923,370,993
2010	9	Vietnam	15,479	954,114,480

Figure 13.

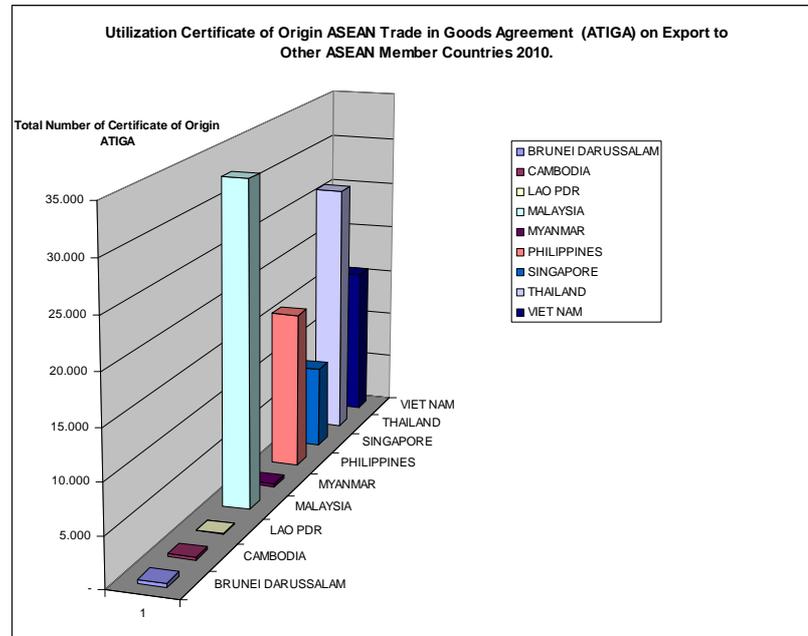
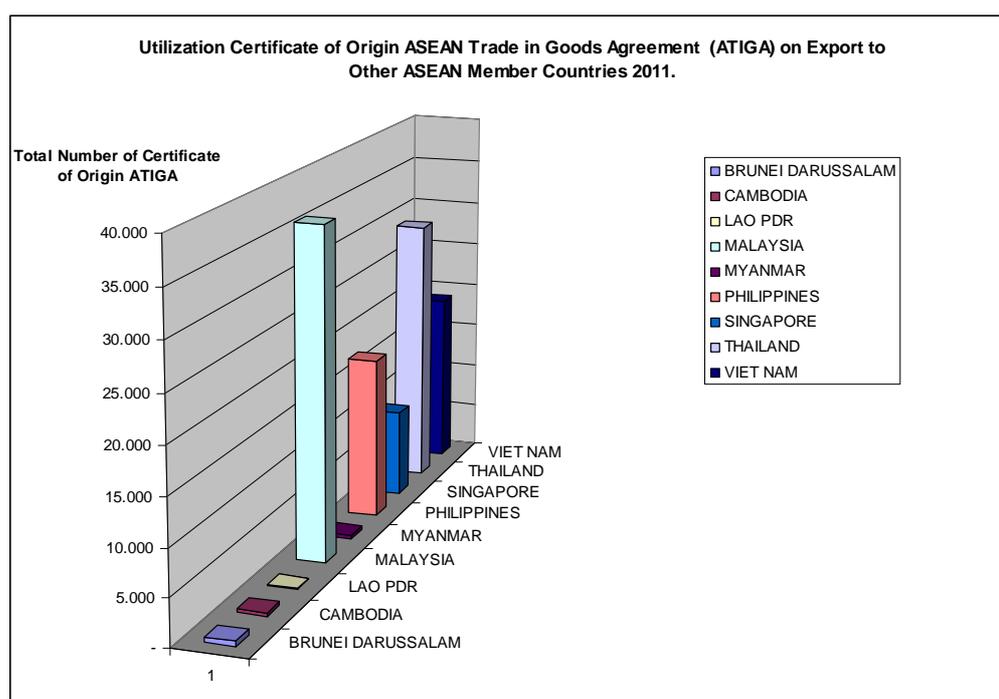


Table 19. Utilisation of the Certificate of Origin ASEAN Trade in Goods Agreement (ATIGA) on export to other ASEAN member countries 2011.

YEAR	No.	ASEAN Member Countries Exports Destinations	Total Number of Certificate of Origin ATIGA	FOB USD
2011	1	Brunei Darussalam	519	23,207,183
2011	2	Cambodia	416	21,287,168
2011	3	Lao PDR	35	4,664,260
2011	4	Malaysia	36,042	4,012,309,792
2011	5	Myanmar	401	64,627,933
2011	6	Philippines	17,725	2,298,166,912
2011	7	Singapore	9,585	1,275,420,153
2011	8	Thailand	29,429	2,786,721,810
2011	9	Vietnam	18,922	1,376,647,088

Figure 14.



Source: Directorate General of Export and Import Facilitation Ministry of Trade Republic of Indonesia May 2012.

VI. Legal implication of GSP post pause ASEAN-EU FTA negotiations.

VI.a. Legal background establishing ASEAN-EU FTA.

As previously mentioned, in the middle of the 1990s, ASEAN countries started establishing a network of bilateral and regional free trade agreements. Along with the immense progress of trade volumes between ASEAN, thus, since 2002 the EU has been considering the opportunity of proposing a FTA to ASEAN member states.⁴⁶⁴

On 4 May 2007 the ASEAN Economic Ministers (AEM) and the Trade Commissioner of the European Union (EU) held an 8th EM-EU Consultation in Bandar Seri Begawan, Brunei Darussalam. The Consultation was co-chaired by H.E. Dato' Seri Rafidah Aziz, Minister of International Trade and Industry of Malaysia, and H.E. Mr Peter Mandelson, the EU Trade Commissioner. The ministers confirmed their shared desire to enhance economic relations by establishing a FTA providing for comprehensive trade and investment liberalisation.⁴⁶⁵

FTA of trade on goods is one of the forms of Regional Trade Agreements (RTAs), wherein its establishment is based on Article XXIV of GATT. As mentioned above, Article XXIV was established as an "exception" of the general obligation under GATT, especially Article I:1 on MFN treatment. From the legal framework FTA exception is the same with the exception of the Enabling Clause.⁴⁶⁶ Under such exception contracting parties of FTA are allowed to establish preferential tariffs and remove the barriers to trade that only apply among them. WTO does not provide further elaborations on the norms regulating conflict and tension of rules within and outside the multilateral system. Article XXIV does not imply particular rules to govern conflict that are likely to occur between WTO obligations and obligations derived from RTAs. When conflict occurs between two legal obligations, the WTO regime and RTAs, and the general rules of international law on the treaty are applied. Inherently the existence of RTAs under the WTO regime are based on the "*principle freedom of contract*", temporal sequencing (*lex posterior derogate legi priori*) and respect of third party rights (*pacta tertiis nec nocent nec prosunt*).⁴⁶⁷ In general public international law, the principle of freedom of contract is exercised when states are free to establish any agreement in any form and content. This free right is also derived from the equality principle in international relations between states. According to Thomas Cottier and Marina Foltea, equality of states entails the power to choose partners, and to discriminate against others. Since the ILC Draft Articles on MFN clauses never come as a treaty and are non-binding,⁴⁶⁸ There is no general obligation to treat all states alike.⁴⁶⁹ Article XXIV and the Enabling Clause are subject to the principle of *pacta sunt servanda*. According to Article 26 of the Vienna Convention on the Law of Treaties (VCLT), parties are under an obligation to honour a binding treaty in good faith.⁴⁷⁰

⁴⁶⁴ See Michael Astuto, *EU – ASEAN Free Trade Agreement – Negotiation, Analysis*, Istituto per gli Studi di Politica Internazionale, (ISPI), No. 26 – October 2010, available at : http://www.ispionline.it/it/documents/Analysis_26_2010.pdf, last accessed : 12 February 2012.

⁴⁶⁵ See Joint Ministerial Statement of the ASEAN Economic Ministers and the European Union Trade Commissioner on the Launch of Negotiations for the ASEAN-EU Free Trade Agreement (FTA), available at : <http://www.aseansec.org/ASEAN-EU-FTA.pdf>, last accessed : 12 February 2012.

⁴⁶⁶ See Bartels, Lorand., and Ortino, Federico., *Regional Trade Agreements and the WTO Legal System*, Oxford University Press Inc., New York, 2006, p. 52.

⁴⁶⁷ See *Ibid.*, p. 52.

⁴⁶⁸ See Radi, Yannick., 2007.

⁴⁶⁹ See Thomas Cottier and Marina Foltea, *Constitutional Functions of the WTO and Regional Trade Agreement*; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 43.

⁴⁷⁰ See Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 52.

The FTA is universally practiced among WTO member since it is considered economically significant. Viet D. Do and William Watson wrote an analysis about welfare improving of RTAs from normative perspectives. FTAs are the most common use to form RTAs rather than the customs union. FTAs are seemingly easier to negotiate than customs union. In the FTA there is no need to establish an agreement on the common external tariff or common policies, however rules of origin are required. The establishment of WTO in 1995 brought implications of the increasing and proliferation of RTAs, however, many of those agreements were not implemented properly or were sometimes just a paper agreement. It has been estimated that the total amount of world trade covered by such agreements is roughly 40%⁴⁷¹. Referring to Jacob Vinner (1950) the existence of PTAs especially in RTAs, such as CEPT AFTA, have goals of trade creation and trade diversion.⁴⁷² However, Viet D. Do and William Watson consider that proliferation of RTAs do not yet successfully create trade diversion in the world trading system. Trade seems to increase in most intra-regional trade agreements, for instance AFTA.⁴⁷³

The current rules of Articles XXIV of GATT fail to address the problem of trade diversion. Article XXIV of GATT was drafted before Viner pioneered economic research and the doctrine of trade creation and trade diversion in the 1950s.⁴⁷⁴ The existing Articles XXIV of the GATT text taken from the Havana sessions where a significant reworking and expansion of the customs union Article was made. This occurred as a result of a referral to a specially formed joint subcommittee of both Development and the Commercial Policy Committees to resolve the relationship between the MFN Article, the customs union Article, and the Charter's Development Chapter provisions. Article 15 of this Chapter permitted "regional" preferences, but only subject to ITO membership vote and waiver. The general conference record is clear on a hostile developing country's response to the new Generalised MFN clause that permits "standstill" provisions for existing preferential systems, but then requires all future preferential systems other than the customs union to be subject to a voting waiver according to Article 15.⁴⁷⁵

The establishment of preferential agreements is justified from the economic perspective to develop market expansion and promote deeper integration among the countries of a region. In addition, RTAs are also established for "defensive reasons", raising competitiveness of the region, and also serve as a tool to "lock out" competition from third countries. Nowadays, RTAs cover provisions on intellectual property rights, rules of origin, SPS standards, MRA (Mutual Recognition Agreement), elimination of NTB and trade facilitation. In the end, the establishment of RTAs may be used by developed countries to gradually replace the dependency upon unilateral preferences, such as GSP schemes.⁴⁷⁶ Therefore, the negotiations of AEUFTA exclude LDC ASEAN member states, such as Cambodia, Myanmar and Laos. However, the establishment of individual FTAs within ASEAN would erode the preferential margin of the beneficiary countries covered under the general arrangement.

⁴⁷¹ See Chad Damro, *The Political Economy of Regional Trade Agreements*; Viet D. Do and William Watson, *Economic Analysis of Regional Trade Agreements*; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, pp. 10-12.

⁴⁷² See Viet D. Do and William Watson; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, pp. 10-12.

⁴⁷³ See Viet D. Do and William Watson; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 17

⁴⁷⁴ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 65.

⁴⁷⁵ See James H Matis, *Regional Trade Agreements and Domestic Regulation*; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 85.

⁴⁷⁶ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 45.

VI. b. Political economic interest.

ASEAN growth as one of the biggest regional organisations in Asia as well as its strategic position have influenced its bargaining power in external economic relations. After the Second World War, ASEAN external economic relations were dominated by three major trading partners US, Japan, and the EU.⁴⁷⁷ ASEAN's FTA negotiation with Japan and the US were considered as one of the driving factors of the AEUFTA negotiations.⁴⁷⁸ ASEAN's "key" member states, such as Singapore, Malaysia, Thailand, Indonesia and the Philippines, had already concluded bilateral agreements with key players outside the region. In addition, US interest as the dominant power in the region had increasing rapidly. Given the accumulation of regional FTAs in ASEAN, the EU as one of the big players in international trade had to take part to keep its interest in the region.⁴⁷⁹ From the EU perspective the trade diversion resulting from ASEAN FTA proliferation could bring disadvantages to its trade in ASEAN. Therefore, the EU thought that AEUFTA would restore the EU's role in ASEAN foreign trade.⁴⁸⁰ The goal of AEUFTA was to acquire the same concessions from ASEAN that it had granted to Japan and the US.⁴⁸¹ The faster the EU grasped FTA opportunities with ASEAN countries, the better its chances of setting a footing in the region⁴⁸² and stepping out from its economic crisis.

Recently, however, the pattern of ASEAN external economic relations has shifted to China. Such pattern has been influenced by the immense growth of Asian Economic Power. ASEAN established ASEAN + 3 with China⁴⁸³, Japan⁴⁸⁴, and Korea⁴⁸⁵. ASEAN-China Free Trade Area (ACFTA) has strongly increased trade flows between the two parties. Under the FTA, India⁴⁸⁶ has gradually improved its shares of ASEAN external trade. However, it started from an insignificant volume. ASEAN also established FTAs with Australia-New Zealand. Such FTAs will be huge trade multipliers once they enter

⁴⁷⁷ See Lena Lindberg and Claes G. Alvstam, *EU-ASEAN trade: interregional FTA negotiations in the pipeline*, Paper presented at the 10th Annual Conference on European Integration, SNEE, Mölle, 20-23 May 2008, available at : <http://www.snee.org/filer/papers/469.pdf>, last accessed : 12 February 2012.

⁴⁷⁸ See The European Commission SEC 2006 (1230, p. 17); The European Union and the Integration of Southeast Asia, available at : http://www.jean-monnet-coe.keio.ac.jp/workingpapers/alfredo_robles_01.pdf, last accessed : 12 February 2012.

⁴⁷⁹ See Gauri Khandekar, *The EU's mistaken approach to ASEAN*, Policy Brief, ISSN : 1989 – 2667, No. 58, July 2011, A European Think Tank for Global Action, available at : <http://www.iie.com/publications/wp/wp05-12.pdf>, last accessed : 12 February 2012.

⁴⁸⁰ See The European Commission SEC 2006 (1230, pp. 14, 16).

⁴⁸¹ See The European Commission SEC 2006 (1230, p. 17); The European Union and the Integration of Southeast Asia, available at : http://www.jean-monnet-coe.keio.ac.jp/workingpapers/alfredo_robles_01.pdf, last accessed : 12 February 2012.

⁴⁸² See Gauri Khandekar, 2011.

⁴⁸³ See ASEAN-CHINA Free Trade Agreement (ACFTA) available at : http://www.mtib.gov.my/repository/woodspot/website_acfta_23july09.pdf, last accessed : 02 February 2012.

⁴⁸⁴ See Agreement on Comprehensive Economic Partnership among Member States of the Association of Southeast Asian Nations and Japan, available at : <http://www.aseansec.org/agreements/AJCEP/Agreement.pdf>, last accessed : 12 February 2012. See Framework for Comprehensive Economic Partnership between the Association of Southeast Asian Nations and Japan, available at : <http://www.aseansec.org/15274.htm>, last accessed : 12 February 2012.

⁴⁸⁵ See Framework Agreement on Comprehensive Economic Cooperation Among the Governments of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea, available at : <http://www.aseansec.org/18063.htm>, last accessed : 12 February 2012.

⁴⁸⁶ See Agreement On Trade In Goods Under The Framework Agreement On Comprehensive Economic Cooperation Between The Association Of Southeast Asian Nations And The Republic Of India, available at : <http://www.asean.org/22677.pdf>, last accessed : 12 February 2012. See also Framework Agreement on Comprehensive Economic Cooperation Between the Republic of India and the Association of Southeast Asian Nations, available at : <http://www.asean.org/15278.htm>, last accessed : 12 February 2012. See also Protocol to Amend The Framework Agreement on Comprehensive Economic Cooperation between The Association Of Southeast Asian Nations and The Republic Of India, available at : <http://www.asean.org/22678.pdf>, last accessed : 12 February 2012.

fully into force⁴⁸⁷ and reduce the economic dependency of ASEAN with the EU.⁴⁸⁸ Therefore, the proposal of AEUFTA is aimed to prevent further mutual decline of dependency, or at least to maintain the existing level, but the main goal is to improve this.⁴⁸⁹ Therefore, the AEUFTA negotiations were launched due to the falling of trade shares between the two regions. Based on the ASEAN statistical yearbook, the EU share of the ASEAN-6 exports fell from 15.3% in 2001 to 13.2% in 2004 while the corresponding ASEAN import shares fell from 12.6% to 11.3%.⁴⁹⁰

The 2006 Commission communication entitled “Global Europe”, had formally announced the EU’s intention of negotiating “second-generation FTAs”.⁴⁹¹ However, the Commission communication did not mention explicitly the FTAs’ potential role to speed up regional integration among the EU’s partners. Regarding regional integration in Southeast Asia, the Commission ASEAN recognised different levels of economic development. Therefore, it is strongly recommended to take into account such differences in the FTA negotiation.⁴⁹² It is most likely aimed to narrow intraregional inequalities.⁴⁹³

The EU’s 2006 paper laid down the criteria for EU FTA partners. The main criteria are based on market potential (economic size and growth), the level of protection against EU exporters (tariff and non-tariff barriers), and the potential partners’ negotiations with EU competitors. According to such criteria there were three partners consisting of ASEAN, Korea, and Mercosur that were considered as preferred partners of FTA.⁴⁹⁴ According to Astuto, the Commission’s objectives on FTA had two major components related to political economic interest covering international trade competition and market expansion.⁴⁹⁵ In this regard, the establishment of AEUFTA strongly aimed to dynamically maintain European interests in Southeast Asia, since some ASEAN member states actively established free trade agreements with other regions or individual states.⁴⁹⁶ The Commission noted that “[...] in the context of multiplication of bilateral and regional free trade initiatives in Southeast Asia, the EU has both offensive and defensive interests in forging stronger economic ties with the region [...]”. The “offensive” interest has the aim to advance the EU’s presence in important and growing markets. While the “defensive” interest is intended to protect its existing economic interests in Southeast Asia.⁴⁹⁷

According to Lena Lindberg and Claes G. Alvstam the efforts of the EU to establish FTA with ASEAN are considered as part of the strategy to maintain “its traditional political and commercial linkages”, which began in the 1600s. Historically, ASEAN is closely linked with Europe due to the common colonial past. Nowadays, ASEAN has developed the regional organisation and balances its external trade relations between the US, Europe and its own neighbours in the East Asian region. Relating to the trade

⁴⁸⁷ See Gauri Khandekar, 2011.

⁴⁸⁸ See Lena Lindberg and Claes G. Alvstam, 2008.

⁴⁸⁹ See *Ibid.*

⁴⁹⁰ See Céline Carrère, Jaime de Melo, and Bolormaa Tumurchudur, *Disentangling Market Access Effects of Preferential Trading Arrangements with an Application for ASEAN Members under an ASEAN – EU FTA*, EUDN/WP 2008 – 04, 17 November 2008, available at : http://www.eudnet.net/download/wp/EUDN2008_04.pdf, last accessed : 12 February 2012.

⁴⁹¹ See The European Commission 2006 (567final).

⁴⁹² See The European Commission SEC 2006 (1230, pp. 18-19).

⁴⁹³ See The European Union and the Integration of Southeast Asia, available at : http://www.jean-monnet-coe.keio.ac.jp/workingpapers/alfredo_robles_01.pdf, last accessed : 12 February 2012.

⁴⁹⁴ See Michael Astuto, 2010.

⁴⁹⁵ See *Ibid.*

⁴⁹⁶ See *Ibid.*

⁴⁹⁷ See *Ibid.*

policy preferences, both ASEAN and the EU seem to be ambivalent on supporting multilateral trading processes in WTO and on the other hand also promote interregional trade agreements. Since ASEAN has no common external policies on its external trade relationships, unlike the EU, each of its member states are allowed to pursue bilateral trade agreements with other individual states or entire trade blocs or regional groups.⁴⁹⁸

Since the EU has a common commercial policy that is governed by supranational decision-making, its individual member states have limited opportunities to design and decide upon their own trade policy. On the other hand, since the beginning of its establishment ASEAN has not intended to be designed as a supranational organisation, in this regard, there is no high authority to represent the member states through a single voice. Dissimilarity between the organisation structures in the EU and ASEAN creates an asymmetrical relationship in which individual ASEAN member states can potentially establish bilateral trade agreements with the EU as a single entity, which is known as a “regional-bilateral” agreement. While an individual EU member state is not allowed to establish bilateral trade agreements, neither with ASEAN as a group nor with a single ASEAN member.⁴⁹⁹ The establishment of AEUFTA as a region to region agreement has the purpose of creating efficiency in trade rather than establishing seven bilateral agreements with ASEAN member states excluding CML.⁵⁰⁰

The ASEAN region is the fifth largest export market of the EU and the fifth largest trading partner of the EU. While the EU is nominated as the second largest trading partner for most countries in ASEAN after the US. ASEAN exports to the EU account for about 13% of its total exports. EU exports to ASEAN account for around 4% of its total exports.⁵⁰¹ In the area of trade in goods the establishment of an AEUFTA is considered as an effort of ASEAN member states to secure their market access in one of their largest markets.⁵⁰²

For more than four decades, the EU-ASEAN relationship has been focused on promoting region-to-region economic cooperation including closer investment cooperation.⁵⁰³ The EU is one of ASEAN’s major trading partners and the largest foreign investor in the region. Throughout the period from 2006 to 2008, European firms invested on average €10.4 billion Euro per year in the ASEAN member states.⁵⁰⁴ Significant improvement of two way trade and investment flows between ASEAN and EU have critical economic importance for the EU, thus, a new form of relationship was discovered between both regions. Such critical point is not simply due to the volume of value of trade and investments but also because of their strategic regional nature.⁵⁰⁵

TREATI Trans Regional EU-ASEAN Trade Initiative (TREATI) functioned as a channel to promote dialogue and cooperation on investment flows between ASEAN-EU. TREATI also encouraged both sides to consider deeper economic integration through an FTA.⁵⁰⁶ In 2006, the EU Commission launched a new strategy called “*Global Europe*:

⁴⁹⁸ See Lena Lindberg and Claes G. Alvstam, 2008.

⁴⁹⁹ See Lena Lindberg and Claes G. Alvstam, 2008.

⁵⁰⁰ See Michael Astuto., 2010.

⁵⁰¹ See EU trade relations with ASEAN, Brussels, 7 May 2008, available at : http://trade.ec.europa.eu/doclib/docs/2008/may/tradoc_138792.pdf, last accessed : 11 February 2011.

⁵⁰² See Michael Astuto., 2010.

⁵⁰³ See EU trade relations with ASEAN, Brussels, 7 May 2008.

⁵⁰⁴ See Michael Astuto., 2010.

⁵⁰⁵ See Willem van der Geest, *An EU-ASEAN Free Trade Agreement : Sharing Benefits of Globalization?*, ASEF University Lecture Note, Lecture delivered at the ninth ASEF University Session, Manila, 6 February 2004, available at : <http://www.eias.org/conferences/euaseam4/willem.pdf>, last accessed : 11 February 2011.

⁵⁰⁶ See EU trade relations with ASEAN, Brussels, 7 May 2008.

Competing in the World". Global Europe contains "the guidelines for the new market-opening commercial strategy that the EU would follow in its negotiations, both at the multilateral and bilateral level".⁵⁰⁷ The FTA negotiation was part of the Commission's Global Europe strategy. In April 2007, the Commission was given mandate by EU member states to negotiate an FTA with ASEAN member states. The negotiations round was launched in May 2007.⁵⁰⁸

Appraisal has been made to examine the positive effect of the establishment of FTA for both regions. According to independent research commissioned by the European Commission, it has been suggested that the economic benefits for both ASEAN and the EU from an AEUFTA were probably significant. ASEAN could see its exports to the EU rise by 18.5%. As expected, ASEAN has economic gains equivalent to 2% of its GDP by 2020. The EU could see its exports to ASEAN boost considerably and total EU global exports is expected to increase by almost 2%.⁵⁰⁹ According to Willem van der Geest through AEUFTA the ASEAN's trade policy regime is opening up and the gains of further tariff elimination will be modest. Such conditions, due to the low tariff that has already been applied by most ASEAN member states and EU tariff on import from ASEAN, are also low. However, a further reduction could benefit both the EU and ASEAN because a significant share of imports is intra-firm trade, with EU firms operating from ASEAN as a production platform for the EU markets.⁵¹⁰ The FTA deemed will directly reduce the costs to EU owned firms operating both in ASEAN and the EU.⁵¹¹

VI. c. Coverage of ASEAN-EU FTA negotiations.

As mentioned above, RTAs, especially FTAs have a wide variety of provisions. AEUFTA as an inter-regional trade agreement is an opportunity to accommodate some delicate issues such as public procurement, competition policy, intellectual property and dispute settlement that could not be agreed during the Cancun Meetings 2003.⁵¹² In this regard, AEUFTA is supposed to produce benefits on issues relating to non-tariff barriers such as trade facilitation, MRA, SPS, and technical standard agreements.⁵¹³

Therefore, the EU is looking for partners to engage in the FTAs that are eager not only to reduce the traditional tariff barrier but also non-tariff barriers and develop agreement in the new area of trade such as services, public procurement and IPR.⁵¹⁴ In addition, the Commission is also enthusiastic to include in the negotiations of some non-trade issues convergent with the trade and development objectives such as sustainable development, environmental standards, labour standards, and human rights.⁵¹⁵ With regards to trade in goods, the EU was intended to negotiate rules on NTBs (technical barriers to trade, and sanitary and phytosanitary measures), IPRs protection, and rules of origin.⁵¹⁶

In order to explore the possibility to integrate such issues into FTA, in 2005, the Vision Group on the ASEAN-EU Economic Partnership was established.⁵¹⁷ With regard

⁵⁰⁷ See Michael Astuto., 2010.

⁵⁰⁸ See EU trade relations with ASEAN, Brussels, 7 May 2008.

⁵⁰⁹ See EU trade relations with ASEAN, Brussels, 7 May 2008.

⁵¹⁰ See Willem van der Geest, 2004.

⁵¹¹ See *Ibid.*

⁵¹² See *Ibid.*

⁵¹³ See *Ibid.*

⁵¹⁴ See Michael Astuto., 2010.

⁵¹⁵ See *Ibid.*

⁵¹⁶ See *Ibid.*

⁵¹⁷ See *Ibid.*

to the various levels of economic development among ASEAN countries, the Visions recommended the granting of some kind of Special and Differential Treatment for the LDCs of ASEAN member states (Cambodia, Laos and Myanmar). The granting of SDTs is in line with the rules of WTO. According to such recommendation, the AEUFTA should take into account “the disparities between ASEAN and the EU as well as among members of ASEAN”.⁵¹⁸ The Vision Group also conducted a quantitative study to assess the economic impact of the envisaged FTA. According to the study the traditional tariffs are not considered as the major barrier to trade in manufactured goods between ASEAN and the EU.⁵¹⁹

Non-tariff barriers are considered as the major obstacle in the two way trades of ASEAN-EU. The EU considered that ASEAN applied restricted access on its services sectors. Such inner-ASEAN restrictions hampered the development of trade in services. Conversely, EU import regulations on SPS applied toward ASEAN’s export products were apparently seen as the greatest obstacle for ASEAN member states, especially for LDCs. Most ASEAN countries are facing difficulties to meet such requirements and standards. Furthermore, under the Common Agriculture Policy the EU applied tariff quotas on some of ASEAN’s agricultural exports.⁵²⁰ In this regard, AEUFTA intended to open greater market access and integration.⁵²¹

Since trade facilitation is considered as non-tariff barriers to trade that significantly reduce transaction costs in exports and imports, the Commission proposed strong trade facilitation in the AEUFTA. In this regard, the EU required ASEAN governments to adopt a competition policy based on the principles of transparency, non-discrimination, and procedural fairness in line with EU legislation. In fact, such requirements faced obstacles since, most ASEAN countries did not have a competition law when the FTA negotiations were launched. For instance, Indonesia established its competition after the reformation era by Law No. 5/1999.⁵²² In addition, the EU also emphasised for more transparent rules relating to state aid and other subsidies. The EU believed that there had been many cases of ‘unfair subsidisation’ and proposed to bring such issue to the negotiations.⁵²³ Other contentious issues in which ASEAN refused to discuss related to the mandate of the Commission on issues of sustainable development, in particular to labour and environmental standards.⁵²⁴

It is also clear that the EU wants a “WTO Plus” agreement with ASEAN, leading to rapid and radical trade, services and FDI liberalisation. Apart from the removal of non-trade barriers, which is a top priority, the harmonisation of trade rules and regulations is aimed at enhancing EU member states’ competitive advantage. Also, measures to protect intellectual property rights and the opening up of government procurement markets feature prominently.⁵²⁵

⁵¹⁸ See *Ibid.*

⁵¹⁹ See *Ibid.*

⁵²⁰ See *Ibid.*

⁵²¹ See *Ibid.*

⁵²² See *Ibid.*

⁵²³ See *Ibid.*

⁵²⁴ See *Ibid.*

⁵²⁵ See Ludo Cuyvers, *An EU-ASEAN Free Trade Agreement: Reflections on issues, priorities, strategies*, CAS Discussion paper No 53, October 2007, Centre for ASEAN Studies, Centre for International Management and Development Antwerp, available at : <http://webh01.ua.ac.be/cas/PDF/CAS53.pdf>, last accessed : 12 February 2012.

VI. b. Behind the deadlock of AEUFTA negotiations.

In 2007, the joint committee was established consisting of senior officials from both parties. This committee worked to set up modalities, a work programme, and a timeframe for the FTA negotiations. To develop the details of the FTA negotiations the joint committee had to hold the meeting seven times. During those meetings, six Expert Groups were established, consisting of Trade in Services/Investment, Rules of Origin, Sanitary and Phytosanitary (SPS) measures, Technical Barriers to Trade (TBT), Customs and Trade Facilitation, and Dispute Settlement. Unfortunately, at the 7th meeting of the Joint Committee, in March 2009, the parties of AEUFTA agreed to temporarily suspend the negotiations, allowing to allow for reflection on the appropriate format for the FTA negotiations.⁵²⁶ The suspension of negotiations was considered as an indication of the deadlock of the AEUFTA negotiations. Therefore, in December 2009, the Commission also gave authorisation to negotiate FTAs with individual ASEAN member states.⁵²⁷ According to Astuto, the main reason to suspend AEUFTA was due to the complexity and wide scope of issues brought onto the negotiations table. AEUFTA is a region to region negotiation, wherein more than two states are engaged into negotiations, consequently both parties have to make up their minds in order to reach the deals. The configuration of issues became varied and sensitive, in the context of AEUFTA, the EU with a single voice was represented by the Commission and ASEAN neither had a single voice nor a supranational body. The Commission was given the mandate to negotiate with seven of the ASEAN countries and the mandate excluded the three LDCs of ASEAN (CML). However, the possibility was still open for Cambodia and Laos to join the agreement in the future. The EU decided not to negotiate with Myanmar for various reasons. From the start the EU was aware of such difficulties. There was a doubt about the choice of negotiating one regional agreement instead of seven bilateral deals and the negotiations were probably affected by those doubts.⁵²⁸ Related to such issues, Willem van der Geest addresses a question relating to “[...] *the precise nature of possible mechanisms to ensure that an inter-regional agreement will extend benefits to all ASEAN member states, including the least developed countries (CML) [...]*”.⁵²⁹ While Gauri Khandekar notes the main reasons why the EU dropped the FTA negotiation were due to incompatible legal frameworks within ASEAN; the disparities created by two of ASEAN’s states already benefiting from the EU’s Everything but Arms treaty; and Myanmar’s human rights record.⁵³⁰

It is also interesting to take into account the open trade policy of the countries. In this regard, ASEAN has an open and neutral trade policy regime. For instance, among ASEAN member states Singapore is considered as one of the most competitive countries in the world. Compared to Singapore and some ASEAN member states, the EU trade policy regime is not so open due to some of its restrictive policies on non-tariff barriers to trade, especially on its CAP. Therefore, in the AEUFTA, the EU had to open its markets for its FTA partners.⁵³¹

Anticipating those possibilities, the EU prepared three options for negotiation. First, the EU will negotiate AEUFTA with ASEAN as a whole. The region-to-region FTA will bring advantages to promote closer integration for ASEAN.⁵³² Second, the EU will

⁵²⁶ See Michael Astuto, 2010.

⁵²⁷ See *Ibid.*

⁵²⁸ See *Ibid.*

⁵²⁹ See Willem van der Geest, 2004.

⁵³⁰ See Gauri Khandekar, 2011.

⁵³¹ See Willem van der Geest, 2004.

⁵³² See Gauri Khandekar, 2011.

negotiate with the seven ASEAN member states but exclude three of ASEAN's LDCs (CML). Second option, AEUFTA only involves six developing countries of ASEAN and one advanced developing country the AEUFTA. This option is intended to minimise the gap of economic development of FTA trading partner. The third negotiation is negotiating seven bilateral FTAs with seven ASEAN individual member states, includes Brunei, Indonesia, Malaysia, the Philippines, Singapore, Vietnam and Thailand.⁵³³

In 2010, the EU FTA negotiation with Singapore and Malaysia had already been launched. Negotiations with Singapore advanced significantly after eight rounds. The EU-Malaysia FTA is still on-going, along with the EU Malaysia Partnership and Cooperation Agreement (PCA) negotiations. Thailand is considering the scope of a bilateral FTA with the EU. An EU Indonesia PCA was signed in November 2009, as the only Southeast Asian country that has such an agreement. The EU officials indicated Indonesia as a potential candidate for a Strategic Partnership. The FTA negotiation with individual ASEAN member states are more likely to be the building blocks rather than the stumbling blocks in the region.⁵³⁴

AEUFTA is supposed to bring benefit to the ASEAN member states involved and for the EU as a whole. But the coming challenges and obstacles will be more difficult, especially some powerful groups in ASEAN have sceptical minds about the FTA negotiations. Besides, as previously mentioned, many individual ASEAN member states have already set up FTA negotiations with some countries in the Asia-Pacific region. According to Cuyvers, the suspension of the AEUFTA negotiations with the seven ASEAN member states was caused by the lack of government capacity. In this regard, six out of seven ASEAN member states, except Singapore, were anxious not to be able to follow negotiations with the EU closely and comprehensively enough. Cuyvers also highlights the weakness of the ASEAN institutional structure. Compared to the EU, ASEAN lacks the capacity to negotiate with a single voice and to be represented by supranational institutions.⁵³⁵ The asymmetrical economic development between ASEAN and EU has also become another factor that has raised doubts about the implementation of region to region FTAs.⁵³⁶ In addition, many ASEAN countries may not be able to meet the high regulatory standards applied by the EU. On the other hand, countries like China, Korea and Japan have been more flexible in their negotiations with ASEAN, with greater possibilities to gain more benefit.⁵³⁷

VI. c. Trade facilitation AEUFTA.

A number of recent studies examine whether the implementation of AFTA has contributed to any increase in trade among member states. Although early results suggest little or no effect, a more recent study by Thornton and Goglio concludes that AFTA did facilitate trade, especially during the late 1990s. Other studies by Tang also found that the implementation of AFTA has contributed to the gradual but significant growth of trade among the member states.⁵³⁸

As acknowledged above, trade facilitation brought about a reduction in the bulk of NTBs to trade. According to the study by Shepherd & Wilson (2008), "[...] trade facilitation in ASEAN countries would bring about higher welfare benefits and reduce the costs of intraregional trade further than comparable tariff reductions [...]". Based on this

⁵³³ See Ludo Cuyvers, 2007.

⁵³⁴ See Gauri Khandekar, 2011.

⁵³⁵ See Cuyvers, 2002; Ludo Cuyvers, 2007.

⁵³⁶ See Ludo Cuyvers, 2007.

⁵³⁷ See Gauri Khandekar, 2011.

⁵³⁸ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 63.

study, reduction in applied tariffs would increase intraregional trade by only 2%, while improvements in port facilities, limiting unofficial payments and improving competitiveness in e-trade services would increase trade by 7.5%, 2.3% and 5.7% respectively.⁵³⁹ In 2002, Wilson et al. discovered trade facilitation along four dimensions (port efficiency, customs environment, own regulatory environment and e-business usage) could increase intra-APEC trade by around 10% (\$280 billion USD). Francois & Manchin (2006) carried out a study on the different levels of trade facilitation (especially for infrastructure and institutions). Hertel & Keeney (2006) estimate that worldwide gains from trade facilitation (\$110 billion USD) would be nearly as large as from full liberalisation of goods and services (\$150 billion USD).⁵⁴⁰

Many sectors are affected by poor trade facilitation that are most likely to reduce the benefits of the firms due to the high cost of trade transactions. Poor trade facilitations often affect trade in large quantities of goods. The WTO members need to address such problem through the improvement of existing GATT provisions on trade facilitation.⁵⁴¹ Trade facilitation became one of the crucial issues brought into AEUFTA negotiations. Both parties agreed that trade facilitation has a significant role within FTA. Trade facilitation will become the driving force to reduce NTBs between the parties in the FTA. However, due to economic development disparities ASEAN-EU has an asymmetric relationship on trade facilitation.

Most EU member states are the key players in international trade. As noted, the establishment of the single market in the EU has driven its member states to develop their trade facilitations. A sufficient trade facilitation system is the most important skeleton within the single market of customs union to guarantee the free flow of goods. Therefore, EU member states have made immense efforts to develop further their trade facilitation on trading goods. Based on the Global Enabling Trade Report of 2008 from the World Economic Forum, three of the top ten in the enabling trade index were EU Member States. The trade index indicator is assessed based on four sub-indexes, includes, market access, border administration, transportation and communication infrastructure, and the business environment. Those four sub-indexes are evaluated based on ten aspects, covering tariffs and non-tariff barriers, proclivity to trade, efficiency of customs administration, efficiency of import-export procedures, transparency of border administration, availability and quality of transport infrastructure, availability and quality of transport services, availability and use of ICTs, regulatory environment, and physical security.⁵⁴²

Compared to the EU member states, which mostly have further developed trade facilitation, the ASEAN member states generally continue to be less developed. Such situations generate non-tariff barriers for export and imports from EU to ASEAN and from ASEAN to EU. In this regard, poor trade facilitation in ASEAN creates obstacles for both parties.⁵⁴³ As has been explained previously, trade facilitation in ASEAN was exposed by the World Bank "Doing Business" data where Singapore was nominated as the most favourable country in ASEAN to do business and trade across borders. Lao PDR and Cambodia were nominated as countries in ASEAN with the worst trade

⁵³⁹ See Trade Sustainability Impact Assessment for the FTA between the EU and ASEAN, Phase 2 – Interim Report, Ref : TRADE07/C1/C01 – Lot 2, Rotterdam, 06 March 2009, available at : http://www.ces.in.th/PDF/interim_report_v2.pdf, last accessed : 12 February 2012.

⁵⁴⁰ See *Ibid.*

⁵⁴¹ See *Ibid.*

⁵⁴² See *Ibid.*

⁵⁴³ See *Ibid.*

facilitations.⁵⁴⁴ The establishment of ASW was acknowledged as the driving force to create a trade facilitating environment in ASEAN. The harmonisation of rules and regulations within the ASW system with international standards could significantly improve trade facilitation in ASEAN.

As previously mentioned, both states and business actors play important roles in trade facilitation. Business actors, in this term, domestic traders have a contradictory position within trade facilitation. Domestic traders usually seem unenthusiastic to support trade liberalisation of the internal market for foreign competitors. In one fell swoop, they are pressuring their governments to reduce trade barriers and improve the trade facilitation programme. The issue of trade facilitation within FTA is part of the shared interest between government and traders.⁵⁴⁵

VI. d. Legal implication: AEUFTA versus GSP

RTAs have been seen as both building blocks and stumbling blocks to multilateral liberalisation.⁵⁴⁶ As building blocks, RTAs facilitate the further liberalisation of trade through, for example, the WTO; they establish incentives that lead governments to oppose protectionism generally at both the regional and multilateral levels. As stumbling blocks, RTAs divert trade and clash with the economic goals of multilateral liberalisation.⁵⁴⁷

As elaborated above, in the coming future the FTA are intended to gradually reduce the dependency of developing countries upon the GSP facility scheme. The proposal of the new GSP policy reduces the beneficiary countries from 176 countries to 80 countries and focuses on the countries most in need. Reciprocal RTAs between developed countries and developing countries can be used to boost foreign investment and secure market access. However, developing countries needs to sacrifice their enjoyment of facilities granted under the GSP scheme. This is elaborated further by Chad Damro:

“[...] Developing countries, in particular, might be willing to sacrifice the benefits conferred by GSP programmes and as a replacement for committing themselves to signing reciprocal RTAs with developed countries in order to secure access to their markets; such a strategy is usually deemed to have strong signalling effects and act as a pull for foreign investment. Thus, RTAs may perform a sort of dual locking function, locking out competition and locking in investment [...]”⁵⁴⁸

The dual locking function that is enshrined in the provisions of RTA might serve as a new barrier to trade for third parties. In this regard, RTAs function as building blocks instead of stumbling blocks. Avoiding such trade distortion effects the need of the FTA to comply with basic requirements such as avoiding additional barriers for third countries, clarifying substantial trade coverage, eliminating internal trade barriers, and minimising requirements on preferential rules of origin.⁵⁴⁹

Jagdish Baghwati called the effect of significant increase and proliferation of FTA the “spaghetti bowl” phenomena. In the international trade perspective, the

⁵⁴⁴ See *Ibid.*

⁵⁴⁵ See *Ibid.*

⁵⁴⁶ See J. Bhagwati, *The World Trading System at Risk*, Princeton NJ, PUP, 1991; R. Lawrence, *Emerging regional arrangements : Building Blocks or Stumbling Blocks?*, R. O'Brien (ed), Finance and the International Economy, The AMEX Bank Review Prize Essays, Oxford, OUP, 1991); Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 63.

⁵⁴⁷ See V. Zahrnt, *How Regionalization can be a Pillar of a More Effective World Trade Organization*, 39 *JWT* 671, 2005; Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 63.

⁵⁴⁸ See Chad Damro; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 36.

⁵⁴⁹ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, pp. 47-49.

complexities of FTA have raising issues of implications of those developments to the multilateral trading system. For instance John H Jackson refers to the report of Sutherland Consultative Board in January 2005 concerning the jeopardy of the significant increase of FTA to the multilateral system that led to the “*erosion of non-discrimination principles*”. Further Jackson argued that to some extent FTAs might develop protectionist measures or serve as indirect discrimination that discriminate against certain parts of world trade and even create additional transaction costs and excessive trade bureaucracy due to the necessity to provide the proof of origin of the goods. The rules of origin is often manipulated in such a way to provide a protectionist effect of FTA, for instance to lock out competition of non-contracting parties. In addition, the more complex and detailed the rules of origin within FTAs, the more complex and detailed the non-tariff barriers to trade. On the other hand, the rules of origin are one of the basic requirements in the FTAs to prevent trade deflection and also to ensure that the benefits of the agreement improve the contracting parties’ welfare.⁵⁵⁰

In the fifth WTO Ministerial Meeting, held in Cancun, Mexico, the issues related to regional integration, such as rules of origin, safeguards, GSP, and SPS measures emerged⁵⁵¹ along with the issues of transparency in RTAs.⁵⁵² India has raised issues about the GSP provisions within RTAs that are most likely to erode the principles embodied in the Enabling Clause. India argues the existence of such provisions within RTAs is not in line with the spirit of the WTO regimes and of the Doha Ministerial Declaration. According to India, the Enabling Clause is vital to the economic development of poorer nations. It also gives opportunities to developing countries to increase their competitiveness in the international markets. The rapid development of RTAs threatens to divert trade away from India and other developing countries towards RTA signatories, for instance AEUFTA.⁵⁵³

The EC-Tariff Preferences case is an example of the issue on granting particular trade preferences by applying non-trade conditionality, known as drug arrangement. India argues that this was inconsistent with the MFN principle and the Enabling Clause. The panel was asked to recommend that the EC withdraw these trade incentives. The panel found India’s favour with regard to the breach of Article I:1 GATT. The Appellate Body essentially upheld the decision and ruled that the Enabling Clause does not exclude conditionality. However, such conditions need to be applied in a consistent and coherent manner to provide “identical treatment to similarly-situated beneficiaries”. As such, discrimination between different similarly-situated countries could be avoided.⁵⁵⁴

According to independent research, the Commission claimed that AEUFTA would increase EU exports to ASEAN by 24.2%; the latter would see an increase of 18.5% of its exports to the EU.⁵⁵⁵ Robles argues that if ASEAN countries enter into an FTA with the EU, they will find themselves in the absurd situation of reversing their success in expanding the share of manufacturing in their economies. AEUFTA criticised it might

⁵⁵⁰ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. vi.

⁵⁵¹ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 63.

⁵⁵² See World Trade Organization, Negotiating Group on Rules : Summary Report of the Meeting Held on 21-22 July 2003, TN/RL/M/11, 8 September 2003, available at : http://www.jmcti.org/2000round/com/doha/tn/tn_rl_m_011.pdf, last accessed : 12 February 2012.

⁵⁵³ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 63.

⁵⁵⁴ See Thomas Cottier and Marina Foltea; Bartels, Lorand., and Ortino, Federico., 2006, *Op. Cit.*, p. 63.

⁵⁵⁵ See Alfredo C. Robles, Jr., *The False Promises of an ASEAN-EU FTA*, International Studies Department, De La Salle University, and AEPF Reference Group, in collaboration with IPD, 2 May 2007, available at : <http://www.caramasia.org/enews/2007/June/Critic%20EU%20ASEAN%20FTA.pdf>, last accessed : 12 February 2012.

prevent developing countries from diversifying their economic structures, which still rely heavily on the production of primary commodities.⁵⁵⁶

As mentioned above, region to region negotiations of AEUFTA took into account the different level of development of ASEAN member states.⁵⁵⁷ Within the EU external trading system, all ASEAN members states, excluding Singapore, are granted preferential access to the EU market. According to Celine Carere et al., in the terms of preferential trade access given by a developed country to ASEAN, the EU is considered as the most generous developed country through its scheme of the GSP and free-trade status (with the EBA scheme) to the three low-income countries, such as CML.⁵⁵⁸

The extensive policy of EU trade preferences has to be taken into account in the AEUFTA negotiations. In granting preferential access the EU categorises its beneficiary countries into three different groups, that is the most preferred group, the middle group, and the least preferred group. The most preferred group benefits from a trade agreement that is superior to the standard GSP. The preferential access for the most preferred groups includes the Cotonou Agreement and Non-Cotonou Agreement. The Non-Cotonou Agreement covers EBA (CML ASEAN member states), the EU's regional and bilateral trade agreements with its neighbours, Turkey, EUROMED countries, and more distant countries such as South Africa, Chile, and Mexico. The EPAs covering ACP countries are also included in this group.⁵⁵⁹ The middle group consists of the GSP beneficiary countries under the general arrangement scheme, covering developing countries of ASEAN member states such as Brunei, Indonesia, Malaysia, the Philippines, Thailand and Vietnam. This group is party to the standard GSP preferences and grants other regimes of preferential access.⁵⁶⁰ Third is the least preferred group, which includes industrialised countries such as Singapore that trade with the EU on a MFN basis.⁵⁶¹

According to such categorisation of EU preferences, it can be seen that ASEAN member states are divided into different groups. As a result, ASEAN has heterogeneous differential access to the EU market under the current trade regime. In this regard, the proposed FTA with the EU considered that preferences for the low-income ASEAN member states would erode in comparison with other ASEAN member states. However, in relative terms at least, it is to be expected that there will be a significant increase in market access for the ASEAN partners that are not granted EBA status.⁵⁶²

The export shares among the EBA group are quite similar compared to the general arrangement scheme of the GSP. The export shares under the general arrangement scheme of GSP are varied and are likely to cause strong conflicts of interests in the negotiations as far as market access issues are concerned.⁵⁶³ In this regard, Celine Carrere et al. argue that "one size does not fit all" is suitable to help understanding the difficulties and tensions in the AEUFTA negotiations since each ASEAN member state has a different level of development, different market access, different individual exception list in the FTAs, and divergent interests of each member states.⁵⁶⁴

⁵⁵⁶ See Alfredo C. Robles, Jr., 2007.

⁵⁵⁷ See Céline Carrère, Jaime de Melo, and Bolormaa Tumurchudur, 2008.

⁵⁵⁸ See *Ibid.*

⁵⁵⁹ See *Ibid.*

⁵⁶⁰ See *Ibid.*

⁵⁶¹ See *Ibid.*

⁵⁶² See *Ibid.*

⁵⁶³ See *Ibid.*

⁵⁶⁴ See *Ibid.*

VII. Impact of the Eurozone crisis towards ASEAN Export under GSP Regime.

From 2006–2010 ASEAN's export to the EU had no significant increase. Export value increased by a small significant amount between 2006–2008 from €77.46 million Euro into €79.11 million Euro or increased €1.7 million Euro or 2.08%. However, the amount of this significantly crumbled in 2009 when the global crisis worsened the economic situation of the EU. The amount of ASEAN export to EU decreased to €66.18 million Euro or 16.34% lower than the previous amount of exports. In 2010, ASEAN exports to the EU considerably rose to €77.6 million Euro or increased by 14.75%. Singapore dominates the amount of ASEAN exports to the EU with 35.15% of the total share in 2010. Thailand is in the second position, followed by Malaysia and Indonesia, respectively. Indonesia's export to the EU rose significantly in 2010 to an amount of €12.96 million Euro, 24.54% higher than 2009. Indonesia had 16.70% of the total share of ASEAN exports to the EU in 2010. (See Table 20).

All ASEAN product exports to the EU significantly increased by 25.09% or by €90.05 million Euro in 2010. ASEAN has a 2.28% import share of the total of all EU product imports from the rest of the world. ASEAN's total exported products to EU was 11.42% of ASEAN's total exported products to the rest of the world. In this regard, ASEAN depends more on exports to the EU. In 2009, the EU's total exported products from the rest of the world decreased by 21% from €4.13 billion Euro to €3.26 billion Euro in 2008. However, the EU's total exported products from the rest of the world rose again by 17.21% in 2010. (See Table 19). The trade balance between ASEAN and EU increased by 100% in 2010, however, before it declined by 30% in 2009. (See Table 22).

Singapore is the largest EU trading partner among the other ASEAN member states with the total export value in 2010 of €28.94 million Euro and the total import value in 2010 of €26.52 million Euro. Malaysia is in the second position with the total export value in 2010 of €12.70 million Euro and the total import value in 2010 of €16.10 million Euro. This is followed by Thailand in third position, Indonesia in fourth position and the Philippines in fifth position. After the FTA negotiations with ASEAN this paused, the EU pursued bilateral negotiations on FTA with individual countries, starting with Singapore and Malaysia.⁵⁶⁵ (See Table 25).

Germany is the largest import market for ASEAN exported products among the 27 EU member states with the total export value from ASEAN at €95.45 million Euro. This is followed by the Netherlands and United Kingdom, placed in second and third place, respectively. (See Table 24).

Indonesia is the largest exporter on S-III of Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes with the export values in 2010 at €2.0 million Euro. Malaysia was in the second rank with exports values in 2010 of €1.27 million Euro. In 2005, Indonesia and Malaysia were granted section graduation under the general arrangement of the EU GSP. According to this data, section graduation does not have a negative influence but instead a positive influence. It has been shown that export values on such section rose after graduation. (See Table 25).

Indonesia is the largest exporter in Section IX of Wood and articles of wood, and wood charcoal among the ASEAN member states with export values in 2010 at €421,688,67 Euro. In 2005, Indonesia was granted section graduation, but the

⁵⁶⁵ See EU to start bilateral trade negotiations with Singapore, available at : <http://trade.ec.europa.eu/doclib/press/index.cfm?id=519&serie=320&langId=en>, last accessed : 09 February 2012. See also http://www.eeas.europa.eu/malaysia/index_en.htm.

recalculation of 2004-2006 trade data led to re-inclusion ("*degradation*") of certain product sections for six beneficiaries under the 2009-2011 schemes.⁵⁶⁶ In this regard, the section graduation granted under general arrangement of GSP applied the open principle by re-considering the section concerned, which after being excluded from the list of GSP products declined its export value. (See Table 26).

ASEAN member states included in the top 50 partners of the EU GSP include Singapore, Thailand, Malaysia, Indonesia, the Philippines, and Vietnam. (See Table 25). EU GSP imports from ASEAN in 2010 were 10.6% of the total GSP imports among 12 regional groups. The biggest regional group of GSP imports to the EU was BRIC at 17.1%, and ASEAN placed in third position. (See Table 27).

ASEAN-EU trade in goods significantly increased in 2010 after decreasing in 2009. At the same time, ASEAN trade in goods with the rest of the world in 2010 also increased after decreasing in 2009. Since the EU is the second largest trading partner and the first largest export market of ASEAN, therefore, the economic crisis that has struck the global economy since the summer of 2007⁵⁶⁷ caused the GDP of EU to fall by about 4% in 2009.⁵⁶⁸ (See Figure 15).

Machinery and transport equipment was the largest share of merchandise products in the trading between EU-ASEAN in 2010. This is followed by agricultural products, chemicals products, fuels and mining products, textiles and clothing, and other products, respectively. (See Figure 18, 19, 20, 21). Figures 16 and 17 show asymmetric trade balances between ASEAN and EU, where from 2006 to 2010 ASEAN had more exports to the EU than imports from the EU to ASEAN. The assumption of generous trade preferences, in this term GSP, which provide tariff reductions until zero to ASEAN member states can be considered as one of the driving factors of such situation.

There are five ASEAN member states included as the top 50 EU major trading partners such as Singapore, Malaysia, Thailand, Indonesia and the Philippines. (See Table 29). ASEAN was nominated in third place as the biggest EU partner region of twelve other partners with import-export shares of 5.2% of the total value. EU imports from ASEAN covered 5.8% of EU total imports from twelve partner regions. While EU exports to ASEAN had a lower value than the import value that is 4.5% of the total EU exports to twelve partner regions. (See Table 30).

EU 27 is placed as the third largest trading partner with ASEAN covering 10.3% of ASEAN total trade. While China and Japan are in first and second position, with values of 14% and 11.0%, respectively. (See Table 31). According to Standard International Trade Classification (SITC)⁵⁶⁹, machinery and transport equipment (SITC 7) are the

⁵⁶⁶ See Column C of annex I to the regulation No. 732/2008 (*Official Journal* L 211, 6.8.2008) against column C of annex I to Regulation (EC) No. 980/2005 (*Official Journal* L 139/1,30.6.2005). See also United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 - 34. See also Graduation from the Generalised System of Preference Scheme of the European Union (EU - GSP Scheme), 1998.

⁵⁶⁷ See The European Commission, Economic Crisis in Europe : Causes, Consequences, and Responses, European Economy 7 2009, Directorate General of Economic and Financial Affairs, European Communities, 2009, available at : http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf, last accessed : 03 February 2012, p. 9.

⁵⁶⁸ See *Ibid.*

⁵⁶⁹ The Standard international trade classification, abbreviated as SITC, "[...] is a product classification of the United Nations used for external trade statistics (export and import values and volumes of goods), allowing for international comparisons of commodities and manufactured goods [...]". The groupings of SITC reflect of the production materials; the processing stage; market practices and uses of the products; the importance of the goods in world trade; and technological changes. See Glossary:Standard international trade classification (SITC), available at :

biggest imported products from ASEAN to EU, covering 43.8% of total imports. The value of food and live animals imported from ASEAN to EU is 6.9% of total imports. While the value of animal and vegetable oils, fats and waxes imported from ASEAN to EU is 63% of total imports. (See Figure 18).

According to Standard International Trade Classification (SITC) machinery and transport equipment (SITC 7) is also the biggest export products from the EU to ASEAN, covering 53.2% of total exports. The value of food and live animals exported from the EU to ASEAN is 4.0% of total imports. While the value of animal and vegetable oils, fats and waxes exported from the EU to ASEAN is 0.1% of total imports. (See Figure 19).

According to product grouping manufactures, products imported from ASEAN to EU cover 7.7% of the share of total EU imports. According to EU-Trade statistic data from 2006, 2008 and 2010, the total manufactured products imported from ASEAN to the EU were 82.2%, 77.5%, and 80.4%, respectively. When the economic crisis initially struck the EU in late 2007 the imported manufactured products from ASEAN to the EU decreased, however, they rose again in 2010. Agricultural products cover 11.2% of the total share of EU imports. In 2006, 2008 and 2010, the total agricultural products imported from ASEAN to the EU were 12.6%, 16.2%, and 15.0%, respectively. (See Figure 21).

http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:Standard_international_trade_classification_%28SITC%29, last accessed : 14 October 2011.

See also Metadata Standard International Trade Classification, Revision 3 (1988), available at: http://ec.europa.eu/eurostat/ramon/nomenclatures/index.cfm?TargetUrl=LST_NOM_DTL&StrNom=SITC_REV3&StrLanguageCode=EN&IntPcKey=&StrLayoutCode=HIERARCHIC, last accessed : 14 October 2011. See also Standard International Trade Classification, Revision 4, available at : <http://unstats.un.org/unsd/trade/sitcrev4.htm>, last accessed : 14 October 2011.

Table 20. List of supplying markets in ASEAN for products imported by the European Union (EU 27)⁵⁷⁰
Product: TOTAL All products

Unit: thousand euro

Exporters	Exported value in 2006	Exported value in 2007	Exported value in 2008	Exported value in 2009	Exported value in 2010
ASEAN Aggregation	77,459,785.29	78,470,318.99	79,105,143.83	66,182,460.8	77,630,766.41
Singapore	24,395,379.36	23,598,439.82	23,825,955.38	18,649,108.96	26,514,862.36
Thailand	14,468,206.51	15,653,574.39	15,771,257.57	13,058,422.29	16,472,915.46
Malaysia	16,339,977.66	16,529,453.68	15,275,212.1	12,232,077.74	16,105,556.7
Indonesia	9,604,075.76	9,781,306.53	10,522,654.7	9,781,042.19	12,955,300.48
Philippines	6,955,342.24	6,267,826.87	5,789,862.32	5,712,546.94	5,582,131.42
Cambodia			514,817.52		
Vietnam	5,682,274.5	6,639,717.7	7,405,384.25	6,749,262.68	
Brunei Darussalam	14,529.27				

⁵⁷⁰ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/tradestat/Country_SelProductCountry_TS.aspx, last accessed : 16 November 2011.

Table 21. Bilateral trade between ASEAN and European Union (EU 27)⁵⁷¹
Product: TOTAL All products

Unit: thousand euro

Product code	Product label	ASEAN's exports to EU 27			EU 27's imports from world			ASEAN's exports to world		
		Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010
TOTAL	All products	79,496,793.77	67,458,485.88	90,050,718.71	4,133,800,783.06	3,265,970,619.8	3,946,669,746.92	669,505,973.3	581,286,791.8	788,412,789.23

Table 22. Bilateral trade between ASEAN and European Union (EU 27)⁵⁷²
Product: TOTAL All products

Unit: thousand euro

Product code	Product label	Trade Balance between ASEAN & EU 27			World Trade Balance for EU 27			World Trade Balance for ASEAN		
		Balance in value in 2008	Balance in value in 2009	Balance in value in 2010	Balance in value in 2008	Balance in value in 2009	Balance in value in 2010	Balance in value in 2008	Balance in value in 2009	Balance in value in 2010
TOTAL	All products	15,815,154.38	11,006,296.81	21,998,274.74	-187,180,879.92	-46,250,138.48	-79,561,980.86	30,218,710.9	55,393,204.34	67,640,318.62

⁵⁷¹ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

⁵⁷² Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

Table 23. List of importing markets in ASEAN for products exported by European Union (EU 27)⁵⁷³
Product: TOTAL All products

Unit: thousand euro

Partners	Balance in value in 2006	Balance in value in 2007	Balance in value in 2008	Balance in value in 2009	Balance in value in 2010	Exported value in 2010	Imported value in 2010
ASEAN Aggregation	23,762,502.88	19,778,262.41	15,762,674.9	10,196,397.48	14,897,410.43	62,733,355.98	77,630,766.41
Singapore	2,725,543.92	-200,955.88	-2,968,143.49	-5,724,463.36	-2,421,229.71	28,936,092.06	26,514,862.36
Malaysia	4,450,245.64	3,819,501.13	2,704,176.07	1,880,903.02	3,408,504.06	12,697,052.64	16,105,556.7
Thailand	5,496,193.68	6,871,186.94	6,071,978.54	4,358,732.78	6,019,883.95	10,453,031.5	16,472,915.46
Indonesia	4,783,569.42	4,176,153.52	3,342,257.67	3,555,682.57	5,524,232.68	7,431,067.8	12,955,300.48
Philippines	3,256,899.41	2,225,106.76	2,551,020.8	3,207,641.19	2,366,019.45	3,216,111.97	5,582,131.42
Cambodia			449,499.37				
Vietnam	3,179,093.17	2,887,269.95	3,611,885.93	2,917,901.28			
Brunei Darussalam	-129,042.37						

⁵⁷³ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Country_SelProductCountry_TS.aspx, last accessed : 16 November 2011.

Table 24. List of importing markets from European Union (EU 27) for products exported by ASEAN⁵⁷⁴

Unit: thousand euro

Importers	Exported value in 2006	Exported value in 2007	Exported value in 2008	Exported value in 2009	Exported value in 2010
Total	608,288,138.35	628,685,397.67	668,714,976.35	564,358,230.8	673,719,219.54
EU 27 Aggregation	85,782,562.28	88,747,120.05	88,626,912.18	76,246,806.78	95,454,139.93
Germany	18,410,881.45	18,902,264.93	19,154,843.64	16,975,885.38	23,267,536.14
Netherlands	13,942,057.1	14,141,296.02	14,136,781.45	12,057,319.58	17,552,377.61
United Kingdom	15,024,282.93	14,666,602.84	12,769,693.45	10,041,332.71	12,265,620.67
France	9,362,210.26	10,026,751.39	9,674,012.89	8,371,084.11	10,585,292.74
Belgium	4,438,129.17	5,128,416.9	5,502,115.85	5,010,390.15	6,202,856.57
Italy	4,773,118.25	5,110,869.49	5,323,009.35	4,417,166.19	5,695,760.04
Spain	5,362,065.43	5,762,779.12	5,841,980.23	4,669,608.04	4,432,683.66
Czech Republic	1,477,377.01	1,953,172.62	2,497,022.97	2,334,000.22	3,297,554.88
Denmark	1,121,030.25	1,038,321.77	1,204,136.87	2,024,637.91	1,627,272.23
Poland	1,650,078.03	1,751,417.17	2,256,428.85	1,996,058.29	1,545,533.36

⁵⁷⁴ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Country_SelProductCountry_TS.aspx, last accessed : 16 November 2011.

**Table 25. List of supplying markets in ASEAN for products imported by European Union (EU 27)
Product: 15 Animal, vegetable fats and oils, cleavage products, etc.⁵⁷⁵**

Unit: thousand euro

Exporters	Exported value in 2007	Exported value in 2008	Exported value in 2009	Exported value in 2010
ASEAN Aggregation	2,529,503.57	3,470,289.54	2,721,281.4	3,788,235.86
Indonesia	1,262,771.47	1,949,934.12	1,627,807.24	2,003,970.63
Malaysia	995,953.53	1,170,495.36	890,742.27	1,272,154.72
Philippines	237,241.29	280,688.95	177,420.52	462,714.75
Singapore	5,052.73	7,962.15	16,905.56	35,957.12
Thailand	28,268.6	60,933.02	8,215.8	13,438.64
Vietnam	215.94	275.94	190.01	

⁵⁷⁵ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Country_SelProductCountry_TS.aspx, last accessed : 16 November 2011.

Table 26. List of supplying markets in ASEAN for products imported by European Union (EU 27)⁵⁷⁶
Product: 44 Wood and articles of wood, wood charcoal

Unit: thousand euro

Exporters	Exported value in 2007	Exported value in 2008	Exported value in 2009	Exported value in 2010
ASEAN Aggregation	1,170,102.07	1,050,404.58	810,300.16	859,516.51
Indonesia	517,507.41	459,571.84	381,088.14	421,688.67
Malaysia	463,877.39	420,639.22	302,135.31	359,675.12
Thailand	111,542.37	90,353.2	65,491.2	58,002.67
Singapore	23,299.76	26,294.45	13,627.27	13,580.97
Philippines	11,649.88	9,100.57	7,204.78	6,569.08
Cambodia		2.04		
Vietnam	42,225.25	44,443.25	40,753.46	
Brunei Darussalam				

⁵⁷⁶ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Country_SelProductCountry_TS.aspx, last accessed : 16 November 2011.

Table 27. EU GSP'S trade with top 50 main partners (2010)⁵⁷⁷

The Major Imports Partners				The Major Export Partners				The Major Trade Partners			
Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%
	World (all countries)	3,530,688.5	100.0%		World (all countries)	3,802,615.2	100.0%		World (all countries)	7,333,303.6	100.0%
6	Singapore	124,274.7	3.5%	8	Singapore	108,528.9	2.9%	7	Singapore	232,803.6	3.2%
11	Malaysia	79,227.1	2.2%	16	Malaysia	45,299.3	1.2%	12	Thailand	130,219.3	1.8%
13	Thailand	76,861.0	2.2%	17	Indonesia	43,519.7	1.1%	13	Malaysia	124,526.4	1.7%
15	Indonesia	52,433.7	1.5%	18	Vietnam	29,863.9	0.8%	17	Indonesia	95,953.4	1.3%
30	Philippines	18,231.1	0.5%	23	Philippines	23,167.8	0.6%	25	Vietnam	43,978.8	0.6%
								27	Philippines	41,398.8	0.6%

⁵⁷⁷ See EU GSP Statistic, available at : http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147291.pdf, last accessed : 14 October 2011.

Table 28. EU GSP'S trade with main partners (2010)⁵⁷⁸

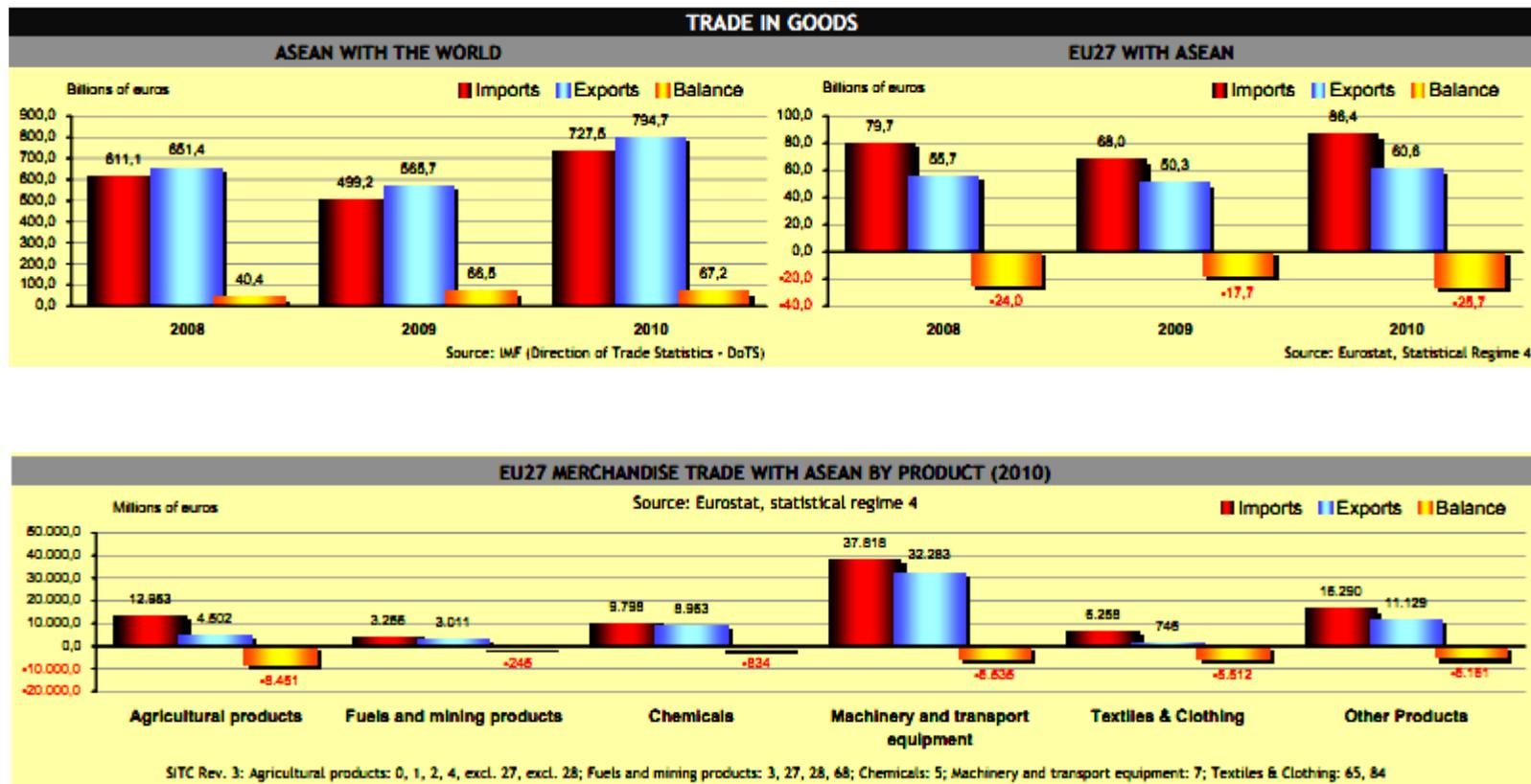
GSP's Imports from ...				GSP's Exports to ...				GSP's Trade with ...			
No.	Partner regions	Mio euro	%		Partner regions	Mio euro	%		Partner regions	Mio euro	%
1.	ACP	114,037.0	3.2%		ACP	122,967.6	3.2%		ACP	237,004.5	3.2%
2.	Andean Community	28,386.2	0.8%		Andean Community	26,439.2	0.7%		Andean Community	54,825.4	0.7%
3.	ASEAN	372,603.9	10.6%		ASEAN	315,583.3	8.3%		ASEAN	688,187.3	9.4%
4.	BRIC	604,398.8	17.1%		BRIC	519,177.2	13.7%		BRIC	1,123,576.0	15.3%
5.	CACM	14,332.4	0.4%		CACM	25,868.4	0.7%		CACM	40,200.7	0.5%
6.	Candidate Countries	39,544.3	1.1%		Candidate Countries	55,471.4	1.5%		Candidate Countries	95,015.7	1.3%
7.	CIS	144,465.2	4.1%		CIS	120,745.3	3.2%		CIS	265,210.5	3.6%
8.	EFTA	42,216.6	1.2%		EFTA	24,609.8	0.6%		EFTA	66,826.5	0.9%
9.	Latin American Countries	239,661.3	6.8%		Latin American Countries	200,459.0	5.3%		Latin American Countries	440,120.3	6.0%
10.	MEDA (excl EU and Turkey)	44,093.9	1.2%		MEDA (excl EU and Turkey)	65,422.6	1.7%		MEDA (excl EU and Turkey)	109,516.5	1.5%
11.	Mercosur	132,743.3	3.8%		Mercosur	91,260.1	2.4%		Mercosur	224,003.4	3.1%
12.	NAFTA	482,175.7	13.7%		NAFTA	759,090.1	20.0%		NAFTA	1,241,265.8	16.9%

EFTA: Iceland, Liechtenstein, Norway, Switzerland; **Candidates**: Croatia, FYR of Macedonia, Turkey; **Andean Community**: Bolivia, Colombia, Ecuador, Peru;
CIS: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Kazakhstan, Moldova Republic of, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan;
CACM: Honduras, El Salvador, Nicaragua, Costa Rica, Guatemala, Panama; **Mercosur**: Argentina, Brazil, Paraguay, Uruguay; **NAFTA**: Canada, Mexico, United States;
Latin American Countries: CACM, Mercosur, ANCOM, Chile, Cuba, Dominican Republic, Haiti, Mexico, Panama, Venezuela; **BRIC**: Brazil, Russia, India, China;
ASEAN: Brunei Darussalam, Indonesia, Cambodia, Lao People's Democratic Republic, Myanmar, Malaysia, Philippines, Singapore, Thailand, Vietnam;
ACP: 79 countries; **MEDA (excl EU & Turkey)**: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Occupied Palestinian Territory, Syrian Arab Republic, Tunisia.

Source: IMF (DoTS) DG TRADE
European Union: 27 members. 8-Jun-11

⁵⁷⁸ See *Ibid.*

Figure 15. ASEAN – EU trade in goods statistics⁵⁷⁹

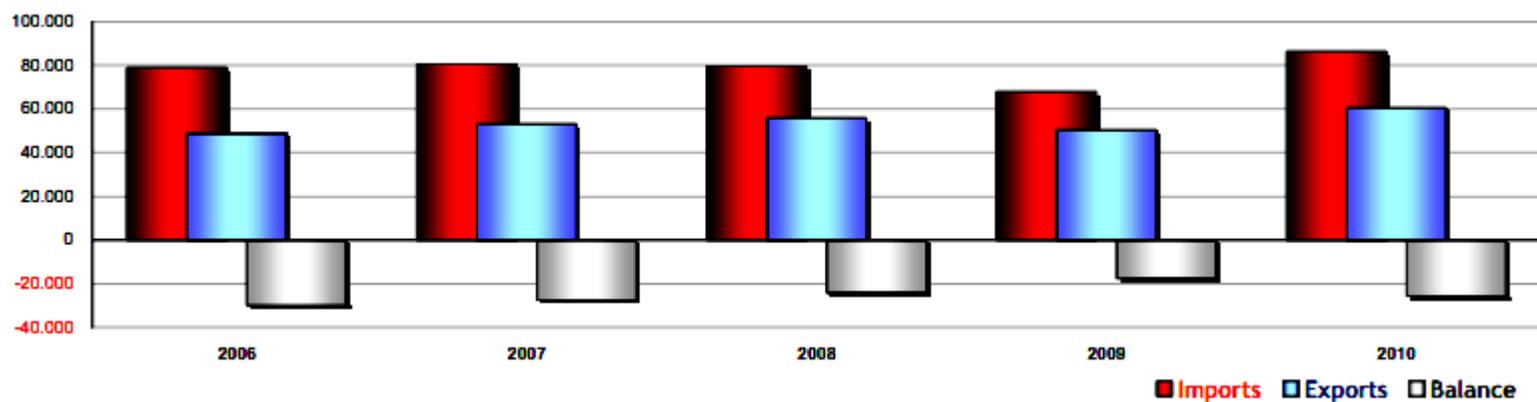


⁵⁷⁹ See EU – ASEAN Trade (2010), available at : http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113471.pdf, last accessed : 14 October 2010.

Figure 16. EU's trade balance with ASEAN⁵⁸⁰

European Union, Trade with ASEAN millions of euro, %

Period	Imports	Variation (% y-o-y)	Share of total EU Imports (%)	Exports	Variation (% y-o-y)	Share of total EU Exports (%)	Balance	Trade
2006	78.818	10,0	5,8	48.811	7,8	4,2	-30.007	127.629
2007	80.499	2,1	5,6	53.091	8,8	4,3	-27.407	133.590
2008	79.743	-0,9	5,1	55.701	4,9	4,3	-24.042	135.445
2009	67.967	-14,8	5,6	50.296	-9,7	4,6	-17.671	118.262
2010	86.374	27,1	5,8	60.635	20,6	4,5	-25.739	147.009
2010Q1	18.659	-	5,6	13.923	-	4,7	-4.736	32.582
2010Q2	21.090	-	5,6	14.757	-	4,4	-6.333	35.846
2010Q3	23.613	-	6,1	15.546	-	4,4	-8.067	39.159
2010Q4	23.012	-	5,7	16.409	-	4,5	-6.603	39.421
2011Q1	23.788	27,5	5,7	16.278	16,9	4,4	-7.510	40.066
2011Q2	-	-	-	-	-	-	-	-
2011Q3	-	-	-	-	-	-	-	-
2011Q4	-	-	-	-	-	-	-	-
Average annual growth (2006-2010)		2,3			5,6			3,6

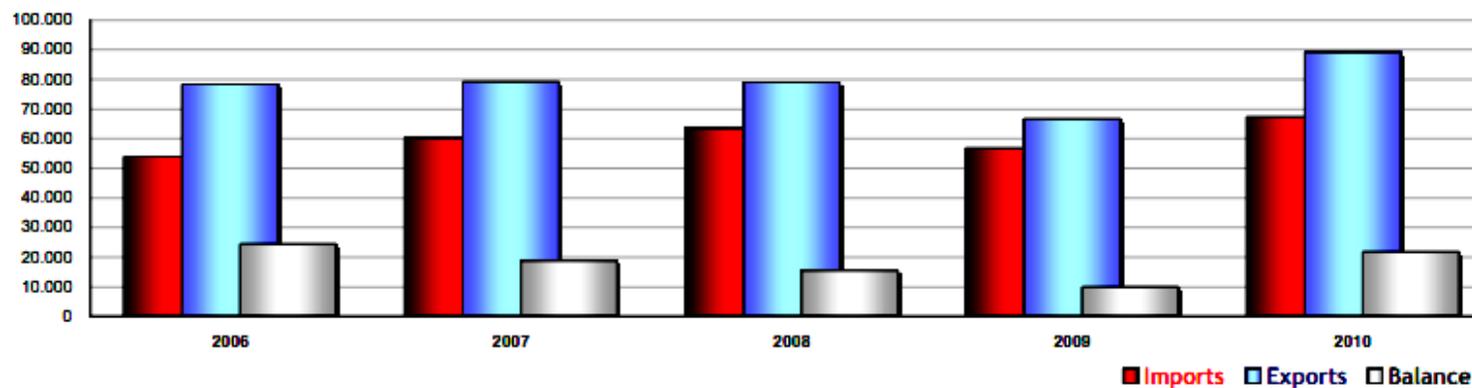


⁵⁸⁰ See *Ibid*,

Figure 17. ASEAN's trade balance with EU⁵⁸¹

millions of euro, %

Period	Imports	Variation (% y-o-y)	EU Share of total Imports (%)	Exports	Variation (% y-o-y)	EU Share of total Exports (%)	Balance	Trade
2006	53.946	11,1	10,8	78.290	16,8	13,2	24.343	132.236
2007	60.290	11,8	11,5	79.188	1,1	13,0	18.898	139.478
2008	63.552	5,4	10,4	79.006	-0,2	12,1	15.454	142.558
2009	56.784	-10,6	11,4	66.691	-15,6	11,8	9.907	123.475
2010	67.257	18,4	9,2	89.108	33,6	11,2	21.851	156.365
2010Q1	14.138	-	9,2	19.607	-	11,5	5.469	33.745
2010Q2	17.038	-	9,1	21.151	-	10,5	4.113	38.190
2010Q3	18.012	-	9,3	24.430	-	11,5	6.418	42.442
2010Q4	18.068	-	9,4	23.920	-	11,3	5.852	41.988
2011Q1	-	-	-	-	-	-	-	-
2011Q2	-	-	-	-	-	-	-	-
2011Q3	-	-	-	-	-	-	-	-
2011Q4	-	-	-	-	-	-	-	-
Average annual growth (2006-2010)		5,7			3,3			-2,7



⁵⁸¹ See *Ibid.*

**Table 29. EU's trade with top 50 main trading partners 2010⁵⁸²
country by country**

The Major Imports Partners				The Major Exports Partners				The Major Trade Partners			
Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%
	Extra EU-27	1,501,843.9	100.0%		Extra EU-27	1,348,792.4	100.0%		Extra EU-27	2,850,636.3	100.0%
14	Malaysia	20,701.2	1.4%	15	Singapore	24,043.3	1.8%	12	Singapore	42,747.7	1.5%
16	Singapore	18,704.4	1.2%	26	Malaysia	11,243.4	0.8%	22	Malaysia	31,944.6	1.1%
18	Thailand	17,212.3	1.1%	30	Thailand	9,992.4	0.7%	24	Thailand	27,204.7	1.0%
23	Indonesia	13,729.2	0.9%	35	Indonesia	6,372.2	0.5%	32	Indonesia	20,101.3	0.7%
31	Vietnam	9,431.3	0.6%	46	Philippines	3,736.0	0.3%	42	Philippines	9,115.0	0.3%
41	Philippines	5,379.0	0.4%								
-	ASEAN	86,373.8	5.8%	-	ASEAN	60,635.1	4.5%	-	ASEAN	147,009.0	5.2%

⁵⁸² See *Ibid.*

**Table 30. EU's trade with main trading partners 2010⁵⁸³
region by region**

EU Imports from ...				EU Exports to ...				Imports + Exports			
No.	Partner regions	Mio euro	%		Partner regions	Mio euro	%		Partner regions	Mio euro	%
1.	ACP	64,793.1	4.3%		ACP	68,722.2	5.1%		ACP	133,515.3	4.7%
2.	Andean Community	12,198.6	0.8%		Andean Community	7,905.9	0.6%		Andean Community	20,104.5	0.7%
3.	ASEAN	86,373.8	5.8%		ASEAN	60,635.1	4.5%		ASEAN	147,009.0	5.2%
4.	BRIC	505,863.7	33.7%		BRIC	265,708.2	19.7%		BRIC	771,572.0	27.1%
5.	CACM	7,576.1	0.5%		CACM	4,504.6	0.3%		CACM	12,080.7	0.4%
6.	Candidate Countries	48,616.5	3.2%		Candidate Countries	73,897.7	5.5%		Candidate Countries	122,514.2	4.3%
7.	CIS	200,474.7	13.3%		CIS	123,694.2	9.2%		CIS	324,168.8	11.4%
8.	EFTA	167,022.8	11.1%		EFTA	150,030.1	11.1%		EFTA	317,052.9	11.1%
9.	Latin American Countries	90,034.3	6.0%		Latin American Countries	84,013.5	6.2%		Latin American Countries	174,047.8	6.1%
10.	MEDA (excl EU and Turkey)	60,624.3	4.0%		MEDA (excl EU and Turkey)	80,733.3	6.0%		MEDA (excl EU and Turkey)	141,357.6	5.0%
11.	Mercosur	43,955.3	2.9%		Mercosur	40,104.0	3.0%		Mercosur	84,059.2	2.9%
12.	NAFTA	202,632.3	13.5%		NAFTA	290,074.1	21.5%		NAFTA	492,706.4	17.3%

EFTA: Iceland, Liechtenstein, Norway, Switzerland; **Candidates**: Croatia, FYR of Macedonia, Turkey; **Andean Community**: Bolivia, Colombia, Ecuador, Peru;
CIS: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Kazakhstan, Moldova Republic of, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan;
CACM: Honduras, El Salvador, Nicaragua, Costa Rica, Guatemala, Panama; **Mercosur**: Argentina, Brazil, Paraguay, Uruguay; **NAFTA**: Canada, Mexico, United States;
Latin American Countries: CACM, Mercosur, ANCOM, Chile, Cuba, Dominican Republic, Haiti, Mexico, Panama, Venezuela; **BRIC**: Brazil, Russia, India, China;
ASEAN: Brunei Darussalam, Indonesia, Cambodia, Lao People's Democratic Republic, Myanmar, Malaysia, Philippines, Singapore, Thailand, Vietnam;
ACP: 79 countries; **MEDA (excl EU & Turkey)**: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Occupied Palestinian Territory, Syrian Arab Republic, Tunisia.

Source: EUROSTAT (Comext, Statistical regime 4)
European Union: 27 members.

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⁵⁸³ See *Ibid.*

**Table 31. ASEAN's trade with top 10 main trading partners (2010)⁵⁸⁴
country by country**

The Major Import Partners				The Major Export Partners				The Major Trade Partners			
Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%
	World (all countries)	727,473.0	100.0%		World (all countries)	794,653.3	100.0%		World (all countries)	1,522,126.2	100.0%
1	China	111,130.7	15.3%	1	China	104,925.4	13.2%	1	China	216,056.1	14.2%
2	Japan	90,401.4	12.4%	2	EU27	89,108.3	11.2%	2	Japan	167,726.3	11.0%
3	Singapore	70,071.4	9.6%	3	United States	80,255.2	10.1%	3	EU27	156,365.1	10.3%
4	EU27	67,256.8	9.2%	4	Japan	77,325.0	9.7%	4	United States	143,173.1	9.4%
5	United States	62,917.8	8.6%	5	Hong Kong	55,241.4	7.0%	5	Singapore	119,318.3	7.8%
6	Malaysia	46,331.8	6.4%	6	Malaysia	49,362.1	6.2%	6	Malaysia	95,693.9	6.3%
7	South Korea	38,842.2	5.3%	7	Singapore	49,246.9	6.2%	7	South Korea	70,516.5	4.6%
8	Thailand	36,372.7	5.0%	8	Indonesia	38,156.0	4.8%	8	Hong Kong	68,827.3	4.5%
9	Indonesia	29,281.3	4.0%	9	South Korea	31,674.2	4.0%	9	Indonesia	67,437.4	4.4%
10	Saudi Arabia	19,248.8	2.6%	10	Australia	29,335.6	3.7%	10	Thailand	62,026.9	4.1%

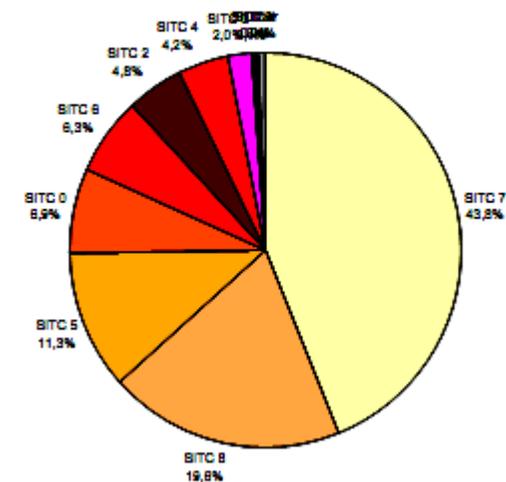
⁵⁸⁴ See *Ibid.*

Figure 18. European Union imports from ASEAN⁵⁸⁵ according to Standard International Trade Classification (SITC)

European Union, Imports from... Asean			
SITC Codes	SITC Sections	Value (Millions of euro)	Share of Total (%)
TOTAL		86.374	100,0%
SITC 7	Machinery and transport equipment	37.818	43,8%
SITC 8	Miscellaneous manufactured articles	16.937	19,6%
SITC 5	Chemicals and related prod, n.e.s.	9.798	11,3%
SITC 0	Food and live animals	5.939	6,9%
SITC 6	Manufactured goods classified chiefly by material	5.457	6,3%
SITC 2	Crude materials, inedible, except fuels	4.123	4,8%
SITC 4	Animal and vegetable oils, fats and waxes	3.655	4,2%
SITC 3	Mineral fuels, lubricants and related materials	1.765	2,0%
SITC 9	Commodities and transactions n.c.e.	312	0,4%
SITC 1	Beverages and tobacco	185	0,2%

Share of total EU Imports
5,8%
8,5%
8,3%
7,1%
8,0%
3,5%
6,5%
55,3%
0,5%
1,1%
2,7%

European Union, Imports from... Asean



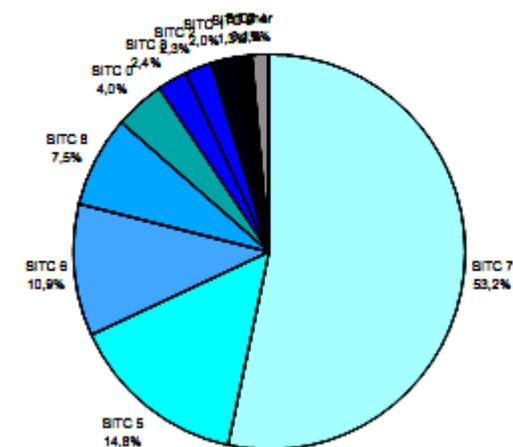
⁵⁸⁵ See *Ibid.*

Figure 19. European Union exports to ASEAN according to Standard International Trade Classification (SITC)⁵⁸⁶

European Union, Exports to... Asean			
SITC Codes	SITC Sections	Value (millions of euro)	Share of Total (%)
TOTAL		60.635	100,0%
SITC 7	Machinery and transport equipment	32.283	53,2%
SITC 5	Chemicals and related prod, n.e.s.	8.963	14,8%
SITC 6	Manufactured goods classified chiefly by material	6.616	10,9%
SITC 8	Miscellaneous manufactured articles	4.574	7,5%
SITC 0	Food and live animals	2.451	4,0%
SITC 3	Mineral fuels, lubricants and related materials	1.470	2,4%
SITC 2	Crude materials, inedible, except fuels	1.395	2,3%
SITC 1	Beverages and tobacco	1.223	2,0%
SITC 9	Commodities and transactions n.c.e.	795	1,3%
SITC 4	Animal and vegetable oils, fats and waxes	65	0,1%

Share of total EU Exports
4,5%
5,6%
3,8%
3,9%
3,3%
4,5%
1,9%
4,0%
5,7%
2,0%
2,1%

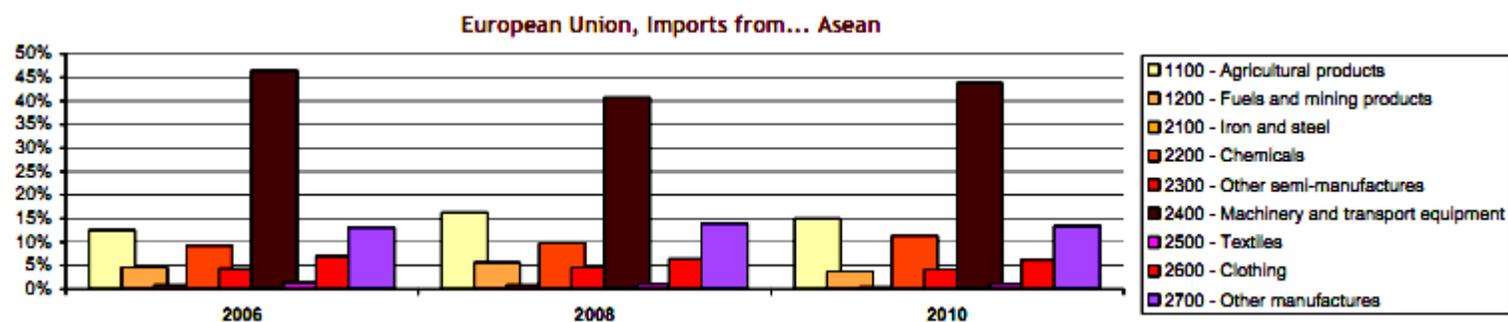
European Union, Exports to... Asean



⁵⁸⁶ See *Ibid.*

Figure 20. European Union imports from ASEAN according to product grouping⁵⁸⁷

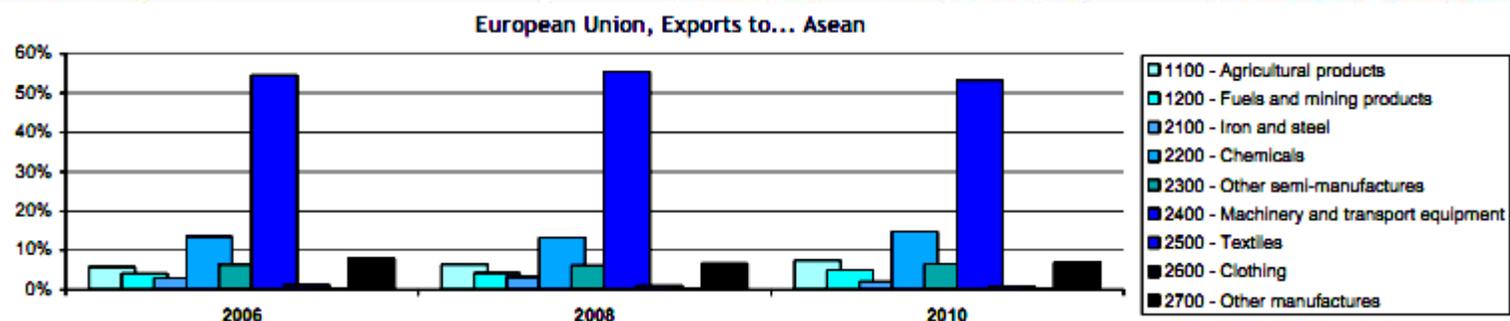
European Union, Imports from... Asean							
SITC Rev.3 Product Groups	2006		2008		2010		Share of total EU Imports
	Millions euro	%	Millions euro	%	Millions euro	%	
0000 - Total	78.818,0	100,0%	79.743,4	100,0%	86.373,8	100,0%	5,8%
1000 - Primary products	13.570,9	17,2%	17.455,2	21,9%	16.209,3	18,8%	2,8%
1100 - Agricultural products	9.914,2	12,6%	12.950,4	16,2%	12.953,4	15,0%	11,2%
1200 - Fuels and mining products	3.656,7	4,6%	4.504,7	5,6%	3.255,9	3,8%	0,7%
2000 - Manufactures	64.824,7	82,2%	61.778,8	77,5%	69.449,0	80,4%	7,7%
2100 - Iron and steel	612,5	0,8%	616,6	0,8%	353,3	0,4%	1,4%
2200 - Chemicals	7.263,9	9,2%	7.800,1	9,8%	9.797,7	11,3%	7,1%
2300 - Other semi-manufactures	3.368,9	4,3%	3.694,7	4,6%	3.627,1	4,2%	4,9%
2400 - Machinery and transport equipment	36.746,6	46,6%	32.504,0	40,8%	37.818,4	43,8%	8,5%
2410 - Office and telecommunication equipment	28.524,4	36,2%	23.597,0	29,6%	27.642,4	32,0%	14,4%
2420 - Transport equipment	2.355,5	3,0%	2.611,2	3,3%	3.286,1	3,8%	3,0%
2430 - Other machinery	5.866,7	7,4%	6.295,8	7,9%	6.889,9	8,0%	4,9%
2500 - Textiles	1.044,4	1,3%	873,8	1,1%	934,9	1,1%	4,6%
2600 - Clothing	5.475,8	6,9%	5.122,6	6,4%	5.323,2	6,2%	8,1%
2700 - Other manufactures	10.312,6	13,1%	11.167,1	14,0%	11.594,4	13,4%	8,5%
3000 - Other products	387,9	0,5%	462,3	0,6%	331,3	0,4%	1,2%



⁵⁸⁷ See *Ibid.*

Figure 21. European Union exports to ASEAN according to product grouping⁵⁸⁸

SITC Rev.3 Product Groups	2006		2008		2010		Share of total EU Exports 2008
	Millions euro	%	Millions euro	%	Millions euro	%	
0000 - Total	48.810,8	100,0%	55.701,4	100,0%	60.635,1	100,0%	4,5%
1000 - Primary products	4.825,4	9,9%	5.866,0	10,5%	7.512,9	12,4%	3,6%
1100 - Agricultural products	2.834,1	5,8%	3.537,7	6,4%	4.502,0	7,4%	4,6%
1200 - Fuels and mining products	1.991,4	4,1%	2.328,3	4,2%	3.010,9	5,0%	2,7%
2000 - Manufactures	42.410,3	86,9%	47.940,1	86,1%	51.361,6	84,7%	4,7%
2100 - Iron and steel	1.435,0	2,9%	1.799,4	3,2%	1.216,8	2,0%	3,6%
2200 - Chemicals	6.597,1	13,5%	7.354,2	13,2%	8.963,3	14,8%	3,8%
2300 - Other semi-manufactures	3.119,0	6,4%	3.427,7	6,2%	3.980,8	6,6%	3,9%
2400 - Machinery and transport equipment	26.624,0	54,5%	30.859,3	55,4%	32.283,5	53,2%	5,6%
2410 - Office and telecommunication equipment	11.034,0	22,6%	10.686,7	19,2%	8.110,1	13,4%	10,6%
2420 - Transport equipment	4.111,1	8,4%	6.365,8	11,4%	9.188,5	15,2%	4,4%
2430 - Other machinery	11.378,8	23,3%	13.722,1	24,6%	14.861,3	24,5%	5,2%
2500 - Textiles	545,3	1,1%	522,2	0,9%	495,0	0,8%	3,2%
2600 - Clothing	198,7	0,4%	232,0	0,4%	251,1	0,4%	1,5%
2700 - Other manufactures	3.876,0	7,9%	3.728,0	6,7%	4.151,3	6,8%	3,4%
3000 - Other products	952,2	2,0%	1.369,5	2,5%	961,7	1,6%	2,3%



⁵⁸⁸ See *Ibid.*

VIII. The ASEAN trade facilitations policies to support the utilisation of EU Generalised System of Preferences.

The development relationship between ASEAN-EU has brought enhancement towards GSP utilisation to ASEAN member states. As previously mentioned, from the 1950s until the late 1970s relations between Southeast Asian Countries and the EU were sunk in the hegemony of US domination. The commitment to open markets for developing countries were driving most Southeast Asia products to the US market. The establishment of ASEAN in 1967 as the biggest regional organisation in Southeast Asia did not have much influence on the economic and trade relationship between ASEAN-EU. As noted in the first two decades, ASEAN as the strategic regional organisation developed very slowly, especially in its external trade relations with the EU.

ASEAN as the regional organisation that was created during the Cold War era was intended to create and keep politic stability and security of the regions. Due to economic demands, regionalism in ASEAN developed to have a better bargaining position with other regions such as the EU, NAFTA, East Asian countries, and South American countries. The ASEAN position of bargaining influenced its trade "*diplomacy*" with the EU. The history of European colonialism strongly affected the relationship between ASEAN-EU. The early concept of the ASEAN-EU relationship was between recipient countries and donor countries. The weakness of ASEAN economic integration did not perform many "*concrete integrative efforts*".⁵⁸⁹

For more than four decades, GSP has been the only trade preferential scheme granted by the EU to ASEAN member states. The slow development of ASEAN has placed ASEAN countries in the low priority for the granting of the EU preferential trade scheme. At the beginning of the ASEAN-EU development relationship, the GSP scheme grant was one of the channels to open trade and economics. In this regard, GSP played an important role in strengthening cooperation between the two regions. Almost all ASEAN member states are beneficiary countries of EU GSP, therefore, the improvement of EU GSP utilisation does not only concern the national interests of each member states but is also deemed as a collective interest to expand ASEAN external trade at the regional level.

For 40 years, trade facilitation conducted by ASEAN to improve the utilisation of EU GSP has been divided into two phases. In the first phase, (1972-1991) ASEAN trade facilitation focused on the promotion of the utilisation of GSP through either formal or informal dialogue. Since the beginning ASEAN carried out trade facilitation support to improve GSP utilisation through trade "*diplomacy*" in inter-regional forums such as the "ASEAN-EC Ministerial Meeting Brussels". The slow process of economic integration and minimum trade cooperation among ASEAN member states impeded concrete regional trade facilitation. Consequently, throughout the first phase, ASEAN was using trade diplomacy to advocate its region's interest in the GSP scheme. Along with the demands of global economic development, ASEAN also deliberated its constructive idea to improve the EU GSP scheme in order to respond positively to the development needs of the developing countries and LDCs.

In the second phase (1992-2011), the trade facilitation conducted by ASEAN to improve utilisation of EU GSP increasingly developed into concrete policy measures. Such development was influenced by several factors, which came from inside and outside ASEAN. First, in 1992 ASEAN member states signed the "*Agreement on the CEPTS for the AFTA*" where ASEAN member states agreed effective tariff preferential to

⁵⁸⁹ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 91.

be applied to the goods and products originating from its members.⁵⁹⁰ Second, the needs of closer economic integration through the establishment of the single market and production base under AEC construction. The next factor is the strong demands from the private sector, such as traders, producers, business actors, and related stakeholders to “establish a concrete trade facilitation system at the regional level”. The shifting of the ASEAN political landscape also led to the development of regional trade facilitation that started through the declaration of “*ASEAN Vision 2020*”. The unity of the vision of ASEAN member states at the regional level accelerated economic integration under the AEC blue print through some visible trade facilitation projects. The reform of the EU GSP scheme in the mid-1990s also contributed to the development of ASEAN trade facilitation. That reform introduced some new rules such as application of non-trade conditionality clauses, the graduation mechanism, cumulative rules of origin, simplification of product category, and more complex administrative and technical requirements to obtain GSP facilities.

There are some important notes from the ASEAN trade diplomacy to facilitate utilisation of EU GSP by its member states. As previously mentioned, the EU is the first region to implement the Decision of Waiver 1971 by extending its GSP scheme to developing countries regardless of former colonial ties or selected preferences. The extension of the GSP scheme granted to ASEAN opened up trade dialogue between both regions in 1972. The first formal meeting between ASEAN and EU that discussed the implementation of the GSP scheme was the “The ASEAN-EC Ministerial Meeting” in 1978.

During the meeting, ASEAN criticised some measures related to trade adopted by the EU that considered export constraints⁵⁹¹. ASEAN also expressed its needs to improve market access into the EU, especially for manufactured, semi-manufactured, and primary product exports.⁵⁹² ASEAN demanded the EU to remove or relax tariffs and NTBs, and streamline its administrative procedures.⁵⁹³ ASEAN requested the efficiency improvement and excessive bureaucracy reduction that was imposed on ASEAN’s export products. ASEAN argued that the relaxation of tariffs and NTBs to trade could increase ASEAN product competitiveness in the EU market. It is important to note that ASEAN requested that the EU improve its GSP scheme and formalise the scheme into a permanent policy.⁵⁹⁴ At that time, the request to formalise GSP into a permanent policy due to the international legal basis of EU GSP under the Waiver 1971 of GSP, which only waived Article I of GATT 1947 for a period of ten years.⁵⁹⁵ Thus, the EU responded to ASEAN’s requests positively. Before the legalisation of GSP into the Enabling Clause, the EU intended the GSP scheme formalised as its permanent policy and improved the scheme as part of its commitment to favour economic development of developing countries.

The important milestone of ASEAN-EU trade diplomacy was the Cooperation Agreement between “*Member Countries of ASEAN and European Community in 1980*”. The Cooperation Agreement laid down the fundamental basis of trade facilitations that were useful to help the improvement of GSP implementation in ASEAN.⁵⁹⁶

⁵⁹⁰ See Paragraph 1 Article 1 Agreement on the CEPTS for the AFTA.

⁵⁹¹ See Paragraph 21 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

⁵⁹² See Paragraph 23 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

⁵⁹³ See Paragraph 24 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

⁵⁹⁴ See Paragraph 24 of the Joint Declaration The ASEAN-EC Ministerial Meeting Brussels, 21 November 1978.

⁵⁹⁵ See Waiver of Generalized System of Preferences, Decision of 25 June 1971, BISD 18S/24.

⁵⁹⁶ See Paragraph 3 Article 2 of the Cooperation Agreement between Member Countries of ASEAN and European Community, 1980.

During the 5th AEMM, the EU agreed to take into account the interests and needs of the ASEAN countries in the second phase of their GSP scheme improvement to ensure utilisation of GSP economic benefit.⁵⁹⁷ In the AEMM on Economic Matters, in 1985, ASEAN and the EU agreed, “*that the EU GSP is the effective tool to expand trade between ASEAN and EU*”. Still in the 6th AEMM the EU GSP scheme was regarded as the effective instrument to penetrate the EU market. In other words, EU GSP still played a significant role in the expansion of ASEAN market access in the EU. Therefore, ASEAN “welcomed” the EU intention to make further improvements to its GSP scheme.⁵⁹⁸

Significant improvements were made to the EU GSP Scheme 1989 and 1990, where the EU opened access to its sensitive products under GSP product coverage.⁵⁹⁹ In 1994, the EU applied new features to the GSP scheme, and provided opportunities for further discussions regarding such features with ASEAN.⁶⁰⁰ The Joint Declaration of the EU and ASEAN in 1994 focused on the labour rights conditionality in the EU GSP. ASEAN did not challenge its legality under the Enabling Clause,⁶⁰¹ however, the non-trade conditionality that applied in the GSP, seemed to be a burden for the developing countries.⁶⁰²

Some factors were identified as undermining the utilisation of GSP such as high transaction costs, excessive bureaucracy, corruption practices, lack of good governance practices, lack of customs modernisations, lack of e-trade services, lack of infrastructures, lack of information and knowledge of GSP, lack of human resources and lack of cooperation among member states. In order to cope with those factors, the establishment of a concrete project of trade facilitation at the regional level would seem to be the best solution. As mentioned, trade facilitation is an integrated system that is also very complex. It involves so many elements, a comprehensive master plan and the need for synergic cooperation between the national government and regional institutions.⁶⁰³ Trade facilitations must be provided for public goods to deliver benefits for all parties.⁶⁰⁴ Collaborative effort between the private and public sector is needed to establish comprehensive trade facilitation, including the political will to agree on concrete acts, commitments, and payments.⁶⁰⁵ Strong collaboration builds a complementary system covering simplification, harmonisation, automation of trade procedures (e-trade and e-business), guarantee of secure information, reduction of excessive bureaucracy procedures, and removal of other obstacles to trade. Therefore, ASEAN has set forth principles on trade facilitation⁶⁰⁶ in order to give guidance to the member states on how to carry out trade facilitation measures.

⁵⁹⁷ See Paragraph 25 of the Joint Declaration The Fifth ASEAN-EC Ministerial Meeting, Dublin, 15-16 October 1984, available at : <http://www.asean.org/5630.htm>.

⁵⁹⁸ See Paragraph 19 of the Joint Declaration The Sixth ASEAN-EC Ministerial Meeting, Jakarta, 20-21 October 1986, available at : <http://www.asean.org/5633.htm>.

⁵⁹⁹ See Paragraph 35 of the Joint Declaration The Eighth ASEAN-EC Ministerial Meeting, Malaysia, 16-17 February 1990. See also paragraph 47 of the Joint Declaration The Ninth ASEAN-EU Ministerial Meeting, Luxembourg, 30-31 May 1991, available at : <http://www.asean.org/5638.htm>. “[...] The Minister agreed that the EU GSP Scheme was an important tool by which ASEAN’s exports to the EU could be diversified and increased. They welcomed the significant increase in benefits arising from the use of GSP. The ASEAN Ministers noted that the EU is revising the GSP Scheme in order to make it simpler and more transparent. They urged the EU to take into account ASEAN interests inter alia the inclusion of the donor country content [...]”.

⁶⁰⁰ See Joint Declaration The Tenth ASEAN-EC Ministerial Meeting Manila, 29-30 October 1992.

⁶⁰¹ See Robert, Howse., 2003, *Op. Cit.*, p. 193.

⁶⁰² See M. Dent, Christopher., 2002, *Op. Cit.*, pp. 64-65.

⁶⁰³ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 15.

⁶⁰⁴ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 11.

⁶⁰⁵ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, pp. 19-20.

⁶⁰⁶ See Article 47 ASEAN Trade in Goods Agreement.

As of two decades ago, ASEAN established concrete trade facilitation projects, such as CEPT ROO, ASEAN Single Window, ASEAN customs integration, ASEAN Consultation to Solve Trade and Investment Issues (ACT), Trans-ASEAN transportation network, and ASEAN connectivity. With regard to the implementation of good governance and corruption eradication, the ASEAN member states agreed to establish the ASEAN Customs Code of Conduct⁶⁰⁷ and ASEAN Agreement on Customs⁶⁰⁸. Both agreements contain six principles, which endeavour to establish good customs conduct. The objectives of the ASEAN Agreement on Customs are to ensure consistency, transparency, and the fair application of the customs regulations. Related to the e-trade development, the e-ASEAN Framework Agreement is designed to facilitate the establishment of the ASEAN information infrastructure, promoting electronic commerce, and enhancing e-government applications.⁶⁰⁹

ASEAN customs integration is an essential component to increase the collection of revenues and reduce transaction costs for traders. ASEAN established a “*strategic plan of customs development*”, which was implemented from 2005 until 2010. Customs integration was conducted through the modernisation of customs techniques, the simplification, and harmonisation of procedures and formalities aligned with international standards and best practices.

As mentioned above, the single window has become a global trend in trade facilitation due to the significant reduction in transaction costs of trade.⁶¹⁰ The basic concept of the ASW is to achieve better economic efficiency through trade facilitation. The ASW will be in full operation by the end of 2012 when the national window of ten ASEAN member states are ready to operate. ASW has been used to support the flow of intra-trade and extra-trade of ASEAN as part of the global supply chain.

Since 1975, the EU has applied “*cumulative rules of origin provisions*” to ASEAN imported products under the GSP scheme. Cumulative origin has promoted trans-national export-oriented production within regions and facilitates closer economic integration, particularly to attain a single market and production base.⁶¹¹ Therefore, in the 10th AEMM EU GSP Scheme, it was still considered as an important tool to diversify and increase ASEAN exports to the EU.⁶¹² Cumulative origin is a good opportunity to improve GSP utilisation among ASEAN countries. It promotes production networking among ASEAN member states. The cumulative origin could facilitate trade and investment among ASEAN member states, promote a regional production network, encourage growth of Small and Medium Enterprises (SMEs), generate jobs opportunities, narrow economic development gaps, and promote the usage of the AFTA CEPTS. Therefore, ASEAN established the rules of origin (ROO) under the CEPT scheme and continuously enhances the rules to respond to the dynamic international market.

Due to the improvement of the GSP scheme, the EU applied some requirements in import formalities and procedures such as the certificate of origin document. Exporters from beneficiary countries who were allowed to obtain GSP facility only authorised exporters or registered exporters. The EU also requires beneficiary countries to apply

⁶⁰⁷ See ASEAN Customs Code of Conduct 1995 amended Customs Code of Conduct 1983, available at : <http://www.asean.org/2165.htm>, last accessed : 30 October 2011.

⁶⁰⁸ See ASEAN Agreement on Customs, 1997 available at : <http://www.aseansec.org/1905.htm>, last accessed : 30 October 2011.

⁶⁰⁹ See Article 3 of the e-ASEAN Framework Agreement, sign in Singapore November, 2000 available at : <http://www.aseansec.org/6267.htm>, last accessed : 30 October 2011.

⁶¹⁰ See Alvin C.K, 2007.

⁶¹¹ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 51. Its has emerge the establishment of multinational company in ASEAN.

⁶¹² See Joint Declaration The Tenth ASEAN-EC Ministerial Meeting Manila, 29-30 October 1992.

custom modernisation. The lack of trade facilitation could create barriers for trade and hinder the purpose of GSP. Successfulness of GSP utilisation is supported by the shared responsibility between the preference granting country and the beneficiary country. The beneficiary country has the responsibility to provide trade facilitation for its traders in order to utilise the GSP scheme properly.

The proposal of EU GSP regulation that is more focused on the requirements to grant preferences on the country most in need, in the near future, may exclude some ASEAN that are classified as upper middle-income countries by its scheme. The requirements set out in the proposal of the EU GSP regulation give a warning to ASEAN member states not to hold on forever to GSP. Particularly, for ASEAN member states that have become candidates of the upper middle-income country, to be well prepared to design the best trade policy to maintain their trade performance, especially export competitiveness, after GSP graduation. In the proposal of EU GSP regulation, total graduation would be based on economic criteria, i.e., when the beneficiary country was categorised as an upper-middle income country and high-income country. In this regard, Brunei Darussalam (high-income country), Malaysia (upper-middle income country), and Thailand (upper-middle income country) would be excluded from the GSP beneficiary lists. Based on growth assumption, in the coming future Indonesia, the Philippines, and Vietnam which are now classified as lower-middle income countries, will soon follow the other ASEAN member states to have total graduation from the GSP scheme. It would leave Cambodia, Lao PDR, and Myanmar as the beneficiaries of GSP, especially in the EBA arrangement scheme. Therefore, to address such new policy, and after the negotiation of the postponed AEUFTA , the ASEAN member states need to design a trade policy to maintain and increase their export competitiveness that also considers the possibilities of establishing new preferential trading agreements with the EU. The ASEAN member states need to improve and strengthen their trade facilitation on export to maximise GSP utilisation and increase their export competitiveness.

In conclusion, over 40 years ASEAN has developed its policies on trade facilitations to support the utilisation of EU GSP. ASEAN has conducted facilitation support through trade diplomacy, establishing agreements at a regional level in the related areas and providing concrete trade facilitation services.

Chapter V Indonesia's Trade Policies in EU GSP Utilisation

The trade relationship between Indonesia and European countries can be traced back to the 14th and 15th century when “long distance trade” was booming. Indonesia had a strategic position in world trade sea-lane and the Strait of Malacca was an international trade route linking the east and west. Indonesia was recognised as an important producer of raw materials with a high selling price in Europe. At that time, Indonesia still consisted of kingdoms and its trade relationship with the Europeans experienced various difficulties. After the era of independence, Indonesia's political configurations influenced national and foreign trade policies. The turning point of the trade relationship between Indonesia and the EU began after the severe economic crisis, through the establishment of PCA and CEPA. However, in 1971 the EU GSP was extended “to most developing countries” and played a significant role for some of Indonesia's exports. The rules and regulations of GSP applied the standards and requirements needed for cooperation from beneficiaries to ensure that the facilities granted through such scheme were utilised properly. This chapter covers the wide range of aspects of Indonesia's trade policies and other related national policies contributing to the utilisation of EU GSP.

I. Indonesian foreign trade policy developments : The causal link of politics and law towards evolutions of national policy.

During the 67 years of Indonesian independence, the direction of Indonesia's national development policy has strongly been influenced by the political configuration and characteristics of the country's leaders. The national development policy of each regime has influenced the evolution of Indonesia's trade policies. Broadly speaking, the characteristics of Indonesia's national leadership can be divided into three regimes, that is, the Old Order regime, the New Order regime, and the Reformation regime. Each of these regimes has its own policy characteristics influencing the vision and mission in leading the nation's economic development. During the Old Order regime, President Soekarno's leadership placed politics as the commander of national policy, while the New Order regime placed economic development as the commander of national policy. In the Reformation regime, democracy and supremacy of law were placed as the foundation of national policy.

To understand the development of Indonesia's trade policy it is important to understand the characteristics of each regime in the governing of national policy and in the attainment of its development goals. National policy is implemented through legislation. In fact, the process of legislation cannot be separated from political interests, since the legislators are representatives of political parties. In theory, members of parliament represent the people, but in practice, they have to obey the interests of their political parties.

According to Mahfud MD, law is a political product that is influenced by political configuration.¹ As a political product, the characteristics of each law are determined by political configuration. In practice, law is defined as a political decision product, where it is born from the crystallisation of political interaction and compromise. Law consists of two aspects, that is *das sollen* (idea) and *das sein* (reality). According to *dass sein*, politics must conform to the law, on the contrary, *das sollen* posits the law in practice

¹ See Mahfud MD, Moh.1993. *Perkembangan Politik Hukum*, disertasi doctor dalam Ilmu Hukum di Universitas Gadjah Mada : Yogyakarta; Moh. Mahfud MD.1999, *Pergulatan Politik dan Hukum di Indonesia*. Gama Media : Yogyakarta.

that is determined by the political configuration. In their book *"Toward Responsive Law: Law & Society in Transition"*, Philippe Nonet and Philip Selznick categorise the typology of legal ordering, which consists of: repressive law, autonomous law, and responsive law. Nonet and Selznick's typology is based on the acknowledgment that *"law is defined by its relationship to political power"*. Inherently, legal systems, judiciaries, and law enforcement bodies are created and funded by political authorities. Law is both a mode of legitimating political power and a mode of exercising power, enlisting judges and prosecutors and police officers to enforce the prerogatives and policies of the state.²

Nonet and Selznick characterise repressive law as *"law that is subordinated to power politics"*. The rule of laws and the judges who apply them legitimise and serve the interests of the politically powerful, who personally are only weakly bound by legal constraints. While autonomous law is characterised as *"law that is independent of politics and acts as a restraint on political power"*. This is the notion that underlies most contemporary understanding of the "rule of law". With regard to responsive law, Nonet and Selznick state that *"law is a facilitator of response to social need and aspirations"* and claim that the idea of responsive law arises from the criticisms of autonomous law.³ The legal system and national policy of states often change due to political change, such as revolution or reformation. Therefore, it is elaborated how and why the legal system of a state changes:

"[...] most social scientists accord a primary causal role to political and economic development, such as revolution or reformation. [...] judges and lawmakers are responsive above all to popular political attitudes, the demands of important interest groups, or the policy preferences of economic and political elites. A nation's legal norms, institutions, and practices may be polished and re-wrapped at the retail level by legal professionals, but the basic production process, it is assumed, is dominated by the political forces [...] institutional change would also require the support of political elites".⁴

Trade facilitation is the crucial issue in boosting export earnings, however, in fact Indonesia needs to improve and transform its trade institutions to be more professional in delivering its services. Trade facilitation is included as a *"public good"* that should deliver benefits for all parties (including the public and private sector). In the economic perspective, public goods were defined as goods that are *non-rivalrous* and *non-excludable*,⁵ which means they should be free and commonly enjoyed by its all citizens.⁶ Trade facilitation enables trade liberalisation as an important tool for development based on predictable rules, openness, and lack of discrimination.⁷ It is considered that the government has not fulfilled its major tasks to its citizens when it does not provide public goods, in this regard trade facilitations, based on predictable rules.⁸ To provide trade facilitation as public goods, collaborative effort between the private and public sector is needed in order to agree on concrete acts, commitments, and payments. Therefore, trade facilitation would be realised as long as the sum of all the stakeholders' willingness to contribute goes beyond the cost of the product.⁹ However, to elaborate all of the interested parties together in less than one vision is not an easy job.

² See Philippe Nonet, and Philip Selznick, *Toward Responsive Law : Law & Society in Transition*, Transaction Publishers, New Brunswick, New Jersey, 2001.

³ See Philippe Nonet, and Philip Selznick, 2001.

⁴ See Philippe Nonet, and Philip Selznick, 2001.

⁵ See Public good, available at : <http://are.berkeley.edu/courses/EEP101/spring05/Chapter07.pdf>.

⁶ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, p. 11.

⁷ See *Ibid.*, p. 11.

⁸ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, p. 19.

⁹ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, pp. 19-20.

The benefits not only go to business actors, traders, or stakeholders but are also distributed for the general welfare of society through the improvement of economic development. To deliver benefits for all, collaboration of political will is needed¹⁰, together with good government and good governance, and private sector participation. Pasca Lamy emphasises that political pressure from the top down is crucial to properly establish and run trade facilitation. In other words, the lack of “*political will*” hampers trade facilitation from running properly.¹¹ In this regard, to reform or change institutions would require political will from the political elite.

The New Order regime was characterised by autonomous law that proclaimed the rule of law as the basis of economic development. The Five Principles and the 1945 Constitution became the highest law of the state.¹² The New Order regime was backed up by the doctrine introduced by Mochtar Kusumaatmadja that *law is a tool of development*, which was derived from Roscoe Pound’s theory of *law as a tool of social engineering*. Law is established to serve economic development interests. According to Bernard et al.,¹³ autonomous law contains *status quo*, where it is often misused by the authorities to maintain their powers and benefit certain interests.

According to Nonet and Selznick, “law is a facilitator of response to social needs and aspirations”.¹⁴ In additions, Kagan, et al. write that in order to create modern law that is more responsive to social needs, a construction of responsive law is necessary.¹⁵ Responsive law emphasises more on the process of achieving the objectives and principles behind the establishment of a legal and social order. Responsive law establishes the outcome-oriented system rather than the strict rule oriented system, and the legality placed as the main element of such system is based on justice and fairness.¹⁶ According to Mahfud MD, the Reformation regime is heading into responsive law. Responsive law features the openness system and is responsive towards social change and sovereignty of purpose.

II. Indonesian trade policies after independence (Soekarno era 1945-1966).

From 1957 to 1965, President Soekarno’s authoritarian tendencies hard-pressed the country beyond the limits of its economic base, its social framework and its political institutions. Soekarno thought that anti-neo-colonialism and anti-western influenced its government policy. In the name of the Revolution, Sukarno nationalised the Dutch company in Indonesia and increased its military power. The nationalisation of the foreign company was an unpopular policy and brought Indonesia *vis à vis* with the capitalist world.¹⁷

Due to the political situation, from 1945 to 1959, Indonesia changed its constitution three times. The 1945 Constitution of the Republic of Indonesia was replaced by the 1949 Federal Constitution, where it was only implemented for a while because many of Indonesia’s national leaders rejected the federation state. Thus, it was replaced by the 1950 Constitution. However, this Constitution did not provide the right

¹⁰ See Alexander Arevalo, also argued that trade facilitation needs “highest-level support”, in this terms, can be interpreted as political will, and since it is not purely involve government functions, it is also necessary to mobilize private and public sectors participation and support.

¹¹ See Cosgrove-Sacks, et.al., 2003; Carol Cosgrove-Sacks, *Op. Cit.*, pp. 13-14.

¹² See Vickers, Adrian., *A History of Modern Indonesia*, Cambridge University Press, New York, 2005, p. 161.

¹³ See Tanya L. Bernard, Simanjuntak, Yoan N., and Hage, Markus Y., *Theory Hukum : Strategi Tertib Manusia Lintas Ruang dan Generasi*, Genta Publishing, Yogyakarta, 2010, p. 204.

¹⁴ See Nonet, Phillipe., and Selznick, Philip., *Toward Responsive Law : Law & Society in Transition*; with new introduction by Robert A. Kagan, Transaction Publisher, USA, 2009, p. xi.

¹⁵ See Kagan, Robert A., Krygier, Martin., and Winston., Kenneth, *Legality and Community, On the Intellectual Legacy of Philip Selznick*, Rowman and Littlefield Publisher, Inc, USA, 2002, p. 250.

¹⁶ See Tamanaha, Brian Z., *On the rule of law : History, Politics, and Theory*, Cambridge University Press, UK, 2004, p. 82.

¹⁷ See Vickers, Adrian., *A History of Modern Indonesia*, Cambridge University Press, New York, 2005, p. 144.

formula to create a balance between the political parties. The failures of the People's Consultative Assembly to re-write the Constitution, made President Soekarno announce the Presidential Decree on 5 July 1959 to return to the 1945 Constitution as a foundation of Guided Democracy. Under this Constitution, the president was the centre of power, and the status of the prime minister was reduced. In the later development, the position of prime minister was abolished. Although, in theory, the president's powers were limited by a principle of responsibility to the People's Consultative Assembly.¹⁸

Soekarno's "revolutionary will" slogan believed it would overcome all obstacles to development¹⁹, and his continuing Revolution campaign brought him politically closer to the left (China), causing concern in the US. His advocacy of the Third World articulated as resistance against western imperialism.²⁰ In 1965, Indonesia withdrew from the UN because of political tensions regarding West Papua and border confrontations with Malaysia, thus, Indonesia was isolated from the international community.²¹

Soekarno's government formulated an economic policy that became an eight-year plan in which the main goals were to create welfare through projects aimed at improving health, education and the provision of necessities. These were to be paid through other projects for promoting exports and paying off foreign debt. Massive dams were built, and basic infrastructure expanded rapidly. In the period of constitutional democracy, the primary aim of the state was to improve the lives of the people, rather than promote capital.²² In 1964, uncontrolled inflation and political turmoil hit the country.²³

Rent seeking behaviour and corruption caused those programmes to fail. Soekarno's government was looking for alternative aid from the USSR and China.²⁴ However, this aid was not enough to fund all Sukarno's promises. The policies could have boosted the economy if the government had not invested so much state revenue on military adventures. The inflation rate climbed to 700%.²⁵ Import tariffs only served as extra sources of income for government officials, they did nothing to improve the situation and all kinds of consumer goods were in extremely short supply. Foreign investors were frightened off by Sukarno's policies. By 1965 foreign reserves were insignificant.²⁶ A drastic readjustment of the Rupiah in 1966 saw the exchange rate fixed, devaluing the currency by 1.000%.²⁷

Sukarno transferred much of his authority over to the army and parliament to Suharto in the presidential decree of 11 March 1966. By 1967 Suharto had effectively taken hold of power legitimated through the People's Consultative Assembly. In 1968 Suharto was inaugurated as 'Acting President' and had to organise an election in 1971 to confirm his position.²⁸

Political characteristics in the Soekarno era influenced Indonesia's foreign trade policy. First, the trauma of colonialism created negative stigma to the western world that was associated with neo-colonialism. As noted previously, western colonialism in

¹⁸ See Vickers, Adrian., 2005, *Op. Cit.*, p. 144.

¹⁹ See Vickers, Adrian., 2005, *Op. Cit.*, p. 146.

²⁰ See Vickers, Adrian., 2005, *Op. Cit.*, p. 149.

²¹ See Vickers, Adrian., 2005, *Loc. Cit.*, p. 149.

²² See Vickers, Adrian., 2005, *Op. Cit.*, pp. 150-151.

²³ See Vickers, Adrian., 2005, *Op. Cit.*, p. 143.

²⁴ See Vickers, Adrian., 2005, *Loc. Cit.*, pp. 150-151.

²⁵ See Vickers, Adrian., 2005, *Op. Cit.*, pp. 163-164.

²⁶ See Vickers, Adrian., 2005, *Loc. Cit.*, pp. 150-151.

²⁷ See Vickers, Adrian., 2005, *Loc. Cit.*, pp. 163-164.

²⁸ See Vickers, Adrian., 2005, *Op. Cit.*, p. 160.

Indonesia started from trade and economic interests. Practically, Indonesia limited itself to trade relations with the western world. Mistrust of the neo-colonialism agent led to the decision to nationalise Dutch companies in Indonesia. Second, the decision to withdraw from international organisations, i.e., the United Nations, IMF, and World Bank, isolated Indonesia from the international community and international networks. In 1962, Soekarno's campaign to take over West Papua New Guinea and brought Indonesia into arms conflict with the Dutch. The fact that Irian was still in Dutch hands made it an evident symbol of imperialism and hindered Indonesia's national destiny. The campaign was succeeded by integrating Irian Jaya as one of Indonesia's Provinces.²⁹ In 1963, Indonesia was involved in confrontation with Malaysia, which was under the British Commonwealth. This conflict caused British and other Commonwealth businesses located in Indonesia to be taken over by the Soekarno's government during 1964 and 1965.³⁰ Because of these conflicts, Indonesia spent most of its state budget on military equipment, which was prominently soviet-made.³¹ The members withdrew from the IMF and World Bank because these organisations were considered as the agent of neo-liberalism against the Five Principles of the nation. Third, Indonesian foreign policy, which was closer to the communist regimes (China-Russia), had offended the US. Another one of Soekarno's slogans was "standing on our own two feet" or "berdikari", created another protectionism regime towards imports.³² Fourth, corruption existed at all levels, for instance the favourite practice among politicians was handing out lucrative import-export licenses. Politicians became business partners of licensees.³³ From this background, the political instability did not give the government a chance to deliver its public services properly. The political configuration that campaigned anti-neo-colonialism and anti-capitalism created closed economic policies and protectionism regimes.

III. Indonesian trade policies during the New Order era (1967-1998).

At the beginning of 1966, due to the chaotic situation regarding politics and security, the Presidential Decree of 11 March was issued, and was well known as the acronym of Surat Perintah Sebelas Maret (Supersemar). It provided Soeharto with some legitimacy to assume effective political power over the country. The emergence of the New Order was marked down by the appointment of Soeharto as Acting President in March 1967 by the Provisional People's Consultative Assembly (the country's highest state body). In 1968, Major General Soeharto was officially inaugurated as Indonesia's second president. The New Order government shifted the national economy policy from a closed economy to an open economy, therefore, "economic development" was placed as the priority programme of this regime.³⁴

Along with the emergence of the New Order regime, the Jakarta-Beijing alliance was dissolved. The anti-western doctrine that was campaigned by President Soekarno was ignored by the new regime. Change of national political leadership influenced Indonesian foreign policy, shifting from China-Russia (communist) hegemony to Western (US-Japan) hegemony. After the fall of the Old Order, Indonesia was dashed

²⁹ See Vickers, Adrian., 2005, *Op. Cit.*, p. 149.

³⁰ See *Ibid.*, p. 149.

³¹ See Vickers, Adrian., 2005, *Loc. Cit.*, pp. 150-151.

³² See *Ibid.*, pp. 150-151.

³³ See Vickers, Adrian., 2005, *Op. Cit.*, p. 138.

³⁴ See Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, *The Emergence of A National Economy : An Economy History of Indonesia, 1800-2000*, ASAA Southeast Asia Publications Series, Asian Studies Association of Australia in association with Allen & Unwin and University of Hawai'i Press Honolulu, 2002, p. 194.

into a worse economic situation. Therefore, economic assistance, especially from western countries and Japan, was needed so much to help Indonesia recover from the difficult economic situation. During the New Order regime, it was realised that integration into the international system was necessary to develop Indonesia's economy. During the Old Order regime, the anti-western campaign had cut the country's link with the international community system, which was associated as the capitalist world. Indonesia re-joined the United Nations, International Monetary Fund (IMF) and the World Bank, from which it had withdrawn in August 1965. Building networks and involvement with these multilateral organisations was considered crucial to assist Indonesia's economic recovery.³⁵

The most serious economic problem left by the Old Order government was severe inflation due to uncontrolled deficit spending. In September 1966, the New Order government appointed some "economic technocrats" to establish a "*Team of Experts in the Field of Economics and Finance*". These highly qualified economists came from the Faculty of Economics of the University of Indonesia (FEUI) Jakarta.³⁶

Based on the Provisional People's Consultative Assembly Decree No. 23/1966, this team of economists was given the task to carry out the "*Programme for Stabilisation and Rehabilitation*". At the beginning of the New Order Era, national economic development was focused on economic recovery, through specific policies on a balanced budget, the balance of payments, stabilised prices, rehabilitation of the physical infrastructure, economic liberalisation, food production, and agricultural development.³⁷ By 1969 inflation was under control, the free market was gradually being established in many areas³⁸ and foreign capital was welcomed back.³⁹

At the beginning of the 1990s, along with the end of the Cold War, Indonesia's government proclaimed a period of liberalisation of the economy, together with an official "Openness" policy. The beginning of the openness policy was marked by relaxing laws on foreign investment in order to support the freer flow of capital. This policy led to significant economic growth with an annual rate of over 7% and suppressed the inflation rate at a low level.⁴⁰ Poverty reduced to 10 million in 1996. Sectors such as manufacturing continued to improve as export earners.⁴¹

The New Order economic development programme had successfully transformed Indonesia's economic landscape from the "prime economic underperformer" among the Southeast Asian economies into a "Newly Industrialising Economy" (NIE). Indonesia experienced rapid industrial growth. This was marked by transformation from an economy that was highly dependent on agriculture in the mid-1960s to one where the manufacturing sector contributed more to GDP than agriculture in the mid-1990s.⁴² In 1993 the World Bank included Indonesia as the "East Asian Miracle", which was nominated as one of the "high performing Asian economies" (HPAEs).⁴³

On the other hand, the New Order economic growth of the 1990s had been built on enormous foreign loans. The effects of the economic crisis that struck Indonesia were worse than those of the economic crises of the 1960s or the Great Depression of

³⁵ See Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 195.

³⁶ See *Ibid.*, p. 195.

³⁷ See Salim, 1997, *Op. Cit.*, p. 57; Subroto, 1998, *Op. Cit.*, pp. 74–75; Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 196. See also Vickers, Adrian, 2005, *Op. Cit.*, p. 163.

³⁸ See Vickers, Adrian, 2005, *Op. Cit.*, pp. 163-164.

³⁹ See Vickers, Adrian, 2005, *Op. Cit.*, p. 164.

⁴⁰ See Vickers, Adrian, 2005, *Op. Cit.*, p. 198.

⁴¹ See Vickers, Adrian, 2005, *Op. Cit.*, p. 199.

⁴² See Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 196.

⁴³ See World Bank, 1993a, *Op. Cit.*, p. xvi; Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 196.

1929-1931.⁴⁴ Most industries collapsed, and poverty doubled, slipping back to levels that had not been seen since the early 1980s. With the Letter of Intent, the International Monetary Fund agreed to pour \$43 billion USD into the country in stages. The IMF support drove reformation of Indonesia's financial sector, and encouraged fair business practice and antimonopoly. Borrowing Adrian words, Suharto's age of development and the subsequent age of globalisation had turned into the 'age of crisis'.⁴⁵ The causes of the crisis were identified in the popular acronym KKN, 'Collusion, Corruption and Nepotism'.⁴⁶

Suharto was brought down by a combination of factors. There was significant external pressure to liberalise the economy and let Indonesians participate in international consumer society. Suharto resigned on 21 May 1998, handing power over to Habibie, who was hastily sworn in as Indonesia's third president.⁴⁷

In the end, the political configuration of the New Order that claimed the rule of law as the foundation of economic development and campaigned the doctrine "law as a tool of development", laid down the foundations of openness, liberalism and integration with the multilateral trade regime. The establishment of ASEAN also brought a positive impact to the role of Indonesia in the international stage as one of the main powers in the region. Politically, ASEAN had laid down the foundations of cooperation between Indonesia-EU through the 1980 Cooperation Agreement. This agreement became one of the legal bases for the EU to grant aid through the Country Strategy Paper. However, there were some restraints that impeded Indonesia's foreign trade policy to fully participate in the multilateral trading system, such as massive corruption, monopoly, unfair business practices, excessive bureaucracy, lack of infrastructure, lack of capable human resources, lack of democracy and public participation, and lack of political will to boost foreign trade growth.

IV. Indonesian trade policies Reformation era (1999-today)

The new regime preferred to use the term "reformation" rather than revolution, so as not to frighten away international investors and aid agencies. The Reformation regime has promoted a new look for Indonesia with good governance, transparency, social capital and empowerment.⁴⁸ Over the last fourteen years, massive changes in the Indonesian business environment have taken place through legal reforms. Some laws have been established to encourage business development, such as Law No. 05/1999 concerning Prohibition against Monopolistic Practices and Unfair Business Competition, Law No. 25/2007 concerning Investment, Law No. 40/2007 concerning Company Law, and Law No. 8/1999 concerning Customer Protection. As previously noted, massive corruption has been identified as the most severe problem impeding the business environment in Indonesia, therefore, the Reformation regime laid down its commitment to combat corruption through establishing Law No. 31/1999 Jo Law No. 20/2001 concerning Combating Corruption. With regard to accelerating bureaucracy reforms, the government issued Law No. 25/2009 concerning Public Services.

Among those new legal regimes, Law No. 05/1999 has had significant influence on driven trade liberalisation⁴⁹, since fair business practices are the requirement for the friendly business environment and fair competition. Fair competition is open,

⁴⁴ See Vickers, Adrian., 2005, *Op. Cit.*, p. 203.

⁴⁵ See Vickers, Adrian., 2005, *Op. Cit.*, pp. 203-204.

⁴⁶ See Vickers, Adrian., 2005, *Op. Cit.*, p. 205.

⁴⁷ See *Ibid.*, p. 205.

⁴⁸ See Vickers, Adrian., 2005, *Op. Cit.*, p. 209.

⁴⁹ See Pardede, Soy Martua., *Persaingan Sehat dan Akselerasi Pembangunan Ekonomi*, Cetakan Pertama, Pustaka Sinar Harapan, Jakarta, 2010.

equitable, and just competition between business competitors.⁵⁰ The legal doctrine of unfair competition is a development of the fundamental idea that dealings based on deceit are legally wrong.

Competition is a situation in a market in which firms or sellers independently strive for the patronage of buyers in order to achieve a particular business objective, e.g., profits, sales and/or market share. Competition in this context is often equated with rivalry. Competitive rivalry between firms can occur when there are two firms or many firms. This rivalry may take place in terms of price, quality, service or combinations of these and other factors that customers may value. Competition is viewed as an important process by which firms are forced to become efficient and offer a greater choice of products and services at lower prices. This gives rise to increased consumer welfare and locative efficiency, including the concept of "dynamic efficiency" by which firms engage in innovation and foster technological change and progress.⁵¹

Indonesian business actors shall base their business on economic democracy with due attention to the equilibrium between the business actors' interest and public interests. Considering the principles of the philosophy on Indonesian competition policy, the objectives of Indonesian competition law are⁵²:

- a. to maintain public interest and improve the efficiency of the national economy as one of the means to improve public welfare;
- b. to create a conducive business climate through healthy business competition, thus securing equal business opportunity for large, middle and small scale entrepreneurs;
- c. to prevent monopolistic practices and/or unfair business competition by the entrepreneurs; and
- d. to create effectiveness and efficiency in business activities.

Due to its objectives Indonesian competition law can be categorised as one of the products of responsive law where law is not being used merely as a tool to drive economic growth but also as a tool to protect public interest. The social needs and aspiration for the public to get the best products and services with affordable prices can only be fulfilled when fair competition occurs. The fair business environment believes in boosting trade and driving economic growth through the enhancement of business competitiveness by firms.

The unfair trading practices in exports under the EU GSP regime could lead to temporary withdrawal from the scheme. According to Articles 15-19 of Council Regulation (EC) No. 732/2008 amended by Regulation (EU) No. 512/2011, temporary withdrawal may be invoked due to unfair trading practices⁵³ that are regulated under the WTO agreements in which the effect of such conduct initially has to be determined by the competent body of the WTO.

⁵⁰ See Bryan A. Garner, *op.cit*, p. 302.

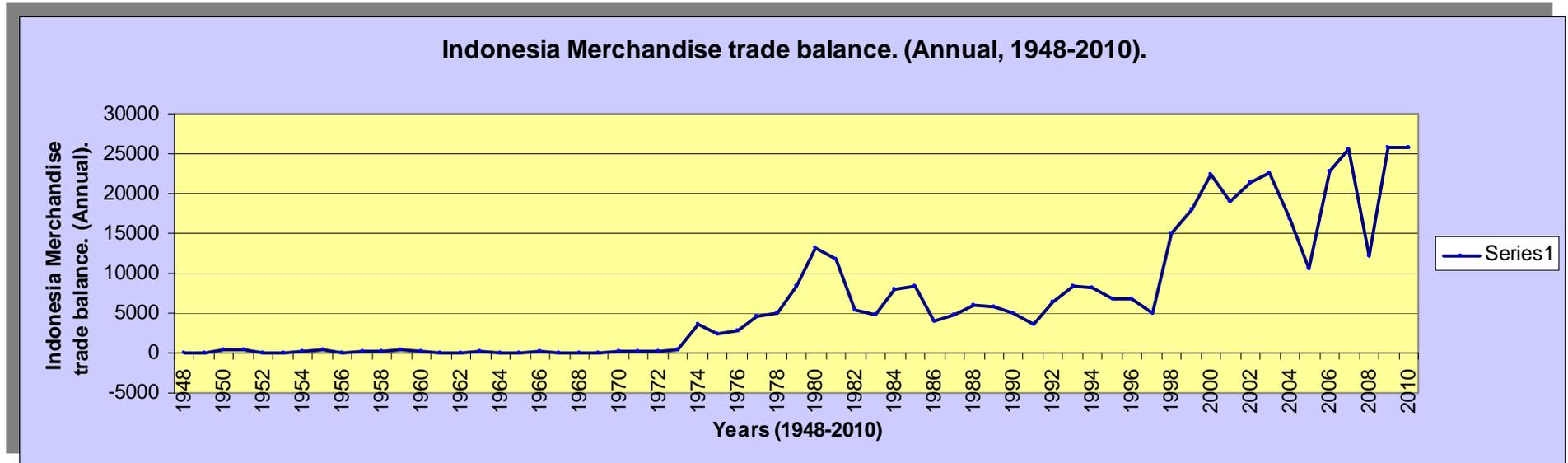
⁵¹ See Glossary of Industrial Organization Economics and Competition Law.

⁵² See Articles 3 of Law Number 05 Years 1999.

⁵³ See Subparagraph (d) Paragraph 1 Article 15 Section 1 Chapter III Council Regulation (EC) No. 732/2008.

Figure 22. Indonesian merchandise trade balance, annual, 1948-2010.⁵⁴

Measure: US dollars at current prices and current exchange rates in millions.



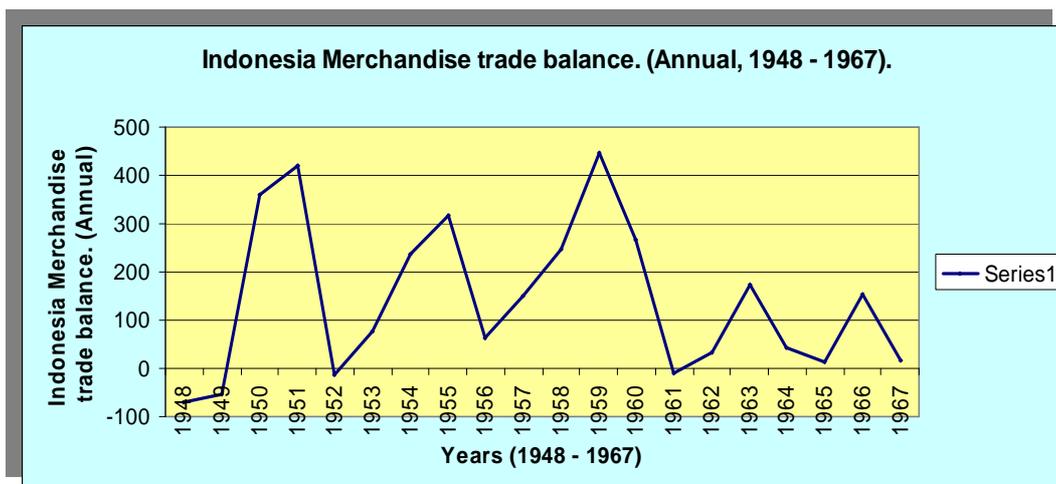
Indonesian merchandise trade balance started to significantly improve in 1974 and consistently received positive trade balance.

⁵⁴ See Source : UNCTAD, UNCTADstat, available at : <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>, last accessed : 18 May 2012. Data and charts treated by the researcher.

**Table 32. Indonesian merchandise trade balance.
(Annual 1948-1967) Old Order era.⁵⁵**

No.	Year	Indonesian merchandise trade balance. (Annual 1948-1967) US dollars at current prices and current exchange rates in millions
1.	1948	-70
2.	1949	-52
3.	1950	360
4.	1951	419
5.	1952	-13.9
6.	1953	75.3
7.	1954	238
8.	1955	316
9.	1956	65
10.	1957	151
11.	1958	246.9
12.	1959	448.3
13.	1960	267
14.	1961	-10
15.	1962	35
16.	1963	175
17.	1964	44
18.	1965	13
19.	1966	152
20.	1967	16

Figure 23.



⁵⁵ See Source : UNCTAD, UNCTADstat., available at : <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>, last accessed : 18 May 2012. Data and charts treated by the researcher.

**Table 33. Indonesian merchandise trade balance.
(Annual 1968-1998) New Order era.⁵⁶**

No.	Year	Indonesian merchandise trade balance.	No.	Year	Indonesian merchandise trade balance.
		(Annual 1968-1998)			(Annual 1968-1998)
		US dollars at current prices and current exchange rates in millions			US dollars at current prices and current exchange rates in millions
1	1968	15	17	1984	8006
2	1969	73	18	1985	8328
3	1970	106	19	1986	4087
4	1971	131	20	1987	4766
5	1972	215	21	1988	5971
6	1973	482	22	1989	5800
7	1974	3584	23	1990	5039.2
8	1975	2332	24	1991	3530.3
9	1976	2874	25	1992	6485
10	1977	4623	26	1993	8496.2
11	1978	4953	27	1994	8233.3
12	1979	8387	28	1995	6799
13	1980	13116	29	1996	6885
14	1981	11893	30	1997	4990
15	1982	5469	31	1998	15091
16	1983	4794			

Figure 24.

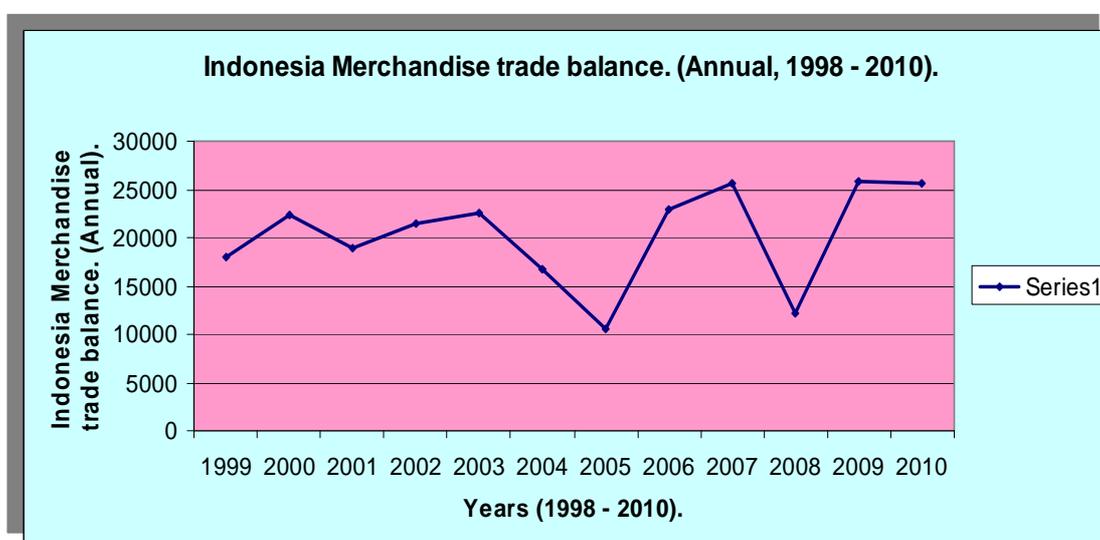


⁵⁶ See Source : UNCTAD, UNCTADstat, available at : <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>, last accessed : 18 May 2012. Data and charts treated by the researcher.

**Table 34. Indonesian merchandise trade balance.
(Annual 1999-2010) Reformation era.⁵⁷**

No.	Year	Indonesian merchandise trade balance. (Annual 1999-2010) US dollars at current prices and current exchange rates in millions
1.	1999	17921
2.	2000	22331.7
3.	2001	18933.3
4.	2002	21434.6
5.	2003	22541.3
6.	2004	16776.9
7.	2005	10548.4
8.	2006	22827.4
9.	2007	25627.4
10.	2008	12151
11.	2009	25843.7
12.	2010	25724

Figure 25.

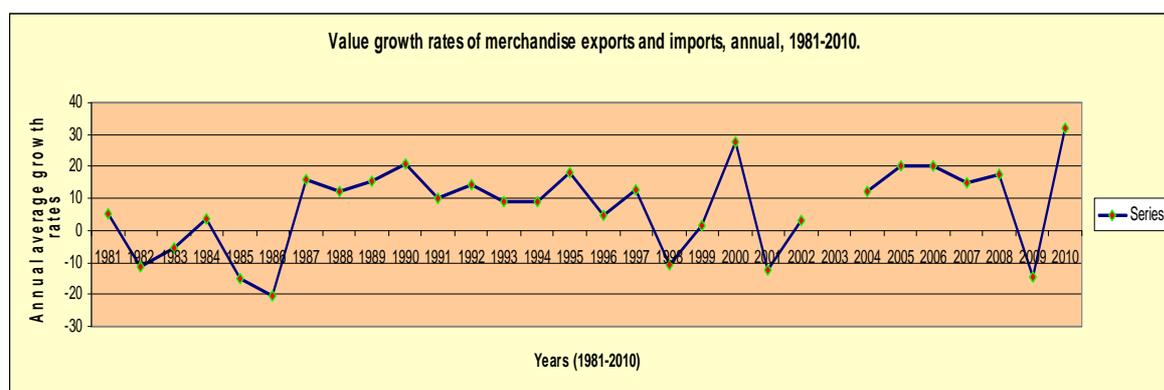


⁵⁷ See Source : UNCTAD, UNCTADstat., available at : <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>, last accessed : 18 May 2012. Data and charts treated by the researcher.

**Table 35. Value growth rates of merchandise exports and imports.⁵⁸
(Annual, 1981-2010).**

No.	Year	Annual average growth rates	No.	Year	Annual average growth rates
1	1981	5.073069	16	1996	4.973237
2	1982	-11.2736	17	1997	13.01441
3	1983	-5.2938	18	1998	-10.5281
4	1984	3.508938	19	1999	1.731189
5	1985	-15.0813	20	2000	27.64334
6	1986	-20.3476	21	2001	-12.2953
7	1987	15.74468	22	2002	3.137802
8	1988	12.1557	23	2003	
9	1989	15.30257	24	2004	11.97336
10	1990	20.97022	25	2005	20.05154
11	1991	10.20629	26	2006	20.08262
12	1992	14.39597	27	2007	14.72856
13	1993	8.961416	28	2008	17.58389
14	1994	9.225898	29	2009	-14.2968
15	1995	17.98021	30	2010	31.9083

Figure 26.



⁵⁸ See Source : UNCTAD, UNCTADstat, available at : <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>, last accessed : 18 May 2012. Data and charts treated by the researcher.

In 2012, Indonesia's recent economic situation, as showed in Table 5, had a 6.8% growth rate, which was the highest among other countries in Southeast Asia. It had an inflation rate of 5.4%, above the average inflation rate in Southeast Asian countries. In this respect, Indonesia's economic growth expected to boost foreign trade.

Table 36. Growth rate of GDP (% per year).⁵⁹

Sub region/Economy	2010	ADO 2011	2011 Update	ADO 2011	2012 Update
Southeast Asia	7.9	5.5	5.4	5.7	5.6
Indonesia	6.1	6.4	6.6	6.7	6.8
Malaysia	7.2	5.3	4.8	5.3	5.1
Philippines	7.6	5.0	4.7	5.3	5.1
Singapore	14.5	5.5	5.5	4.8	4.8
Thailand	7.8	4.5	4.0	4.8	4.5
Vietnam	6.8	6.1	5.8	6.7	6.5

Table 37. Inflation (% per year).⁶⁰

Sub region/Economy	2010	ADO 2011	2011 Update	ADO 2011	2012 Update
Southeast Asia	4.0	5.1	5.4	4.2	4.4
Indonesia	5.1	6.3	5.6	5.8	5.4
Malaysia	1.7	3.0	3.4	3.0	3.0
Philippines	3.8	4.9	4.9	4.3	4.3
Singapore	2.8	3.2	4.3	2.0	2.4
Thailand	3.2	3.5	3.8	3.0	3.0
Vietnam	9.2	13.3	18.7	6.8	11.0

V. Indonesia-European Union trade relationship: Re-discovering the emerald archipelago of Southeast Asia.

V.a. Genesis of Indonesia- EU trade relationships.

The EU is one of the major trading partners for Indonesia and other ASEAN member states. The important position of the EU in Indonesia's foreign trade is supported by some factors such as its open market policy, preferential trade policy (GSP), GDP, and market size. It has to be admitted that the EU is the first initiator to adopt GSP into its national policy. Along with membership enlargement, the EU has evolved into the biggest single market in the world.⁶¹ For five decades, the EU has established trade polices to provide more favourable treatments for exported products from developing countries and LDCs, such as reducing import tariffs until 0% under the EBA scheme. The trade relationship between Indonesia and the EU started many years

⁵⁹ See Asian Development Outlook 2011 Update : Preparing for Demographic Transition, Asian Development Bank, Phillipines, 2011.

⁶⁰ See *Ibid*,

⁶¹ See The European Commission, The EU is the most open market in the world and we import more from developing countries than anyone else, available at : http://trade.ec.europa.eu/doclib/docs/2012/january/tradoc_148990.pdf, last accessed : 14 February 2012.

ago. Therefore, in terms of this research, it is necessary to study the “genesis” of the trade relationship between the Indonesians and Europeans in order to have a better understanding of the EU’s trade policy to Indonesia. The roles of Indonesian traders in international trade can be traced back to the early 12th century. It started when Indonesian traders imported pepper from India and exported it to China through the port of Sumatra. According to historians, Southeast Asia, especially Indonesia, reached its Golden Age of Commerce between the middle of the 15th century and the late 17th century. China and Europe were the main markets of Indonesian products especially for spices and black pepper. Java, Sumatera, and Maluku were and continue to be the main islands in Indonesia producing pepper and spices.⁶²

Technological, economic, social, and demographic development has influenced international trade, raising the market demand of more supply of Indonesian products, especially spices and black pepper from Maluku. The significant increase of these products in the international market created competition between traders to build direct links with the producers. This was the milestone when Indonesian traders had direct contact with foreign traders, especially those from Europe. At that time, many new ports were built across the islands and became centres of spice and pepper production. The boost of international trade brought prosperity and new culture, which influenced local customs.⁶³

The first arrival of the Europeans in Indonesia was between the end of the 14th and the early 15th century, when the political power in Europe was gradually shifting from the south to “westward”. European political power shifted from the Italian peninsular states to the Atlantic coast, especially to Portugal and Spain. This situation made Spain and Portugal the new economic powers of Europe that led to the long distance trade with Southeast Asia.⁶⁴

The Portuguese were the first Europeans to reach Indonesia in the early 14th century. Trade interest and economic competition became the reason why Portuguese traders and navigators went on such voyages. They wanted to search the direct resources of spices and pepper products, since at that time those products had high demand in the international market. They sailed across the west coast of Africa, passing the Cape of Good Hope. They continued their voyage across the western side of the Indian Ocean to India itself and reached Malaka by 1511. Eventually, in 1512 they arrived in Maluku and built their base there in order to do trade. Initially, their economic activities were out of pure trading interests, especially when buying spices and pepper to be sold in Europe. However, since the demand of economic competition between European traders rose, the Portuguese made efforts to secure production resources through monopoly.⁶⁵

The Portuguese had important roles in the trade progress of the Indonesia archipelago. Besides their monopoly in the east part of Indonesia Portuguese also capturing Malaka that has vital role as the “primary port” for the trade to Europe. Portuguese thought that they are controlling the international trade through Malaka, yet, they were realized that they only capturing Malaka as location but not its trading functions. Practically, the capture of Malaka was not giving significant benefit for Portuguese. At the same time, the trade spread within archipelago was starting to develop. For instance, the local ruler such as Aceh, Jambi, Banten, Cirebon, Denmak,

⁶² See Brown, Colin., *A Short History of Indonesia The Unlikely Nation*, Allen & Unwin, Australia, 2003, p. 29.

⁶³ See Brown, Colin., 2003, *Op. Cit.*, p. 30.

⁶⁴ See Brown, Colin., 2003, *Op. Cit.*, pp. 32-33.

⁶⁵ See *Ibid.*, pp. 32-33.

Surabaya, and Makassar has built some new important ports. Thus, most of main islands in Indonesia have own port to support trade activities.⁶⁶

The arrival of Portuguese was followed by other Europeans such as Britain, Spanish, and Dutch. For some centuries, the Dutch becomes the ruler of the trading in the archipelago. The arrival of these Europeans to Southeast Asia because of the economic and political rivalry's among themselves. They were having the same reasons with Portuguese to search the producer resources of spices and pepper. In their rivalries, according to Collin, "*each of them wanted to do a monopoly over Indies trade and each wanted to excludes others*".⁶⁷

The Dutch made their first voyage in the 1590s. They manage to reach the Indonesian archipelago in April 1595, where they landed with four ships and 249 members of crew. In 1597 the rest of the crew, 89 people, travelled back to Amsterdam in order to report the possibilities of Dutch ships to travel to the Indies. This was followed by the arrival of 22 Dutch ships in Indonesia and then the numbers continuously increased.⁶⁸

The Dutch company based in Amsterdam encouraged to send more ships since they were getting enormous profit from this trade. For example, one voyage expedition was giving more than 300% profit return. The central and provincial government in Holland calls the major Dutch company to make collective efforts under single business entities. The establishment of single business entities was purposed to eliminate competition between traders. Each company is the shareholders of the new big company that called as the United East India Company (*the Vereenigde Oost-Indische Compagnie* or VOC). The VOC was established on 20th March 1602.⁶⁹

The VOC established as a joint stock company or incorporated company. At that time, Amsterdam was the biggest shareholders among six regional chambers of commerce. As a company the VOC governed by a "board of seventeen directors". The English East India Company is the strong competitor of the VOC, however they were having similarity in some respect. The establishment of the VOC is creating a new trading system where the traders were not invested their money in the individual expeditions but to the Company. Hence, the traders are the shareholders of the company. The establishment of single business entities is having some advantages such as, clear strategic business plan through long-term objectives.⁷⁰

The VOC businesses are develops rapidly in Indonesia archipelago. In 1605, the VOC took over Ambon archipelago from Portuguese and establishing regional headquarter there. At that time, Chinese, Japanese, and Indian are dominating Asian traders. The intra-Asian trade has been existed a long time before the arrivals of VOC and it has large networks and profitable big markets. The VOC became the single trading company that carry out monopoly over Indonesia archipelago and it made them in the very good positions in intercontinental spice trade. Therefore, VOC soon realized in order to expand their business and to secure their positions, they have to involve into intra –Asian trade networks and inter continental trade to Europe.⁷¹

Along with the development of the businesses, the VOC want to expand the control over the regions by searching a new place to establish another base. Finally, they found place called Jayakarta located in west of Java island. In 1610, they made the contract with the local ruler, named Pangeran Jayakarta or Prince Jayakarta. The

⁶⁶ See Brown, Colin., 2003, *Op. Cit.*, p. 33.

⁶⁷ See Brown, Colin., 2003, *Op. Cit.*, p. 39.

⁶⁸ See Brown, Colin., 2003, *Op. Cit.*, pp. 39-40.

⁶⁹ See Brown, Colin., 2003, *Op. Cit.*, p. 40.

⁷⁰ See *Ibid.*, p. 40.

⁷¹ See *Ibid.*, p. 40.

contract contained the permission for the VOC to build storage house and settled headquarter in Jayakarta. Along with development and changing political situation, they changed the named of Jayakarta city into Batavia. However, the name was changed again into Jakarta where today becoming the capital city of Indonesia.⁷² Batavia was the centres headquarter of the VOC but their businesses were operating in some Asian countries , such as Japan, China, and India.⁷³

The VOC's decision establishing settlements and headquarter in Batavia has changed the landscape of the city into trading city that equipped with some facilities such as storagehouses, foods granary, and ship-repair services. The vast development of the Batavia changed the role of the VOC as pure trading company into quasi-governmental entities or territorial administrator.⁷⁴ According to Colin, it had brought inevitably military conflict with the local rulers and Britain.⁷⁵

The rise of Dutch colonisation gradually eliminated Portugal's power over the eastern regions of Indonesia, especially Maluku. Afterwards, the Dutch succeeded in dispelling the Spanish from Ternate in 1606 and Tidore in around 1666. The Dutch continued to expand its control over local rulers by forcing them to sign agreements that contained "*recognition of the latter's sole right to participate in the spice trade*". This meant that the local producers were only allowed to sell their goods and products to the VOC.⁷⁶

At that time, Indonesia local rulers have recognized free trade principle. For example, at 17th century the rulers of Makassar agreed opening their ports' to all traders from around the world. The free trade in spices has attracted many traders to come into the islands. Spice was the commodity that have high market price in international trade. Colin citing a well-known quotation taken from the Makassar ruler as the basis of free trade :⁷⁷

"[...] God made the land and the sea; the land he divided among men and the sea he gave in common. It has never been heard that anyone should be forbidden to sail the seas [...]"

The free trade policy implemented by the ruler of Makassar brought them into confrontation with the Dutch, because it against the VOC's interest to perform trade monopoly over the regions, especially in spice trade. The Dutch felt insecure by such free trade, because it potentially reduce their trade profit's.⁷⁸

In middle of 17th century, the Dutch succeeded took over Maluku under their controls. The Dutch was earning a lots of profit from the spices trading. They sold the goods in the European market with the price seventeen times higher than the price that they bought from Maluku. Ironically, these profits did not bring any change of social welfare for the island inhabitant, but instead giving economic oppression. The local spice producers and intermediaries traders suffered losses because of the VOC's monopoly. In this regard, the VOC transformed from a trading company into a regional power.⁷⁹ Big power and authority in the trade monopoly that given to the VOC were used as a tool to begin the era of "*European imperialism*" in Indonesia at the end of the 18th century.⁸⁰

⁷² See Brown, Colin., 2003, *Op. Cit.*, p. 42.

⁷³ See Brown, Colin., 2003, *Op. Cit.*, p. 68.

⁷⁴ See Brown, Colin., 2003, *Op. Cit.*, pp. 42, 55.

⁷⁵ See Brown, Colin., 2003, *Op. Cit.*, p. 42 .

⁷⁶ See Brown, Colin., 2003, *Op. Cit.*, p. 44.

⁷⁷ See *Ibid.*, p. 44.

⁷⁸ See *Ibid.*, p. 44.

⁷⁹ See *Ibid.*, p. 44.

⁸⁰ See Brown, Colin., 2003, *Op. Cit.*, p. 49.

In the middle of 1600s, Indonesia's "age of commerce" started to decline. The local traders were not able to compete with the Europeans traders that more organize, using advance technology, having modern knowledge of commerce, and backed up by powerful and modern military power. Many of local rulers forced to agree with the rules applied by the Europeans traders.⁸¹

To control their power the Dutch monopolize intra-trade and external-trade of Indonesia's through the transportation, communication, and administration. The Dutch cut off all the international contacts and the international networks between Indonesia's islands with international trade community. Practically, Indonesia was "isolated" from international marketplace and away from the idea of international marketplace. In this regard, Indonesia entered into deterioration era of commerce where they had to step backward from the open market into isolated market. Apparently, such situation gave the full advantages to the VOC and Chinese.⁸²

In the end 17th century, the VOC businesses started to collapse. Four major factors has been identified as causes the company gradually lose theirs power, i.e., war, conflict of interest, miss management, debt, and corruption. The VOC suffered loss of 70% of its total asset's including extensive shipping and facilities because of the Fourth Anglo-Dutch War, which happened around 1780-1784. Economically the Dutch suffered of losses because of this war. Mixing the business interest and politics causes conflict of interest inside the VOC and hinder its bussiness development. The VOC was holding two important roles, that is, acting as territorial administrator and a trading company. In this regard, governing people and administering region is totally different tasks from managing company.. As the territorial administrator, the VOC had to deal with inevitable conflict with the local rulers or local traders. On the other hand, it is important to keep the business stability and security to ensure the company business survival. At the end, the VOC prefer to focus on their businesses rather than their politic's roles. Gradually, the VOC had started loss their power's and entered into failures to have full control over the regions. In the 18th century, the VOC debt increased because most of their profits were used to pay the dividends to the shareholders. At the same time, the profits earned by VOC from the trade started to decrease. Their's representatives corrupts most of the VOC profits in Indonesia. Therefore, Colin wrote, "corruption in business is not new phenomenon in Indonesia".⁸³ In addition, in the first half of the 18th century the Dutch trade monopoly eroded by the activities of the English East India Company and private British traders.⁸⁴

The changing economy and political situation in North Asia and in Europe was much affecting the trade in Southeast Asia, particularly Indonesia. After the collapse of VOC in 1799, Dutch imperialism in Indonesia ended by default. The administration was shifted from the VOC to the Dutch government. In 1806, Netherlands was ruled under Napoleon Bonaparte. Napoleon's brother, Louis was appointed as the Dutch throne. It had changed the Dutch policy in Indonesia in line with the spirit of French Revolution. Louis appointed Herman Daendels as Governor-General to Indonesia (Indies) and brought the idea of liberalism from French revolution into his administration.⁸⁵

Between 1870 until 1900, Indonesia experienced the era of liberalism under Dutch colonization's. At that period, the Dutch investment on agriculture increased driven by the establishment of the Agrarian Law of 1870. Collin noted two important

⁸¹ See *Ibid.*, p. 49.

⁸² See Brown, Colin., 2003, *Op. Cit.*, pp. 54-55.

⁸³ See Brown, Colin., 2003, *Op. Cit.*, p. 69.

⁸⁴ See Brown, Colin., 2003, *Op. Cit.*, p. 73.

⁸⁵ See Brown, Colin., 2003, *Op. Cit.*, pp. 70-72.

features in this act that recognizing the private ownership of indigenous people of Indonesia and giving the right to cultivate the land to the foreigner through leasing or renting agreement.⁸⁶

“[...] it provided that the only people who could own land in Indonesia were Indonesians: that is to say, people belonging to one of the ethnic groups indigenous to the archipelago. Europeans and Chinese were thus prevented from becoming or remaining landowners. The Law made provision for the leasing or renting of land by foreigners; it was on the basis of these leases that the major late nineteenth-century privately managed plantations were established [...]”.

During the liberal era Java were became the market for the Dutch manufacture products. Java was recognized as raw materials exporter, started engaged as the goods importer. The shifting of trade relationship pattern placed Java as the important market for the Dutch products'.⁸⁷ In this point of view, the liberal era is the milestone of the export/import relationship between Java and the Dutch. In the colonial era, the economy of Java once experience severe depression, especially affecting sugar industry.⁸⁸

Entering the 20th century population of Java grown rapidly, yet it was not balanced with the foods production, consequently decreased the standard of living. To manage this situation the Dutch adopting the new policy, named “*Ethical Policy in 1901*”.⁸⁹

After the collapse of cultivation system, the Dutch build the economy by reforming the government system and public infrastructures. Education and public administration were placed as the main priority of the development. The development of public infrastructures were carried out by railways building, expanding ports, improving communications links, supplying gas and electricity.⁹⁰

Dutch taught the democracy to Indonesian through the establishment of “*Volksraad*” that carried out function as “joint legislative body” with colonial authorities. *Volksraad* given authority “to discuss the Indies budget, present petitions, draft legislative proposals, suggest amendments to legislation proposed by the government and request information from the Governor-General on specific matters”. Yet, the authority of *Volkstraad* did not have any powers to force the colonial government “to take any particular action”.⁹¹ In 1931, the composition of *Volkstraad* were consisting of 30 Indonesians, 25 Europeans and 5 “foreign oriental”. In fact, Indonesian was dominating 50% of the *Volkstraad* seats.⁹² In the colonial period, the populations of Indonesia were divided into three groups: European, Indonesian, and Foreign Oriental. Foreign oriental comprised of Chinese, Arabs and Indians communities.⁹³ This division influenced the Indonesian legal system, which applied different law to the non-native people.

In the beginning of 1900s, the landscape of Indonesia social and cultural changed because of more educated young people came to realize about the importance of political movement to attain state independence. Budi Oetomo and Indische Partij are the first modern movement formed by nationalist intellectual on 20th May 1908.⁹⁴ Major changes happened “in the *Second All Indonesia Youth Congress*” on 28 October

⁸⁶ See Brown, Colin., 2003, *Op. Cit.*, p. 89.

⁸⁷ See *Ibid.*, p. 89.

⁸⁸ See *Ibid.*, p. 89.

⁸⁹ See Brown, Colin., 2003, *Op. Cit.*, p. 91.

⁹⁰ See Brown, Colin., 2003, *Op. Cit.*, pp. 102-103

⁹¹ See Brown, Colin., 2003, *Op. Cit.*, p. 133.

⁹² See Brown, Colin., 2003, *Op. Cit.*, p. 134.

⁹³ See Brown, Colin., 2003, *Op. Cit.*, p. 107.

⁹⁴ See Brown, Colin., 2003, *Op. Cit.*, p. 117.

1928, which well known with a Youth Pledge. One the pledge declared that Indonesia language is the language of unity.⁹⁵ This is the path of the Indonesia to attain their independence. The Indonesia language plays important roles to unite various differences in the pluralist society. Bahasa Indonesia was originating from Riau islands in Sumatra and the southern part of the Malay Peninsula, and very small population in Indonesia archipelago spoke it. However, the spirit of “modernity and democracy” brought bahasa Indonesia being amenable in the national level.⁹⁶

On 10 January 1942, the Pacific War started bringing massive changes to Indonesia when the Japanese army invaded the islands of Java and Sumatera. The Dutch surrendered without condition to Japan on 8 March 1941 and ended the long period of colonisation for good.⁹⁷ The Japanese occupation lasted 3.5 years, which was a very short time compared to the 350 years of Dutch colonisation.⁹⁸ The Japanese lost the Pacific War and Indonesia declared its independence on 17 August 1945. Somehow, the Dutch did not recognise this independence and tried to invade Indonesia again through military aggression from 1947 until 1949. However, by 1949 the Dutch eventually acknowledged Indonesia independence.

After suffering from both colonisation and war, Indonesia needed to re-build its economy, especially through international trade. On 24 February 1950, Indonesia joined GATT 1947 as a contracting party.⁹⁹ Indonesia actively participates in the GATT negotiations to advocate its interest in international trade. Between the early 1950s to the late 1960s, Indonesia went through difficult times regarding its economic and political situation. Such situation was worsened by the Cold War between the US and Communism Bloc of the USSR and China.

Indonesia state constitution 1945 govern political, economic, and administrative matters. Article 33 of the 1945 Constitution reflects the mixed economy ideology of the national political leaders. It creates special system of market economy based on the national ideology Pancasila (five principles). The basic principle of Indonesian national economy is familial system and cooperation. Article 33 of the 1945 Constitution contains four principles of national economic ideology :

1. The economy shall be organized as a common endeavour based upon the principles of the family system.
2. Sectors of production which are important for the country and affect the life of the people shall be under the powers of the State.
3. The land, the waters and the natural resources within shall be under the powers of the State and shall be used to the greatest benefit of the people.
4. The organisation of the national economy shall be conducted on the basis of economic democracy upholding the principles of togetherness, efficiency with justice, continuity, environmental perspective, self-sufficiency, and keeping a balance in the progress and unity of the national economy.
5. Further provisions relating to the implementation of this article shall be regulated by law.

According to the Article 33 important branches of production, and land, water and natural resources, are regulated by the state. The word “regulated” rather than “owned” shown that Indonesia has open economic policies that ensure the resources deliver social welfare for the society. State has important roles but not dominating and vice versa for the private sector. Therefore, state and private sector must cooperate and

⁹⁵ See Brown, Colin., 2003, *Op. Cit.*, p. 106.

⁹⁶ See Brown, Colin., 2003, *Loc. Cit.*, p. 107.

⁹⁷ See Brown, Colin., 2003, *Loc. Cit.*, p. 133.

⁹⁸ See Brown, Colin., 2003, *Op. Cit.*, p. 139.

⁹⁹ See The 128 countries that had signed GATT by 1994, available at : http://www.wto.org/english/thewto_e/gattmem_e.htm, last accessed : 24 January 2012.

supporting each other to keep the economic developed in balance. Article 33 placed public society as the economic actor and having function to control of economic activities. In this regard, the constitution recognized public participation and democracy in the state economic.

In the early 1950s, the indigenous business was very weak, therefore, many Indonesia policy makers considers that state intervention is necessary for economic development.¹⁰⁰ Heavy bureaucracy had become the great obstacles in the early Indonesia economic development.¹⁰¹

V.b. GSP and the status quo period in the EU-Indonesia trade relationship.

As a single entity, the European Union is the world's largest economic power, having the value of total trade equal to more than 40% of GDP. The EU's openness to trade is more than three times greater than that of either the US or Japan. In 2009, the EU's total value of imports nearly reached \$1.7 trillion USD, which represents over 18% of total world trade. The ASEAN countries share 5% of those EU imports and Indonesia contributes to 18% of that share.¹⁰² The European Union's trade regime consists of tariff and non-tariff measures. Most-favoured-nation (MFN) rates in the European Union average 5% and GSP rates average less than 2%.¹⁰³ The average *ad valorem* MFN tariff is 6.7%. The highest rates of MFN *ad valorem* tariff apply to agricultural products.¹⁰⁴ The EU's main import sectors are machinery and equipment, manufactures and chemicals. Raw material and foods have a small share in total imports, but have experienced strong growth in the last decade.¹⁰⁵ Telecommunication instruments, television and audio equipment, garments and footwear are the Indonesian export products that most utilise the GSP facility.¹⁰⁶

In fact, GSP is the only trade preference granted by the EU to Indonesia. Over 40 years there has been no significant changes in the trade preferences policy of the EU to Indonesia, which is known as a "stagnancy period". Indonesia's political and economic situation contributes towards such situation. In the late 1960s until the 1980s, Indonesia sank into economic and political instability. After the New Order era replaced the Old Order era, Indonesia's national politics totally changed.

According to Pahre, political scientists often use the term hegemony instead of leadership in defining the dominant power in international systems. The term of hegemony started to be used to explain developments in international economy after the Second World War. The hegemonic theory is commonly used to describe the United States leadership of the *Pax Americana*. The dominance of US leadership is rooted in its position as the winner of the World War and the economic superpower. Therefore, a state hegemonic is associated with that state's share of world gross domestic product (GDP) or other material resources.¹⁰⁷ Where after the Second World War, the US and Japan occupied the first and second rank of world GDP.

The hegemony of the US and Japan as a dominant power in Southeast Asia also influenced Indonesia. As mentioned above, the United States market was the largest

¹⁰⁰ See Brown, Colin., 2003, *Op. Cit.*, p. 176.

¹⁰¹ See Brown, Colin., 2003, *Op. Cit.*, p. 177.

¹⁰² See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., *Indonesia's Trade Access to the European Union: Opportunities and Challenges*, November 2010, available at : http://eeas.europa.eu/delegations/indonesia/documents/press_corner/tradeaccess_report_en.pdf, p. 1.

¹⁰³ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 39-43.

¹⁰⁴ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, p. 18.

¹⁰⁵ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, p. 16.

¹⁰⁶ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 71-72.

¹⁰⁷ See Pahre, Robert., *Leading Questions : How Hegemony Affects the International Political Economy*, Michigan Studies in International Political Economy, Ann Arbor, The University of Michigan Press, USA, 2002, pp. 3-4.

importer for Indonesian products and Japan was the largest exporter into Indonesia's market. The hegemony of the US as the dominant economic power in international trade relations started at the end of the Second World War. The ITO failed as an international trade organisation to administer the GATT due to the lack of US participation. Conversely, there are some international organisations that were considered to bring success and development, such as the WTO, IMF, UNCTAD, IBRD, World Bank, and OECD, where the US has strong involvement in the establishment of such regimes. Nowadays, these regimes have become the supporter of free trade policy and market economy.¹⁰⁸

During the era of New Order, Indonesia changed its foreign trade policy in order to support its economic development programme. From the late 1960s to the 1980s, Indonesia was facing serious economic problems such as a high poverty numbers and a high rate of inflation caused by unrestrained deficit spending. To cope with such severe economic problems, President Soeharto established an economic team consisting of a group of economists from the Faculty of Economics at the University of Indonesia in Jakarta. The reason why President Soeharto chosen FE UI economists as his government advisors started from a series of lectures on Indonesia's economic problems delivered by five FE UI economists at the Second Army Seminar in August 1966. They consisted of Widjojo Nitisastro, Ali Wardhana, Sadli, Emil Salim and Subroto.¹⁰⁹

Officially, in September 1966, President Soeharto appointed them as the '*Team of Experts in the Field of Economics and Finance*'. The team was coordinated by the late Major-General Sudjono Humardani.¹¹⁰ The establishment of this team started the era of "economic technocrats" in Indonesia, which were sometimes known as the "Berkeley Mafia". They were given the name Berkeley Mafia because most of these economists, including their leader Professor Widjojo, had pursued their postgraduate studies in economics at the University of California in Berkeley. In the hands of a well-qualified group of economic technocrats, enjoying the full support and confidence of President Soeharto, Indonesia experienced full economic transformation into a "Newly Industrialising Economy" (NIE) among the Southeast Asian economies. In 1993 the World Bank, classified Indonesia, along with Japan, South Korea, Taiwan, Hong Kong, Singapore, Malaysia and Thailand, as one of the 'high performing Asian economies' (HPAEs).¹¹¹ From such facts it can be understood that the economic policy pattern of Indonesia during the New Order era, especially on foreign trade policy tended to the US rather than to Western Europe. Practically, from the 1970s until the late 1990s, there was no significant change in the EU's policy pattern on trade preferences towards Indonesia. In addition, the EU's trade preference policies were mostly given to African and South American countries.

Even though GSP has been the only EU trade preference given to Indonesia until today, some progress on trade diplomacy has been made by the EU and Indonesia. The EU-Indonesia PCA is an on-going progress of ratification and adoption, which is considered as the milestone to strengthen the trade relationship between two parties. There are some factors that attracted EU traders to do business with Indonesian traders such as the application of the open trade policy regime, the reduction of barriers to trade, and the decrease in domestic protectionism. Strengthening of the

¹⁰⁸ See Pahre, Robert., 2002, *Op. Cit.*, p. 4.

¹⁰⁹ See Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 195.

¹¹⁰ See Subroto, 1998, *Op. Cit.*, p.75; Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 196.

¹¹¹ See The "East Asian Miracle" World Bank , 1993a, *Op. Cit.*, p. xvi; Howard Dick, Vincent J.H. Houben, J. Thomas Lindblad, and Thee Kian Wie, 2002, *Op. Cit.*, p. 196.

trade relationship between the EU and Indonesia reduced US and Japanese hegemony. In addition, it also created trade diversion and lowering trade dependency on certain states.

V.c. ALA and Indonesia's economic crisis.

Since 1976, the EU has had a commitment to grant financial and technical assistance to some developing countries in Asia and Latin America. On 17 February 1981, the EU issued Council Regulation No. 442/81 on Financial and Technical Assistance to Non-Associated Developing Countries.¹¹² Establishment of the 1981 Regulation is pursuant to Article 235 of the EEC Treaty (amended by Article 308 TEC, thus, amended by Article 352 of the TFEU). It is aimed to give assistance to "the poorest developing countries", through financial grants.¹¹³ The EU considers Asia and Latin America as "*especially needy regions*". There were forty-four ALA developing countries that received such grant assistance.¹¹⁴ According to the 1981 Regulation, there were three main purposes of granting such assistance to ALA countries. First, it aimed to improve living conditions in the neediest sections of developing countries. Second, it aimed to develop rural areas and improve food production. Third, it provided disaster relief.¹¹⁵

In order to enhance its aid programme, by 22 February 1991 the EU replaced the 1981 regulation with Council Regulation 443/92 of 25 February 1992 on Financial and Technical Assistance to, and Economic Cooperation with, the Developing Countries in Asia and Latin America. The 1992 Regulation significantly extend the ALA aid programme by implementing policies promoting democracy, human rights, environmental protection, and the role of women.¹¹⁶ The 1992 Regulation significantly increased its financial assistance and focused more on humanitarian matters.¹¹⁷ The policy behind the assistance programme was the implementation of mutually advantageous assistance and cooperation through expanded trade and increased financing.¹¹⁸

Articles 7 and 8 of Council regulation (EEC) No. 443/92 deals with economic cooperation. It is intended to serve the mutual interests of the EU and its beneficiaries through development of business and technology. This development will improve the developing country's potential to "*make the most of the prospects opened up by the growth of international trade,*" eventually its benefit goes to the EU.¹¹⁹

Council Regulation (EEC) No. 443/92 of 25 February 1992 on "*financial and technical assistance to, and economic co-operation with the developing countries in Asia and Latin America*" ("ALA Regulation") applies to Indonesia. It aims to strengthen the co-operation framework and to make an effective contribution, through institutional dialogue, economic and financial co-operation, to sustainable development, social and economic stability and democracy.¹²⁰ Based on the ALA Regulation, the EU granted financial assistance to Indonesia during the recovery period of the economic crisis. The

¹¹² See Savery, Donald J., *Improved Assistance for Asian and Latin American Developing Countries: Regulation No. 443/92*, volume 16, Issue I, Article 11, 12 January 1993, Boston College International and Comparative Law Review, p. 191., available at : <http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1326>, last accessed : 05 December 2012.

¹¹³ See Article 2 and Article 5 Council Regulation No. 442/81; Savery, Donald J., 1993, *Op. Cit.*, p. 192.

¹¹⁴ See Savery, Donald J., 1993, *Op. Cit.*, p. 193.

¹¹⁵ See Article 6 Council Regulation No. 442/81; Savery, Donald J., 1993, *Loc. Cit.*, p. 192.

¹¹⁶ See Savery, Donald J., 1993, *Loc. Cit.*, p. 191.

¹¹⁷ See Council regulation (EEC) No. 443/92; Savery, Donald J., 1993, *Op. Cit.*, p. 198.

¹¹⁸ See Council regulation (EEC) No. 443/92; Savery, Donald J., 1993, *Op. Cit.*, p. 195.

¹¹⁹ See Council regulation (EEC) No. 443/92; Savery, Donald J., 1993, *Op. Cit.*, p. 197.

¹²⁰ See National Indicative Programme 2005-2006, available at : http://eeas.europa.eu/indonesia/csp/nip_05-06_en.pdf, last accessed : 05 December 2012.

financial assistance of the EU was mostly used to improve the economic sector, especially to boost Indonesia's trade. The ALA Regulation is the only EU regulation that is used to grant financial aid to Indonesia.

V.d. The roles of the EU in the Indonesian trade reform policy.

V.d.1. Country Strategy Paper (CSP) on Indonesia.

The first Country Strategy Paper (CSP) on Indonesia was made during the recovery period after the economic crisis. In March 2000 the Commission made a communication to re-evaluate and improve the relationship between the EU. Enhancement of trade promotion and investment was part of the subject within the communication. The CSP was prepared based on the assessment of the dialogue input from Indonesian authorities, public society, NGOs and related stakeholders. Through CSP, the EU mapped out its aids to Indonesia to be used appropriately in the sectors that were considered crucial to drive economic development and political transformations in the context of crisis recovery. The first CSP contained the broad lines of EU cooperation and support to Indonesia for five years from 2002–2006.

Since 1975, the EU has granted development aid to Indonesia at the amount of €300 million euros, which have mostly focused on the programme to alleviate poverty. However, the first CSP acknowledged the importance of prioritising the development needs of the Indonesians.¹²¹ In this regard, the first CSP took into account the main priorities of the Indonesia government to restructure its economy post crisis such as enforcing good governance and the rule of law, improving the capacity of local government in a framework of local autonomy, alleviating poverty, and minimising social conflict. However, the EU considered two priority sectors that needed to be addressed in the first CSP, that is, cooperation to improve the implementation of good governance and sustainable management of natural resources.¹²² In the first CSP, the EU provided a budget of €216 million euros for the five-year period of 2002–2006.¹²³

With regard to local autonomy, a new challenge was created in poverty reduction and economic development in which there was fragmentation and different policies in certain sectors from region to region. Decentralisation policy was defined as conferring some of the central government competences to the local government in order to deliver welfare effectively and to give greater authority to the regions managing their specific development based on local needs and characteristics. The first CSP considered that economic growth was a pre-condition for Indonesia to reduce poverty in the long term. In this regard, the first CSP emphasised closer economic and commercial cooperation.¹²⁴

Intensive cooperation in trade and investment between Indonesia and the EU had become one of the major focuses of the Commission Communication to the Councils and to the European Parliament on *“Developing Closer Relations between Indonesia and the European Union”*.¹²⁵ In 2000, the Commission reviewed the bilateral relationship between the EU and Indonesia. The Communication contained *“comprehensive re-assessment of Indonesia – EU cooperation”*. Thus, in 2001, the Commission proposed the

¹²¹ See Point 5 Council Conclusion of 20 March 2000, available at : http://eeas.europa.eu/indonesia/csp/02_06_en.pdf, last accessed : 26 January 2012.

¹²² See Indonesia Country Strategy Paper 2002-2006, available at : http://eeas.europa.eu/indonesia/csp/02_06_en.pdf, last accessed : 26 January 2012, p. 3.

¹²³ See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, pp. 4-5.

¹²⁴ See *Ibid.*, pp. 4-5.

¹²⁵ The Union should intensify its trade and investment relations with Indonesia and support the process of restructuring Indonesia's economy. See COM (2000) 50, dated 02.02.2000, Council Conclusion of 20 March 2000, available at : http://eeas.europa.eu/indonesia/csp/02_06_en.pdf, last accessed : 26 January 2012.

Communication on *"Europe and Asia: A Strategic Framework for enhanced partnerships"*. This communication contained three focal points that were important to help boost Indonesian exports. First, to strengthen Indonesia – EU mutual trade and investment flows. Second, to promote the implementation of good governance and the rule of law to combat corruption. Third, to build global partnerships and alliances with Asian countries and help strengthen the awareness of Europe in Asia (and vice versa). Subsequently, in 2003, the Commission adopted a Communication on a *"New Partnership with South East Asia"*, that contained a comprehensive strategy for future EU relations with the region.¹²⁶

Since the 1970s, the EU has extended its GSP beneficiary to ASEAN countries including Indonesia. In the earlier implementation of GSP the focus was to boost export earnings and poverty alleviation in the beneficiary countries. The Communication also identified significant progress of poverty alleviation from 1975 to 1996.¹²⁷ The Council released its conclusion regarding the Commission Communication on March 2000.

In May 2001, the Council re-evaluated and re-asserted its findings. Thus, the Council concluded the strategy of EU cooperation with Indonesia for the five-year term of 2002-2006, including:¹²⁸

1. Support to trade and investment in a framework of more intensive economic co-operation with the European Union and,
2. To achieve higher visibility for both European Union aid and the European Union as an economic, and political partner for Indonesia – commensurate with the scale of EU trade and finance for Indonesia.

However, the first CSP placed the promotion of “good governance and sound development and economic management policies” as the main priority on the reform agenda.¹²⁹ The legal basis of EU cooperation with a third country such as Indonesia can be found in Articles 177 and 179 of the TEC. Article 177 was later amended by Article 209 of the TFEU. After the Treaty of Lisbon, Paragraph 1 of Article 188 D was amended. Article 177 of the TEC of the EU Treaty lays down three broad objectives for Union development cooperation, consisting of the *“fostering of sustainable economic and social development, poverty reduction, and the integration of the developing countries into the world economy”*.¹³⁰

In the last sentence of Article 188C Paragraph 1 of the Treaty of Lisbon indicated the Principle of Consistency in the respect of conducting CCP.¹³¹ Article 205 of the TFEU concerning the Union’s external action amended and replaced by Article 188 A, stipulated as follows :

“[...] The Union's action on the international scene, pursuant to this Part, shall be guided by the principles, pursue the objectives and be conducted in accordance with the general provisions laid down in Chapter 1 of Title V of the Treaty on European Union [...].”

This article clearly stated that all of Union external action must compliance with the principles which written in the Chapter 1 of Title V of the TEU. In the context of establishment GSP this article linking to Article 3 paragraph 5 of the TEU.

The TFEU provide special chapter on the development cooperation with the third countries that addressed for poverty eradication. It is accommodated in the Title III on

¹²⁶ See Indonesia – European Community Strategy Paper 2007-2013, available at : http://ec.europa.eu/europeaid/where/asia/documents/indonesia_csp_2007-2013_en.pdf, last accessed : 26 January 2012, p. 27.

¹²⁷ See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 8.

¹²⁸ See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 9.

¹²⁹ See *Ibid.*, p. 9.

¹³⁰ See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 7.

¹³¹ See Balan, George-Dian., 2008, *Op. Cit.*, p. 3.

Cooperation with Third Countries and Humanitarian Aid Chapter 1 on Development Cooperation Article 208 (ex Article 177 TEC), which is amended in the Treaty of Lisbon by Article 188 D paragraph 1 which stipulated as follows :

1. Union policy in the field of development cooperation shall be conducted within the framework of the principles and objectives of the Union's external action. The Union's development cooperation policy and that of the Member States complement and reinforce each other.
Union development cooperation policy shall have as its primary objective the reduction and, in the long term, the eradication of poverty. The Union shall take account of the objectives of development cooperation in the policies that it implements which are likely to affect developing countries.
2. The Union and the Member States shall comply with the commitments and take account of the objectives they have approved in the context of the United Nations and other competent international organisations.

It is stipulated clearly that in the framework of development cooperation the Unions must consider establishing a policy in favour of developing countries to reduce and eradicate poverty.¹³²

Article 209 (ex Article 179 TEC) the Union allows to conclude any agreement with the third countries and competent international organisations to carry out the objectives mentioned in the Article 21 of the TEU and Article 208 of the TFEU. In the Treaty of Lisbon this article was replaced by Article 188 E, which stipulated as follows:

1. The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the measures necessary for the implementation of development cooperation policy, which may relate to multi annual cooperation programmes with developing countries or programmes with a thematic approach;
2. The Union may conclude with third countries and competent international organisations any agreement helping to achieve the objectives referred to in Article 10 A of the Treaty on European Union and in Article 188 D of this Treaty.
The first subparagraph shall be without prejudice to Member States' competence to negotiate in international bodies and to conclude agreements.

In the sphere of the international agreement Article 217 (ex Article 310 TEC) of the Treaty on the Functioning of the European Union, it is stipulated that the "*Union may conclude with one or more third countries or international organisation agreements establishing an association involving reciprocal rights and obligations, common action and special procedure*". Then in the Treaty of Lisbon, Article 188 M was amended and is substantially similar to Article 217 of the TFEU. In Article 217 of the TFEU and Article 188 M of the Treaty of Lisbon, the word "States" in Article 310 TEC have been replaced with "third countries", to emphasise more clearly the external relation of the Union with non-member states.

Regarding the 10th ASEAN Foreign Ministers Meeting (AMM), held on 5–8 July 1977, ASEAN and the EU agreed to formalise their "*dialogue relation*" into "*formal cooperation*". This agreement is known as "*ASEAN's formal cooperation and relationship with the European Economic Community (EEC)*". Cooperation formalisation involved "*the Council of Ministers of the EEC, the Permanent Representative of the EEC countries and the EEC Commission*". This stage of cooperation between ASEAN and the EU covered some areas such as politics and security, economic and trade, social and cultural issues, and development cooperation.¹³³

¹³² *Ibid.*, p. 3.

¹³³ See Overview of ASEAN-EU Dialogue Relations, available at : <http://www.asean.org/23216.htm>, last accessed : 21 September 2011.

In 1975, during several informal meetings, ASEAN and the EU established the Joint Study Group¹³⁴ that focused on trade sectors.¹³⁵ Since 1977, the dialogue relations between ASEAN and the EU were formalised in the 10th ASEAN Foreign Ministers Meeting (AMM) attended by the Council of Ministers of the EEC, the Permanent Representative of the EEC countries and the EEC Commission. Hence, both regions agreed to establish formal cooperation and relationship.¹³⁶ In 1978, the ASEAN-EU Ministerial Meetings (AEMMs) had greater political significance and improved cooperation between both regions. On March 1980, the ASEAN-EU Cooperation Agreement was signed. This agreement started the new era of cooperation between the two regions.¹³⁷ As previously mentioned, this agreement covered provisions on trade and development cooperation, promoting investments, joint ventures and other miscellaneous economic issues such as technological transfers.¹³⁸ Indonesia also participated in the EU-ASEAN regional programmes, covering energy, environment, transport, as well as education and communication technology. Indonesia was involved in EU-Asia horizontal co-operation programmes such as Asia-Urbs and Asia-Invest.¹³⁹

The 1980 cooperation agreement brought positive progress in the trade relations between the two regions. The EU extended its GSP to ASEAN to enhance market access for ASEAN exports. As noted before, ASEAN saw that the GSP scheme did not go far enough and demanded further concessions. However, after the millennium there were no bilateral co-operation agreements with Indonesia, however, the Council's ALA Regulation 4 applied to Indonesia.¹⁴⁰

The first CSP raised two "*delicate*" issues faced by Indonesia during its struggle on its earlier economic recovery, that is corruption and local autonomy. Indonesia's public sector and public business corruption were deemed as the "*chronic*" diseases in Indonesian bureaucracy, becoming the "*invisible barriers*" to trade that have caused high cost economics for related business actors, traders, and others economic operators. Such corruption has hindered the firms or companies by maximising profits from trade. In addition, it has also caused a high cost economy and massive losses of state revenues, which impede economic development. However, according to CSP "*the decentralisation policy may in fact offer new opportunities for corruption*".¹⁴¹ The other problems correlated to decentralisation are expertise and human resources, the coordination between districts and provinces on cross-border issues, budgetary issues, and market disintegration.¹⁴²

The key issues of the second CSP 2007-2013 are poverty reduction, the promotion of sustainable economic growth, the promotion of good governance, and law certainty. The second CSP allocated a budget of €494 million euros to Indonesia under the Development Cooperation Instrument (DCI). One of the focuses of the assistantship programme was the promotion of Indonesia's economic growth through the

¹³⁴ See Paragraph 6 of the Joint Statement The Informal Meeting of ASEAN Ministers and Vice-President and Commissioner of the EC Commission, Jakarta, 24-25 September 1974, available at : <http://www.asean.org/5615.htm>, last accessed : 22 September 2011).

¹³⁵ See Luhulima, C.P.F., 1992; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 46. See also Luhulima, 1993; Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, p. 84.

¹³⁶ See Overview of ASEAN-EU Dialogue Relations.

¹³⁷ See Balme, Richard., and Bridges, Brian., 2008, *Op. Cit.*, pp. 84-85. See also Rueland, J, 1996; Welfens, Paul J.J., et. al., 2009, *Op. Cit.*, p. 47.

¹³⁸ See M. Dent, Christopher., 2002, *Op. Cit.*, p. 48.

¹³⁹ See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 21.

¹⁴⁰ See Regulation (EEC) N° 443/92 of 25 February 1992 on financial and technical assistance to, and economic co-operation with, the developing countries in Asia and Latin America. See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 7.

¹⁴¹ See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 16.

¹⁴² See Indonesia Country Strategy Paper 2002-2006, *Op. Cit.*, p. 12.

improvement of trade relations.¹⁴³ The second CSP still considers that poor governance in Indonesia generates corruption and creates a negative impact on the economic situation.¹⁴⁴ In this regard, the assistance of the second CSP is addressed to promote trade and good governance.

According to the assessment of the second CSP, Indonesia's trade performance, especially in exports, is weaker compared to some other Asian countries. The erosion of cost competitiveness in the manufacturing sector is identified as one of the factors. Another factor is the lack of transportation infrastructures and export clearance processes that often cause delay and create high cost trade. Other aspects that influence export performance are technical skills in the SMEs and, in addition, marketing matters are very low.¹⁴⁵ In short, trade facilitation is still becoming the export constraint in Indonesia.

Before 1998, Indonesia implemented protectionism in foreign trade policies. However, after the Reformation era Indonesia implemented open foreign trade policy that advanced into unilateral liberalisation measures. However, the lack of trade supports was also identified, for example trade facilitation in foreign trade. The open trade policy was a positive contribution to Indonesia's total external trade, amounting to 56% of GDP in 2004.¹⁴⁶

The second CSP also highlighted the weaknesses of the trade strategy and lack of strong coordination between related stakeholders such as ministries at the central level, local authorities, traders, business actor, and other economic operators.¹⁴⁷ In 2005, the EU represented 15% of Indonesia's total external trade. The EU was one of its major trading partners and the main market destination for non-oil and gas exports. Indonesian imports from the EU are smaller than its exports, thus creating an asymmetric trade relationship. According to data in 2005, Indonesia exported €10.1 billion euros to the EU and imported only €5.7 billion euros, thus, there was a €4.4 billion euro trade surplus.¹⁴⁸

Nowadays, the rise in unemployment has become the focus of economic development. Indonesia's government has a target to create 2.5 million positions of employment every year. The Indonesian government needs to accelerate export growth, enlarge markets access, increasing export capacity, and export diversification. In order to upgrade the environment for exports more efforts are needed on export promotion and export supporting services, creating a friendly business environment, legal certainty, acceleration of infrastructure development, and a speedy distribution system.¹⁴⁹

With respect to the enhancement of trade facilitation, the second CSP also focused on the modernisation of customs operations. This policy has been realised into "*EU-Indonesia customs improvement project*" and is aimed to enhance the capacity of customs operations in order to raise tax revenue and facilitate international trade. Under the second CSP project, technical assistance was given in the areas of post-clearance auditing, risk analysis, customs intelligence, anti-corruption measures and human resources development. This project started in October 2005.¹⁵⁰

¹⁴³ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 19.

¹⁴⁴ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 4.

¹⁴⁵ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, pp. 7-8.

¹⁴⁶ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 8.

¹⁴⁷ See World Bank "Making Indonesia Competitive: Promoting exports, managing trade" (Nov. 2004). Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 8.

¹⁴⁸ See *Ibid.*, p. 8.

¹⁴⁹ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 7.

¹⁵⁰ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 16.

As previously identified, the technical barrier to trade is one of the weakness factors in Indonesia's trade performance. This technical barrier could also erode the competitiveness of the Indonesian product in the EU market. March 2005 saw the beginning of "the EU-Indonesia Trade Support Programme (TSP)" with a budget of 8.5 million euros coming from EU contributions. TSP is a programme dedicated to overcoming technical barriers to trade such as in SPS area, standard and quality control, and WTO capacity building. The executing authority of this programme is the Ministry of Trade. However, the implementation of this programme was delayed because Indonesia applied the decentralised management approach.¹⁵¹ With regard to the implementation of local autonomy in Indonesia, the second CSP looked for the possibility to have direct cooperation with selected local authorities.¹⁵²

The National Indicative Programme (NIP) is a set of operational guidelines of CSP. CSP covers a period of five years, and NIP is established annually. The first National Indicative Programme (NIP) was established within the framework of the CSP to identify the actions that need to be launched in general terms. Trade Related Technical Assistance (TRTA) has been considered as one of the main priorities on EU external policies, therefore, it is clearly identified as a critical sector activity.¹⁵³

V.d.2. Trade Support Programme.

Trade Support Programme 1 (TSP 1) was conducted for a three-year period, starting in March 2005 and finishing in April 2008. The Ministry of Trade of the Republic of Indonesia was appointed as the leading institution responsible for TSP implementations. It also acted as the main coordinator of the involvement of the different components. The TSP 1 was a joint funded programme with the EU contributing 90% of its budget at the amount of 8.5 million euros and Indonesia contributing the remaining 10% at the amount of 944 thousands euros. The TSP 1 was designed to support the economic and social recovery of Indonesia through the improvement of bilateral trade flows, which aimed to generate growth and contribute to poverty alleviation. The TSP 1 projects covered WTO capacity building, standard harmonisation with EU practices, research and development issues, and technical fishing laboratories.¹⁵⁴ Significant progress was made under the EU's Trade Support Programme (TSP-I), which contributed to the identification, adaptation and dissemination of EU technical standards to the local industries in Indonesia. This programme was also aimed to enhance quality control processes and SPS compliance by Indonesian exporters.¹⁵⁵

The second generation of the Trade Support Programme, known as TSP 2, commenced in 2009. A general objective of TSP 2 is facilitating Indonesia's further integration into the international trade system. The project of TSP 2 focuses on improving the quality of Indonesia's infrastructures to support its access into the international market. More specifically, the TSP 2 is directed to enhance an export quality infrastructure system that comprises of export quality management and control, standardisation, inspections and certification, rapid alert systems and market surveillance. The Ministry of Trade is still placed as the coordinating institution of TSP 2. The budget of the TSP 2 has been increased by 50% from the budget of TSP 1. The contribution of the Commission reached 15 million euros. One of the outputs of TSP 2 is

¹⁵¹ See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 41.

¹⁵² See Indonesia – European Community Strategy Paper 2007-2013, *Op. Cit.*, p. 23.

¹⁵³ See National Indicative Programme 2005-2006.

¹⁵⁴ See Trade Support Programme 1 (TSP 1), available at : http://eeas.europa.eu/delegationstsp1_en.pdf, last accessed : 7 January 2012.

¹⁵⁵ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 8-9.

expected to improve government capacity to formulate and implement trade policy related to export quality infrastructure.¹⁵⁶

V.e. PCA: Framework Agreement Indonesia – EU.

On 9 November 2009, Indonesia and the EU signed the Framework Agreement on Comprehensive Partnership and Cooperation between the European Community and the Republic of Indonesia, hereafter referred to as the Partnership and Cooperation Agreement (PCA). Indonesia was represented by its Foreign Minister Marty Natalegawa and the EU was represented by the Foreign Minister of Sweden as the incumbent EU Presidency.¹⁵⁷ The PCA between Indonesia and EU was established due to the 1980 Cooperation Agreement between ASEAN and the EU and its subsequent accession protocols. The PCA also takes into account activities under the regional framework. In this regard, the implementation of PCA between the EU and Indonesia should be aligned with the interregional cooperation such as ASEAN-EU dialogues, ASEAN Regional Forum (ARF), and the Asia – Europe Meeting (ASEM).¹⁵⁸

Both parties recognised the importance of good governance, combating corruption, and law enforcement as the common principles of the PCA. The PCA was implemented based on principles of equality and mutual benefit.¹⁵⁹ Consequently, the PCA can be regarded as the focal point of where the EU has shifted its external policy towards Indonesia from the donor-recipient relationship to the partnership relationship. Within such partnership both parties have more opportunities to cooperate more in trade.

The critical objectives of PCA are trade and investment enhancement. More specifically, they focus on trade facilitation, investment flow improvement, and elimination of trade and investment obstacles based on mutual interests and advantages.¹⁶⁰ The EU is one of the biggest markets for Indonesian export products. According to the paper on the “Perception of the EU in Indonesia” by ASEF, it notes how a public opinion survey was carried out by “*the EU through the Eyes of the Asia research team*”. The EU was ranked seventh in a list of the most important partners for Indonesia with only 8.9% of respondents listing the EU as among Indonesia’s most important partners compared to the US, China and Japan, and, neighbouring economic partners such as Australia and Singapore. However, the research highlights that such perception is not in line with reality, where based on the IMF, the EU is Indonesia's second largest export partner.¹⁶¹

With respect to promoting its profiles, both parties have agreed to raise its profiles in both regions. More EU profile rising in Indonesia and *vice versa*, it is believed that this could increase public trust and encourage improvements in two way trade and investment flow. The EU efforts to promote the countries’ profile (member states) in

¹⁵⁶ See Trade Support Programme 2 (TSP 2), available at : http://eeas.europa.eu/eu_indonesia/tsp2_en.pdf, last accessed : 7 January 2012.

¹⁵⁷ See Pembahasan Ratifikasi Framework Agreement On Comprehensive Partnership and Cooperation INA – UE, 18 April 2011, available at : <http://202.46.15.98/index.php/module/News+News/id/8434>, last accessed : 10 March 2012. See also Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 73.

¹⁵⁸ See Article 6 of the PCA.

¹⁵⁹ See Paragraph 5 and 6 Article I General principles of PCA.

¹⁶⁰ See Article 2 Aims of Cooperation of the PCA. The PCA also covering other sectors related to trade such as financial services; taxation and customs; macro-economic policy; industrial policy and SMEs; information society; science and technology; energy; transport and transport safety; environment and natural resources, food safety; animal health; statistics; personal data protection; cooperation on the modernisation of the state and public administration; and intellectual property rights.

¹⁶¹ See Asia – Europe Foundation, How the EU is Perceived in Asia : Perception of the EU in Indonesia, 4 December 2009, Jakarta, Indonesia, available at : http://www.asef.org/pr0919_perceptions_of_the_eu_in_indonesia.pdf, last accessed : 05 December 2012.

the partner countries (Indonesia) have also been included in the country's strategy paper. According to Prof. Martin Holland¹⁶², *"misperception or ill-informed views of the European Union's global role puts the EU at risk of being overlooked or undervalued by non-EU countries, which the EU is a significant partner. Similarly, low awareness of the EU exposes countries, like Indonesia, to the risk of slipping under the EU's radar."*¹⁶³

Cooperation on trade and investment is included in Article 8 of the PCA. One step forward to enhance market access conditions have been noted in the PCA through scheduled removal of non-tariff barriers and transparency improvement. The PCA also recognised advantages of trade preferences towards developing countries. Both parties are obliged to inform each other regarding their development of trade and policies related to trade as part of information transparency.

There are eight areas includes into the cooperation of trade and investment, it's consist of SPS, TBT, IPR protections, trade facilitation, customs cooperation, investment, competition policy and services. In the last decade, the SPS regulations becomes the most delicate issues between EU and Indonesia. Protest done by Indonesia because the EU banned of some of export products entering their market,, especially agricultural and food products. The shrimp case, for example, happened when the EU based on the SPS reasons banned the shrimp product from Indonesia. Implementation of such standard is based on the WTO Agreement on Sanitary and Phytosanitary. The application of such standards cannot be separated from the issues of customer protection policy, health policy, and food safety in the EU. On the other hand, such standards create non tariff barriers to trade for the developing countries, including Indonesia. To fulfil such standards the developing countries needs to be well-prepared on technology, knowledge, infrastructures, and human resources. Yet, from different perspective, implementation of SPS brings positive effects for the developing countries because it would help them enhancing competitiveness in the international markets through implementation of international best practices on trade.

To boost two way trades, the Article 12 of the PCA provides provisions of trade facilitation, which recommends of simplifying foreign trade procedures and customs procedures, increase transparency of trade regulations, develop customs cooperation, enhance infrastructures, and combating the trade fraud. The fight against corruption stipulated in the Article 35 of the PCA. In this point, both of parties agreed to cooperate and to contribute combating corruption through full compliance to the mutual international obligations.

Article 39 of the PCA regulate the cooperation in the modernisation of the public administration, which indicating the strong support to the improvement of trade facilitation and fight against corruption. This article expected to driving progress on improving organizational efficiency, increasing institutions effectiveness in public service delivery, ensuring transparency management of public resources and accountability, improving the legal and institutional framework, capacity building and legal enforcement.

In order to implement the PCA, Article 41 of the agreement mandated the establishment of a Joint Committee, comprising of representatives from both sides at the highest possible level. According to the agreement, the Joint Committee should meet not less than every two years in Indonesia and Brussels. To assist its tasks and performance the Joint Committee can set up specialised working groups.

According to Article 48, the PCA would enter into force on the first day of the month following the date on which the last Party notified the other of the completion of

¹⁶² Jean Monnet Chair ad personam, National Centre for Research on Europe of the University of Canterbury

¹⁶³ See Asia – Europe Foundation, How the EU is Perceived in Asia : Perception of the EU in Indonesia, 2009.

the legal procedures. The legal procedures in Indonesia concerning adoption and ratification of international agreements are regulated under Acts No. 24 of 2000. For the purposes of ratification of such agreement, on 12-14 April 2011, the Indonesian Ministry of Foreign Affairs held a meeting with related ministries and agencies to discuss the ratification drafts of the PCA into Indonesian national law. While some EU member states such as Estonia, Denmark, Latvia, Poland, Austria, Slovenia, Bulgaria, Hungary, Slovakia, and Portugal ratified the PCA. Such ratification aimed to enact the legal basis in each party's national law aiming to ensure the efficiency of PCA implementation.¹⁶⁴ Today, the ratifications of the EU-Indonesia PCA are still on going.

V.f. CEPA (Comprehensive Economic Partnership Agreement).

While the PCA is still on going for adoption and ratification by both parties, at the end of 2009, the Indonesian President Susilo Bambang Yudhoyono and the European Commission President José Manuel Barroso met to discuss further efforts to strengthen the economic and trade relationships. Therefore, it was agreed to establish a Vision group, which was given the task of examining how to deepen cooperation between both parties through more comprehensive actions. This Vision Group consists of reputable and important persons from both parties. The Vision Group worked for six months through open discussion regarding the relevant matters on economics and trade between the two parties. At the end of its task, the Vision Group had to compile a final report for the two Presidents. The result of the Vision Group was used to explore the further possibilities establishing the "*Comprehensive Economic Partnership Agreement (CEPA)*". On 4 May 2011 in Jakarta, the Vision Group presented its recommendations to Indonesia's Minister of Trade Mari Pangestu and the European Commissioner for Trade Karel de Gucht.¹⁶⁵ To sum up, the Vision Group has specific objectives consists of:¹⁶⁶

1. Providing a strategic view of EU – Indonesia trade and investment relations.
2. Identifying the basis EU – Indonesia trade and investment relationship can best be improved in an innovative way.
3. Identifying opportunities for fostering trade and investment between EU and Indonesia.
4. Exploring the feasibility of an Economic Partnership Agreement and Free Trade Area between the EU and Indonesia.
5. Providing recommendations to the Government of Indonesia, the EU, the business community, and the academic society about the ways to bring into realization the trade and investment potential between both parties.

Some important recommendations were submitted by the Vision Group to deepen trade relations. The establishment of CEPA must be based on a free trade area. The CEPA has three important triangular pillars, which consist of market access, capacity building, and facilitation of trade and investment. According to the Vision Group, combinations of those elements could bring positive impact to Indonesia's exports improving value added exports and increasing Indonesia market competitiveness.¹⁶⁷

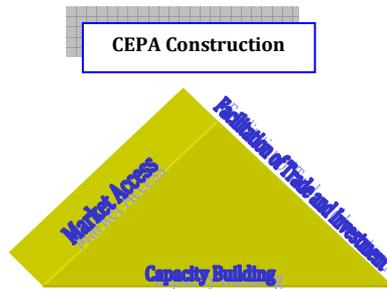
¹⁶⁴ See Pembahasan Ratifikasi Framework Agreement On Comprehensive Partnership and Cooperation INA – UE, 2011. See also RI– EU Siap Implementasikan Kesepakatan Kemitraan dan Kerjasama, 11 November 2011, available at : http://www.deplu.go.id/_layouts/mobile/PortalDetail-NewsLike.aspx?l=en...&ItemID=85c6ef5b-5cb5-45a8-97a7-06095f1d40b9, last accessed : 10 March 2012. See also Suara Merdeka, *RI - UE Pererat Kerjasama*, , available at : <http://www.suaramerdeka.com/v1/index.php/read/news/2012/01/07/106193/RI-UE-Pererat-Kerjasama>, last accessed : 10 March 2012.

¹⁶⁵ See *Invigorating The Indonesia – EU Partnership : Towards a Comprehensive Economic Partnership Agreement*, available at : <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=C:2000:021E:0065:0065:EN:PDF>, last accessed : 19 March 2012, pp. 3-4.

¹⁶⁶ See *Ibid.*, p. 5.

¹⁶⁷ See *Ibid.*, p. 9.

Figure 27. CEPA Constructions



According to the Vision Group, capacity building and trade facilitation are the primary vehicles to optimise market access compared to improving the operating and investment climate, and also to improving Indonesia's investment performance.¹⁶⁸ Related to the markets in goods, it is recommended to reduce tariffs to zero for 95% of tariff lines with at least 95% of trade value within a period of 9 years maximum. However, it is emphasised that the economic development disparities between parties should be taken into account. Since SPS, TBT, and NTM (Non-Tariff Measures) are considered as the most delicate trade issues between Indonesia and EU, therefore, the CEPA constructions, especially capacity building, are addressed to help both parties overcome such problems. Under a CEPA, capacity building should go beyond the already existing, substantial efforts in a range of sectors. It is essential for effectiveness that capacity building is not only output oriented, but also outcome oriented. Wherein that the capacity to comply with EU health, safety and environmental requirements is sufficiently improved for exports to reach the EU market. Capacity building efforts should therefore be measurable and carefully implemented based on the intended purpose. Dialogues covering business to business and business to government are essential to support more comprehensive and responsive capacity building. The combination of facilitation and capacity building is a fundamental aspect behind the CEPA.¹⁶⁹ Capacity building could raise the capability of Indonesian producers to comply with European standards. The Vision Group includes the role of the EU GSP as one of the essential foundations of CEPA,¹⁷⁰ in this regard, about 58% of exports of industrial products from Indonesia are sent to the EU zero-duty under the GSP.¹⁷¹ Relating to the Rules of Origin (RoO), the Vision Group accentuated that it should be facilitating trade. The CEPA should adhere to a RoO regime, which is trade and investment friendly.¹⁷²

V.g. Implication of the proposal of the New EU GSP to Indonesia.

The proposal of a new GSP has applied a merit standard on the countries most in need by reforming the crucial components of the graduation mechanism and rules of origin. The wording of countries most in need is not merely based on economic criteria, in this regard, it also refers to the beneficiary countries' GDP. According to the World Bank, Indonesia is categorised as a lower-middle income country. Hence, its GDP is included into a general arrangement scheme in the proposal of a new GSP. As already

¹⁶⁸ See *Ibid.*, p. 20.

¹⁶⁹ See *Ibid.*, pp. 9-10.

¹⁷⁰ See *Ibid.*, p. 14.

¹⁷¹ See *Ibid.*, p. 19.

¹⁷² See *Ibid.*, p. 20.

noted, Indonesia has a utilisation GSP rate less than 75%,¹⁷³ which means it still lacks optimisation.

There are three important elements in the proposal of the new GSP, which could possibly bring implications to Indonesian exports. The proposal of the EU GSP regulation that is more focused on requirements to grant preferences on the country most in need, in the near future, may exclude some ASEAN countries that are classified in the upper-middle income countries from its scheme. The requirements set out in the proposal of the EU GSP regulation give a warning to ASEAN member states not to hold on to the GSP forever. Before GSP graduation is put into effect, ASEAN member states need to be well prepared in designing their trade policy in order to maintain their trade performance, especially regarding their export competitiveness. In the proposal of the EU GSP regulation, total graduation would be based on economic criteria, i.e., when the beneficiary country is categorised as an upper-middle income country and a high-income country. In this regard, Brunei Darussalam (high-income country), Malaysia (upper-middle income country), and Thailand (upper-middle income country) would be excluded from the GSP beneficiary lists. Based on the assumption of growth, in the coming future Indonesia, the Philippines, and Vietnam, which are currently classified as a lower-middle income country, will soon follow the other ASEAN member states to total graduation from the GSP scheme. It would leave Cambodia, Lao PDR, and Myanmar as GSP beneficiaries, especially in the EBA arrangement scheme. Therefore, to address such new policy, and after the negotiation of AEUFTA is postponed, the ASEAN member states need to design a trade policy to maintain and to increase their export competitiveness and consider possibilities of establishing a new preferential trading agreement with the EU. The ASEAN member states need to improve and strengthen their trade facilitation on exports to maximise GSP utilisation and increase their export competitiveness.

V.h. Eurozone crisis and GSP.

The Eurozone crisis started along with the global economic crisis in late 2007 and continues today, it has provoked anxiety for most Asian countries, one of which is Indonesia. The reason for this anxiety is down to the fact that most Eurozone countries are potential trade partners for Indonesia. The table and charts descriptively explain the overall trade situation between the EU and Indonesia.

In general, the EU merchandise imports have grown faster than those of the rest of the world, despite its poor domestic economic performance. Between 2003 and 2008 the growth in the value of EU imports averaged 12.8%.¹⁷⁴ The demands of foreign products in the EU depend on three factors: income, population, and the rate of economic growth.¹⁷⁵ In this regard, therefore, the EU is still considered as a strong market for export products from third countries. Based on studies on *Indonesia's Trade Access to the European Union: Opportunities and Challenges*, November 2010, carried out by Lord et al. in 2010, Indonesia has four main export products, consisting of fisheries and agri-food, electronics, furniture, and cosmetics.

The EU is the world's largest importer of fishery products, accounting for 25% of the world total. However, the EU market only accounts for 11% of Indonesia's total exports.¹⁷⁶ Indonesia is a GSP beneficiary with preferential duties on fisheries. The GSP rates range from a low of zero for some products to a high of 18 to 19.5% in the case of

¹⁷³ Cited from Gasiorek, Michael, 2011, *Op. Cit.*, p. 72.

¹⁷⁴ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 16.

¹⁷⁵ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 39.

¹⁷⁶ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 66.

some products like fresh, chilled or frozen sardines, some tuna products like long-finned and yellow-fin tuna, and skipjack or stripe-bellied bonito.¹⁷⁷

For fisheries and agri-foods, the demand derives from a combination of broad demand dynamics, domestic supply trends, and trade policies.¹⁷⁸ In the case of fisheries, the import demand has been estimated for the most important types of products exported by Indonesia to the European Union. The product groups are (a) crustaceans (55% of exports to the EU market); (b) molluscs (nearly 20% of exports to the EU market); (c) fish fillet (14% of exports to the EU market); (d) live fish (6% of exports to the EU market); and (e) frozen fish (6% of exports to the EU market).¹⁷⁹ For fishery products, the average MFN rate is 10.8%, with a range of 0 to 23%; the average GSP rate is 7.1%, with a range from 0 to 19.5. For crustaceans, an *ad valorem* tariff of 11.1% applies to third countries, with a range of 6 to 18%; the preferential tariff rate for GSP recipient countries is 5.1%, with a range of 2.1 to 14.6%.¹⁸⁰

Since Indonesia does not have any processed meat establishments approved by the EU, the demand for agri-food imports targets non-meat processed products. Major materials such as fruits, nuts or other parts of plants and animals used in processing should be wholly obtained in the originating country, e.g., Indonesia. The manufacturing material used in the processing of the products should not exceed 30% of the ex-works price of the product for the non-originating materials.¹⁸¹

In electronic products, the EU is Indonesia's largest export market for consumer electronics. Germany, the Netherlands, Belgium and the United Kingdom are the most important markets for Indonesia's import products.¹⁸² Indonesia's major export demands consist of four product groups: (a) radio and TV transmitters, television cameras; (b) video recording and reproducing apparatus; (c) insulated wire and cable, optical fibre cable; and (d) electric transformers, static converters and rectifiers. These four categories represent nearly 40% of Indonesia's total electronic export products.¹⁸³ According to the GSP rules of origin, the material used in the manufacturing process cannot exceed 30% of the ex-works price of the product for the non-originating materials under the rules of origin.¹⁸⁴ For electronics, the *ad valorem* tariff average of 2.8%, ranges from 0 to 14%; the average GSP tariff rate ranges from 0 to 7% and averages 1.7%.¹⁸⁵

Indonesia's furniture exports to the EU covered 33% of all furniture exports. Germany, France, the Netherlands, the United Kingdom, and Belgium are the largest markets within the EU member states. Among the different types of furniture, over two-thirds of exports to the EU market are in the form of wooden furniture and the remaining one-third is made of bamboo, rattan, cane or osier.¹⁸⁶ For furniture, an average MFN tariff of 2.3% applies to third countries, and an average preferential tariff rate of 0.2% applies to Indonesia.¹⁸⁷ The value of all the materials from non-originating countries should not exceed 40% of the ex-works price of the furniture product under the rules of origin.¹⁸⁸

¹⁷⁷ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 39-43.

¹⁷⁸ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Op. Cit.*, p. 39-40.

¹⁷⁹ See *Ibid.*, pp. 39-40.

¹⁸⁰ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 53.

¹⁸¹ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 54.

¹⁸² See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Loc. Cit.*, pp. 66.

¹⁸³ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Loc. Cit.*, pp. 39-40.

¹⁸⁴ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Op. Cit.*, p. 55.

¹⁸⁵ See *Ibid.*, pp. 55.

¹⁸⁶ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Loc. Cit.*, pp. 66.

¹⁸⁷ See Lord, Montague, Oktaviani, Rina, and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 56.

¹⁸⁸ See *Ibid.*, pp. 56.

Related to cosmetic products, the EU import demand has been estimated for the two types of product groups in which Indonesia's exports are concentrated: (a) essential oils, resinoids and terpenic by-products; and (b) beauty, make-up preparations. These two product groups account for one-half of all exports of cosmetic products by Indonesia.¹⁸⁹ The biggest markets for cosmetic products are Germany, France, the United Kingdom, the Netherlands and Spain.¹⁹⁰ For cosmetics, an average MFN rate of 2.5%, and an average preferential tariff rate of 0.2% applies to Indonesia.¹⁹¹ With respect to the GSP rules of origin, materials of the same product classification group as the cosmetic product can be used, provided that the total value does not exceed 20% of the ex-works price of the product for non-originating materials. For manufactured cosmetics, the value of all the materials from non-originating countries should not exceed 40% of the ex-works price of the product.¹⁹²

Massa et al., in their paper entitled "*the Eurozone crisis and developing countries*", analysed the vulnerability of developing countries in the Eurozone crisis, including the potential effects of trade shocks caused by the crisis on lower income economies. This paper notes that lower income and lower-middle income countries, mostly GSP beneficiaries, are highly likely to be impacted by the Eurozone crisis through trade channels because of their high dependence on trade with European countries. The result of this paper shows that a drop of 1% in export growth could reduce growth rates in lower income countries and lower-middle income countries by an average of 0.4% and 0.5% respectively. However, the impact of the crisis on developing countries can be seen from "symptoms" such as export reductions, declining portfolio flows, cancelled or postponed investment plans, and falling remittances and aid flows. There are some factors that affect the degree of risk of the impact of the Eurozone crisis to the lower income countries such as a significant share of exports to crisis-affected countries in the EU, exports of products with high income elasticities, heavy dependence on FDI and cross-border bank lending, and dependence on aid.¹⁹³

Indonesia is vulnerable to a slowing import demand growth in the EU¹⁹⁴, in this regard, the EU 27 is ranked at 4th place as Indonesia's major trade partner and Indonesia's major import partner. EU 27 is the second biggest major exports partner for Indonesia's goods and products. Indonesia's exports to the EU cover 11.2% of Indonesia's total exports to the rest of the world. Total Indonesian exports to Japan, EU 27, China, and the US is 47.7% of Indonesia's exports to the world. (See Table 14).¹⁹⁵ According to the Indonesian Statistic Agency, Indonesia's export to EU 27 on March 2012 was 1.540, 4 million USD, thus, it decreased on April 2012 to 1.459, 1 million USD.¹⁹⁶

Table 38. The vulnerability of Indonesia as a lower-middle income country in the Eurozone crisis.

¹⁸⁹ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 41.

¹⁹⁰ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Loc. Cit.*, pp. 66.

¹⁹¹ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 57.

¹⁹² See *Ibid.*, pp. 57.

¹⁹³ See Massa, Isabella., Keane, Jodie., and Kennan, Jane., The Euro Zone Crisis and Developing Countries, Working Paper 345, Results of ODI research presented, Overseas Development Institute, May 2012, available at : <http://www.odi.org.uk/resources/docs/7688.pdf>.

¹⁹⁴ See Massa, Isabella., Keane, Jodie., and Kennan, Jane., 2012.

¹⁹⁵ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/doclib/tradoc_113391.pdf, last accessed : 15 June 2012.

¹⁹⁶ See Perkembangan Ekspor dan Impor Indonesia 2012, Berita Resmi Statistik, Badan Pusat Statistik, No. 35/06/Th.XV, 1 Juni 2012, available at : http://www.bps.go.id/brs_file/eksim_01jun12.pdf. See also Perkembangan Ekspor dan Impor Indonesia 2012, Berita Resmi Statistik, Badan Pusat Statistik, No. 16/03/Th.XV, 1 Maret 2012, available at : http://www.bps.go.id/brs_file/eksim_01mar12.pdf.

Country	Dependence on Eurozone trade	Fiscal Space in 2010 compared to 2007	Fiscal balance (surplus/deficit)	Dependence on remittances	FDI dependence	Aid dependence	Dependence on cross-border bank lending from European banks	Peg to Euro
Indonesia	High	Worsened	Deficit	Low	Low	Low	Medium	No

Trade dependence: exports to the Eurozone/total exports to world (%). Dependence on remittances: total remittance inflows/GDP (%). FDI dependence: total FDI inflows/GDP (%). Aid dependence: total DAC countries' aid/GDP (%). Dependence on cross-border bank lending from European countries: foreign claims from European banks/GDP (%). Fiscal space: fiscal balance/GDP (%). Source: Massa, Jodie Keane and Jane Kennan, The Eurozone Crisis and Developing Countries, Working Paper 345, Results of ODI research presented, Overseas Development Institute, May 2012.

Table 39. The country groups of countries highly dependent on the EU Market.

Country	LIC	LMIC	LDC	SIDS	CDDC	Exports to EU, % of GDP
Côte d'Ivoire	✓				✓	18
Mozambique	✓		✓		✓	14
Malawi	✓		✓		✓	8
Madagascar	✓		✓		✓	6
Belize		✓		✓	✓	6
Burundi	✓		✓		✓	5
Zimbabwe	✓				✓	5
Armenia		✓			✓	5
Kenya	✓				✓	4
Ghana		✓			✓	3
Nicaragua		✓			✓	3
Paraguay		✓			✓	3
São Tomé and Príncipe		✓	✓	✓	✓	3
Mali	✓		✓		✓	2
Uganda	✓		✓		✓	2
Ethiopia	✓		✓		✓	2
Tanzania	✓		✓		✓	2
Niger	✓		✓		✓	1
Burkina Faso	✓		✓		✓	1
Cambodia	✓		✓			8
Mauritania		✓	✓			4
Senegal		✓	✓			2
Gambia, The	✓		✓			2
Zambia		✓	✓			2
Cape Verde		✓		✓		3
Nigeria		✓				10
Cameroon		✓				10
Ukraine		✓				9
Moldova		✓				6
Sri Lanka		✓				6
Philippines		✓				4
Egypt, Arab Rep.		✓				4
Bolivia		✓				3
Pakistan		✓				3
Georgia		✓				2
Indonesia		✓				2
Guatemala		✓				1

LDC : Least Developed Country
 LIC : Low-Income Country
 LMIC : Lower-Middle Income Country
 SIDS : Small Island Developing States
 CDDC : Commodity-Dependent Developing Country

Source : Massa, Jodie Keane and Jane Kennan, The Eurozone Crisis and Developing Countries, Working Paper 345, Results of ODI research presented, Overseas Development Institute, May 2012.

Some export products have significantly decreased in the import demand by EU 27 and the Eurozone (especially demand from the Greek and Italian market). The symptoms of export reduction were perceived in the last quarter of 2011, covering a wide range of products, for instance manufactured goods classified chiefly by materials, machinery and transport equipment, miscellaneous manufactured articles, and crude materials except fuels.¹⁹⁷ Based on the SITC section, machinery and transport equipment is the second biggest EU import from Indonesia or 15.1% of the EU's total imports from Indonesia, which is followed by animal and vegetable oils, fats and waxes in the third rank with 15.0% of EU total imports from Indonesia.¹⁹⁸ However, there are some products that seem to be more stable such as chemicals and related products, animal and vegetable oils, fats and waxes, beverages, tobacco, and food and live animals.¹⁹⁹

¹⁹⁷ See Massa, Isabella, Keane, Jodie., and Kennan, Jane.,2012.

¹⁹⁸ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/doclib/tradoc_113391.pdf, last accessed : 15 June 2012.

¹⁹⁹ See Massa, Isabella, Keane, Jodie., and Kennan, Jane., 2012.

Table 40. Bilateral trade between Indonesia and the European Union (EU 27)²⁰⁰

Product: TOTAL All products

Unit: Thousand euros

Product code	Product label	Indonesia's exports to European Union (EU 27)			European Union (EU 27)'s imports from world			Indonesia's exports to world		
		Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010
TOTAL	All products	10,522,654.7	9,781,042.19	12,955,300.48	4,133,800,783.06	3,265,970,619.8	3,946,669,746.92	93,126,479.25	83,541,858.62	118,819,655.77

Sources: ITC calculations based on COMTRADE statistics.

In 2008 Indonesia's exports to EU 27 were 11.23% of Indonesia's total exports to the world. In 2009 Indonesia's exports to EU 27 decreased by 7.05%, then, in 2010 increased by 24.05%. In 2010 Indonesia's exports to EU 27 were 10.90% of Indonesia's total exports to the world. (See Table 40).

Table 41. Percentage of Indonesia's exports to the European Union (EU 27) of Indonesia's total exports to the world 2006-2010.²⁰¹

No.	Year	Percentage of Indonesia's exports to European Union (EU 27) of Indonesia's total exports to world 2006-2010
1.	2006	11.97%
2.	2007	11.75%
3.	2008	11.23%
4.	2009	11.71%
5.	2010	10.90%

The average percentage of Indonesia's exports to the European Union (EU 27) of Indonesia's total exports to the world 2006-2010 above 10% per year. The percentage of Indonesia's export to EU 27 has declined during the economic crisis. (See Table 41).

²⁰⁰ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

²⁰¹ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

Table 42. Bilateral trade between Indonesia and European Union (EU 27) ²⁰²

Product: TOTAL All products

Unit: Thousand euros

Product code	Product label	Indonesia's imports from European Union (EU 27)			European Union (EU 27)'s exports to world			Indonesia's imports from world		
		Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010
TOTAL	All products	7,180,397.03	6,225,359.61	7,431,067.8	3,946,619,903.15	3,219,720,481.32	3,867,107,766.06	87,841,235.56	69,429,995.72	102,164,760.25

Sources: ITC calculations based on COMTRADE statistics.

In 2008 Indonesia's imports from EU 27 were 8.17% of Indonesia's total imports from the world. In 2009 Indonesia's imports from EU 27 fell by 13.3%. In 2010 Indonesia's imports from EU 27 increased to 16.23%. In 2010 Indonesia's imports from EU 27 were 7.27% of Indonesia's total imports from the world. (See Table 42).

²⁰² Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

Table 43. Bilateral trade between Indonesia and the European Union (EU 27)²⁰³

Product: TOTAL All products

Unit: Thousand euros

Product code	Product label	Trade Balance between Indonesia and European Union (EU 27)			World Trade Balance for European Union (EU 27)			World Trade Balance for Indonesia		
		Balance in value in 2008	Balance in value in 2009	Balance in value in 2010	Balance in value in 2008	Balance in value in 2009	Balance in value in 2010	Balance in value in 2008	Balance in value in 2009	Balance in value in 2010
TOTAL	All products	3,342,257.67	3,555,682.57	5,524,232.68	-187,180,879.92	-46,250,138.48	-79,561,980.86	5,285,243.69	14,111,862.9	16,654,895.52

Sources: ITC calculations based on COMTRADE statistics.

In fact the bilateral trade between Indonesia and EU 27 created an asymmetric trade relationship, where Indonesia exported more to EU 27 than it imported from EU 27. For instance in 2010 Indonesia's exports to EU 27 were 42.64% higher than Indonesia's imports from EU 27. (See Table 43).

²⁰³ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

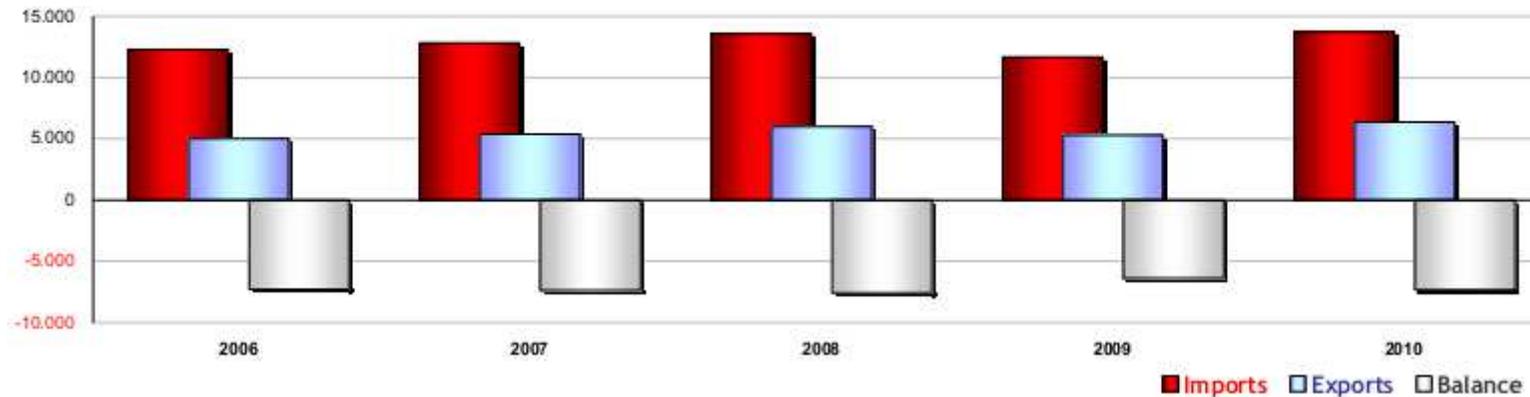
Figure 28. Indonesia Trade Balance with EU 27²⁰⁴



²⁰⁴ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf, last accessed : 15 June 2012.

Figure 29. EU Trade Balance with Indonesia²⁰⁵

European Union, Trade with Indonesia								millions of euro, %
Period	Imports	Variation (% , y-o-y)	Share of total EU Imports (%)	Exports	Variation (% , y-o-y)	Share of total EU Exports (%)	Balance	Trade
2006	12.293	13,2	0,9	4.999	4,4	0,4	-7.294	17.292
2007	12.790	4,0	0,9	5.401	8,0	0,4	-7.389	18.191
2008	13.569	6,1	0,9	5.975	10,6	0,5	-7.594	19.544
2009	11.677	-13,9	1,0	5.273	-11,8	0,5	-6.404	16.949
2010	13.729	17,6	0,9	6.372	20,8	0,5	-7.357	20.101
2010Q1	2.999	-	0,9	1.340	-	0,5	-1.659	4.339
2010Q2	3.424	-	0,9	1.558	-	0,5	-1.866	4.982
2010Q3	3.643	-	0,9	1.656	-	0,5	-1.987	5.298
2010Q4	3.663	-	0,9	1.819	-	0,5	-1.844	5.482
2011Q1	4.175	39,2	1,0	1.664	24,2	0,5	-2.512	5.839
2011Q2	-	-	-	-	-	-	-	-
2011Q3	-	-	-	-	-	-	-	-
2011Q4	-	-	-	-	-	-	-	-
Average annual growth (2006-2010)		2,8			6,3			3,8



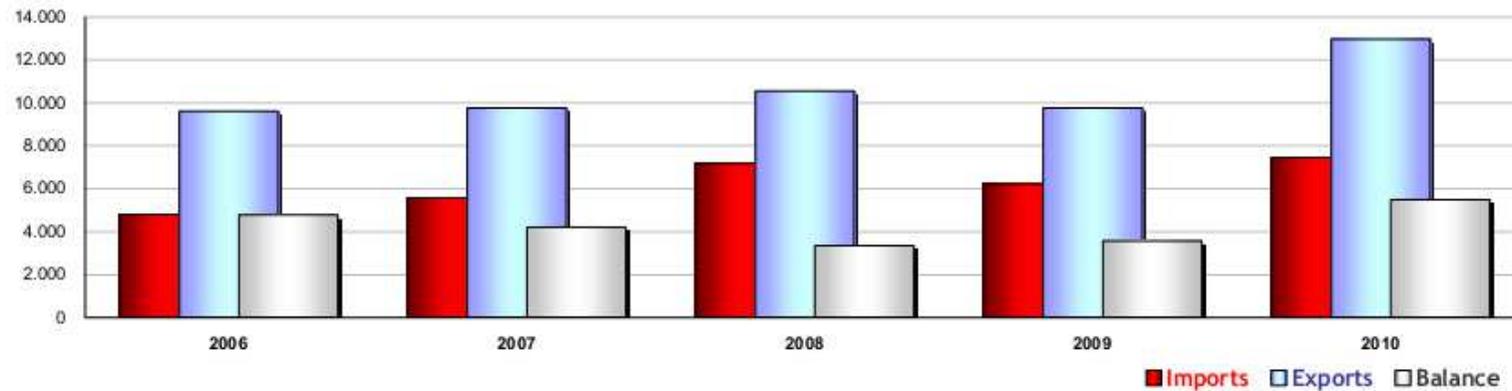
²⁰⁵ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf, last accessed : 15 June 2012.

Figure 30. Indonesia Trade Balance with EU²⁰⁶

INDONESIA, Trade with the European Union

millions of euro, %

Period	Imports	Variation (%, y-o-y)	EU Share of total Imports (%)	Exports	Variation (%, y-o-y)	EU Share of total Exports (%)	Balance	Trade
2006	4.820	2,1	10,1	9.605	15,2	12,3	4.784	14.425
2007	5.579	15,7	10,5	9.771	1,7	12,0	4.192	15.350
2008	7.185	28,8	8,4	10.553	8,0	11,6	3.368	17.738
2009	6.206	-13,6	9,2	9.767	-7,5	12,1	3.560	15.973
2010	7.457	20,1	7,5	12.960	32,7	11,2	5.504	20.417
2010Q1	1.510	-	7,1	2.899	-	11,6	1.388	4.409
2010Q2	1.868	-	7,4	2.885	-	10,2	1.016	4.753
2010Q3	2.033	-	7,8	3.528	-	12,2	1.495	5.561
2010Q4	2.045	-	7,4	3.649	-	10,9	1.604	5.694
2011Q1	-	-	-	-	-	-	-	-
2011Q2	-	-	-	-	-	-	-	-
2011Q3	-	-	-	-	-	-	-	-
2011Q4	-	-	-	-	-	-	-	-
Average annual growth (2006-2010)		11,5			7,8			3,6



²⁰⁶ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf, last accessed : 15 June 2012.

Table 44. List of importing markets from European Union (EU 27) for a product exported by Indonesia²⁰⁷

Product: TOTAL All products

Unit: Thousand euros

Importers	Exported value in 2006	Exported value in 2007	Exported value in 2008	Exported value in 2009	Exported value in 2010
World	80,239,427.88	83,240,123.98	93,126,479.25	83,541,858.62	118,819,655.77
European Union (EU 27) Aggregation	9,604,075.76	9,781,306.53	10,522,654.7	9,781,042.19	12,955,300.48
Netherlands	2,004,706.15	2,005,815.57	2,668,596.18	2,085,911.5	2,803,291.52
Germany	1,612,530.56	1,689,601.82	1,675,455.17	1,668,305.43	2,247,684.1
Italy	965,600.84	1,012,041.15	1,291,942.05	1,184,177.78	1,785,148.58
Spain	1,306,393.83	1,390,648.77	1,131,851.59	1,312,504.28	1,753,685.07
United Kingdom	1,140,230.66	1,060,854.8	1,051,328.91	1,046,404.34	1,275,081.17
Belgium	904,504.21	971,861.5	918,193.52	751,680.31	896,265.87
France	592,397.2	603,756.21	656,657.23	640,534	866,531.42
Poland	114,255.19	139,246.31	186,314.91	186,240.06	235,927.41
Denmark	113,636.67	102,704.1	116,139.28	121,010.58	135,709.57
Czech Republic	43,534.47	74,342.86	63,455.9	122,869.14	124,811.8
Sweden	107,785	80,123.66	91,151.12	103,486.22	117,868.44
Greece	100,158.97	170,344.76	145,629.46	118,782.03	116,992.62
Finland	140,619.14	88,522.75	73,702.36	43,868.26	92,434.05
Romania	37,921.61	43,065.67	53,290.31	35,763.6	70,109.12

²⁰⁷ Cited from Trade Map-International Trade Statistic, Trade Statistic for international business development, available at : http://www.trademap.org/countrymap/Bilateral_TS.aspx, last accessed : 16 November 2011.

Portugal	90,838.17	69,398.1	68,526.11	73,334.14	69,459.96
Slovenia	85,365.42	53,924.74	59,887.71	60,789.6	67,229.35
Slovakia	31,687.84	33,291.42	26,973.43	46,123.34	56,757.83
Hungary	52,269.38	26,662.9	27,126.35	36,206.73	55,673.4
Ireland	82,060.27	56,867.67	61,057.4	29,550.49	39,672.04
Austria	19,419.32	17,594.1	23,693.42	29,513.92	34,010.42
Bulgaria	15,254.46	27,369.81	48,574.19	20,604.75	29,824.07
Luxembourg	11,201.04	262.63	4,311.72	7,456.46	23,018.52
Lithuania	7,943.65	14,509.64	23,428.35	23,523.8	21,965.72
Estonia	4,870.15	13,793.97	16,366.75	13,804.38	16,482.57
Latvia	5,822.21	7,832.97	7,178.51	6,140.7	9,104.69
Cyprus	8,960.99	9,113.3	10,606.68	9,860.68	8,115.9
Malta	4,108.35	17,755.33	21,216.08	2,595.67	2,445.24

Sources: ITC calculations based on COMTRADE statistics.

It has to be noted that the EU comprises of 27 states and has a population of 500 million that represents the biggest regional market in the world. Seventeen of its twenty-seven member states use the single currency, the euro. The EU is the major trading partner for lower-middle income countries, for instance Indonesia. Among the 27 EU member states the Netherlands, Germany, and Italy are the biggest three importers of Indonesian goods and products. The top ten EU importing countries are included in the Eurozone except for the United Kingdom. (See Table 44). Today, Italy and Greece are the third and fourth biggest trading partners, which are included as the crisis-affected countries due to the Eurozone crisis.²⁰⁸

²⁰⁸ See Massa, Isabella., Keane, Jodie., and Kennan, Jane., 2012.

Table 45. Indonesia's export products to the EU 27 on Animal, vegetable fats and oils, cleavage products, etc.

Unit: Thousand euros

Product code	Product label	Indonesia's exports to European Union (EU 27)			European Union (EU 27)'s imports from world			Indonesia's exports to world		
		Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010
'1511	Palm oil & its fraction	1,416,531.47	1,334,365.99	1,635,404.69	4,488,027.9	3,814,214.92	4,624,429.61	8,411,105.65	7,433,957.49	10,143,155.04
'1513	Coconut (copra), palm kernel/babassu oil & their fractions	485,088.77	267,280.91	333,657.85	1,378,611.53	942,827.77	1,247,244.47	1,490,543.07	1,060,609.54	1,727,376.36
'1517	Margarine	25,638.59	21,427.9	20,616.96	1,526,961.65	1,365,748.51	1,435,600.83	361,189.2	189,504.01	261,018.4
'1516	Animal or veg. fats, oils & fract, hydrogenated	5,522.87	581.52	6,474.95	1,096,153.45	784,625.25	842,790.7	192,465.1	48,706.82	111,839.32
'1521	Vegetable waxes, beeswax & other insect waxes	4,280.46	4,054.84	5,243.67	56,761.98	53,277.93	71,719.95	14,214.96	10,893.93	19,438.4
'1522	Degras and residues	23.79	11.47	1,315.62	29,435.14	42,534.58	47,802.25	2,535.79	4,870.83	9,494.03
'1510	Other oils from olives	0	30.83	900.68	85,976.23	76,694.17	84,431.87	0.68	2,805.76	900.68
'1518	Animal or vegetable fats & oils chemically modified; inedible mixtures	11,804.23	45.89	189.78	654,633.22	467,967.81	717,483.37	120,517.61	60.23	1,273.45
'1512	Safflower, sunflower/cotton-seed oil & fractions	0	0	124.26	2,668,017.8	1,866,605.32	2,004,061	45.54	66.68	469.92
'1515	Fixed vegetable fats & oils & their fractions	4.08	5.74	40.67	976,816.4	720,711.53	873,263.92	336.43	597.29	4,318.89
'1508	Ground-nut oil & its fractions	0	0	0	169,866.6	113,491.74	115,373.5	63.21	0	8.28
'1509	Olive oil and its fractions	2.04	0	0	2,554,323.24	2,089,870.97	2,299,336.83	2.72	22.95	38.41

'1503	Lard stearin & oil, oleostearin & oil & tallow oil	0	0	0	16,466.66	12,558.17	17,481.91	0	0	0
'1507	Soya-bean oil & its fractions	0	0	0	1,813,975.46	832,303.84	1,008,972.73	0.68	0.72	0.75
'1520	Glycerol (glycerine)	1,020.84	0	0	108,502.68	47,153.72	57,308.33	20,630.9	6,957.4	4,455.2
'1502	Bovine, sheep & goat fats	0	0	0	247,611.55	165,278.95	243,118.54	0	0	0
'1504	Fish/marine mammal, fat, oils & their fractions	15.63	0	0	421,834.73	340,548.36	372,346.38	5,256.44	1,906.6	550.5
'1501	Lard and other pig & poultry fat	0	0	0	195,698.89	158,170.25	188,741.18	0	842.52	0
'1514	Rape, colza or mustard oil & their fractions	0	0	0	2,465,095.54	1,889,914.01	1,911,826.51	6.12	0	1.51
'1505	Wool grease and fatty substances derived therefrom (including lanolin)	0	0	0	45,750.23	62,187.1	64,104.84	0	0	0.75
'1506	Animal fats & oils & their fractions	0	0	0	87,677.4	56,511.04	79,760.54	0.68	10.76	18.83

Sources: ITC calculations based on COMTRADE statistics.

In 2005 Indonesia graduated in two sections, that is, Sections III²⁰⁹ and Sections IX^{210,211} While, in 2002 Indonesia graduated from 3 sectors, i.e., Section X, XIX, and XXIII.²¹² In 1998 Indonesia graduated in Chapter 15²¹³, Chapters 44 to 46²¹⁴, and Chapters 64 to 67^{215,216} (See Table 45).

²⁰⁹ Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.

²¹⁰ Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basket ware and wickerwork.

²¹¹ See Annex I Beneficiary countries and territories of the Community's scheme of generalised tariff preferences Council Regulation (EC) No. 980/2005 of 27 June 2005 applying a scheme of generalised tariff preferences (Official Journal, L 169/1, 30.6.2005, EN).

²¹² See Annex I Beneficiary countries and territories of the Community's scheme of generalised tariff preferences Council Regulation (EC) No. 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004 (Official Journal, L 211/1, 6.8.2008, EN).

²¹³ Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.

²¹⁴ Wood products.

²¹⁵ Footwear products.

²¹⁶ See Annex II Part I List of sectors and countries referred to in Articles 3 and 4 (a) Council Regulation (EC) No. 2820/98 of 21 December 1998 applying a multiannual scheme of generalised tariff preferences for the period 1 July 1999 to 31 December 2001 (Official Journal, L 357, 30.12.1998, p. 1).

Table 46. Indonesia's export products to the EU 27 on wood and articles of wood, wood charcoal

Unit: Thousand euros

Product code	Product label	Indonesia's exports to European Union (EU 27)			European Union (EU 27)'s imports from world			Indonesia's exports to world		
		Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010	Value in 2008	Value in 2009	Value in 2010
'4409	Wood continuously shaped along any edges	114,092.16	96,923.19	122,649.72	1,696,854.08	1,279,514.89	1,465,223.83	289,205.69	267,982.17	363,205.54
'4412	Plywood, veneered panels and similar laminated wood	138,427.85	98,454.78	114,355.34	3,197,033.29	2,042,127.85	2,535,382.48	1,038,003.61	852,922.21	1,231,559.4
'4418	Builders' joinery & carpentry of wood	132,342.23	92,588.71	111,422.87	4,524,537.56	3,643,880.15	4,080,741.12	288,799.94	206,920.81	238,606.11
'4420	Wood marquetry & inlaid wood; caskets & cases or cutlery of wood	42,511.68	67,573.47	44,127.99	502,148.09	413,194.15	441,107.49	104,581.08	120,117.15	110,760.91
'4408	Veneer sheets & sheets for plywood & other wood sawn lengthwise	10,315.11	7,085.03	11,162.85	1,363,655.75	917,641.16	1,028,627.26	20,466.42	15,348.16	19,795.36
'4402	Wood charcoal (including shell or nut charcoal)	2,319.66	5,611.52	6,767.14	243,834.71	277,875.83	296,037.94	37,240.28	46,502.65	48,889.69
'4414	Wooden frames for paintings, photographs, mirrors or similar objects	5,650.64	5,424.38	5,709.07	259,748.81	227,184.97	246,210.67	66,691.73	61,068.52	57,134.37
'4407	Wood sawn/chipped lengthwise, sliced/peeled	11,570.43	5,321.12	3,670.49	9,309,882.14	6,985,798.52	8,283,982.85	37,518.94	25,814.73	23,265.53
'4417	Tools, tool & broom bodies & handles, shoe lasts of wood	899.18	669.71	607.73	90,302.23	80,461.48	92,269.13	6,617.79	5,575.67	5,275.3
'4419	Tableware and kitchenware of wood	405.07	402.97	542.21	256,099.06	208,801.6	233,842.15	2,460.35	2,855.24	2,949.05
'4421	Articles of wood, n.e.s.	286.81	501.93	305	1,947,678.35	1,763,172.88	1,977,063.98	8,569.08	8,207.19	11,880.53
'4415	Packaging materials of wood	507.02	448.86	220.65	1,505,653.82	1,110,806.36	1,287,015.17	3,936.56	2,582.76	2,898.59
'4401	Fuel wood; wood in chips or particles; sawdust & wood waste & scrap	49.61	25.1	134.05	1,423,291.31	1,545,791.95	2,062,226.33	7,205.01	26,042.03	51,343.97

'4416	Casks, barrels, vats, tubs etc. of wood	4.08	0	6.78	164,752.89	150,181.04	133,317.8	42.82	0.72	12.05
'4413	Densified wood, in blocks, plates, strips or profile shapes	65.93	5.02	6.02	104,018.33	67,273.75	85,368.7	292.93	665.41	259.06
'4410	Particle board and similar board of wood or other ligneous materials	12.91	0	1.51	2,663,665.29	2,019,401.39	2,351,586.75	775.49	1,587.52	2,140.24
'4403	Wood in the rough	0	0	0	3,731,628.05	2,217,276.08	3,012,302.49	24.47	58.08	14.31
'4411	Fibreboard of wood or other ligneous materials	116.9	54.49	0	2,887,783.24	2,344,121.9	2,583,463.37	42,375.07	32,983.66	35,426.95
'4405	Wood wool; wood flour	0.68	0	0	23,969.36	22,269.7	26,121.95	1,650.88	962.98	472.18
'4404	Hoopwood; split poles; piles, pickets, stakes; chipwood	0	0	0	109,634.31	87,766.64	94,665.42	825.78	520.57	5,105.86
'4406	Railway or tramway sleepers (cross-ties) of wood	0	0	0	94,224.51	58,668.6	62,795.24	0	3.59	0.75

Sources: ITC calculations based on COMTRADE statistics.

The recalculation of 2004-2006 trade data led to the re-inclusion ("*degradation*") of certain product sections for six beneficiaries under the 2009-2011 schemes. These included Algeria (for Section V "*Mineral products*"); India (for Section XIV "*Jewellery, pearls, precious metals and stones*"); Indonesia (for Section IX "*Wood and articles of wood*"); Russian Federation (for Section VI "*Products of the chemical or allied industries*" and Section XV "*Base metals*"); South Africa (for Section XII "*Transport equipment*"); and Thailand (for Section XVII "*Transport equipment*"). The GSP preferences suspended Vietnam for Section XII "*Footwear, headgear, umbrellas, sun umbrellas, artificial flowers*".²¹⁷ (See Table 46).

²¹⁷ See Column C of annex I to the regulation No. 732/2008 (*Official Journal* L 211, 6.8.2008) against column C of annex I to Regulation (EC) No. 980/2005 (*Official Journal* L 139/1,30.6.2005). See also United Conference on Trade and Development, Generalized System of Preferences : Handbook on The Scheme of The European Community, 2008, *Op. Cit.*, pp. 21 - 34. See also Graduation from the Generalised System of Preference Scheme of the European Union (EU - GSP Scheme), 1998.

Table 47. EU Trade with main trading partners (2010)²¹⁸

The Major Imports Partners				The Major Exports Partners				The Major Trade Partners			
Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%
Extra EU27		1,501,843.9	100.0%	Extra EU27		1,348,792.4	100.0%	Extra EU27		2,850,636.3	100.0%
1	China	282,011.1	18.8%	1	United States	242,095.1	17.9%	1	United States	411,562.5	14.4%
2	United States	169,467.4	11.3%	2	China	113,117.7	8.4%	2	China	395,128.8	13.9%
3	Russia	158,384.9	10.5%	3	Switzerland	105,433.4	7.8%	3	Russia	244,893.7	8.6%
23	Indonesia	13,729.2	0.9%	35	Indonesia	6,372.2	0.5%	32	Indonesia	20,101.3	0.7%

Source: EUROSTAT (Comext, Statistical regime 4)

European Union: 27 members.

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According to EU trade statistics, Indonesia takes rank 32 as EU 27's major trade partners, rank 35 as EU 27's major exports partners and rank 23 as EU 27's major imports partners. (See Table 47).

²¹⁸ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf, last accessed : 15 June 2012.

Table 48. Indonesia's trade with main trading partners (2010)²¹⁹

The Major Imports Partners				The Major Export Partners				The Major Trade Partners			
Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%	Rk	Partners	Mio euro	%
	World (all countries)	100,087.8	100.0%		World (all countries)	115,455.9	100.0%		World (all countries)	215,543.7	100,0%
1	China	15,474.6	15.5%	1	Japan	19,463.5	16.9%	1	Japan	32,298.8	15,0%
2	Singapore	15,278.0	15.3%	2	EU27	12,960.4	11.2%	2	China	27,299.8	12,7%
3	Japan	12,835.3	12.8%	3	China	11,825.3	10.2%	3	Singapore	25,607.6	11,9%
4	EU27	7,456.9	7.5%	4	United States	10,801.3	9.4%	4	EU27	20,417.3	9,5%
5	United States	7,112.2	7.1%	5	Singapore	10,329.6	8.9%	5	United States	17,913.5	8,3%

The EU 27 is placed in the 4th rank as Indonesia's major trade partners and Indonesia's major imports partners. EU 27 is the second biggest major exports partner for Indonesian goods and products. Indonesia's export to the EU covers 11.2% of Indonesia's total exports to the world. Indonesia's total exports to Japan, EU 27, China, and USA are 47.7% of Indonesia's exports to the world. (See Table 48).²²⁰

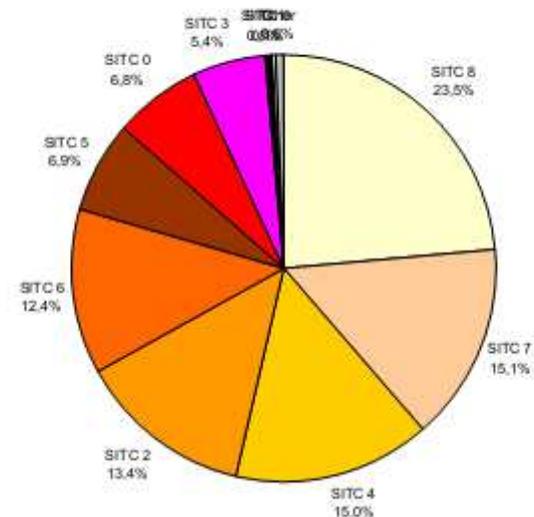
²¹⁹ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf.

²²⁰ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf.

Table 49 & Figure 31. EU imports from Indonesia based on SITC Section (2010)²²¹

SITC Codes	SITC Sections	Value (Million euros)	Share of Total (%)	Share of total EU Imports
SITC T	TOTAL	13,729	100.0%	0.9%
SITC 8	Miscellaneous manufactured articles	3,232	23.5%	1.6%
SITC 7	Machinery and transport equipment	2,077	15.1%	0.5%
SITC 4	Animal and vegetable oils, fats and waxes	2,055	15.0%	31.1%
SITC 2	Crude materials, inedible, except fuels	1,844	13.4%	2.9%
SITC 6	Manufactured goods classified chiefly by material	1,708	12.4%	1.1%
SITC 5	Chemicals and related prod, n.e.s.	943	6.9%	0.7%
SITC 0	Food and live animals	932	6.8%	1.3%
SITC 3	Mineral fuels, lubricants and related materials	736	5.4%	0.2%
SITC 1	Beverages and tobacco	105	0.8%	1.5%
SITC 9	Commodities and transactions n.c.e.	12	0.1%	0.0%

European Union, Imports from... Indonesia



Based on SITC section, machinery and transport equipment is the second biggest EU import from Indonesia or 15.1% of EU total imports from Indonesia, which is then followed by animal and vegetable oils, fats and waxes in the third rank with 15.0% of EU total imports from Indonesia. (See Table 49 and Figure 31).²²²

²²¹ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf.

²²² Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf.

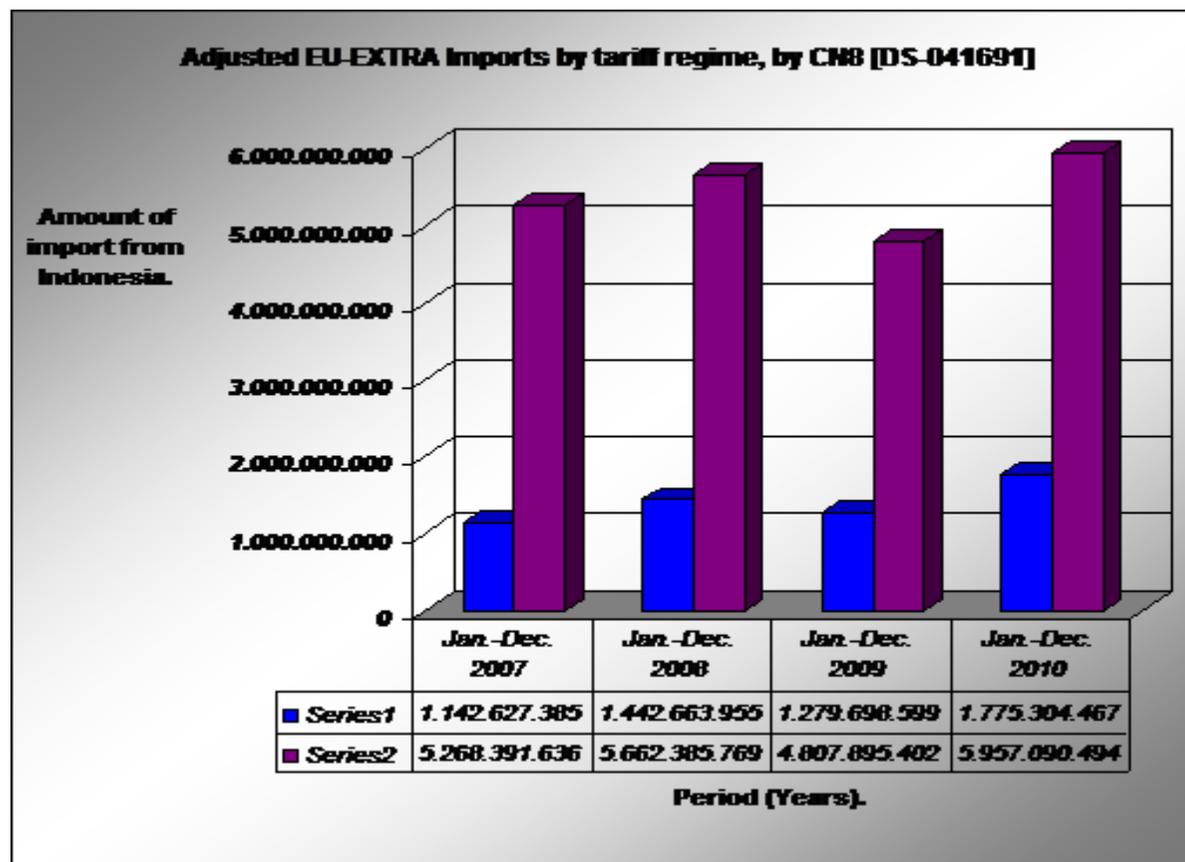
Table 50. Adjusted EU-EXTRA Imports by tariff regime, by CN8 [DS-041691]

Last update 02.03.12
 Extracted on 23.11.12
 Source of Data Eurostat
 INDONESIA (ID+TP from 77,excl.
 PARTNER TP -> 2001)
 PRODUCT TOTAL
 STAT_REGIME NORMAL
 INDICATORS VALUE_IN_EUROS

Declarant/Period	Beneficiary Country	Eligibility	Import regime	Jan.-Dec. 2007	Jan.-Dec. 2008	Jan.-Dec. 2009	Jan.-Dec. 2010
EU 27	Indonesia	E1 (Only MFN), E7 (GSP and/or Preferences), Unknown.	U10 (MFN Zero), U11 (MFN non zero), U70 (Any Preference Zero), U71 (Any Preference non zero), UZZ (Unknown).	1.142.627.385	1.442.663.955	1.279.698.599	1.775.304.467
EU 27	Indonesia	E7 (GSP and/or Preferences)	U70 (Any Preference Zero), U71 (Any Preference non zero),	5.268.391.636	5.662.385.769	4.807.895.402	5.957.090.494

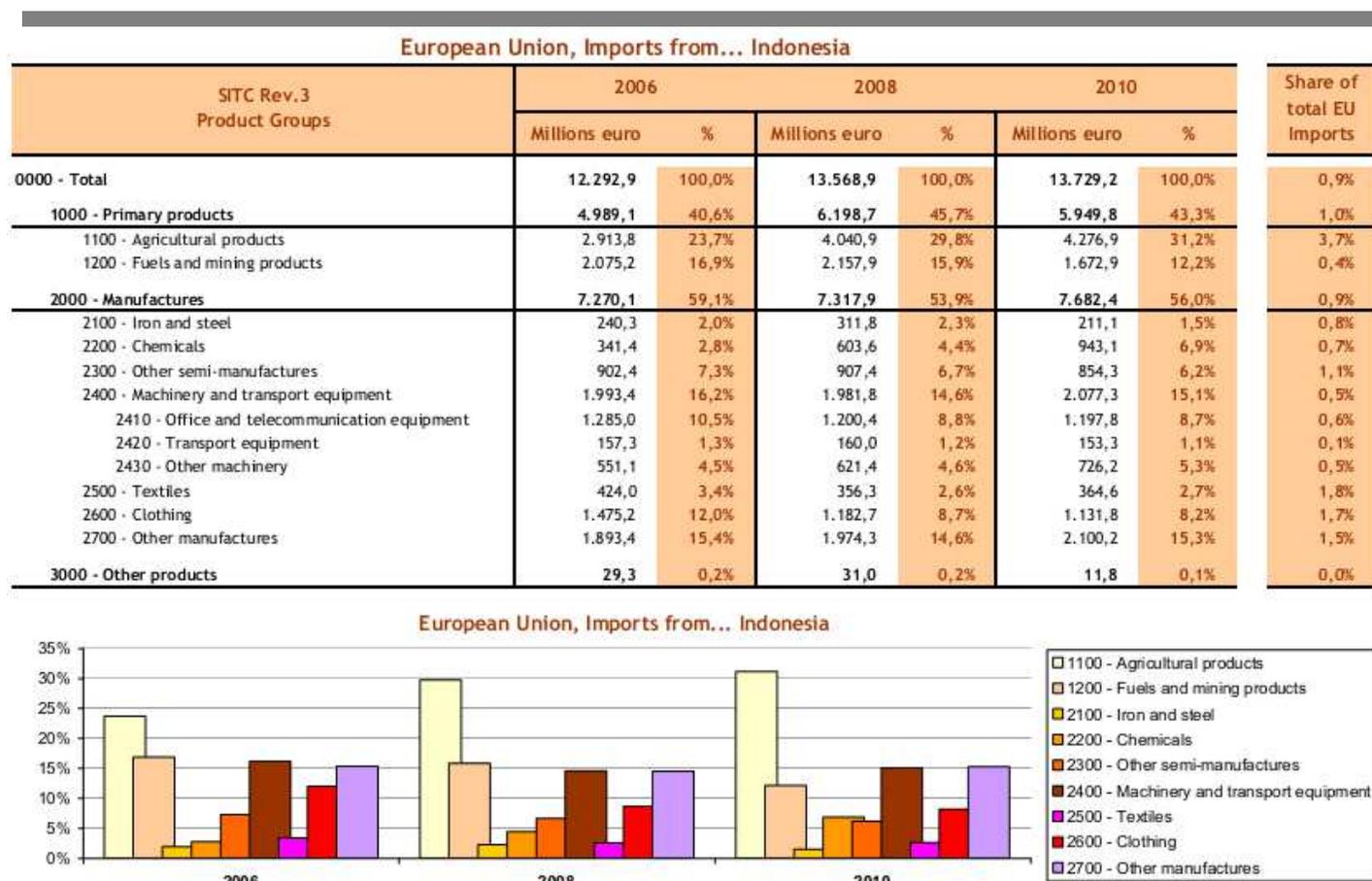
Source : Eurostat.

Figure 32. Adjusted EU-EXTRA Imports by tariff regime, by CN8 [DS-041691]



Source : Eurostat.

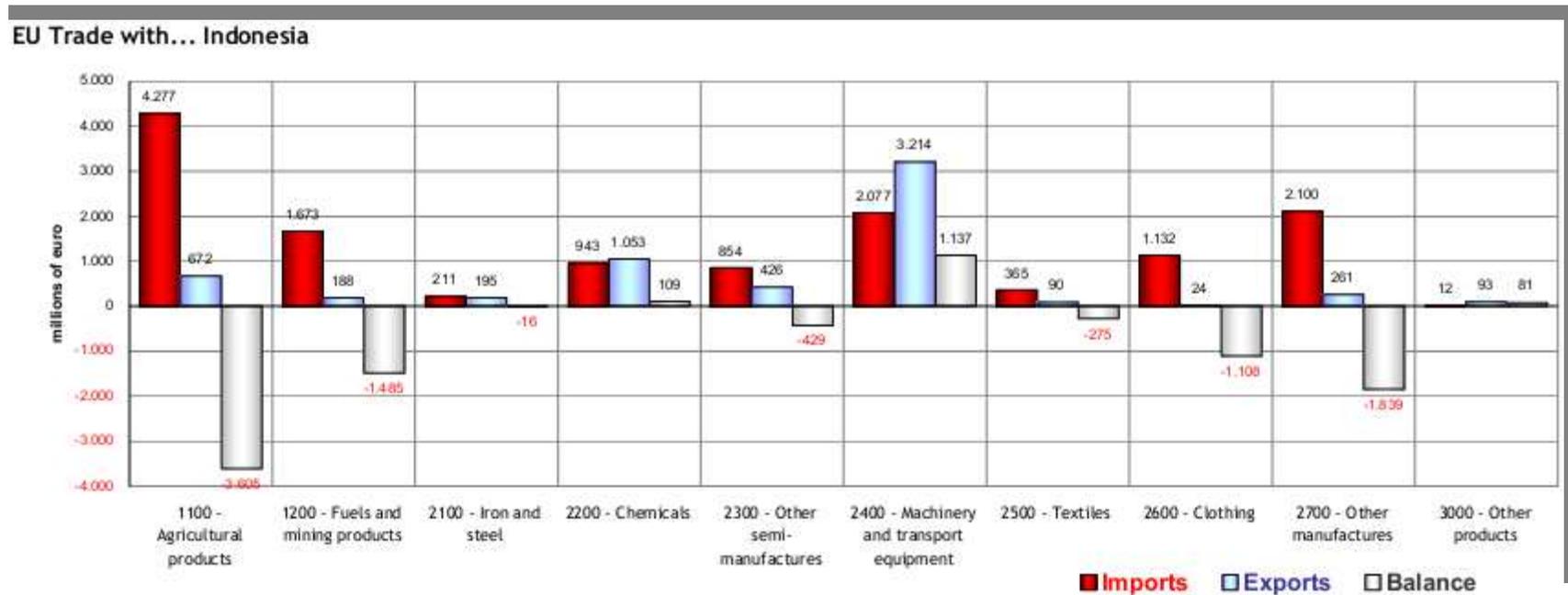
Figure 33. EU imports from Indonesia by product grouping²²³



Agricultural products are one of the primary import products from Indonesia to EU 27 amounting to 31.2% of total import products in 2010. Manufacture products are the biggest import products from Indonesia to EU 27 amounting to 56.0% of total import products in 2010. (See Figure 11).

²²³ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/tradoc_113391.pdf.

Figure 34. Asymmetric trade EU – Indonesia



As mentioned, EU trade with Indonesia has established an unsymmetrical trade relationship where EU imports from Indonesia are larger than EU exports to Indonesia. (See Figure 34).

VI. Indonesian foreign trade policy and decentralisation.

VI.a. General overview of decentralisation in Indonesia.

The demand for decentralisation in many parts of the world is often motivated by the need to enhance public service delivery. However, such demand is in fact more closely linked with control over resources and political and legal autonomy than with a supposed need to enhance public service delivery at a local level.²²⁴ Many economists use the term the “Big Bang Theory” to define the implementation of decentralisation in Indonesia since it was established and implemented in a very limited time. Apparently, it lacks some aspects mainly related to economic and fiscal considerations. Hasty implementation of Indonesia’s decentralisation was most likely based on political consideration in order to reduce tensions between the central government and regions. The Big Bang Theory is used by economists to explain radical migration from centralisation into decentralisation. Law No. 22/1999 is perceived as the “Big Bang” of decentralisation in Indonesia after some decades of centralisation. In this regard, Indonesia swiftly migrated the country from one of the most centralised systems in the world to one of the most decentralised.²²⁵

January 2001 was regarded as the milestone to breakdown the centralisation era, however, it was not Indonesia’s first attempt to implement decentralisation with a lot of challenges and difficulties. The pros and cons of the implementation of decentralisation took place at a central level, with the concern that it could undermine the authority and competences of the central government. In addition, there were some opinions that decentralisation could lead into republic disintegration. There were also some sceptical opinions regarding the sustainability of the decentralisation implementation. According to Marsillam Simandjuntak, decentralisation can be described as an idea that is made into a political decision. In this regard, decentralisation will strongly be influenced by the existence of various interests at the conceptual level. The interpretations of the decentralisation conception depend on the interests of the stakeholders involved. The existences of various interests most likely increases tensions between the stakeholders involved, which might also result in a conflict of rights. The settlement of such conflict can be performed either at a national or local level. Therefore, as an idea alone, “decentralisation” is perceived as quite risky, and as potentially threatening national integrity.²²⁶ On the other hand, Gary Goodpaster argues that decentralisation is also considered as one method of diffusing social and political tensions and enhancing social cohesion.²²⁷ Due to the evolution and dynamisms of the local autonomy in Indonesia, Law No. 22/1999 was amended by Law No. 32/2004 and lastly amended by Law No. 12/2008.

VI.a.1. Legal historical reviews.

Indonesia is the biggest archipelago state in the world, it consists of more than 17,000 islands, and has more than 800 local languages and tribes. The centralisation system in Indonesia was started in the 1950s. At that time, it also took the form of a

²²⁴ See Dillinger, 1994; Ehtisham Ahmad and Ali Mansoor, *Indonesia : Managing Decentralization* ,IMF Working Paper, WP/02/136, International Monetary Fund, 2002, available at : <http://www.imf.org/external/pubs/ft/wp/2002/wp02136.pdf>, p. 3.

²²⁵ See Bert Hofman and Kai Kaiser, *The making of the 'Big Bang' and its aftermath: a political economy perspective*, p. 15.

²²⁶ See Marsillam Simandjuntak, *Indonesian decentralization: opportunities appear but risks abound*, p. 263.

²²⁷ See Gary GoodPaster, *Decentralization, Internal Barriers to Trade, and Local Discriminatory Action*, A Joint Project of USAID and the Government of Indonesia, 25 February 2000, available at : <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN015676.pdf>.

multi-tier unitary state, where many governmental tasks were performed by deconcentrated central government agencies in provinces and districts.²²⁸

Decentralisation can be traced back to the colonial era where many efforts were attempted but none was successful.²²⁹ The Decentralisation Act of 1903 was issued by the Dutch and commenced the “formal” establishment of local governments in Indonesia. The Decentralisation Act of 1903 aimed to establish a sort of elected local council to balance the deconcentration principle in the regions. This Act was reformed by the Act of 1922 to give more autonomy to local governments by including eminent native figures in the local Council.²³⁰

The local government structures in Indonesia, which consist of provinces, municipalities and districts, were created for the first time during the colonial era. The first municipalities were created in 1905. This was followed by the establishment of the first districts (*gewesten*) in 1910. Thus, in the 1920s the first provinces were established on Java island. The first law issued that dealt with “local autonomy” after the proclamation of Indonesia’s independence was Law No. 1/1945. This Law was established under the umbrella of Article 18 of the 1945 constitutions.²³¹

From 1942 to 1945, Japan, as the winner of the Asia-Pacific War, started to invade Asia including Indonesia. The Dutch administration was replaced by Japanese military administration. In fact, the Japanese military administration kept most of the local government system established by the Dutch. Under the deconcentration principle, a governing relationship between the local and central government was still applied. All political activities were prohibited under the Japanese military administration. The Japanese occupation terminated when it was conquered by the allied forces, thus giving Indonesia the opportunity to proclaim its independence on 17 August 1945.²³²

As a matter of fact, the Kingdom of the Netherlands did not recognise Indonesia’s independence on 17 August 1945. At the same time, the Dutch, as the colonialist, wanted to preserve its power by creating numerous Indonesian republics on some islands outside Java, which were placed as subsidiaries of the Dutch government. These Indonesian republics outside Java island were united under the Dutch Crown. Such policy was put into force by the Dutch government as a political movement to demoralise Indonesia as a unitary state. Due to such situation, the Dutch argued that “Republik Indonesia” (referring to Java island), was only one part of Indonesia that was seeking independence from the Dutch.²³³ Such political movement created a federal state or the United Republic of Indonesia over the Unitary State of the Republic of Indonesia. The establishment of the United Republic of Indonesia was based on the 1950 constitution. The United Republic of Indonesia, similar to the commonwealth system, only lasted for a year. After it dissolved, the 1950s constitution was replaced again by the 1945 constitutions, and returned to the implementation of the unitary state concept.²³⁴

Made Suwandi concludes that the Dutch laid down important foundations of the modern local government in Indonesia. Even though, it tended to be deconcentration heavy rather than decentralisation heavy. As previously mentioned, the Act of 1922 introduced the involvement of eminent native figures in the local councils, at the same

²²⁸ See Shah and Qureshi, 1994; Booth, 1996; Aten, 1999; James Alm and Sri Mulyani Indrawati, *Decentralization and local government borrowing in Indonesia*, p. 237.

²²⁹ See De Jong, 1970; Bert Hofman and Kai Kaiser, *Op. Cit.*, p. 16.

²³⁰ See Made Suwandi, *The Indonesian experience with the implementation of regional autonomy*, p. 273.

²³¹ See De Jong, 1970; Bert Hofman and Kai Kaiser, *Loc. Cit.*, p. 16.

²³² See Made Suwandi, *Op. Cit.*, p. 273.

²³³ See Bert Hofman and Kai Kaiser, *Op. Cit.*, p. 16.

²³⁴ See *Ibid.*, p. 16.

time the Head of the Region was appointed by the Dutch. The Japanese military administration did not make any significant changes to the inherited system implemented by the Dutch.²³⁵

Soon after its independence, there were seven main local government laws and one Presidential Decree, including Law No. 1/1945, Law No. 22/1948, Law No. 1/1957, Presidential Decree 6/1959, Law No. 18/1965, Law No. 5/1974, Law No. 22/1999, and Law No. 32/2004 as amended by Law No. 12/2008. Each of the regulations provides a moderately different picture of the local government system. Law No. 1/1945 was more focused on deconcentration while Law No. 22/1948 initiated migration into decentralisation. The decentralisation was marked down by increasing the roles assigned to the Head of the Region. The Head of the Region has the dual role as a local representative and as an agent of the central government.²³⁶

Invigorating the implementation of local autonomy was issued by Law No. 1/1957²³⁷, it increased the extent of decentralisation by obliging the Head of the Region to be exclusively responsible for the Local Council.²³⁸ Unfortunately, this law was cancelled after political riots took place in some regions in Indonesia such as Sumatra, Sulawesi, Maluku, and West Java. The Presidential Decree of 5 July 1959 returned to the 1945 constitution, and effectively abolished the 1957 autonomy law by the passage of Law No. 18/1965.²³⁹ The Presidential Decree 6/1959 turned the decentralisation heavy into deconcentration heavy, where local powers were mainly conferred in the hands of the Head of the Region, who was appointed by the central government, mainly from Civil Servants.²⁴⁰

The issuance of Law No. 18/1965 ended the heavy deconcentration. Law No. 18/1965 tended to favour decentralisation. The regions were given broad autonomy. Deconcentration functions were placed as a supplement to those to be performed under decentralisation. The issuance of this law was driven by the domination of political parties at the national power. Decentralisation was mandated by Law No. 18/1965 and allowed the Head of the Region to hold party membership. The failed coup attempt by the Indonesian Communist Party (PKI) in 1965, started a new regime that was dominated by bureaucracy and the armed forces.²⁴¹

The issue of local autonomy was raised again in the New Order era, it led to the establishment of Law No. 5/1974, however, during that time, such law was never in fact fully implemented because of the strong centralisation system. To implement local autonomy under Law No. 5/1974 required the regions to prove they were ready for implementation. The central government acts as the judge and jury for the local government.²⁴² The issuance of Law No. 5/1974 obviously started the dominant role of the central government over the local governments.²⁴³ According to Hofman and Kaiser, an experimental local autonomy was implemented in 1996 in 26 local governments, and it failed. This was due to difficulties where the resources and facilities were not handed over together with the tasks.²⁴⁴

In the middle of 1997, economic crisis struck Indonesia and was followed by political crisis, and then ended in a severe multi-dimensional crisis. After the fall of the

²³⁵ See Made Suwandi, *Op. Cit.*, p. 274.

²³⁶ See Made Suwandi, *Loc. Cit.*, p. 273.

²³⁷ See Bert Hofman and Kai Kaiser, *Op. Cit.*, p. 20.

²³⁸ See Made Suwandi, *Loc. Cit.*, p. 273.

²³⁹ See Bert Hofman and Kai Kaiser, *Loc. Cit.*, p. 20.

²⁴⁰ See Made Suwandi, *Loc. Cit.*, p. 273.

²⁴¹ See Made Suwandi, *Loc. Cit.*, p. 274.

²⁴² See Bert Hofman and Kai Kaiser, *Loc. Cit.*, p. 20.

²⁴³ See Made Suwandi, *Loc. Cit.*, p. 274.

²⁴⁴ See Bert Hofman and Kai Kaiser, *Loc. Cit.*, p. 20.

New Order, two new laws on local autonomy were passed, Law No. 22/1999 and Law No. 25/1999.²⁴⁵ Law No. 22/1999 reflected the massive political changes at the central government, and broke down the strong centralisation power into decentralisation.²⁴⁶ Dwight Y. King describes Law No. 22/1999 as the “radical departure” from the structures of governance that have been carried out over more than three decades.²⁴⁷

Law No. 22/1999 introduces two basic levels of governance, the central government and the autonomous district governments (city/kota and municipality/kabupaten) whose relationship involves a division of responsibilities and powers.²⁴⁸ District governments no longer perform the doubled function as an administrative area of the central government. In other words, the Head of a District is directly responsible to the People’s Representative Council at local level. While in the centralisation system, the Head of District is responsible for the president through the provincial governor.²⁴⁹

Under Law No. 22/1999, the provincial governments are comprised of autonomous units but at the same time as extensions and administrative regions of the central government. In other words, provincial governors continue to wear two hats, as head of a region and as representative of the central government in a province.²⁵⁰

With regard to improving democratisation on the level of local government, a direct election of heads of regional governments was proposed (i.e. governors, regents and mayors). On January 2003, the government official proposed a partial revision of Law No. 22/1999.²⁵¹ Finally, Law No. 32/2004 concerning Local Government, was replaced Law No. 22 /1999, thus, it was amended by Law No. 12/2008.

VI.a.2. Decentralisation in Indonesia today: Law No. 32/2004 Jo. Law No. 12/2008.

According to Law No. 32/2004, local autonomy must be implemented based on decentralisation, deconcentration, and assistantship tasks principles.²⁵² Local autonomy is aimed to envisage the people’s welfare through the enhancement of public services, people empowerment, and the improvement of the people’s participation in the local development. Article 1 Subparagraph 5 Law No. 32/2004 Jo. Article 1 Subparagraph 4 Government Regulation No. 38/2007, defines local autonomy, as follows:

“[...] Regional autonomy is the right, authority, and obligation of the autonomous regions to govern and manage their own affairs and interests of local communities in accordance with statutory regulations [...]”.

Thus, Law No. 32/2004 differentiates the terms of the deconcentration principle and decentralisation principle. Decentralisation is described as the transfer of central government authority by the government to the autonomous region to govern and manage the affairs of government within the system of the Republic of Indonesia.²⁵³ Thus, deconcentration is described as the delegation of the central government authority by the government to the governor as the representative government and/or the vertical institutions in a particular area.²⁵⁴

²⁴⁵ See *Ibid.*, p. 20.

²⁴⁶ See Made Suwandi, *Loc. Cit.*, p. 274.

²⁴⁷ See Dwight Y. King, *Political reforms, decentralization and democratic consolidation in Indonesia*, p. 49.

²⁴⁸ See *Ibid.*, p. 49.

²⁴⁹ See *Ibid.*, p. 49.

²⁵⁰ See *Ibid.*, p. 49.

²⁵¹ See Dwight Y. King, *Op. Cit.*, p. 55.

²⁵² See Article 2 paragraph 2 jo Article 10 paragraph 2 Law No. 32/2004.

²⁵³ See Article 1 paragraph 7 Law No. 32/2004.

²⁵⁴ See Article 1 paragraph 8 Law No. 32/2004.

Authority distribution between central government and local government is regulated under Article 10 Law No. 32/2004. Local governments carry out government affairs that are included in their authority, except government affairs, which are determined by law as central government affairs.²⁵⁵ There are six crucial government affairs that are determined as exclusively central government affairs, that is, foreign affairs, defence, security, justice, national fiscal and monetary affairs, and religion.²⁵⁶ There are thirty-one government affairs that are shared among the government levels and/structures, where trade affairs is included in this category.²⁵⁷ The implementation of the distribution of government affairs is based on the criteria of externalities, accountability, and efficiency by taking into consideration the harmonisation relationship between the government structures in order to avoid overlap the competency of bureaucracy.²⁵⁸ The implementation of the authority distribution between the central government, province government and municipality/regency must be based on interrelationship, interdependency and synergy under one governmental system.²⁵⁹ Local government affairs are divided into two categories, i.e. obligatory affairs and optional affairs.²⁶⁰ Optional affairs are defined as government affairs that exist and could potentially improve community welfare in correspondence with the conditions, uniqueness, and potential of the regions concerned.²⁶¹ A trade affair is included into optional affairs.²⁶²

Local autonomy creates a new challenge in the foreign trade, such as harmonization of the rules and regulations between local government and central government. Nowadays, this challenge becomes one of the main concerns of the government and the business community. Indonesia's Trade Chamber is emphasizing the importance of harmonization of the rules and regulations between local and central government to provide better business environment.²⁶³ It's reiterated by General Secretary Ministry of Trade, Mr. Ardiansyah Parman, as follows

“[...] Ministry of Trade is continuously carrying out a synergy with local governments and invites support from local governments to participate strengthening domestic trade and international trade, secure domestic trade, developing distribution of infrastructure and consumer protection system [...]”.

Through the harmonization and synergy of the rules and regulation, local autonomy must not impeded the export boost. This demand is based on some perceptions and scepticism on local autonomy, for instance :²⁶⁴

1. Different perceptions among central government ministries or agencies particularly between the Ministry of Home Affairs and sectoral/line ministries.
2. Different perceptions between central ministries and local governments.
3. Different perceptions among local governments themselves, particularly between the province and the districts and cities.

Scepticism on local autonomy rises because creating overlap of tasks and competencies in the local and central level, excessive bureaucracy procedures, and create opportunity of misuse power for corruption. E-trade system, such as INSW and Inatrade, is the example of national integration of public service delivery on trade. It provided

²⁵⁵ See Article 10 paragraph 1 Law No. 32/2004.

²⁵⁶ See Article 10 paragraph 3 Law No. 32/2004 jo Article 2 paragraph 2 Government Regulation No. 38/2007.

²⁵⁷ See Article 2 paragraph 4 Government Regulation No. 38/2007.

²⁵⁸ See Article 11 paragraph 1 Law No. 32/2004 jo Article 4 paragraph 1 Government Regulation No. 38/2007.

²⁵⁹ See Article 11 paragraph 2 Law No. 32/2004

²⁶⁰ See Article 11, 13, and 14 Law No. 32/2004 jo Article 7 Government Regulation No. 38/2007.

²⁶¹ See Article 13 paragraph 2 and Article 14 paragraph 2 Law No. 32/2004 jo Article 7 paragraph 3 Government Regulation No. 38/2007.

²⁶² See Article 7 paragraph 4 Government Regulation No. 38/2007.

²⁶³ See Butir-Butir Pemikiran Perdagangan Indonesia 2009-2014.

²⁶⁴ See Made Suwandi, *Op. Cit.*, pp. 281-282.

uniformity of export-import procedure's, which including automation of issuing certificate of origin.

VI.a.3. Decentralisation from the political-economic perspective.

As explained in the historical perspectives, decentralisation in Indonesia started a century ago. The implementation of decentralisation in Indonesia was mainly influenced by the political configuration at national level. Political changes of the Reformation era brought significant changes to the political and administrative system. The centralised system of administration, which had been instrumental in supporting national development for more than 30 years, shifted into a decentralised system.²⁶⁵

In a broader perceptives, the broader aims of decentralisation were to create more efficient public services, to boost local economic growth, to deliver equality development due to its needs, and to give the local governments the opportunity to manage their own economic resources for the welfare of the people. From the political-economic perspective, there are some reasons why the decentralisation system is chosen as the best solution to cope with Indonesia's political and economic problems. Ryaas Rasyid as the former minister of regional autonomy, perceived the rigid and centralised system as eventually proving itself powerless to cope with the economic monetary crises that struck Indonesia in mid-1997.²⁶⁶ Politically, decentralisation is used as a tool to gather the sympathy, support and trust from the regions to the central government after the collapse of the centralised system. In addition, decentralisation is also perceived as one of the catalysts to improve the implementation of good governance and good government. Therefore, Dwight Y. King considers the law on local autonomy as the key component of political reform in Indonesia.²⁶⁷

Returning to the economic crisis that first hit Thailand in early July 1997, most of Indonesia's political and economic leaders were very confident with their assessment that even though Indonesia was affected by the inevitable regional crisis, it would not be as badly affected as Thailand. They argued that the fundamentals of the Indonesian economy were strong enough to cope with the crisis. Unfortunately, such optimism only lasted for three weeks. Thus, in August 1997, Indonesia was swept out by the great wave of economic crisis, which in fact was much worse than what had hit Thailand.²⁶⁸

In the early economic crisis, the Indonesia Rupiah lost 40% of its value, thus it decreased by 80%. Such situation was unpredictable and destroyed the economic structure of Indonesia. It placed the government in a very difficult situation and caused fear and chaos in society. It affected industry and caused a bank rush. Industries that depended on imported materials were forced to shut down. Thus, it brought increased unemployment numbers, which was capitalised by opposition as the hot political issue to demand President Soeharto to step down. Other implications were security and stability issues due to widespread social conflicts.²⁶⁹ These situations sunk Indonesia into a multidimensional crisis.

Indonesia's economic condition extremely decreased and was worsened by the economic crisis. During 1998, the inflation rate reached almost 80%, the exchange rate depreciated more than 80%, and unemployment and poverty rates more than doubled. Compared to other countries in Southeast Asia that experienced the same crisis, there is compelling evidence that Indonesia suffered the most. Public debts jumped from

²⁶⁵ See M. Ryaas Rasyid, *The policy of decentralization in Indonesia*, p. 65.

²⁶⁶ See *Ibid.*, p. 65.

²⁶⁷ See Dwight Y. King, *Political reforms*, *Op. Cit.*, p. 51.

²⁶⁸ See M. Ryaas Rasyid, *Loc. Cit.*, p. 65.

²⁶⁹ See *Ibid.*, p. 65.

around 45% of GDP before the crisis in 1996 to 110% in 1999, an increase that raised serious questions regarding the capacity of the national government to manage the fiscal risk and to sustain its budget.²⁷⁰

According to Ryaas Rasyid, our excessively centralised administration spent most of its time and energy dealing with domestic and local affairs. Therefore, Ryaas Rasyid perceived such backgrounds as the reason why the central government failed to solve the crisis in creative ways. On the other hand, regional and local administrations that was in fact only given very limited authorities, and had been for a long period put under the control of central government, could not be expected at all to help manage the impact of the crises in their own regions and territories.²⁷¹ In other words, local government did not have enough capacity and capability to help the central government deal with the economic crisis.

The decentralisation policy reduced the authority of the central government and extended the authority of the provincial and local governments. Thus, local governments will be able to initiate policies and bring their people into a better life. In other words, the local governments will be focused to solve regional and local problems, and reduce the burden of the central government dealing with such problems as what had happened in the past. It is expected that the central government will focus its time and energy on dealing with globalisation, and achieving its national interests.²⁷² The central government is the key actor behind the success of decentralisation. The central government has the important task of guarding the unity of the country, to maintain national integration, to guide, supervise and control the implementation of the decentralisation policy.²⁷³

VI.b. Significance of trade to local economic development: the philosophy of law and economics.

VI.b.1. Does trade contribute to economic development?

It is widely believed by most economists that trade brings benefits for economic development in developing countries. The establishment of GSP as a unilateral trade preference has the purpose of improving the economic development of developing countries and LDCs through export boosts. Until today it is argued that trade is considered as the most effective tools to support the economic development of developing countries and mainly LDCs. According to Resolution 21 at UNCTAD II in 1968, the Conference *Agreed* that the objectives of the GSP were dedicated to increasing the export earnings, to promote industrialisation, and to accelerate the economic development of developing countries and LDCs.²⁷⁴

James Riedel posits trade as an engine of growth in developing countries, which is characterised as “highly mechanistic”. Trade is analogous as an engine because it serves to transmit growth from developed to developing countries. According to Riedel Mechanical, the efficiency of an engine requires the gearing of the interconnecting parts to be fitted properly.²⁷⁵ This proposition is established on the basis that there is a stable, mechanical relationship between economic growth in developed countries and

²⁷⁰ See James Alm and Sri Mulyani Indrawati, *Op. Cit.*, pp. 236-237.

²⁷¹ See M. Ryaas Rasyid, *Op. Cit.*, p. 66.

²⁷² See M. Ryaas Rasyid, *Op. Cit.*, p. 67.

²⁷³ See *Ibid.*, p. 67.

²⁷⁴ See Commentaries on the ILC's Draft Articles, 1978. See also Grossman, Gene M., & Sykes, Alan O. (2004).

²⁷⁵ See James Riedel, *Trade as the Engine of Growth in Developing Countries, Revisited*, *The Economic Journal*, Vol. 94, No. 373. (Mar., 1984), p. 71, , available at : http://www.sais-jhu.edu/sebin/i/z/Trade_as_the_Engine_of_Growth.pdf.

export growth in developing countries. Such relationship is explained by Lewis as follows:²⁷⁶

“[...] The growth rate of world trade in primary products over the period of 1873 to 1913 was 0.87 times the growth rate of industrial production in the developed countries; and just about the same relationship, about 0.87, also ruled in the two decades to 1973....We need no elaborate statistical proof that trade depends on prosperity in the industrial countries [...]”.²⁷⁷

In this regard, Lewis makes observations of a stable hundred year's link between growth in developed countries and primary exports of developing countries. It is geared at the ratio 0.87, and is taken as evidence that the trade engine is mechanically efficient. If one of the parts slows down (developed country growth), this mechanically leads to the slowing down of the connecting parts (LDC trade and, connected to that, LDC growth).²⁷⁸

The economic growth and stability of developed countries has a significant influence on the growth of developing countries and LDCs. It can be understood because the biggest exports market of developing countries and LDCs is developed countries. Indonesia's main export partners are mostly developed countries such as the US, Japan, and the EU. According to Prof. Boediono, Indonesia's Vice President, Indonesia is well prepared for the worst possible scenario of the Eurozone crisis that is feared by most developing countries, for instance China, India, and Brazil. The economic growth of these countries is slowed down resulting from the Eurozone crisis.²⁷⁹ The economic deterioration of developed countries, such as the EU, affects the economic growth of its main trading partner. Inevitably, the impact of the Eurozone crisis to Indonesia is the decrease of exports. It is predicted that it would reduce Indonesia's total exports to 4.4%, however, this amount is lower compared to the export decrease of India (9.83%), China (5.16%) and Thailand (6.62%). Some main Indonesian export commodities, where the main destination is the EU, have significantly been affected by the Eurozone due to declining market demand, for instance fishery products and textile products.²⁸⁰ According to Tulus Tambunan, the export of goods is one of the main channels that can be affected by the Eurozone either directly or indirectly. However, the direct effect would not be very harmful since the main important export destinations for Indonesian exports are not in the Eurozone.²⁸¹

According to Oscar Afonso, the positive effects of international trade on economic growth were first pointed out by Smith (1776). Up until today, it is believed that international trade has a role as an economic growth driving force.²⁸² While Marco Neuhaus notes “trade leads to welfare gains” and is the standard answer to the

²⁷⁶ See James Riedel, *Op. Cit.*, p. 58.

²⁷⁷ See Lewis, 1980, *Op. Cit.*, p. 556; James Riedel, *Loc. Cit.*, p. 58.

²⁷⁸ See James Riedel, *Loc. Cit.*, p. 71.

²⁷⁹ See Indonesia ready to anticipate Eurozone crisis, *The Jakarta Post*, Monday 12 December 2012, available at : <http://www.thejakartapost.com/news/2011/12/12/indonesia-ready-anticipate-eurozone-crisis-says-vp.html>, last accessed : 21 April 2012.

²⁸⁰ See Ekspor Kulit dan Tekstil Paling Terpukul Oleh Krisis Euro, *Jaring News*, 3 January 2012, available at : <http://jaringnews.com/ekonomi/umum/7606/ekspor-kulit-dan-tekstil-paling-terpukul-oleh-krisis-euro>, last accessed : 21 April 2012.

²⁸¹ See Tulus Tambunan, Would Indonesian economy be seriously affected by the euro zone debt crisis?, Center for Industry, SME and Business Competition Studies, Trisakti University, Jakarta, available at : <http://www.apeaweb.org/publications/news/vol-02/issue1/021-tambunan.pdf>, last accessed : 22 April 2012.

²⁸² See Oscar Afonso, *The Impact of International Trade on Economic Growth*, Working Papers, Investigação-Trabalhos em curso - n° 106, Maio de 2001, Faculdade de Economia Universidade do Porto, Portugal, pp. 1-3, available at : http://fep.up.pt/investigacao/workingpapers/_old_WP_Fev09/wp106.pdf.

question why open economies are able to achieve more growth.²⁸³ Andrew Berg and Anne Krueger consider that trade policy is only one of the many determinants of growth and poverty alleviation. Their paper addresses questions concerning the importance of trade policy for poverty reduction and whether trade openness is an important determinant of growth.²⁸⁴ They conclude that trade openness is an important determinant of growth, and that openness tends to increase growth. In this regard, they suggest that if poor countries are open, poverty would increasingly fall.²⁸⁵

In Frederico G. Jayme Jr's paper, he critically explores the relationship between trade and growth.²⁸⁶ He believes the relationship between trade and growth lacks its micro economic foundations, therefore, he only analyses macroeconomic aspects of trade and growth, taking into consideration their external constraints and the limits of openness in foster economic growth. The analysis of this aspect using microeconomic foundations has been carried out by neo-Schumpeterian literature and further studies can be connected to the above mentioned tradition with Post Keynesians and Structuralists.²⁸⁷ Jaime argues that the traditional theory of international trade is limited to the examination of the impact of trade to economic growth. On the other hand, Srinivasan and Bhagwati argue that the traditional theory of international trade still shows the best way to understand trade and growth. They maintain that openness to trade, and factor and technology flows, significantly contribute to sources of growth.²⁸⁸

Baldwin suggests that the extent to which exports generate economic growth depends on the characteristics of the production functions of export products particularly as regards input requirements, the incidence of scale economies, and the like.²⁸⁹ Caves lists some of the channels through which export activities are connected to sources of intensive growth, in this regard, growth is related to per capita income. First, skill requirements, including entrepreneurial skills, and exports that require skilled labour generate more favourable linkages than those using unskilled labour. Second, substantial economies of scale in the production of exported goods seems to favour the contribution to intensive growth. Third, activities associated with the construction of social overhead capital is favoured as intensive growth. Some characteristics of the export commodity would favour local processing industries.²⁹⁰ Literature on productive linkages posits that demand and supply characteristics of trade specialisation of a given country will have an effect on the way trade can be translated into economic growth. However, not all productive activities are similar in creating the virtuous process of cumulative causation that is at the root of economic development.²⁹¹

²⁸³ See Marco Neuhaus, *Opening economies succeed : More trade boosts growth*, Deutsche Bank Research, 11 November 2005, p. 2, available at : http://www.dbresearch.ru/PROD/DBR_INTERNET_EN-PROD/PROD0000000000189232.PDF.

²⁸⁴ See Andrew Berg and Anne Krueger, *Trade, Growth, and Poverty : A Selective Survey*, IMF Working Paper, WP/03/30, 2003, pp. 1-4, available at : <http://www.imf.org/external/pubs/ft/wp/2003/wp0330.pdf>, last accessed : 12th April 2012

²⁸⁵ See Andrew Berg and Anne Krueger, 2003, *Op. Cit.*, p. 37.

²⁸⁶ See Frederico G. Jayme, Jr., *Notes on Trade and Growth*, Universidade Federal De Minas Gerais Faculdade De Ciencias Economicas Centro De Desenvolvimento e Planejamento Regional, October 2001, p. 21, available at : <http://cedeplar.ufmg.br/pesquisas/td/TD%20166.pdf>.

²⁸⁷ See *Ibid.*, p. 21.

²⁸⁸ See Srinivasan and Bhagwati (1999); Frederico G. Jayme, Jr., *Op. Cit.*, p. 12.

²⁸⁹ See Baldwin (1954, 1963) ; Vivianne Ventura-Dias, *What can we say about trade and growth when trade becomes a complex system?*, United Nation (Naciones Unidas), International Trade and Integration Division, Serie Comercio Internacional, Santiago, Chile, July 2003, p. 24, available at : <http://www.eclac.org/publicaciones/xml/1/12861/lcl1898i.pdf>.

²⁹⁰ See Caves (1971: 433-437); Vivianne Ventura-Dias, 2003, *Loc. Cit.*, p. 24.

²⁹¹ See Vivianne Ventura-Dias, 2003, *Loc. Cit.*, p. 24.

The fantastic example of economic success linked to export boost is the high performance of Asian countries. In the mid-1990s the economies of Japan, South Korea, Taiwan, Singapore, Hong Kong, Malaysia, Indonesia and Thailand reached great success, which is indicated by the highest GDP growth rate in the world at an amount of 6% per year since 1965. This was also followed by the highest rates of export growth, averaging more than 10% per annum. According to Thirlwall, those successes have not always been driven by free trade and laissez-faire. For instance, Japan and South Korea have been very interventionist, pursuing unyielding export promotion but also import substitution at the same time.²⁹² In 1993 the World Bank published a specific study titled *“The East Asia Miracle”*, where it was concluded that there is “no single East Asian model”. It has been identified that they have their own growth model and that *“what is important for growth is not whether the free market rules or the government intervenes, but getting the fundamentals for growth right”*.²⁹³

According to the World Bank, three policies have been identified as contributing to the economic success of the *“Asian Tiger”*. First, it has been identified that industrial policies have a significant role in the promotion of particular sectors of the economy. Second, the government control of financial markets to lower the cost of capital and to direct credit to strategic sectors. Third, the policies to promote exports and protect domestic industries has also been identified as having an importance contribution to economic growth. In addition, the vital factor that needs to ensure those policies is implemented properly good governance.²⁹⁴

VI.b.2. Law and economics.

Economic analysis of law (EAL) is a practical alternative to Classical Utilitarianism.²⁹⁵ Utilitarianism theory is also known as the principle of utility laid down by the English jurist and philosopher, Jeremy Bentham (1748-1832)²⁹⁶. The principle of utility is famous for the slogan “the greatest happiness for the greatest number”. The basic idea here is that human actions and practices should be evaluated ultimately in terms of their tendencies to advance the general welfare or social good – i.e to produce as a consequence other happiness or well-being or satisfaction of a majority of persons. The more persons who are likely to be made better off by an act or practice, then the better that act or practice from the moral point view. *“Look to the future and promote human welfare”*, this is the basic utilitarian advice in ethics, advice formally expressed in the Principle of Utility: *“Of all the possible actions open to you, perform that action with greatest tendency to bring about the greatest balance of happiness over misery for mankind as a whole”*.²⁹⁷

EAL emphasises the rationality of persons and their desire for efficiency in the processes that lead to the achievement of individual and social goals.²⁹⁸ The EAL philosophical approach is based on the human as *homo economicus*. In this regard, “humans are regarded as primarily economic agents, who act and react essentially for economic reasons, seeking as much as possible to maximise wealth and the satisfaction

²⁹² See Anthony P. Thirlwall, *Trade, Trade Liberalization and Economic Growth : Theory and Evidence*, Economic Research Papers, No. 63, The African Development Bank, 2000, p. 16, available at : <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/00157660-FR-ERP-63.PDF>.

²⁹³ See *Ibid.*, p. 16.

²⁹⁴ See *Ibid.*, p. 16.

²⁹⁵ See Chinhengo, Austin M., *Essential Jurisprudence*, Second Edition, Cavendish Publishing Limited, London, Sydney, 2000, p. 78.

²⁹⁶ See Ratnapala, Suri., *Jurisprudence*, University Cambridge Press, Australia, 2009, pp. 30-33.

²⁹⁷ See Murphy, Jeffrie G., *Philosophy of Law : An Introduction to Jurisprudence*, Westview Press, Boulder, San Fransisco, and London, 1990, p. 72.

²⁹⁸ See Chinhengo, Austin M., 2000, *Loc. Cit.*, p. 78.

of their preferences". To this extent, Chinhengo elaborates, "*the law becomes an economic tool, to be utilised efficiently for the maximisation of happiness. Its creation and application is governed by economic considerations*". Based on the two elements of rationality and efficiency, thus, it places "justice" as an economic standard.²⁹⁹

VI.b.3. Classical international trade theory.

Christopher Bliss describes that the theory of international trade is a very wide field and that most of its theories apply to developing countries. An immense field has been created that deals with the trade and economic development process of developing countries. Extensive literature has been written in relation to trade theory and economic development.³⁰⁰ There are two important theories to explain how trade boost contributes to economic growth or to the process of economic development growth, that is, the Adam Smith (1776) theory and the David Ricardo (1817) theory. These theories are recognised as the standard theories of international trade.³⁰¹ It is explicated that those two countries with absolute and comparative cost advantages can benefit from trade.³⁰²

With regard to the development of international trade theory a question has been raised by Christopher Bliss, that is, "are classical and neoclassical theories of international trade suitable for application to the situation of developing countries?"³⁰³ This question has been raised to question which theories between classical and neoclassical theories on international trade and growth are applicable for today's situation. In this regard, we will discuss the development of these classical theories towards economic development. There are two foundation theories in classical theory that is the Adam Smith Theory and the Ricardian theory.

VI.b.3.a. The Adam Smith Theory

The doctrine that trade enhances welfare and growth derives from Adam Smith's famous book *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). According to Thirlwall, he emphasises "*the importance of trade as a vent for surplus production and as a means of widening the market thereby improving the division of labour and the level of productivity*".³⁰⁴ The term "vent surplus model" on the ideas of Smith on external trade was created by Mill³⁰⁵ and followed by William³⁰⁶ and Myint³⁰⁷.

²⁹⁹ See *Ibid.*, p. 78.

³⁰⁰ See Christopher Bliss, *Trade and Development*, Nuffield College, Oxford, Handbook of Development Economics, Volume II, Edited by H Chenery and T.N. Srinivasan, Elsevier Science Publisher B.V, 1989, p. 1188, available at : <http://www.vnp.edu.vn/downloads/Handbook%20of%20Development%20Economics/Chapter%2023%20Trade%20and%20development.pdf>.

³⁰¹ See Sunanda Sen, *International Trade Theory and Policy: A Review of the Literature*, Working Paper No. 635, Levy Economics Institute of Bard College, November 2010, p. 2, available at : http://www.levyinstitute.org/pubs/wp_635.pdf.

³⁰² See Marco Neuhaus, 2005, *Op. Cit.*, pp. 3-4.

³⁰³ See Christopher Bliss, 1989, *Loc. Cit.*, p. 1188.

³⁰⁴ See Anthony P. Thirlwall, 2000, *Op. Cit.*, pp. 6-7. "[...] between whatever places foreign trade is carried on, they all of them derive two distinct benefits from it. It carries the surplus part of the produce of their land and labour for which there is no demand among them, and brings back in return something else for which there is a demand. It gives value to their superfluities, by exchanging them for something else, which may satisfy part of their wants and increase their enjoyments. By means of it, the narrowness of the home market does not hinder the division of labour in any particular branch of art or manufacture from being carried to the highest perfection. By opening a more extensive market for whatever part of the produce of their labour may exceed the home consumption, it encourages them to improve its productive powers and to augment its annual produce to the utmost, and thereby to increase the real revenue of wealth and society [...]"

³⁰⁵ See Mill, 1844:1909, pp.579-580; Aykut Kibritçioğlu, *On the Smithian origins of "new" trade and growth theories*, Economics Bulletin, Vol. 2, No. 1, 2002, pp.1-15, available at : <http://www.accessecon.com/pubs/eb/2002/volume2/EB-02B00001A.pdf>.

³⁰⁶ See Williams, 1929; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³⁰⁷ See Myint, 1958; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

Myint considers that Smith's model was fit to explicate a specific part of the trade of developing countries.³⁰⁸

According to Smith, the industrial revolution in England drove economic growth, which provided the base for lowering labour costs, thus, it ensured effective competition across countries.³⁰⁹ Surplus productive capacity was the cause of the narrowness of the domestic market. The excess of productive capacity that is not demanded in the domestic market can be exported outside the country. In other words, to absorb the excess productive capacity requires market expansion. Exports are believed to increase the wealth of a nation through the improvement of the division of labour and enhancement of national productivity. However, the incapability of exporting those "surplus" products could cause under-employed of the production factors of the country. Therefore, exports are the vent for surplus and an instrument to ensure the full-employment of factors of production in the *Wealth of Nations*.³¹⁰

Thirlwall explains that the classical trade theory is often associated with colonialism. In which Smith's productivity doctrine of the benefits of trade is developed into an export driven argument, particularly in the colonies.³¹¹ Returning to the colonialism era in Indonesia, with trade monopoly being ruled by VOC Dutch and obliging all domestic products, particularly relating to agriculture, only to be allowed to be exported to the mother colony. Sunanda Sen argues that industrialist capitalism, especially in England, because of the rapid growth of large-scale industries and enslaved markets in overseas colonies. Smith, initiated the doctrine of free trade as a tool to achieve production efficiency.³¹²

The idea Smith explains is, "a dynamic, self-feeding process of trade driven by economies of scale and imperfect competition", in the modern terminology it is described as an attempt towards endogenisation of comparative advantages between countries.³¹³ Kibritçioğlu considers that the Smith theory tends to neglect the possibility that a country, wherein all products are produced by using more inputs per output as in the rest of the world, can gain from free trade. In other words, the trade structure depends on comparative advantages.³¹⁴

³⁰⁸ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³⁰⁹ See Sunanda Sen, 2010, *Loc. Cit.*, p. 2.

³¹⁰ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15. "[...] when the produce of any particular branch of industry exceeds what the demand of the country requires, the surplus must be sent abroad, and exchanged for something for which there is a demand at home. Without such exportation, a part of the productive labour of the country must cease, and the values of its annual produce diminish. The land and labour of Great Britain produce generally more corn, woollens, and hard ware, than the demand of the home market requires. The surplus part of them, therefore, must be sent abroad, and exchanged for something for which there is a demand at home [...]" (Smith, 1776:1937, p.353).

"[...] In every period, indeed, of every society, the surplus part both of the rude and manufactured produce, or that for which there is no demand at home, must be sent abroad in order to be exchanged for something for which there is some demand at home". (Smith, 1776:1937, p. 359).³¹⁰

"[...] Between whatever places foreign trade is carried on, they all of them derive two distinct benefits from it. It carries out that surplus part of the produce of their land and labour for which no demand among them, and brings back in return for it something else for which there is a demand. It gives a values to their superfluities, by exchanging them for something else, which may satisfy a part of their wants, and increase their enjoyments. By means of it, the narrowness of the home market does not hinder the division of labour in any particular branch of art or manufacture from being carried to the highest perfection. By opening a more extensive market for whatever part of the produce of their labour may exceed the home consumption, it encourages them to improve its productive powers, and to augment its annual produce to the utmost, and thereby to increase the real revenue and wealth of the society [...]" (Smith, 1776:1937. p. 415).

³¹¹ See Anthony P. Thirlwall, 2000, *Loc. Cit.*, pp. 6-7

³¹² See Sunanda Sen, 2010, *Loc. Cit.*, p. 2.

³¹³ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³¹⁴ See *Ibid.*, pp. 1-15. "[...] It is the maxim of every prudent master of a family, never to attempt to make at home what it cost him more to make than to buy... what is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can

In his era, Smith saw agriculture as the most important economic advantage sector of a “*young country*”. Such thought was based on the availability of plentiful and cheap land that was useful for agricultural production. At that time, unfortunately, labour was not expensive, and land was limited and pricey in Europe.

Hence, according to Hollander, the comparative advantage of the European nations was to produce manufacture products.³¹⁵ In fact, Smith’s doctrine was almost similar to the idea of comparative advantages before Ricardo.³¹⁶ According to Staley and Bloomfield, Adam Smith “*seems to have missed the chance to be the first economist who stated the rule of comparative advantages explicitly*”.³¹⁷ This reason most likely led to the argumentation of Myint, Hong, and Gomes, that Smith’s ideas on foreign trade are generally ignored, or associated only to the concept of absolute advantages, in textbooks and theoretical surveys on international trade.³¹⁸ In the words of Bloomfield:³¹⁹

“[...] Various writers, while acknowledging his undeniable importance and influence as an economist, have referred to short-comings, oversimplifications, and even inconsistencies in his theorising on foreign trade. Others have questioned the originality of his free-trade ideas [...]”.³²⁰

According to Kibritçioğlu, Smith’s (1776) main contribution to international trade theory cannot be found in his static economic analysis. Smith’s dynamic approach to the extent of the market is essential for modern trade theory. In the words of Gomes, Smith’s principle of free trade was nothing more than the application of specialisation and division of labour to a global scale.³²¹ Explicitly, Smith had not seen any difference between domestic and foreign trade.³²²

Aykut Kibritçioğlu, on the paper of “*the Smithian origins of “new” trade and growth theories*”, explains the Smith theory on long run economic growth. Brewer and Ahmad posit about Smith’s theory in which capital accumulation holds a leading role in the economic growth process of a country, and is followed with technological progress passively.³²³ Barkai argues that the technological change in the Wealth of Nations is more important than other factors to explain the nature and causes of the wealth of nations.³²⁴ In the words of Kibritçioğlu, the determinants of economic growth and development in Smith’s theory consist of capital accumulation, technological progress, and institutional and social factors. These determinants have complex interactions and play a crucial role in the economic development process of a country.³²⁵ In addition, Tezel states that Smith’s thoughts were strongly influenced by the natural philosophy of his age.³²⁶

According to the new growth theory, there are some ways that might drive long run growth such as openness, where it encourages developing countries to fully participate in the world trading system. Technological change and technological gaps

make it, better buy it them with some part of the produce of our own industry, employed in a way in which we have some advantage [...]”. (Smith, 1776:1937, p. 424).

³¹⁵ See Hollander, 1973; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³¹⁶ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15. “[...] The most opulent nations ... generally excel all their neighbours in agriculture as well as in manufactures; but they are commonly more distinguished by their superiority in the latter than in the former [...]”. (Smith, 1776:1937, p. 6).

³¹⁷ See Staley, 1973, and Bloomfield, 1975; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³¹⁸ See Myint, 1977; Hong, 1984; Gomes, 1987; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³¹⁹ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²⁰ See *Ibid.*, pp.1-15.

³²¹ See Gomes, 1987; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²² See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²³ See Brewer, 1991; Ahmad, 1996; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²⁴ See Barkai, 1969; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²⁵ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²⁶ See Tezel, 1995; Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

are considered as some of the driving engines of long run growth. In this regard, Harrison and Hanson, argue that more backward countries will provide more opportunities to absorb new ideas. Thus, this accelerates them to participate in the international trading system, which allows them to benefit from technological change. Therefore, new growth theory also acknowledges that participation in the world market through openness and technological improvement, could strongly drive long run growth.³²⁷

Regarding technological change, Smith recognises the role of the invention on the new machine to increase productivity. Kibritçioğlu elaborates the significant role of technological change in the form of learning by doing as determinant factors to improve the wealth of nations. According to Kibritçioğlu, Smith does not totally neglect the role of machine-makers and philosophers in inventing new machines. Smith construes its contribution as a powerful source of technological change.³²⁸

Furthermore, it has elaborated the role of labour on technological change through simple inventions or improvements in existing machines, which principally come from the rise of experiences of “workman”. However, philosophers and machine-makers make inventions that are more fundamental. Technological change can only be performed through market expansion. In this case, Smith’s theory combines the concept of learning by doing with economies of scale through the concept of division of labour. Technological change is driven by economic scale improvement, experience, or cumulative output, and labour skills. Finally, it concludes that, “*technological change in terms of learning by doing, such as inventing new machines or improving an old one, stimulates the division of labour and specialisation through increases in wealth, profits, and the process of capital accumulation*”.³²⁹

Kibritçioğlu notes that Smith distinguishes between three stages of economic growth. The lowest stage is named as “*a low level equilibrium trap*”, which is characterised by cultural and institutional backwardness. In modern terminology, the countries are placed at such level when they fail to provide guarantees towards basic human rights, freedoms and “property rights” protection. During his era, there were two countries categorised as the leading nations and were placed in the middle stage or second stage, that is England and North America. They were still regarded as environments of “natural freedom”. In this regard, they were also characterised in a progress of economic growth. In the 18th century, Smith regarded that there was no country that had reached an advanced stage of economic growth.³³⁰

Smith’s next theory is about “the natural limits of economic growth beyond a certain level”. In the words of Kibritçioğlu, Smith believed that “falling profit rates along the growth path of an economy, changes in the relative factor scarcity, and decreases in profitable investment opportunities all play a significant role in constraining economic growth”. Further Kibritçioğlu, based on Smith’s theory, elaborates some factors that cause natural limitations of economic growth, for instance limited land endowment, lack of favourable conditions, and both the climate and geographical location of the country. Hence, it has to be underlined that the importance of Smith’s theory is that “every growing economy, has to slow down and stop at an upper limit of development”.³³¹ This theory can be explained as the cycle of the economic global crisis, particularly the crisis in Europe. Smith believed that technological improvements in the

³²⁷ See Harrison and Hanson, 1999; Frederico G. Jayme, Jr., 2001, *Op. Cit.*, p. 8.

³²⁸ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³²⁹ See *Ibid.*, pp. 1-15.

³³⁰ See *Ibid.*, pp. 1-15.

³³¹ See *Ibid.*, pp. 1-15.

manufacturing industry could extend the natural limit of the country's economic growth. In the end Kibritçioğlu, emphasises that we should not misapprehend Smith's opinion on the role of technological development as a determinant of economic growth.³³²

VI.b.3.b. Ricardian Theory.

Following Adam Smith, David Ricardo (1772-1823) developed the theory of the comparative advantage, or more famously, the Ricardian Theory. In 1817, he wrote about *Principles of Political Economy and Taxation*, which explained the assumptions of perfect competition and the full employment of resources, however this was not made explicit. Afterwards, many economists tried to describe the Ricardian theory in developing the relationship on trade and the economic growth model.

According to Ricardian theory, "*countries can achieve welfare gains by specialising in the production of goods with the lowest opportunity cost and trading the surplus of production over domestic demand*". The comparative advantage takes place if the international rate of exchange between commodities lies between the cost ratios of domestic opportunities.³³³ Viner elaborates the Ricardian theory and states "*that foreign trade is gainful for a nation if and only if those products are imported into the country which cannot be produced domestically or which are produced more expensively in comparison to that in the rest of the world*".³³⁴ According to Kibritçioğlu, the role of comparative advantages is emphasised in explaining the structure of foreign trade.³³⁵ Frederico G. Jayme Jr describes comparative advantage as when trade allows a more efficient use of the economy's resources by enabling imports of goods and services that could otherwise only be produced at home at higher resource costs. He uses an example, when trade enables developing countries to import capital and intermediate goods, which are important for long run economic growth, and would be quite expensive to produce locally.³³⁶

Jones states that "*comparative advantage determines that each nation will always find a set of products in which production it can successfully compete in world markets regardless of the degree of efficiency of its technology or service basis*".³³⁷ Jones' opinion stresses comparative advantage on trade diversion by neglecting the role of technological change and the improvement on productivity. On the other hand, Tobias Bidlingmaier states that today's comparative advantages have shifted "*to the production of the goods a country produces best*", where specialisation in production is necessary. As explained by Smith's theory of long run growth, such specialisation will be influenced by technological change.³³⁸

The Ricardian theory introduced the static gains that arise from the reallocation of resources from one sector to another along with the increase in specialisation, in this regard, comparative advantage takes place.³³⁹ Kibritçioğlu elaborates that Ricardian theory on the static approach of comparative advantages was based on exogeneity of division of labour between nations. Therefore, it identified that they were created by

³³² See *Ibid.*, pp. 1-15.

³³³ See Anthony P. Thirlwall, 2000, *Loc. Cit.*, pp. 6-7.

³³⁴ See Viner, 1937.

³³⁵ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15.

³³⁶ See Frederico G. Jayme, Jr., 2001, *Op. Cit.*, pp. 9-10.

³³⁷ See Jones, 1980; Vivianne Ventura-Dias, 2003, *Op. Cit.*, p. 23.

³³⁸ See Tobias Bidlingmaier, *International Trade and Economic Growth in Developing Countries*, Paper prepared for presentation at the DEGIT XII conference in Melbourne in June 2007, Institute of Development Research and Development Policy, Ruhr-Universität Bochum, p. 2, available at : http://www.degit.ifw-kiel.de/papers/degit_12/C012_041.pdf.

³³⁹ See Anthony P. Thirlwall, 2000, *Loc. Cit.*, pp. 6-7.

international differences in exogenous factor-productivities.³⁴⁰ Tobias Bidlingmaier, explains that the gains from trade are rooted in the specialisation in production due to international trade. The improvement of resource allocation can be achieved when countries specialise according to their comparative advantage.³⁴¹ Further, Tobias Bidlingmaier elaborates that this allocation is efficient because resources, which have formerly been employed in the production of other goods, are now shifted to the production of the goods a country produces best. As a result, the welfare income of all trading nations is improved.³⁴²

Srinivasan and Bhagwati, state that various authors have defended the benefits of openness by the efficiency-enhancing role of free trade in a static context.³⁴³ For instance, Frederico G. Jayme Jr considers that the comparative advantage theory deals with the static gains of international trade, which does not deal directly with growth.³⁴⁴ According to Jayme, a country that opens up can be assured the benefits of welfare gains in a static model. The Ricardian theory posits the welfare gains if any country specialises in producing goods in which it has a comparative advantage. The standpoint of these theories is that international trade is the way to achieve static productivity efficiency and international competitiveness.³⁴⁵ The Ricardian static argument stated that there is an improvement in income and welfare when countries engage in international trade.³⁴⁶

However, the static gains are “exhausted” once the tariff barriers among countries have been removed and no further reallocation takes place. This happens when trade creation gains that occur within the Customs Unions or FTA as the barriers to trade are removed between members, but the gains are one for all.³⁴⁷

The static gains theory is in contrary with the dynamic gains from trade that composes a vital link in the causal chain between exports and growth. Dynamic gains from trade are applied in the modern trade theory³⁴⁸ and in the “new” growth theory³⁴⁹. Thirlwall explains that *dynamic gains* from trade continually shift away from the whole production possibility frontier of countries. In this regard, he emphasises that trade is associated with more investment and faster productivity growth based on scale economies, learning by doing and the acquisition of new knowledge from abroad, particularly through foreign direct investment.³⁵⁰

Thirlwall notes that trade has acted as an important engine of growth for countries at different stages of development. It not only contributes to a more efficient allocation of resources within countries, but also spreads growth from one part of the

³⁴⁰ See Aykut Kibritçioğlu, 2002, *Loc. Cit.*, pp.1-15. Definition of exogenous growth : “[...] the belief that economic growth arises due to influences outside the economy or company of interest. Exogenous growth assumes that economic prosperity is primarily determined by external rather than internal factors. According to this belief, given a fixed amount of labor and static technology, economic growth will cease at some point, as ongoing production reaches a state of equilibrium based on internal demand factors [...]”. See Exogenous Growth Model (Neo-Classical Model), available at : http://www.economics4development.com/exogenous_growth_model.htm, last accessed : 26 April 2012. “[...] The Exogenous growth model was an extension to the Harrod-Domar model which included the new term, “productivity growth [...]”. The most important contributor to this model, Robert Solow; in 1956 developed a relatively simple growth model which fit available data on US economic growth with some success. Solow received the 1987 Nobel Prize in Economics for his work on this model”.

³⁴¹ See Tobias Bidlingmaier, 2007. *Loc. Cit.*, p.2.

³⁴² See *Ibid.*, p. 2.

³⁴³ See Srinivasan and Bhagwati, 1999; Vivianne Ventura-Dias, 2003, *Loc. Cit.*, p. 23.

³⁴⁴ See Frederico G. Jayme, 2001, *Op. Cit.*, p. 21.

³⁴⁵ See Frederico G. Jayme, 2001, *Op. Cit.*, pp. 9-10.

³⁴⁶ See *Ibid.*, pp. 9-10.

³⁴⁷ See Anthony P. Thirlwall, 2000, *Loc. Cit.*, pp. 6-7..

³⁴⁸ See Helpman and Krugman, 1985.

³⁴⁹ See Grossman and Helpman, 1991.

³⁵⁰ See Anthony P. Thirlwall, 2000, *Loc. Cit.*, pp. 6-7.

world to another. However, the growth between one country to another can be different due to some factors such as “*production and demand characteristics of the goods that a country produces and trades, the domestic economic policies pursued, and the trading regime it adopts.*” Thirlwall, provides example of exports disparities between developing countries and developed countries, as follows :³⁵¹

“[...] the volume of exports has grown slower than for developed countries since 1950 – 5 percent per annum compared to 8 percent – because developing countries still largely produce and export primary commodities and low value-added manufactured goods with a relatively low income elasticity of demand in world markets. The difference in rates of growth of exports has been even wider in value terms because the terms of trade of developing countries have deteriorated vis à vis developed countries causing the developing countries’ share of the total value of world trade to have fallen from 30 percent in 1965 to 20 percent today [...]”.

From this example, the disparities on export diversification and industrialisation between developed countries and developing countries is identified as one of the factors that influence different stages of economic development. Therefore, one of the basic philosophies of institutionalisation of GSP is to improve export diversifications and stimulate industrialisation in developing countries. Thirlwall believes in the existence of both static and dynamic gains from trade, and that trade provides a vent for surplus production.³⁵²

Thirlwall raises an issue concerning the double standards that are applied by developed countries to developing countries. While the developed world promotes free trade for developing countries, in fact they continue to apply protectionism to their own markets from imports from developing countries, particularly agricultural produce and textiles. Such protectionism is practiced through the application of non-tariff barriers, for instance sanitary and phytosanitary standards, and quota restrictions. Thirlwall believes that developing countries could gain greater benefits from trade if developed countries modified their policies towards developing countries.³⁵³

According to Thirlwall, export growth is defined as “*the only component of demand that provides the foreign exchange to allow other components of demand in an economy to grow faster, such as investment, consumption and government expenditure, all of which have an import content which needs to be paid for in foreign exchange*”. Thus, export growth has roles lowering a balance of payments constraint on demand, and affecting growth from the supply-side. With regard to the monetary or balance payments as the consequences of trade, classical theory of international trade both Smith’s theory and the Ricardian theory neglect such matter.³⁵⁴

Marco Neuhaus argues that economic growth is not an immediate consequence of trade. It has to be noted that a higher level of welfare is not synonymous with higher GDP. Neuhaus relates the boost of the total number of manufactured goods that both countries can consume, and higher consumption means higher welfare. It is believed that trade openness could raise the total value of goods consumed in each country.³⁵⁵

³⁵¹ See *Ibid.*, pp. 6-7.

³⁵² See *Ibid.*, pp. 6-7.

³⁵³ See *Ibid.*, pp. 6-7.

³⁵⁴ See *Ibid.*, pp. 6-7.

³⁵⁵ See Marco Neuhaus, 2005, *Loc. Cit.*, pp. 3-4.

VI.c. Benefiting from export: non-revenues.

According to Oscar Alfonso, the classic theory does not distinguish the questions of economic growth from the questions of international trade.³⁵⁶ There are two main ideas conceived by Smith related to the interaction between international trade and economic growth. First, the international trade considered succeeds to overcome the problem when the size of the internal market shrinks. Second, market expansion improves labour division and increases productivity. With regard to technology development, Smith's theory considers that international trade has brought a positive contribution to improve the ability and skills of workers, encouraging technical innovations and the accumulation of capital. Thus, it makes it possible for a country to overcome technical difficulties in productivity. In the end, it would give participating countries the possibility to enjoy economic growth. Hence, Smith's theory is applied in the long-run economic growth.³⁵⁷

Ricardian theory characterises "progressive states" as "*having high savings, capital accumulation, production, productivity, benefits and labour demand forcing the increase of wages and demographic growth*".³⁵⁸ In his theory, Ricardo recognises that the 'stationary state' underlies the 'progressive state', and that ultimately the force capable of delaying this state is technical progress.³⁵⁹ Technical progress or technological development can be transmitted through international trade. Therefore, he believed that international trade could delay the fall in the rate of profit.³⁶⁰

The Ricardian model assumes that international trade is between two trading partner countries, with two commodities and that all factors of production can be reduced to one single factor, that is, labour. In addition, the production of each commodity is performed based on "*fixed technical coefficients*". The term "*fixed technical coefficients*" is interpreted as the technological factor. In this regard, the pattern of international trade can be explained, particularly related to the improvement of productive capacity. Assumption is made by eliminating the costs of transportation, the conditions for international trade created are the existence of differences between comparative costs in production of both goods in both trading partner countries. According to Ricardian theory, although one country has an absolute advantage in costs of production in both goods, international trade is an option better than autarky (closed economy).³⁶¹ Specialisation on commodities by countries would encourage them to engage in international trade due to less comparative cost, thus, it would increase the welfare of both economies and the world as well.³⁶² In other words, the openness of countries to international trade produces efficiency, mutual benefits and is positive for the entire world.³⁶³ However, Oscar Afonso observes that the followers of Ricardo neglected the question of the foundations of comparative advantages and did not analyse factors resulting from international trade that could increase, in a lasting form, the rate of economics and its tendency in the long-term.³⁶⁴

Ricardo A. Lòpez, in his paper *Trade and Growth: Reconciling The Macroeconomic and Microeconomic Evidence*, states that those companies that enter the export markets are more productive than non-exporters and that this difference in productivity is

³⁵⁶ See Oscar Afonso, 2001. *Op. Cit.*, pp. 4-5.

³⁵⁷ See *Ibid.*, pp. 4-5.

³⁵⁸ See *Ibid.*, pp. 4-5.

³⁵⁹ See *Ibid.*, pp. 4-5.

³⁶⁰ See *Ibid.*, pp. 4-5.

³⁶¹ Autarky exists whenever an entity can survive or continue its activities without external assistance or international trade.

³⁶² See Frederico G. Jayme, Jr., 2001, *Loc. Cit.*, pp. 9-10.

³⁶³ See Oscar Afonso, 2001. *Op. Cit.*, pp. 5-6.

³⁶⁴ See *Ibid.*, pp. 5-6.

achieved before a company becomes involved in exporting. In brief, exporting companies are more productive than companies that focus on the domestic market.³⁶⁵ In the 1990s, a series of empirical studies began to uncover the different characteristics of exporters and non-exporters.³⁶⁶ These findings have challenged the traditional view that openness to trade increases productivity and economic growth. In short, these findings reiterated the idea that exporting increases productivity and economic growth.³⁶⁷ According to this study, learning by exporting created a possibility for companies to acquire information from foreign customers and foreign contacts, which is important to obtain information for the purposes of improving the manufacturing process, new product designs, and increasing the quality of goods.³⁶⁸ According to earlier case studies, information from foreign customers is an important source of knowledge for developing countries. Foreign buyers (traders) seem to prove worthy information on new technologies and product designs. In this regard, foreign buyers also seemed to contribute to improving the quality of the exported goods.³⁶⁹

Effects of international trade to boost an economic growth is explained systematically by Marco Neuhaus. According to him, trade is a tool for technology transfer, improving institutional capacity, enhancing infrastructure developments, and increasing international competitiveness.

“[...] trade can indeed boost economic growth, the main ones being technology transfer and institutional improvements. Technology transfer occurs via the importing of high-tech capital goods, production facilities, patents and licences, as well as knowledge-intensive services.³⁷⁰ Furthermore, the importing of new technologies also stimulates the development of domestic technology via the imitation and enhancement of imported products. So trade accelerates technological progress, which in turn is the key source of long-term economic expansion according to growth theory. Besides technology transfer the improvement of the institutional framework also plays a major role: *“opening up to foreign influences directly generates incentives to adjust and improve domestic rules and facilities so that opportunities for trade and investment are not wasted”*. It encompasses improving infrastructure, boosting capital market efficiency and safeguarding property rights. This process is facilitated by increasing international competition, which prompts domestic companies to continually optimise their production processes and develop new products; this also speeds up technological progress and thus boosts economic growth [...]”³⁷¹

Technology licensing is one of the “point d’entre” of technology transfers from developed countries. Exports could encourage technology licensing from developed countries. According to the World Bank, technology developers usually prefer exporting companies, because this would be a good indicator about the abilities of the potential partner.³⁷² Pack and Page consider that licensing, which constitutes

³⁶⁵ See Ricardo A. Lòpez, *Trade and Growth : Reconciling The Macroeconomic and Microeconomic Evidence*, Journal of Economic Surveys, Vol. 19, No. 4, Blackwell Publishing Ltd., 2005, p. 629, available at : <http://www.montana.edu/econ/gilpin/502/lopezexample.pdf>.

³⁶⁶ See Aw and Hwang, 1995; Bernard and Jensen, 1995, 1999a, 2004; Bernard and Wagner, 1997; Aw and Batra, 1998; Aw et al., 2000; Isgut, 2001; Mengistae and Pattillo, 2002; Alvarez and Lo´pez, 2005; Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 629.

³⁶⁷ See Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 629.

³⁶⁸ See Westphal et al., 1984; Grossman and Helpman, 1991; World Bank, 1991; Keesing and Lall, 1992; World Bank, 1993; Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 629.

³⁶⁹ See Ricardo A. Lòpez, 2005, *Op. Cit.*, . 630.

³⁷⁰ See Marco Neuhaus, 2005, *Loc. Cit.*, pp. 3-4.

³⁷¹ See *Ibid.*, pp. 3-4.

³⁷² See World Bank, 1993; Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 629.

technological knowledge about production processes, offers significant opportunities to developing countries for improving the level of productivity.³⁷³

A country that successfully integrates into the world economy would have large manufacture shares in its exports. For instance, India, Turkey, Morocco and Indonesia have shares that are close to the world average. Moreover, many developing countries have manufacture shares in their exports that are above the world average of 81%.³⁷⁴ Market expansion to developed countries will be necessary, especially for its manufactures and semi-manufactures export destination. In this regard, the need to improve such access to the market of developed countries has been responded by UNCTAD through the adoption of resolution 96 (IV), on 31 May 1976, entitled "*a set of interrelated and mutually supporting measures for expansion and diversification of exports of manufactures and semi-manufactures of developing countries*". Section I of that resolution contains "*improving access to markets in developed countries for manufactures and semi-manufactures of developing countries*", which is later institutionalised as GSP.³⁷⁵ Development of manufactures as exports commodity is associated with the degree of industrialisation of a developing country, in this regard, one of the main purposes of GSP is to promote industrialisation.

VI.d. Implication of decentralisation to boost exports: impact of good governance to trade.

During the second half of the century, the role of trade in the world economy increased significantly. Most countries had faster economic growth and industrialisation was identified because of their rapid participation in the world trade system. The export-oriented policies that were applied by East Asia and Southeast Asian countries succeeding drove high-growth economies. By the 1980s, policy makers in developing countries, began to apply a more open trade regime. This situation changed the landscape of most centrally planned regimes that had previously avoided the use of market-based trade and had either collapsed or made remarkable reforms that placed foreign trade and investment as their development programmes priority.³⁷⁶

Subsequently, trade policies reformed in most developing countries, and their engagement in international trade also significantly changed. Starting in the early 1980s, developing countries significantly increased the share of manufactures in their exports. In the late 1990s, about 80% of exports from developing countries were manufactured goods. This significantly changed the developing country paradigm about the role of trade. In 1994, at Marrakech, when 124 countries as contracting parties signed the WTO agreement, perhaps it was the culmination point of international policy enthusiasm for open trade policies. While, at the same time, in Bogor, Indonesia, the leaders of Asia-Pacific countries, representing nearly half of the world economy, set a goal of achieving completely free trade in the Pacific by 2010 for industrial countries and 2020 for developing countries.³⁷⁷

Many factors have driven the rapid growth in the openness of world economies, such as reductions in trade barriers, reductions in transport costs, and reductions in the costs of communications. Ng and Yeats note that another influence of increased international trade is the improvement of trade shares in manufactures, shifting trade

³⁷³ See Pack and Page, 1994; Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 629..

³⁷⁴ See Will Martin, *Trade Policies, Developing Countries, and Globalization*, Development Research Group, World Bank, 9 October 2001, p. 12, available at: http://siteresources.worldbank.org/INTRES/Resources/469232-1321568702932/2866_trade_martin.pdf.

³⁷⁵ See Commentaries on the ILC's Draft Articles, 1978, *Loc. Cit.*, p. 64.

³⁷⁶ See Will Martin, 2001, *Op. Cit.*, p. 1.

³⁷⁷ See *Ibid.*, p. 1.

patterns from dependency into interdependency (equal two-trade), and widespread multinational companies due to more fragmentation of production processes.³⁷⁸

Will Martin notes that policy changes that improve transparency are included as incremental policy reforms that would be welfare improving.³⁷⁹ While Rodrik argues that the policies imposing export performance requirements on foreign investors could be second-best welfare improving.³⁸⁰ Further, it is explained that in an ideal world, trade policies would be determined at a national level by a government in order to maximise national welfare. The government would have at least one policy instrument for each policy goal it wanted to achieve. Realistic efforts are needed to accomplish these objectives, such as maximising national welfare, by taking into consideration the balance between its objectives, and recognising constraints such as weak institution capacities.³⁸¹

Berg and Krueger, defines the openness of an economy “*as the degree to which nationals and foreigners can transact without artificial (that is, governmentally imposed) costs (including delays and uncertainty that are not imposed on transactions among domestic citizens)*”. They are identifying some constraints that likely raise the costs of transaction. These constraints consists of tariffs and non tariff barriers, domestic content requirements, health and safety requirements, inspection delays and corrupt bureaucracy (rent-seeking behaviour). Trade openness identified reducing rent seeking behaviour among government officials. Trade openness is generating innovation due to its openness character to new ideas and developments.³⁸²

The institutions capacity are holding vital role in economic growth, especially to increase trade and investment. Good institutional environment more likely providing friendly business environment. ³⁸³ Berg and Krueger noted that trade openness is correlating with the quality of institutions. Generally, the good institutional environment is accompanied by the trade openness and other indicators such as adherence of good governance and good government principles. Good institutional environment is vital for development process because it provide political stability and national security, effective government, rule of law, and effective bureaucracy. Therefore, the trade openness is one of the elements to build a strong and healthy institutional environment. ³⁸⁴

The institutions reform in Indonesia has been started since 1999; soon after reformation era begin. Such reform was driven by the conditionality imposed on the Letter of Intend (made by the World Bank and the IMF), which is designed to assist Indonesia exit from severe economic crisis. ³⁸⁵ This conditionality brought positive impact on trade reforms, for instance, establishment of regulation to enhance business competitiveness. In addition, Indonesia established non-ministries institutions to ensure all those reforms agenda are carried out properly, such KPPU (Komisi Pengawas Persaingan Usaha) or the Supervisory Commission on Bussiness Competition.

As elaborated in the previous chapter, that good governance and capacity building are the key elements of trade facilitation. Implementation of good governance and enhancement of capacity building are increasing efficiency in exports administration procedures, reduce transaction cost, and minimizing rent seeking

³⁷⁸ See Ng and Yeats 1999; Deardorff 2000; Will Martin, 2001, *Op. Cit.*, p. 2.

³⁷⁹ See Will Martin, 2001, *Op. Cit.*, p. 4.

³⁸⁰ See Rodrik, 1987; Will Martin, 2001, *Loc. Cit.*, p. 4.

³⁸¹ See Rodrik, 2001; Will Martin, 2001, *Op. Cit.*, p. 14.

³⁸² See Andrew Berg and Anne Krueger, 2003, *Op. Cit.*, pp. 5-6.

³⁸³ See Frederico G. Jayme, Jr., 2001, *Op. Cit.*, p. 15.

³⁸⁴ See Andrew Berg and Anne Krueger, 2003, *Op. Cit.*, p. 38.

³⁸⁵ See Will Martin, 2001, *Op. Cit.*, p. 15.

behaviour of government employee and corruptions practices. According to Ehtisham et.al, decentralization, however, offers considerable opportunities for better governance. The decentralization is improving the capacity of local government to manage and to distribute public goods based on their needs and preferences.³⁸⁶ In addition, decentralization likely to enhance more responsive and efficient government to meets the local needs and preferences.³⁸⁷

The main conception of decentralisation is bringing the government closer to the people.³⁸⁸ Decentralisation in developing countries has generally been caused by the incapability of the central government to meet increasing demands for local services.³⁸⁹ Therefore, decentralisation can be used as a driving force towards generating improvements in Indonesia's notably poor governance environment. The poor governance environment is a chronic problem in Indonesia, where it has suffered as a country with the highest levels of corruption. It has proven to undermine both public service delivery and the private-sector environment.³⁹⁰ Simanjutak and Mahi note that it is commonly thought that bringing service delivery closer to the people allows them to better hold the government accountable for its actions.³⁹¹ In other words, decentralisation increases public participation to control the authority in performing its executive tasks. While Made Suwandi notes three parameters that can be used to guide the distribution of authority to provide services. It consists of externalities, accountability, and efficiency. Based on these three parameters, the authority delivers services among three layers of government (the centre, the province, and the district/city).³⁹²

According to Simanjutak and Mahi, fiscal decentralisation is aimed to improve national and regional government operational efficiency; to enhance accountability, and to increase transparency; to assure the delivery of basic public services to citizens across the country; to ameliorate the social welfare of Indonesians; and to support macroeconomic stability.³⁹³ De Mello and Adam B. Elhiraika consider that fiscal decentralisation responsibilities have implications on increasing efficiency in public service delivery and in reducing information and transaction costs, where it is always associated with the provision of public services.³⁹⁴

The benefits of decentralisation depend crucially on governance. If good governance is applied correctly by the local authorities, it will improve accountability by minimising high cost economy and ensuring the public service is delivered properly to the society. In fact, governance and accountability are still placed as the serious concerns in the implementation of decentralisation in developing countries.³⁹⁵ Made Suwandi identifies one of the problems of decentralisation in Indonesia is lacking professionalism combined with strong political ideals, which often resulted in inefficiency at local government level. Administrative inefficiency was neglected for decades, which chronicled the bureaucracy problem in Indonesia. In fact, most local

³⁸⁶ See Dillinger, 1994; Ehtisham Ahmad and Ali Mansoor, 2002, *Op. Cit.*, p. 3.

³⁸⁷ See Gary GoodPaster, 2000.

³⁸⁸ See Made Suwandi, *Op. Cit.*, p. 286.

³⁸⁹ See Adam B. Elhiraika, Fiscal Decentralization and Public Service Delivery in South Africa, African Trade Policy Center, February 2007, p. 2, available at : <http://www.uneca.org/atpc/Work%20in%20progress/58.pdf>.

³⁹⁰ See Bert Hofman and Kai Kaiser, *Op. Cit.*, p. 24.

³⁹¹ See Robert A. Simanjuntak and B. Raksaka Mahi, Local tax revenue mobilization in Indonesia's decentralizing era, p. 139.

³⁹² See Made Suwandi, *Op. Cit.*, p. 286.

³⁹³ See Robert A. Simanjuntak and B. Raksaka Mahi, *Op. Cit.*, p. 137.

³⁹⁴ See De Mello 2000b; Adam B. Elhiraika, 2007, *Op. Cit.*, p. 2.

³⁹⁵ See Bert Hofman and Kai Kaiser, *Loc. Cit.*, p. 24.

government positions were held by officials who did not have sufficient education and experience, thus causing low professionalism in public service delivery.³⁹⁶

Hofman and Kaiser, is underlining the significant relationship between decentralization with governance and accountability.³⁹⁷ Elhiraika is elaborating that decentralization provide's greater accountability, because it is enhancing assurance for public service to be delivered properly to the society. Moreover, greater accountability is strengthening the institutional capability at the local level. Institutions capacity building is needed to ensure public participation and accountability of policy-makers, service providers, and users.³⁹⁸

With regard to capacity building, lack of professionalism in delivering public would hinder the decentralization process. Incapacity of local government's understands existing's regulations in carrying out their roles more likely causing problems and delays in delivering services. Capacity building at the local government level is becoming a necessity to improve their capacity in performing public services delivery. In order to manage the local government functions, institutions, personnel, finance, representation, and service delivery it is necessary to improve the capacity of civil servant of the local government and other related officials to guarantee adequate human resources. According to Made Suwandi, the improvement of such capacities should be placed as the key agenda in promoting decentralization reform in Indonesia today.³⁹⁹

Kalamova and Kessing in their paper "Decentralisation and International Trade", analyse the relationship between the form and degree of decentralisation of government structures and international trade.⁴⁰⁰ They use the theory-based gravity model to examine the effects of decentralisation on international trade. The form and the degree of decentralisation influence domestic trade costs. The main questions in their paper cover two aspects about how decentralisation affects international trade, and examines the impact of different forms of decentralisation on foreign trade.⁴⁰¹

They assume that vertical decentralisation increases international trade whereas horizontal disintegration reduces it.⁴⁰² They argue that these different forms of decentralisation affect international trade differently.⁴⁰³ In this regard, decentralisation is distinguished into two forms, known as horizontal decentralisation and vertical decentralisation. Horizontal decentralisation is characterised by the division of sub-national government layers into mutually exclusive territorial units, such as states, regions and counties. Horizontal decentralisation causes economic agents to become subjects of different local jurisdictions, with potentially different regulations, taxes, and public infrastructure.⁴⁰⁴ While, vertical decentralisation is characterised by the number of government tiers in a country and relates to the fact that decentralisation makes the economic agents subject to several vertically differentiated government levels.⁴⁰⁵

The main assumption is that decentralisation affects the costs of intra-national trade. This modifies the relative prices of imported goods, and consequently the demand for domestic and foreign goods. Whenever decentralisation increases the costs

³⁹⁶ See Made Suwandi, *Op. Cit.*, p. 274.

³⁹⁷ See Bert Hofman and Kai Kaiser, *Loc. Cit.*, p. 24.

³⁹⁸ See Fosu and Ryan 2004; Adam B. Elhiraika, 2007, *Op. Cit.*, p. 2.

³⁹⁹ See Made Suwandi, *Loc. Cit.*, p. 286..

⁴⁰⁰ See Margarita M. Kalamova and Sebastian G. Kessing, *Decentralization and International Trade*, Free University Berlin and WZB, July 2007, available at : <http://www.etsg.org/ETSG2007/papers/kalamova.pdf>, p. 1.

⁴⁰¹ See Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. i.

⁴⁰² See Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. 1.

⁴⁰³ See Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, pp. 1-2.

⁴⁰⁴ See *Ibid.*, pp. 1-2.

⁴⁰⁵ See *Ibid.*, pp. 1-2.

of internal transactions, foreign goods become relatively cheaper, and an increase in imports can be observed. On the other hand, if decentralisation facilitates internal transactions, domestic goods become relatively cheaper, and a reduction in imports should be observed. Analogous arguments can be made for exports. Vertical decentralisation increases domestic trade costs, whereas horizontal decentralisation creates different effects on the profitability of internal transactions with a combined effect of which the direction is theoretically ambiguous.⁴⁰⁶

Over taxation is identified as one of the weaknesses in the vertical decentralization. Overlap of authorities is resulting vertical fiscal externalities, when more than one level of government levies taxes on the same tax base most likely occurring over taxation. The red tape bureaucracy, bulk of regulatory provision and overlap taxation are identified as factors that caused costly internal transaction and triggering high trade cost.⁴⁰⁷

“[...] Assumed if internal transactions are likely to be subject to some kind of taxes or fees, negative vertical externalities between the different layers of government are likely to arise. These externalities would imply that internal transactions should be more costly, as the number of government levels in a country increases. A similar argument can be made with regard to trade costs resulting from regulatory provisions and red tape. They are increasing in the number of government tiers and will make intra-country trade more expensive in countries with more government tiers. Since international transactions become relatively more attractive and therefore it expected that international trade is increasing in the number of government tiers of the trading countries [...]”.⁴⁰⁸

Kalamova and Kessing find significant effects of decentralisation on trade. Vertical decentralisation increases international trade, whereas horizontal decentralisation decreases international trade. The amount of trade between countries is positively related to the number of government tiers in the exporting as well as in the importing country.⁴⁰⁹ Kessing et al. argue that vertical decentralisation is a more decentralised economy that is more integrated into the world economy, whereas more horizontal decentralisation actually implies less integration.⁴¹⁰ The degree of market openness and the integration of the country into a multilateral trading system brings influence that lowers the high internal barriers. Therefore, the level of decentralisation itself depends on the extent of economic integration with the rest of the world.⁴¹¹

VI.e. Local government competences in boosting exports.

According to Law No. 32/2004, Government Regulation No. 38/2007 and Government Regulation No. 41/2007, local government has the right to establish local trade institutions under its authority. In this research, we will take an example from the Special Province of Yogyakarta (herein after SPY). SPY is geographically located in the south of the Province of Central Java. It is adjacent to Wates and Kulomprogo in the west, Wonosari and Gunungkidul Regency in the east, Sleman Regency in the north and Bantul Regency in the south. SPY consists of areas of land and sea with a total area reaching 3,185.80 cubic kilometres. The SPY area that is capitalised in the City of Yogyakarta is divided into 4 regencies and 1 city, namely the Regency of Kulonprogo,

⁴⁰⁶ See Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. 2.

⁴⁰⁷ See Keen, 1998; Keen and Kotsogiannis, 2002; Wrede, 1997, 2000; Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Loc. Cit.*, p. 2.

⁴⁰⁸ See Keen, 1998; Keen and Kotsogiannis, 2002; Wrede, 1997, 2000; Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Loc. Cit.*, p. 2.

⁴⁰⁹ See Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. 3.

⁴¹⁰ See Kessing et al., 2006a, 2006b; Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. 4.

⁴¹¹ See Alesina et al., 2000; Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. 20.

Bantul, Gunungkidul, Sleman and the City of Yogyakarta. The widest area of the SPY is the Regency of Gunungkidul with an area of 1,485.36 cubic kilometres and the smallest area is the City of Yogyakarta with an area of 32.50 cubic kilometres. The economic structure of the SPY in 2010 was dominated by the trading sector (19.77%), services sector (19.47%) and agriculture sector (15.25%). The main commodity of the SPY is the agriculture sector and services sector. The main commodity of agriculture is the plantation sub-sector with the commodity of coconut; the fishery sub-sector with the commodity of fishery catch, and fishery cultivation. The main commodity of the services sector is tourism, nature and cultural tourism.⁴¹²

Table 51. Total export value of the Special Province of Yogyakarta⁴¹³

Values in million USD

Years	2005	2006	2007	2008	2009	2010	2011
Exports	143.47	138.47	125.56	130.25	108.7	130.39	131.6

The local trade institution that is established under the Local Government of SPY is integrated with three other fields, that is industry, cooperation (*"koperasi"*), and Small and Medium Enterprises. According to Local Regulation of SPY No. 6/2008 on the Establishment and Organisation of Local Institutions in the scope of the Local Government of SPY, it is named the *"District Office of Industry, Trade, Cooperation, and SMEs"*. This local institution has four different tasks that are interrelated and integrated to support economic activities especially at the local level. Industry, trade, cooperation, and SMEs are the prominent sectors to accelerate local development. This complies with the vision of the institution, which has the role as an accelerator of industry, trade, cooperation, and SMEs driving improvements in competitiveness to achieve society welfare. The local institution is a driving force to improve competitive advantage and to accelerate full participation in the world trade trading system. The mission of the institution is to deliver excellent service, in this regard, on trade, by efficient management of the institution. Excellent service is provided to satisfy the business community and society.

To encourage foreign trade by local traders the *District Office of Industry, Trade, Cooperation, and SMEs*, established the *"Division of Foreign Trade"* (herein after named DFT). The DFT has three Sections, consisting of the Section of Export and Import Facilitation, Section of Export Development, and Section of Foreign Trade Cooperation. Each section has its own main tasks and job description. Further, we will elaborate more about their main tasks and job description to portray the role of the local trade institution in foreign trade, especially on export facilitation.

The Section of Export and Import Facilitation has the main task of carrying out the facilitation and promotion of export and import activities. In detail, this section includes nine job descriptions, which include the following:

1. making programme planning on export-import;
2. compiling technical guidance, facilitating, and supervising export-import activities;
3. preparing export licence recommendations;
4. preparing the issuance of the Importer Identity Number;

⁴¹² See Profile Special Province of Yogyakarta, available at : <http://regionalinvestment.bkpm.go.id/newsipid/displayprofil.php?ia=34>, last accessed : 29 April 2012.

⁴¹³ Taken from Export Statistic of District Office of Industry, Trade, Cooperation, and SMEs available at : <http://www.disperindagkop.pemda-diy.go.id/index.php?module=ekspor&halaman=1>, last accessed : 30 April 2012.

5. preparing recommendation letters for the importation/entry of goods;
6. tracing the origin of goods and issuance of certificates of origin (SKA) items;
7. developing exporter-importer human resources (traders) on import-export activities;
8. facilitating dispute settlements between importers and exporters;
9. making evaluation and reports of section programmes on export and import facilitation;

The second section is Export Development, which has the main tasks of carrying out the supervision and development of exports. Under this section there are eight job descriptions, consisting of:

1. making programme planning on export development;
2. preparing technical guidelines of export development;
3. managing export-import data and information;
4. providing analysis of potential export commodities and potential export destinations;
5. supervising the quality of exported goods;
6. facilitating the big exhibition of export products (trade promotion);
7. developing exporter human resources related to export management;
8. making evaluation and reports of section export development programmes.

The third section is foreign trade cooperation, which has to carry out tasks on facilitating foreign trade cooperation, promotion, and the monitoring of foreign cooperation agreements. Under this section there are six job descriptions, consisting of:

1. making programme planning on foreign trade cooperation;
2. compiling technical guidance on facilitation and monitoring implementation of foreign trade cooperation;
3. promoting and monitoring the implementation of foreign trade cooperation agreements;
4. analysing and evaluating the performance potential of foreign trade cooperation;
5. providing facilitation of foreign trade cooperation efforts;
6. making evaluation and reports of section foreign trade cooperation programmes.

Under the District Office of Industry, Trade, Cooperation, and SMEs of SPY, the “*Business Service Centre*”, was also established, which has two main roles as a business service centre and business information centre. As a business information centre, it is entitled to the main function of carrying out the preparation, presentation, and provision of services on business information. This centre has the task of collecting and processing data and business information, managing business information systems, providing business information, and providing business information services. As the business service centre, its main function is to provide business development service, covering business-counselling services, counselling services on the use of ICT for business, design services, and to provide services and facilitation of business development.

VI.f. Trade facilitation in the framework of local autonomy.

Indonesian National Long-Term Development Plan 2005–2025 envisioned “high and inclusive economic growth as a means of achieving sustained prosperity for its people and the protection of its natural resources and environment”. Thus, Indonesia needs to drive its economic development to achieve such vision. High export growth is one of the tools to encourage the acceleration of economic development. As a matter of fact, Indonesia still faces many internal and external constraints that impede the country’s export performance which, in this respect, are often associated with trade-

related policies and its hard and soft infrastructure.⁴¹⁴ These internal problems consist of inadequate organisational resources for export marketing, lack of export financing, insufficient information about overseas markets, product problems related to quality and technical requirements, and lack of knowledge of foreign markets.⁴¹⁵ The fragmentation of responsibilities in public institutions is charged with export quality issues, the absence of a well-integrated roadmap to improve the system, and insufficient interaction between public sector institutions and representatives of private sector interests in the export sector are also identified as the constraints in increasing export performance.⁴¹⁶

Transactions across states borders are costly because of tariffs and other trade barriers that unobservable. ⁴¹⁷ Gary GoodPaster, on his paper of *“Decentralization, Internal Barriers to Trade, and Local Discriminatory Action”*, has wrote :

“[...] Since the foreign trade is a great concern to the national government, e.g., only the national government enters international trade agreements, the national government should take special care to protect foreign commerce from local taxation. Local tariffs and local imposition of non-tariff barriers to trade can interfere directly with the nation’s international obligations, and there are foreign policy implications whenever a locality taxes foreign commerce. In this respect, Indonesia should develop some sort of import-export rule that prohibits regions from imposing tariffs or duties on imports and exports, and on the activities of importing and exporting, and prohibits regions from creating non-tariff barriers to trade not sanctioned by the central government [...]”.⁴¹⁸

Decentralisation brought about a perspective that increased government performance to bring the public service closer to the people. Trade facilitation is one *“public good”* that should be delivered properly and adequately to society, especially to economic operators. Indonesia has struggled with many problems related to improvements of more effective and efficient trade facilitation. One of the big problems is overlapping administrative and formalities procedures due to decentralisation, such as double taxation and red tape bureaucracy. In this regard, Elhiraika has identified three constraints that cause inefficiency in the improvement of public service delivery carried out by local governments, covering lack of sufficient revenue assignments, inadequate access to financial markets, and lack of necessary administrative capacity on the part of local authorities.⁴¹⁹

Local revenue collection is one of the main components of decentralisation related to fiscal aspects. Under the centralised system, local tax based in Indonesia has no significant improvement. Local governments remain vastly dependent on the central government to supply their revenues. Therefore, Simanjuntak and Mahi emphasise the importance for local government to look for alternative additional local taxes and to improve the administrative capacity of the existing taxes.⁴²⁰ Brodjonegoro and Vazquez also note the need for local government to expand local revenue autonomy.⁴²¹ Business registration tax is included as one of the good candidates of tax to be assigned from central government to local government. The improvement of local revenue collection would accelerate and enhance decentralisation in Indonesia.⁴²²

⁴¹⁴ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, p. 7.

⁴¹⁵ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Op. Cit.*, pp. 8-9.

⁴¹⁶ See *Ibid.*, pp. 8-9.

⁴¹⁷ See Margarita M. Kalamova and Sebastian G. Kessing, 2007, *Op. Cit.*, p. 5.

⁴¹⁸ See Gary GoodPaster, 2000, *Op. Cit.*, p. 11.

⁴¹⁹ See Adam B. Elhiraika, 2007, *Loc. Cit.*, p. 2.

⁴²⁰ See James Alm, Jorge Martinez-Vazquez and Dana Weist, *Op. Cit.*, p. 4.

⁴²¹ See James Alm, Jorge Martinez-Vazquez and Dana Weist, *Op. Cit.*, p. 5.

⁴²² See James Alm, Jorge Martinez-Vazquez and Dana Weist, *Loc. Cit.*, p. 4.

Law No. 28 /2009 regulates local tax. Previously, it was regulated under Law No. 34/2000⁴²³, which is acknowledged as the first regulation in early decentralisation that greatly expands the scope for local government revenues. Amendments of local tax followed the policy of decentralisation. In the era of the centralised system, local government taxes were regulated by Law No. 18/1997. Implementation of Law No. 18/1997 was identified as a high cost to the taxpayer and the economy.⁴²⁴

Law No. 28/2009 divided local tax into two categories: local tax and local retribution. Article 1 Paragraph 10 of Law No. 28/2009 stated that “*local tax [is] used for local interest with the purpose for the greater welfare of the people*”. With regard to local contribution, Article 1 Paragraph 10 of Law No. 28/2009, was defined as a local charge having the function of a payment upon services or particular permits provided or granted by the local government to individuals or institutions. Local taxes are divided into two categories, that is, local taxes imposed by the district and city and local taxes imposed by the province.⁴²⁵ Law No. 28/2009 regulates local taxes more simply and clearly. Its aim is to minimise overlapping taxations between the government tiers.

According to Davey, there are six criteria to evaluate the performance of local taxes. It consists of adequacy and elasticity⁴²⁶; equity⁴²⁷; administrative feasibility⁴²⁸; political acceptability⁴²⁹; economic efficiency⁴³⁰; and suitability as local tax/revenue⁴³¹.⁴³² The principal objectives of local revenues are:⁴³³

⁴²³ See Robert A. Simanjuntak and B. Raksaka Mahi, *Op. Cit.*, p. 111. Law No. 34/2000 Article 2, sub-article 4, had described the criteria for the new taxes that local governments could introduce, covering :

1. They are taxes and not charges/levies in nature.
2. Tax objects should reside in the area of the region, with low mobility, and with a residential-based population.
3. The base and object of the tax should confirm to a social justification (do not conflict with the public interests).
4. The local tax objects should not overlap with those used by the central and/or provincial governments.
5. The tax potential should be significant (adequate).
6. The tax should not distort the economy.
7. Equity and the ability to pay the tax should be the concern of the tax policy.
8. Environmental considerations should be a priority (or, environmental sustainability should be maintained).

⁴²⁴ See Bert Hofman and Kai Kaiser, *Op. Cit.*, p. 32.

⁴²⁵ See Article 2 Law No. 28/2009.

⁴²⁶ Adequacy and Elasticity : “[...] It means that revenue sources should be adequate to meet the costs of the services which they are intended to finance and should have some “elasticity” so they able to respond to increasing demands on public expenditure. The cost of public services are not static, its normally increase due to several reasons, such as inflation, growing population, and rising standards of living that inspire demands for higher standards of services. The tax base should grow automatically when prices rise, population increases, and the overall economy expands [...]”.

⁴²⁷ Equity : “[...] Its means that the burden of maintaining public expenditure should be borne by sections of the community somehow in proportion to their wealth. According to these standards, taxation is good if it is progressive, which means if the percentage of a person’s income paid in tax increases with the level of his or her income. Progressive tax structure is quite desirable on the grounds of social justice [...]”.

⁴²⁸ Administrative Feasibility : “[...] Revenue sources vary in the amount of skill, integrity and determination required in their administration. They also vary in the amount of time and money involved in collecting them, compared with their yield [...]”.

⁴²⁹ Political Acceptability : “[...] The political will is needed to levy taxes (i.e. to decide questions of liability and assessment, to collect them physically, and to enforce sanctions against evaders) [...]”.

⁴³⁰ Economic Efficiency : “[...] Taxation basically has two purposes: to provide money for public purposes, and to influence economic behavior. Taxes affect the cost of individual decisions. Taxes must be judged also in terms of their effect on the decisions of a taxpayer, on his or her propensity to work, consume, save and invest [...]”.

⁴³¹ Suitability as Local Revenue : “[...] Tax administration by local authorities raises specific questions of feasibility. Some relating to the availability of administrative skills have already been raised. Whether it is clear to which authority a particular tax liability is due. Local taxes, to the maximum possible extent, should follow the ‘benefit principle’ of taxation: economic efficiency is increased when there is a link between what people pay in taxes and what benefits they receive from public services [...]”.

⁴³² See Davey, 1983; Robert A. Simanjuntak and B. Raksaka Mahi, *Op. Cit.*, p. 105.

⁴³³ See Robert A. Simanjuntak and B. Raksaka Mahi, *Op. Cit.*, p. 142.

1. To raise revenues from the local communities under local legislation to financing local public services. It is relieving the full burden of central government for financing such services through budget transfers.
2. To reinforce local autonomy and democracy, by facilitating a degree of local choice and trade-off between levels of services and local tax and charge burdens.
3. To promote local accountability of regional governments.
4. To provide incentives to improve efficiency and effectiveness in local services delivery.

Indonesia's decentralization give an authority to the local government to establish their own's new sources of revenues, such as local tax and local retribution, but such charges should be based on "good" tax criteria, as follows⁴³⁴ :

1. The tax must be suitable as a regional government tax; that is, the tax base must clearly be located within, or arise from within, the regional government area, and must relate primarily to economic activity from within the regional government area.
2. The tax must be politically acceptable at national and regional levels;
3. The tax base must not overlap with that of another central or local tax or license fees having the characteristics of a tax.
4. The estimated potential yield of the new revenue source should represent a substantial additional contribution to the present total of local revenues, and should be founded on a buoyant revenue base.
5. The gross costs (i.e. costs before deduction of any staff-related grant) of collecting the revenue must be acceptably small compared to the yield of the revenue.
6. The tax must not prejudice national economic policies.
7. Except as a matter of deliberate and justified policy, the tax must not seriously change the allocation of economic resources within the regional government area or between regions, nor disrupt intra- or inter-regional trade.
8. The tax burden must be affordable, both by the majority of those directly liable to pay it and by those on whom it would ultimately impact.
9. The tax must not be unduly regressive.
10. The tax must not unfairly discriminate between particular sections of the community.
11. Regional governments must be able to administer the revenue effectively; that is, regional governments must be able to identify the vast majority of liable taxpayers, to assess each taxpayer's liability readily and accurately, and to enforce collection of the revenues assessed as payable.
12. The tax must not discourage taxpayers from taking proper action to comply with environmental conservation needs.

In fact, many inappropriate new taxes have been created at local level.⁴³⁵ According to Simanjuntak and Mahi, the implementation of these principles apparently would be difficult to some extent. Miss-interpretation due to superficial understanding of these principles by local officials could resulted tax regulations that contrary with basic criteria of taxation. The tax must not creating double taxation.⁴³⁶

There are some important notes related to the Indonesian business actors, particularly small and medium size enterprises (SMEs), which mostly lack awareness of EU market access requirements, product design needed for European customers, and available government support programmes, such as trade promotion. In this regard, collaboration support between the government and business community through trade facilitation could encourage SMEs to expand their market to the EU.⁴³⁷

Export promotion is playing important role to open overseas market access for local exporters. The most successful countries on export's promotions are South Korea and Taiwan. Theirs governments are actively intervening trade, especially in facilitating

⁴³⁴ See Robert A. Simanjuntak and B. Raksaka Mahi, *Op. Cit.*, p. 143.

⁴³⁵ See *Ibid.*, p. 143.

⁴³⁶ See Robert A. Simanjuntak and B. Raksaka Mahi, *Loc. Cit.*, p. 111.

⁴³⁷ See Lord, Montague., Oktaviani, Rina., and Ruehe, Edzard., 2010, *Loc. Cit.*, p. 4.

promotion of manufactured exports. The common feature of Taiwan and Korea is that the high rates of economic growth that accompanied by improvement of human capital, increase of capital accumulation and an impressive exports boost, mainly in the manufactures sector. According to Nelson and Park, assimilation perspective might explain for the success of these countries.⁴³⁸ The assimilation perspective emphasizes the role of learning and mastery of foreign technologies in explaining the industrialization process and rapid economic growth of some East Asian countries.⁴³⁹

Promotion is tools to introduce and to advertise export products, therefore, market created. Promotion plays significant role in the tough trade competition and market expansions. Traders or manufacturers carry out promotion in three ways, i.e., direct promotion by advertising, trade exhibition, and information dissemination to the target market. Because of the high cost and unaffordable for SMEs, only big manufacturer's that carry out overseas trade promotion. In this regard, the government needs to organize or facilitate overseas trade promotion that involving SMEs. The activities of exports promotions activities are covering overseas trade exhibition, sending trade mission, Indonesian Week at department store in abroad, Buyer Reception Desk (BRD), and Permanent Trade Display in abroad.

The National Agency for Export Development (NAFED) and Indonesian Trade Promotion Centre (ITPC)⁴⁴⁰ is a government agency under the Ministry of Trade that carries out the task of facilitating and supporting improvements of national exports. This agency also has the task of improving the country's profile overseas, facilitating promotion of national products, and monitoring foreign trade activities. It is important in the strengthening of export development on commodity aspects and market access in order to increase export competitiveness. In the management of export policies and strategies it is recommended to strengthen sustainable export promotion, especially for SMEs.

VI.g. Government efforts in the legal framework of decentralisation and deconcentration to support GSP utilisation.

From the historical legal perspective "deconcentration" in Indonesia existed a long time before the establishment of Law No. 25/1999. According to the prevailing laws, the current deconcentration definition is not so different from the definition in the previous law.⁴⁴¹ In brief, the implemented deconcentration is derived from the concept of previous laws, and is made into a new legal instrument. Deconcentration had been used by the centralised government as a tool to delegate some central government affairs to its representative at the local level. In the New Order era Law No. 5/1974 was issued in which it was mentioned that the central government was allowed to delegate its tasks and functions to "autonomous" local governments, with the exception of defence and security affairs, judicial system matters, monetary and other functions that can only be handled by the central government. In fact, Law No. 5/1974 was never fully implemented by the central government. In 1996, its implementation was attempted but in the end failed, since in practice the central government still kept its strong domination, especially in human resource management.⁴⁴²

⁴³⁸ See Nelson and Pack, 1999b; Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 636.

⁴³⁹ See Pack and Westphal, 1986; Pack, 1992b; Ricardo A. Lòpez, 2005, *Loc. Cit.*, p. 636.

⁴⁴⁰ Since 2008 ITPC has been opened in many trading partner countries including in EU member states.

⁴⁴¹ See Hartanti., Erlina, *Alokasi dana dekonsentrasi kementerian pendidikan Nasional kesesuaiannya dengan peraturan Pemerintah Nomor 38 tahun 2007*, Fakultas Ekonomi, Universitas Indonesia 2010, p. 36, available at : <http://www.lontar.ui.ac.id/file?file=digital/131541-T%2027590-Alokasi%20dana-Metodologi.pdf>, last accessed : 19 June 2012.

⁴⁴² See Hartanti., Erlina, 2010, *Op. Cit.*, p. 39.

The concept and definition of deconcentration in Indonesia is a delegation of some state official competences at the central government level to state official at the local level.⁴⁴³ From a political perspective, deconcentration was used to bring the central government closer to the people through direct contact with some government affairs. It was also used to minimise complaints and protest from the local level towards the central government policy. While from the legal perspective, it was used to implement government law and policy at the local level. Economically speaking, deconcentration could enhance the efficiency of bureaucracy where government officials or apparatus at the local level were actively involved in the planning-making and implementation of government policy.⁴⁴⁴

In order to implement deconcentration, guidelines are needed, therefore, Government Regulation No. 38/2007 and Government Regulation No. 7/2008 were issued.⁴⁴⁵ These regulations are regarded as the legal basis of the implementation of deconcentration. Deconcentration is the delegation of authority to the Governor as the representative of central government at the local level and/or the vertical institutions in certain areas. In the elucidation Government Regulation No. 7/2008, it is clearly stated that: *"the Republic of Indonesia in executing its administration adheres to the principles of decentralisation, deconcentration and assistantship task"*. This means that deconcentration and assistance tasks are undertaken as a consequence of the unitary state in which central government entitles authorities except for some competences that are delegated to the local governments.⁴⁴⁶ In addition, Government Regulation No. 7/2008 states that in conducting its affairs, the government can execute its own government's affairs, delegate part of the governmental affairs to the Governor as the representative of the government (deconcentration) or assign the local government's affairs (assistantship task).⁴⁴⁷ Specifically, Article 16 Paragraph 5 of Government Regulation No. 7/2008 regulates the implementation of the deconcentration system between the central government and local government.⁴⁴⁸

Article 1 Paragraph 1 of Trade Minister Regulation No. 42/M-DAG/PER/12/2011 defines deconcentration as an authority delegation from government to Governor as the government representative and/or to the vertical institution in a particular area.⁴⁴⁹ Concerning deconcentration in the trade sector, Article 3 Paragraph 1, stipulates that:⁴⁵⁰

"[...] Government delegates some of its affairs in the trade sector under the Minister competences to Governor as the government representative [...]".

Thus, Article 5 Paragraph 1 stipulates that in the implementation of deconcentration on the trade sector, the government entitles the tasks of synchronisation of local government affairs, implementing effective and efficient principles in deconcentration, and undertaking the duty of coordination, management, monitoring, supervision, and reporting.⁴⁵¹

⁴⁴³ See Nurcholis, 2005 : 24; Hartanti., Erlina, 2010, *Op. Cit*, p. 37.

⁴⁴⁴ See Hartanti., Erlina, 2010, *Loc. Cit*, p. 37.

⁴⁴⁵ See Hartanti., Erlina, 2010, *Op. Cit*, pp. 39-40.

⁴⁴⁶ See Hartanti., Erlina, 2010, *Op. Cit*, p. 44.

⁴⁴⁷ See Hartanti., Erlina, 2010, *Op. Cit*, p. 56.

⁴⁴⁸ See Trade Minister Regulation No. 42/M-DAG/PER/12/2011 concerning delegation of government's affairs in trade sector to the governor as the government representative in respect of deconcentration fiscal 2012, available at : <http://www.kemendag.go.id/files/regulasi/2011/12/Permendag%20No.%2042%20Tahun%202011.pdf>, last accessed : 19 June 2012.

⁴⁴⁹ See Trade Minister Regulation No. 42/M-DAG/PER/12/2011.

⁴⁵⁰ See Trade Minister Regulation No. 42/M-DAG/PER/12/2011.

⁴⁵¹ See Trade Minister Regulation No. 42/M-DAG/PER/12/2011.

The transformation of the national management system from the centralised ones into a decentralised system has granted greater autonomy for local government to organise its own public services and give more opportunities for local government to participate in determining the direction of its economic development. Given the important role of the local government, as well as the geographic coverage and economic reasons, the central government needs the local government as its representative to implement programmes and policies at the local level.⁴⁵² Deconcentration on the trade sector is used to support development and trade expansion in order to promote the acceleration of economic growth at the local level.⁴⁵³ As stated in President Regulation No. 29/2010 on Government Work Plans of the Year 2011 wherein a relationship of synergy and harmony between local government and the central government is one of the main focuses of Indonesia's national development.⁴⁵⁴

Development of foreign trade facilitation at the local level is aimed to expand market access on exports, and to improve export competitiveness through the enhancement of export product quality in the global market.⁴⁵⁵ The technical development of foreign trade facilitation at the local level is conducted through optimising the opportunity provided by international trade agreements⁴⁵⁶ such as FTA and/or unilateral trade preferences (GSP). The scope of foreign trade facilitations at the local level is to cover facilitation on export-import licenses and facilitation non-licenses. One of its main programmes is to provide online service on issuing certificates of origin and to establish electronic management on the utilisation of certificates of origin.⁴⁵⁷ The foreign trade facilitation service became the main menu of the deconcentration programmes during the fiscal year of 2012. A significant result of the deconcentration programme on foreign trade facilitation is an automation certificate of origin that is operated online in eighty-five issuing agencies across Indonesia. In order to enhance the quality trade service and to ensure the appropriate implementation of deconcentration of the central government is carried out by coordinating with local trade institutions and certificate of origin issuing agencies.⁴⁵⁸

It is important to strengthen coordination and communication between central government and local government to implement of trade policy and to achieve harmonization on trade service.⁴⁵⁹ The coordination and supervision of foreign trade policy at the local level includes several activities such as dissemination, evaluation and harmonization. Integrated foreign trade's policy is aimed to enhance understanding

⁴⁵² See Trade Minister Decision No. 13/M-DAG/KEP/1/2011 concerning Technical Guidelines for the Utilization Deconcentration Budget on Trade Sector for Fiscal Year 2011, available at : <http://ditjenpdn.kemendag.go.id/informasi/uf/0edfbc5f4.pdf>, last accessed : 19 June 2012. Technical Guidelines for Trade Deconcentration of 2011, the Ministry of Trade of the Republic of Indonesia, of 2010, available at : <http://ditjenpdn.kemendag.go.id/informasi/uf/0edfbc5f4.pdf>, last accessed : 19 June 2012.

⁴⁵³ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, p. 1.

⁴⁵⁴ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, p. 2.

⁴⁵⁵ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, p. 48.

⁴⁵⁶ See *Ibid.*, p. 48.

⁴⁵⁷ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, pp. 48-49.

⁴⁵⁸ See Trade Minister Regulation No. 46/M-DAG/PER/12/2011 concerning Technical Guidelines for the Implementation of Deconcentration Activities on Trade Sector Fiscal Year 2012, available at : <http://www.kemendag.go.id/files/regulasi/2011/12/Permendag%20No.%2046%20Tahun%202011.pdf>, last accessed : 19 June 2012, pp. 58-61.

⁴⁵⁹ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, p. 58.

and cooperation between the business actor, trade officials, and relevant technical agencies.⁴⁶⁰ Supervision and evaluation of foreign trade activities at the local level is encompassing export-import's performance at the local level and development of potential exports products in world market.⁴⁶¹

Coordination activity is conducted in two ways, i.e., establishing coordination forum with related institutions at the local level to promote exports and establishing coordination to provide integrated management dealing with foreign trade issues. Coordination is aimed to improve performance of local government institutions. Local government institutions are expected to design policies for increasing exports performance through reducing trade barriers, utilizing preferences opportunities and local comparative advantages. Integrated coordination is used to collect feedback from stakeholders and business actors toward government's foreign trade policies. This activity is scheduled to be held in thirty-three provinces from February to October 2012.⁴⁶²

Dissemination of foreign trade policy includes general policies of the exports-imports such as, barriers to trade issues; management of export-import; customs procedures; transportation policy to support flow of goods; the role of banking in export financing. Dissemination activities is conducted in thirty-three province from February to October 2011.⁴⁶³ The participants of dissemination activity consist of business actors, civil servant in the foreign trade sector, business agencies and related technical agencies, with composition 60% business actors and 40% civil servants.⁴⁶⁴

Anticipating the rapid development of international trade and its' complexity, civil servants as the elements of stakeholders have to be equipped with the sufficient knowledge and skill. Technical assistantship is the activities to upgrade human resources knowledge and competency in delivering public services of foreign trade. Technical assistantship's on foreign trade policies conducted with purposes to improve technical knowledge of civil servants of the local trade institution in delivering adequate public service of export-import to business actors.⁴⁶⁵ Technical assistantship is covering the technical policy of export and import; technical policy of facilitating the export and import; and management of trade barriers issues.^{466 467}

According to Made Suwandi, public sector reform is needed to improve the local governments' capacity to carry out their functions on service delivery.⁴⁶⁸ Local governments are given greater responsibilities of delivering key development projects and public services.⁴⁶⁹ Anwar Shah and Theresa Thompson reflect on the 'silent revolution' in public sector governance that is sweeping across the globe and has aimed to move decision-making for local public services closer to the people.⁴⁷⁰ Further Made Suwandi describes that the sub-unit of central government (the district and city

⁴⁶⁰ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, pp. 51-52.

⁴⁶¹ See Trade Minister Regulation No. 46/M-DAG/PER/12/2011, *Op. Cit.*, p. 56.

⁴⁶² See Trade Minister Regulation No. 46/M-DAG/PER/12/2011, *Op. Cit.*, p. 52.

⁴⁶³ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, pp. 51-52.

⁴⁶⁴ See Trade Minister Regulation No. 46/M-DAG/PER/12/2011, *Op. Cit.*, p. 50.

⁴⁶⁵ See *Ibid.*, p. 50.

⁴⁶⁶ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, p. 53.

⁴⁶⁷ See Trade Minister Decision No. 13/M-DAG/KEP/1/2011. See also Technical Guidelines for Trade Deconcentration of 2011, *Op. Cit.*, p. 54.

⁴⁶⁸ See James Alm, Jorge Martinez-Vazquez and Dana Weist, pp. 9-10.

⁴⁶⁹ See Adam B. Elhiraika, Fiscal Decentralization and Public Service Delivery in South Africa, African Trade Policy Center, February 2007, available at : <http://www.uneca.org/atpc/Work%20in%20progress/58.pdf>, p. 2.

⁴⁷⁰ See James Alm, Jorge Martinez-Vazquez and Dana Weist, *Op. Cit.*, p. 10.

governments) is the front line of the whole governmental structure, which has the role of delivering services according to established standards and norms. He argues that the main reason for granting authority to delivering services to the districts and cities is due to their closeness to the people, thus, it gives them better knowledge of the needs and preferences of the people. In addition, a close position to the people will enhance accountability and effectiveness in service delivery.⁴⁷¹ Therefore, improving service delivery has been placed as a common factor of the demand for decentralisation.⁴⁷² The trade facilitation system in Indonesia is strongly influenced by special patterns of the local autonomy applied, which are based on decentralisation, deconcentration, and assistantship tasks principles.

Delegation of some government affairs in the trade sector to the governor, as a government representative at the local level to implement deconcentration is regulated by Article 15 of Trade Minister Regulation No. 46/M-DAG/PER/12/2011.⁴⁷³ Article 1 Paragraph 2 Trade Minister Regulation No. 46/M-DAG/PER/12/2011 stipulates that one of the functions of the deconcentration budget is to develop foreign trade facilitation and to develop exports at the local level.⁴⁷⁴

The deconcentration budget is used to finance the implementation of competences delegation from government to local government. The deconcentration budget is taken from the allocation of the state budget.⁴⁷⁵ Most deconcentration programmes on the trade sector are used to support capacity building and the development of human resources in order to accelerate development and economic growth at the local level.⁴⁷⁶ Improvement of human resource capacities is carried out through education and training in foreign trade.⁴⁷⁷

VII. Indonesia's certificate of Rules of Origin

VII.a. Indonesia's certificate of Rules of Origin

Indonesia's certificate of origin has existed since the 1970s. President Directive No. 58/1971 concerns the appointment of government officials who have the authority to issue certificates of origin. The existence of the certificate of origin has been changed many times since its establishment, as a consequence of Indonesia's participation in the international forum, particularly to fully integrate with the multilateral trading system. The certificate of origin must comply with international practices and standards. On the other hand, the market expansion of Indonesian export products has increased the demand for certificates of origin. Therefore, to respond to such challenges, it is urgent to improve the public services related to the issuance of certificates of origin. Trade Minister Regulation No. 33/M-DAG/PER/8/2010, emphasises affectivity and efficiency principles on the process of the issuance of certificates of rules of origin through a simple, speedy, correct, and transparent public service.

International trade practices have evolved along with the development of technology, consequently, the government has been asked to adopt new technology into trade facilitation. Thus, it brought implication of ICT implementation in the issuance of certificates of origin. The establishment of Indonesia's rules of origin is

⁴⁷¹ See Made Suwandi, *Op. Cit.*, p. 280.

⁴⁷² See Ahmed et al. 2005; Shah and Thompson 2004; Adam B. Elhiraika, 2007, *Loc. Cit.*, p. 2.

⁴⁷³ See Trade Minister Regulation No. 46/M-DAG/PER/12/2011.

⁴⁷⁴ See *Ibid.*

⁴⁷⁵ See *Ibid.*

⁴⁷⁶ See *Ibid.*

⁴⁷⁷ Includes education and training in exports, import, and trade facilitation.

based on the WTO legal framework⁴⁷⁸ and on other international legal instruments ratified by Indonesia.

Certificate of origin is defined as documents accompanying Indonesia's export products that have complying rules of origin, for entering the territory of certain countries, evidencing that such product comes from Indonesia. In other words, the certificate of origin is used as a legal document to show the nationality of the export products. Since the EU decided to require certificate of origin as one of the criteria to grant GSP, therefore, it is granted based on the requirements of unilateral stipulation of the preference-granting country.⁴⁷⁹

Article 2 of Trade Minister Regulation No. 33/M-DAG/PER/8/2010 divided the certificate of origin into two types, preferential certificate of origin and non-preferential certificate of origin.⁴⁸⁰ According to this regulation, preferential certificate of origin is issued to obtain facility of reduction or elimination of tariff duty from states or a group of states towards Indonesia's export products that comply with the requirements of international agreements or unilateral preferences.⁴⁸¹ While non-preferential origin is issued for the purpose of proving the national origin of goods without asking to obtain any tariff preferences.⁴⁸² Indonesia preferential certificate of origin consists of :⁴⁸³

1. General System Of Preferences (GSP) (using Form A)
2. ASEAN Free Trade Area (AFTA) (using Form D)
3. Certificate in Regard to Traditional Handicraft Batik Fabrics of Cotton
4. Certificate in Regard to Certain Handicraft Products
5. Certificate Relating to Silk Cooton Handlooms Products
6. Industrial Craft Certification (ICC)
7. Global System of Trade Preference Among Developing Countries (GSTP) (using Form GTSP)
8. Certificate of Handicraft Goods
9. Certificate of Authenticity Tobacco
10. ASEAN China FTA (ACFTA) (using Form E)
11. ASEAN Korea FTA (AKFTA) (using Form AK)
12. Indonesia Japan Economic Partnership Agreement (IJ-EPA) (using Form IJ-EPA)
13. ASEAN India FTA (AIFTA) (using Form AI)

Indonesia non-preferential certificate of origin consists of:

1. International Coffee Organization
2. COO for Imports of Agricultural Products Into the EEC
3. Certificate in Regard to Handlooms Textile Handicraft & Traditional Textile Products of the Cottage Industry
4. COO (using Form K)
5. Certificate in Regard to Handlooms Textile Handicraft Traditional Indonesia Handicraft Batik & Traditional Textile Products of the Cottage Industry

⁴⁷⁸ See Article 1 paragraph 1 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁷⁹ See Article 1 paragraph 2 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010. See also Article 1 paragraph 1 the Trade Minister Regulation No. 59/M-DAG/PER/12/2010.

⁴⁸⁰ See Article 2 paragraph 1 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁸¹ See Article 2 paragraph 2 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010. "[...] Preferential Certificate of origin is issued for obtaining facility in the form of import duty reduction or freedom from a country or group of countries for merchandize export from Indonesia that fulfils international agreement or unilateral determination [...]".

⁴⁸² See Article 2 paragraph 3 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010. "[...] Non preferential certificate of origin is issued for fulfilling provisions made by a country or group of countries for merchandize export from Indonesia based on international agreement or unilateral determination [...]".

⁴⁸³ Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).

6. COO TP
7. Form B
8. Annexo III

Handicraft preferences started to be introduced in 1971. Preference-granting countries of handicraft preferences are all developed countries that grant GSP. Receivers of these preferences are all handicraft products from all countries including developed countries. Handicraft preferences give facility of tariff duties reduction. The Global system of Trade Preferences (GTSP) was introduced in April 1989, and now has 43 member countries⁴⁸⁴, including Indonesia. In 2007 the third negotiation round was held in Sao Paulo, Brazil, during which Market Access and Rules of Origin were discussed.

VII.b. Formalities and procedures of Certificate of Rules of Origin.

The form of certificates of origin is issued based on the development of international agreement, unilateral stipulation, or stipulation from the Indonesian government.⁴⁸⁵ Based on this provision the Indonesian government may issue certificates of origin for the purpose of complying with requirements of unilateral stipulation. The EU has made specific regulations that regulate the rules of origin of their unilateral preferences (in this regard GSP) through Commission Regulation (EU) No 1063/2010. As mentioned above, the rules of origin have important roles in the implementation of the EU GSP scheme in order to prevent trade deflection or trade fraud. It is stipulated that the rules of origin are used to ensure that the benefit of GSP is enjoyed and utilised properly by the beneficiary countries to fulfil their “*development needs*”. Therefore, the rules of origin must comply with the objectives of the GSP scheme.⁴⁸⁶ With regard to the certificate of origin stipulated by Indonesia’s government, it will be issued for specific export products and certain export destinations, which require certificate of origin.⁴⁸⁷ The Director General, for and on behalf of the Minister, stipulates the certificate of origin issuing agency.⁴⁸⁸ The Director General is also entitled to change the certificate of origin issuing agency based on the principle of affectivity and efficiency.⁴⁸⁹ To obtain the certificate of origin, the exporter must submit a request to the certificate of origin issuing agency.⁴⁹⁰ While Article 7 Paragraph 2 regulates the requirement documents that need to be submitted to obtain certificate of origin. The list of the certificate of origin issuing agencies is regulated under Trade Minister Regulation No. 60/M-DAG/PER/12/2010.

As explained previously, the existence of the certificate of origin, particularly the preferential one, is designed to prevent trade deflection or trade fraud in foreign trade. The certificate of origin is used to ensure that the benefits of trade go to those who are supposed to receive it. There are five important principles that should be applied in the procedures of issuing certificates of origin, including accuracy, prudence, transparency, simplicity, and speed.

⁴⁸⁴ Algeria, Argentina, Bangladesh, Benin, Bolivia, Brazil, Cameroon, Chile, Colombia, Cuba, Democratic People’s Rep. of Korea, Ecuador, Egypt, Ghana, Guinea, Guyana, India, Indonesia, Iran, Iraq, Libya, Malaysia, Mexico, Morocco, Mozambique, Myanmar, Nicaragua, Nigeria, Pakistan, Peru, Philippines, Rep. of Korea, Romania, Singapore, Sri Lanka, Sudan, Thailand, Trinidad and Tobago, Tunisia, United Rep. of Tanzania, Venezuela, Vietnam dan Zimbabwe.

⁴⁸⁵ See Article 3 paragraph 2 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁸⁶ See European Commission, Directorate-General for Trade, *Trade policy the EU’s relations with the rest of the world*, Office for Official Publications of the European Communities, Luxembourg, 2006, available at : http://trade.ec.europa.eu/doclib/docs/2006/october/tradoc_128505.pdf, last accessed : 23 September 2010.

⁴⁸⁷ See Article 4 paragraph 1 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁸⁸ See Article 5 paragraph 1 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁸⁹ See Article 5 paragraph 2 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁹⁰ See Article 7 paragraph 1 of the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

The first two principles, accuracy and prudence, have been set forth in Article 7 Paragraphs 3, 4 and 5 of Trade Minister Regulation No. 33/M-DAG/PER/8/2010. In brief, those provisions were applied to the measures of checking, examining, and verifying documents that are submitted to obtain certificate of origin. Paragraph 3 obliges the certificate of origin issuing agency to check and examine every request submitted by the exporter to make sure it has been completed in compliance with the rules of origin according to international agreements or unilateral stipulation (for instance GSP rules of origin). Thus, checking and examining whether the information and documents submitted by the exporter are correct and accurate.

In order to confirm whether such information is correct and justified, it needs verification. With regard to the compliance of the rules of origin, Paragraph 4, regulates verification towards the first request certificate of origin that has been made by the exporter and verification towards the request certificate of origin that is allegedly doubted.⁴⁹¹ Such verifications must be conducted and at least cover four aspects, as regulated by Paragraph 5, that is, the real existence and the legality of the company, justified local invoice documents, production capacity, and production process.⁴⁹² Such aspects are implemented to prevent trade deflection and trade fraud, which is committed by certain parties to take advantage of trade through circumvention conducts. The real existence and the legality of the company are crucial to ensure that the export company or the trader actually exist in the area of jurisdiction of the republic of Indonesia. This has the purpose of avoiding SPV (special purpose vehicle) companies or false companies obtaining certificate of origin for illegal use. The production process and capacity are used to justify whether the exported products are compliant with the rules of origin. In this regard, exported products must comply with the rules of origin that regulate the value content such as the percentage of local content and/or regional content.⁴⁹³

The following principles of transparency, simplicity, and speed are envisaged in Paragraph 6. This principle is implemented with a time limit for the issuing agency to issue the requested certificate of origin, which means all requirements should be completed and confirmed. It is regulated at a maximum of one day after the documents are received by the certificate of origin issuing agency. Regarding the refusal of the requested certificate of origin, the certificate of origin issuing agency must issue written notice containing the reasons for refusal. This complies with the application of the transparency principle. Further, Trade Minister Regulation No. 59/M-DAG/PER/12/2010 regulates the details of the technical procedure of issuing certificate of origin for Indonesian export products.

In order to ensure that such procedures are implemented properly in the process of issuing the certificate of origin, sanctions towards any violations are regulated. Article 9 Paragraph 1 of Trade Minister Regulation No. 33/M-DAG/PER/8/2010 stipulates that in case the certificate of origin issuing agency on carrying out its competences violates the regulations, it would lead to a sanction to reduce its competences on issuing certificates of origin. However, the worse sanction is to revoke all the competences of the certificate of origin issuing agency. Further, Article 2 Paragraph 5 of Trade Minister Regulation No. 60/M-DAG/PER/12/2010 regulates the revocation of competency of the certificate of origin issuing agency. The competency of the certificate of origin issuing agency will be revoked, in the case of:

- a. not issuing a certificate of origin for six months consecutively.

⁴⁹¹ See Article 7 paragraph 4 the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

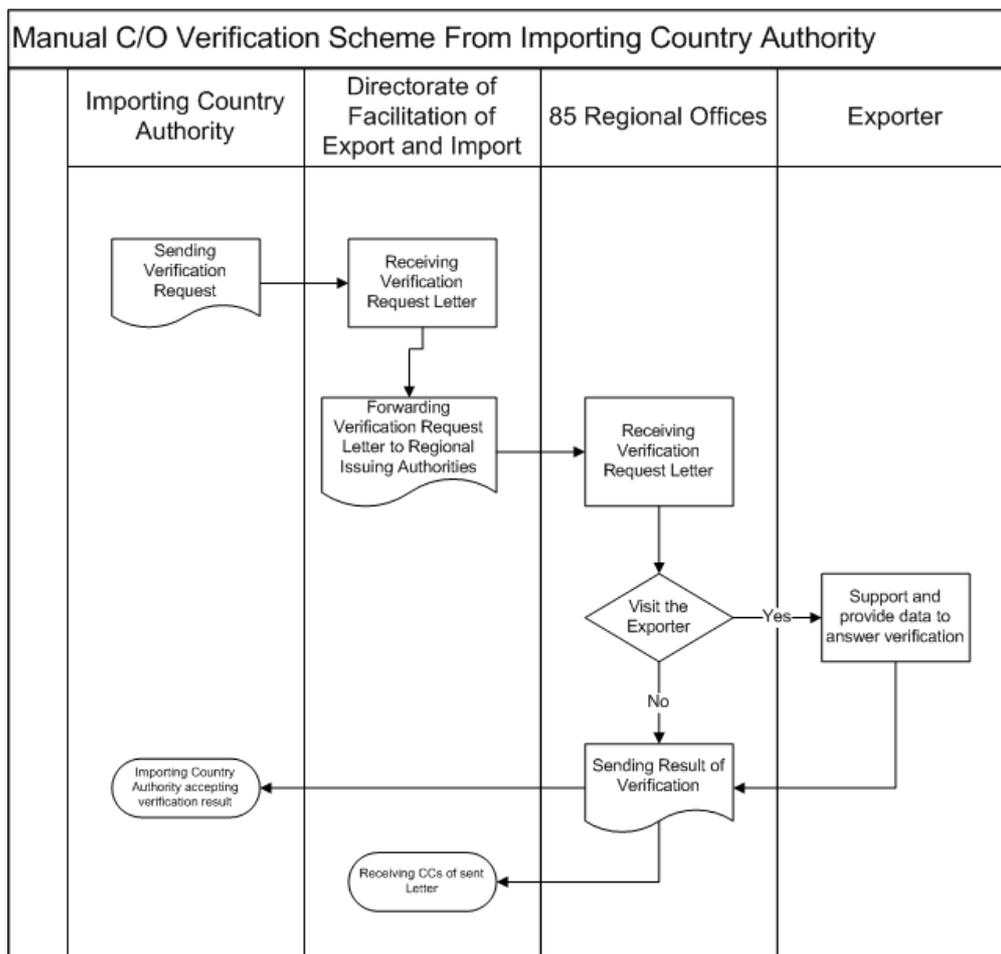
⁴⁹² See Article 7 paragraph 5 the Trade Minister Regulation No. 33/M-DAG/PER/8/2010.

⁴⁹³ See Estevadeordal, Antoni., Harris, Jeremy., and Suominen, Kati., 2009, *Op. Cit.*, p. 9.

- b. not submitting reports of export realisation based on the certificate of origin issued for six months consecutively.
- c. not submitting reports of the number of requested certificates of origin and certificates of origin that have been issued over six months consecutively.

Article 9 Paragraph 2 of Trade Minister Regulation No. 33/M-DAG/PER/8/2010 regulates the sanction of the violation, which is conducted by the government officials who are in charge of signing the certificate of origin (Authorised Signer Officers). If it is proven that the official concerned has committed violation again the rules he/she will be sanctioned through revocation of his/her competences to sign the certificate of origin. Further, Article 3 of Trade Minister Regulation No. 60/M-DAG/PER/12/2010 regulates the criteria of government officers who are appointed as the official with the competency to sign the certificate of origin (Signer Officers). There are some benefits of using the e-SKA (e-CO) verification system such as improving accuracy, eliminating document fraudulence, document exchange enabling technology, web based verification for endorsed customs partners, and faster services.

Figure 35. Standard Operational Procedure verification scheme from importing country authority.⁴⁹⁴



⁴⁹⁴ Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).

Figure 36. Proposed Certification of origin verification through electronic certification of origin.⁴⁹⁵

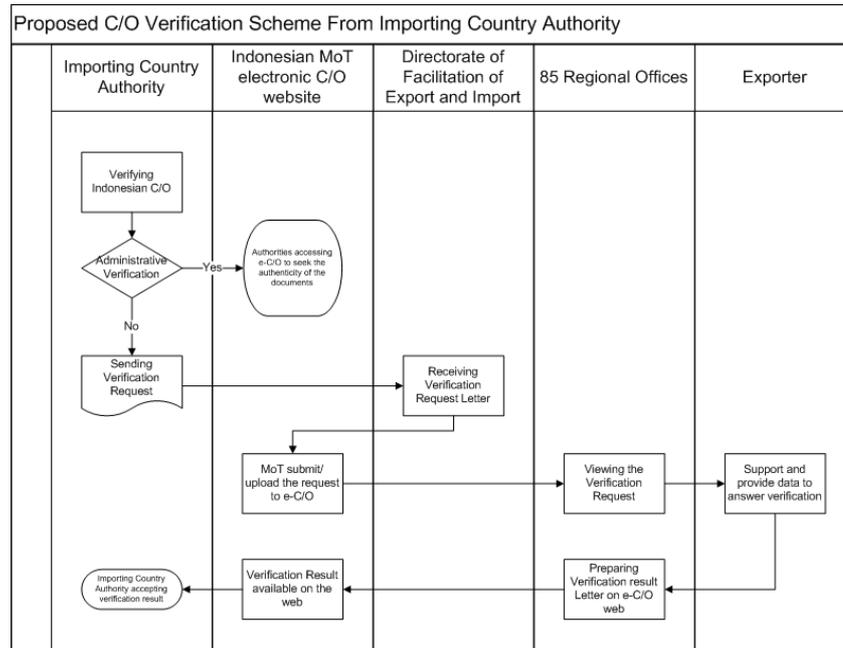
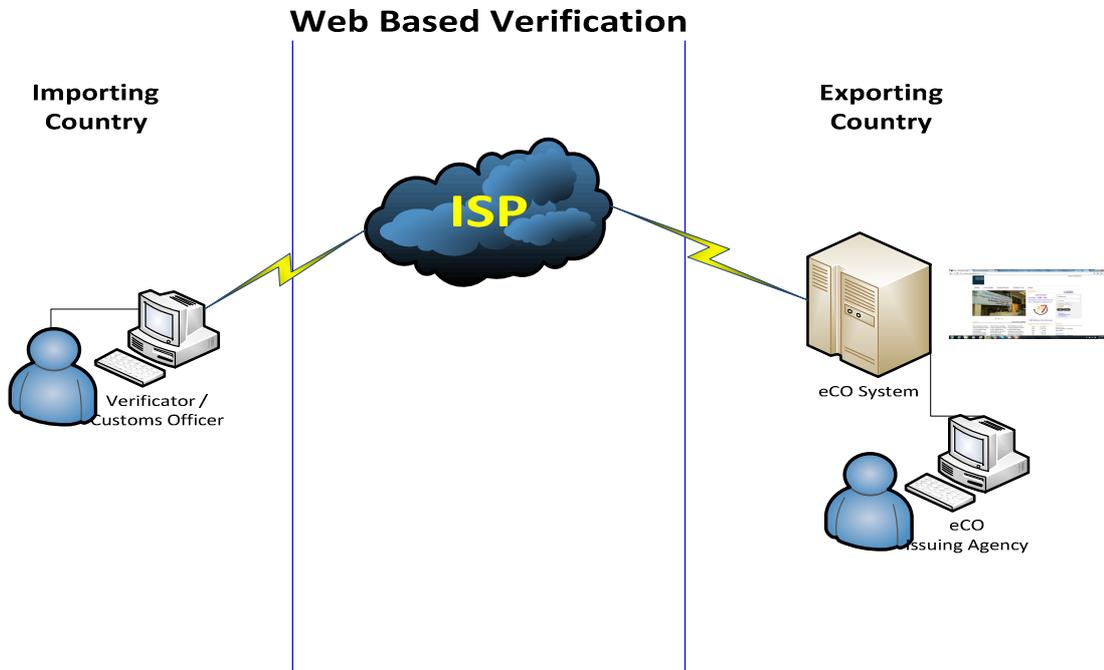


Figure 37. e-Certificate of origin verification option.⁴⁹⁶



⁴⁹⁵ See *Ibid.*

⁴⁹⁶ See *Ibid.*

Figure 38. Automation certificate of origin.

The screenshot shows the registration page for the Certificate of Origin (Surat Keterangan Asal) on the website e-ska.kemendag.go.id. The page header includes the title "SURAT KETERANGAN ASAL Certificate of Origin" and the logo of the Indonesian Ministry of Trade. Below the header, there is a section titled "Registrasi Eksportir" (Exporter Registration) with a sub-section "Profil Perusahaan" (Company Profile). This section contains various input fields for company information, including:

- NPWP (Tax ID) with a masked input field.
- No. TDP (Trade License Number) with a masked input field.
- No. SIUP / Surat Izin Industri (Industrial License Number) with a masked input field.
- Jenis Usaha (Business Type) with radio buttons for "Produsen" (Producer) and "Trader".
- Nama Perusahaan (Company Name) with a text input field.
- Status Perusahaan (Company Status) with a dropdown menu.
- Skala Perusahaan (Company Scale) with a dropdown menu.
- Alamat Perusahaan (Company Address) with a text area.
- Propinsi Perusahaan (Company Province) with a dropdown menu.
- Kabupaten Perusahaan (Company District) with a dropdown menu.
- Kota (City) with a text input field.
- Kelurahan (Sub-district) with a text input field.
- RT/RW (RT/RW) with a text input field.
- No. Telp. (Phone Number) with a text input field.
- No. Reg. Kopy (Copy Registration Number) with a text input field.
- Tgl. TDP (TDP Date) with a date picker.
- Tgl. SIUP / Surat Izin Industri (Industrial License Date) with a date picker.
- Kecamatan (Sub-district) with a text input field.
- Kode Pos (Postal Code) with a text input field.
- No. Fax (Fax Number) with a text input field.

Figure 39. Web based e-certificate of origin verification page.

The screenshot shows the verification page for the Certificate of Origin (Surat Keterangan Asal) on the website e-ska.kemendag.go.id. The page header includes the title "SURAT KETERANGAN ASAL Certificate of Origin" and the logo of the Indonesian Ministry of Trade. Below the header, there is a navigation menu with links for "Home", "Profil", "Tools", and "Logout". The main content area is titled "Find COO" and contains a search form with the following fields:

- COO NUMBER: 0010091JKU/2012
- Buttons: "Find" and "Reset"

Below the search form, there is a table displaying the search results for the COO Type: FORM B:

COO Type : FORM B			
COO Number	: 0010091JKU/2012	COO Date	: 2013-06-05
Exporter Name	: PT. NUTRIFOOD INDONESIA	Consignee Name	: AL-KHAIR TRADERS
Exporter Address	: J.L. RAYA CAWI NO. 183A SINDANGSARI, BOGOR TIMUR, BOGOR, JAWA BARAT	Consignee Address	: SHENGUS MARKET KHAI BAZAR BAJAUR AGENCY PAKISTAN TEL: +93-91-3581770/73 FAX: +93-91-3581773
Exporter	: INDONESIA	Consignee	: PAKISTAN

Figure 40. e-certificate of origin verification option.⁴⁹⁷

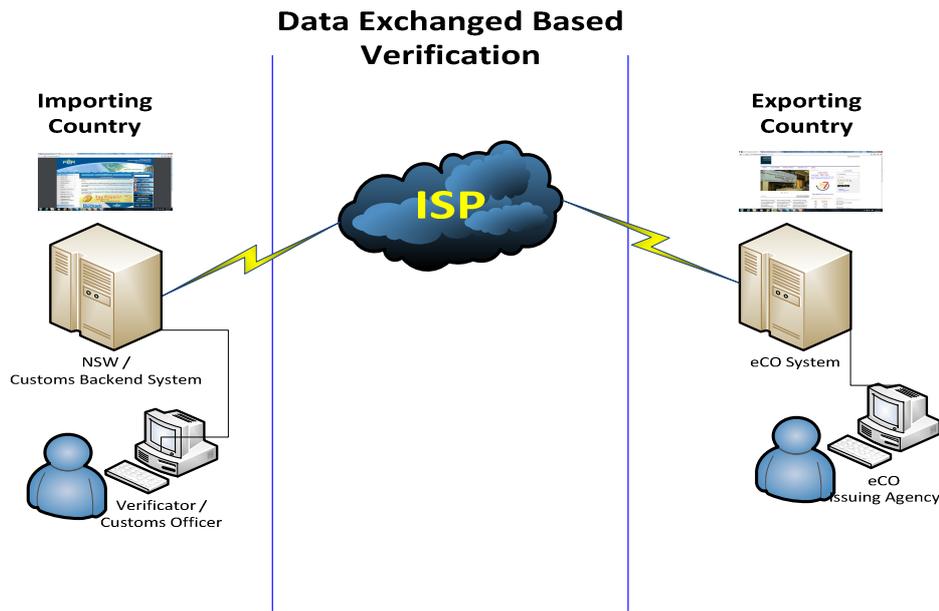
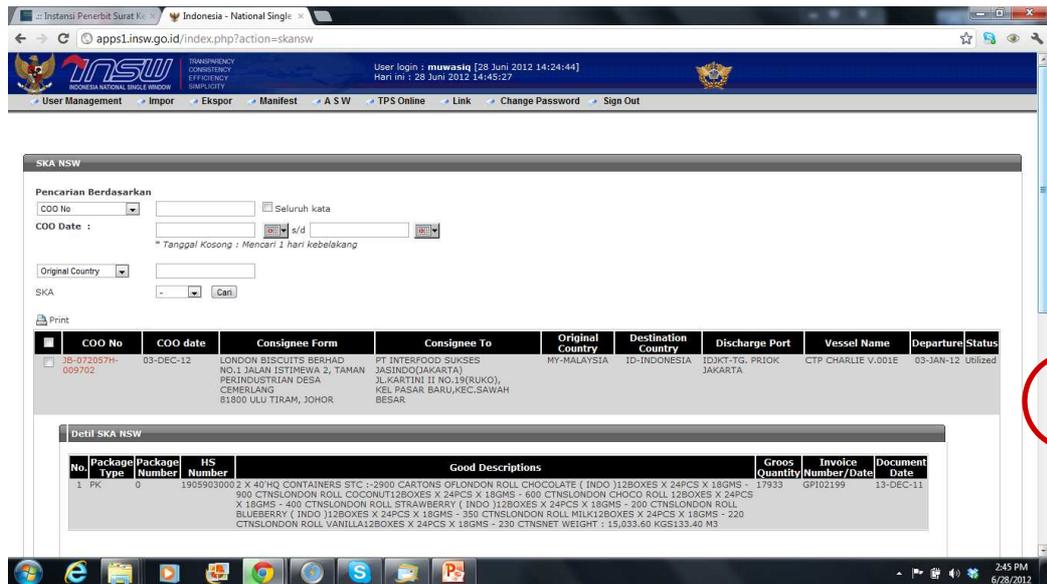


Figure 41. Example of automatic data reconciliation/verification through ASW/INSW.



VII.c. Institutions in Indonesia with the competence to issue certificate of origin.

The list of certificate of origin issuing agencies is regulated in Trade Minister Regulation No. 60/M-DAG/PER/12/2010, which has recently been amended by the new Trade Minister Regulation No. 21/M-DAG/PER/4/2012. To submit request for certificate of origin the exporter may choose the venue for the issuance at the Issuing

⁴⁹⁷ See *Ibid*.

Agency based on the location or work area of the certificate of origin Issuing Agency, as follows:⁴⁹⁸

- a. The certificate of origin Issuing Agency whose work area includes the manufacturing area of the merchandise.
- b. The certificate of origin Issuing Agency whose work area includes the location of the foreign exchange bank used by the exporter.
- c. The certificate of origin Issuing Agency whose work area includes the location of Customs and Excise Service Office that issues the Merchandise Export Notification and/or the location where the Merchandise Export Notification is approved by the Customs and Excise Service Office official.
- d. The certificate of origin Issuing Agency whose work area includes the location where the merchandise is purchased.
- e. The certificate of origin Issuing Agency whose work area includes the location of merchandise shipment.
- f. The nearest certificate of origin Issuing Agency.

The certificate of origin issuing agency is the institution/agency in Indonesia that is appointed by the Minister and that is given the authority to issue certificate of origin.⁴⁹⁹ The certificate of origin issuing agency is divided into two types, i.e. the certificate of origin issuing agency for common export commodities and the certificate of origin issuing agency for certain export commodities. There are eighty-five institutions and agencies listed as issuers of the certificate of origin for common export commodities. The list of government officials who act as the authority signer the certificate of origin are appointed by Trade Minister Directive No. 26/M-DAG/KEP/1/2012 amended by Trade Minister Directive No. 299/M-DAG/KEP/3/2011.

Figure 42. The distribution of the locations of regional Issuing Authorities of certificate of origin.⁵⁰⁰



⁴⁹⁸ See Article 8 the Trade Minister Regulation No. 59/M-DAG/PER/12/2010.

⁴⁹⁹ Certificate of origin issuing agency shall be any agency/body/institution specified and authorized by the Minister for issuing certificate of origin. Certificate of origin signing official shall be any official authorized and responsible for signing SKA at the SKA Issuing Agency the Minister stipulates.

⁵⁰⁰ Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).

VII.d. The significance of e-CO (e-SKA) application: Automation of issuance of certificate of origin towards utilisation of GSP. (<http://e-ska.kemendag.go.id/>).

Simplification, harmonisation and automation of the rules of origin of the GSP is essential to facilitate its utilisation. This leads to the question, why are these documents so important in the GSP? First, a certificate of origin is one of the legal documents required to obtain the GSP facility. Second, failure or non-compliance to the rules of origin may lead to the temporary withdrawal of GSP. Third, rules of origin is one of the factors that undermines GSP utilisation.

Firstly, it has to be noted that GSP facilities are granted based on the origin of the goods or products, thus, the goods must fulfil the conditions to be originating from the beneficiary country. Trade preferences given under GSP are directed at certain target countries with the objective of helping to improve the economic development of those countries. Therefore, the rules of origins have become the crucial technical requirement to obtain the GSP facility. The beneficiary country is obliged to demonstrate evidence to obtain the originating status of its products. It should be in compliance with the standards applied by the EU. The beneficiary country is also required to provide “*administrative structures and systems*” to comply with the rules and procedures determined by the regulation. More details and complex rules of origin create more difficulties for exporters to demonstrate evidence to obtain the certificate of origin. To assist exporters and simplify the formalities and procedures of issuing certificate of origin, therefore, digital issuance of the certificate of origin is provided. One of the aims of automation is to reduce the excessive documents and long chain procedures in issuing certificates of origin. One of the automation processes of issuing the certificate of origin is transforming paper documents into electronic documents, as stipulated by Article 5 of the Trade Minister Regulation No. 59/M-DAG/PER/12/2010 concerning provisions in issuing the certificate of origin for Indonesia’s export merchandise:

“[...] To accelerate the SKA issuance, in addition to submitting the certificate of origin request and support document directly to the certificate of origin issuing agency, the exporter is required to submit the certificate of origin request and support documents using electronic data storage such as a diskette, memory stick (USB), optical disc, electronic mail or website [...]”.

The withdrawal system of the EU GSP is regulated in Articles 15–19 of Council Regulation (EC) No. 732/2008 is amended by Regulation (EU) No 512/2011. Temporary withdrawal is due to the failure or non-compliance to the rules of origin, elaborated as follows:

“[...] the fraud case; irregularities or systematic failure to comply with or to ensure compliance with the rules concerning the origin of the products and the procedures related thereto; or failure to provide the administrative cooperation as required for the implementation; and policing of the arrangements under EU GSP scheme [...]”.⁵⁰¹

Administrative cooperation is one of the elements that has to be provided by the beneficiary country in order to implement the EU GSP scheme.⁵⁰² The beneficiary country should keep communications and send updates of the indispensable information regarding the implementation and controlling the rules of origin. The technical procedures on managing and controlling issuance of the certificate of origin is regulated under Article 7 of the Trade Minister Regulation No. 59/M-DAG/PER/12/2010, i.e.:

⁵⁰¹ See Paragraph 1 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁵⁰² See Paragraph 2 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

- (1) The certificate of origin Signer Officer shall inspect the correctness of the certificate of origin form and any supporting documents before such certificate of origin is signed by the certificate of origin Signer Officer.
- (2) When in doubt about the correctness and completeness of any certificate of origin form or supporting document prior to the signing, such certificate of origin Signer Officer may:
 - a. ask for additional information from the exporter.
 - b. conduct verification by using data/information from the survey for comparison regarding data from the exporter, type of merchandise, source of raw material, and the production process, survey for comparison regarding data from the exporter, type of merchandise, source of raw material, and the production process, including the cost structure per unit, made based on data from Merchandise State of Origin Tracking (PNAB) available in the database of the certificate of origin issuing system.
- (3) The Survey Merchandise State of Origin Tracking (PNAB) shall include general data of the exporter, type of merchandise, source of raw material, and the production process, including the cost structure per unit, and the results shall be stored in the database for reference in the certificate of origin issuing system, and such survey shall be conducted by the certificate of origin Issuing Agency and/or an independent surveyor.

The beneficiary country can assist the Union, based on a request from the customs authorities of the member states, to verify the origin of the goods and promptly communicate its results. The beneficiary country can also assist the Union by allowing the Commission to coordinate and closely cooperate with the competent authorities of the member states, in order to verify the authenticity of the documents or the accuracy of information that is relevant to obtain the GSP scheme facilities. The beneficiary country should undertake the appropriate enquiries to identify and prevent infringement of the rules of origin. The beneficiary country must ensure the compliance of the rules of origin in respect of regional cumulation. The beneficiary country must assist the Union in the verification of processes, in terms of the presumption of origin relating to fraud. Non-compliance with the rules of origin, and/or failure to provide administrative cooperation can be sufficient evidence for temporary withdrawal. It could also lead to suspension of the preferential arrangements.⁵⁰³ In the suspension mechanism, the Commission first has to inform the Generalised Preferences Committee⁵⁰⁴. The investigation is established by cooperation with the beneficiary country concerned. In this matter, the Commission shall provide the beneficiary country concerned with every opportunity to cooperate in the investigation.⁵⁰⁵

In addition, the Commission may verify the information received from the economic operators in the beneficiary country concerned. The findings are made based on the available facts. If the information requested by the Commission cannot be provided within the period specified in the notice investigation announcement. The investigation period must be completed within one year. However, the Commission may extend this period in accordance with the procedure referred to in Article 27(5).

⁵⁰³ See Paragraph 3 Article 16 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

⁵⁰⁴ As Stipulated by Paragraph 1 Article 27 of the Council Regulation (EC) No. 732/2008, that the Commission shall be assisted by a Generalised Preferences Committee (hereinafter referred to as the Committee). Paragraph 2 governs the competence of the Committee, which may examine any matter relating to the application of this Regulation, raised by the Commission or at the request of a Member State. Further, paragraph 3 stipulated that the Committee shall examine the effects of the scheme, on the basis of a report from the Commission covering the period since 1 January 2006. This report shall cover all of the preferential arrangements, and the result will be presented in time for the discussion on the next Regulation.

⁵⁰⁵ See Paragraph 1 Article 18 Section 1 Chapter III of the Council Regulation (EC) No. 732/2008.

The EU regulation is related to the procedure to verify and to investigate that failure or non-compliance to the rules of origin is in line with Article 11 of Trade Minister Regulation No. 59/M-DAG/PER/12/2010, that is stipulated as follows:

1. The certificate of origin Issuing Agency is required to respond and settle any demand for certificate of origin verification from any government/formal agency of the country of export destination regarding validity and correctness of certificate of origin data/information.
2. Exporters related to such verification are required to provide data and information regarding the validity and correctness of certificate of origin data/information certificate of origin Issuing Agency.
3. The Certificate of origin Issuing Agency shall respond to any demand for certificate of origin verification from any governmental/formal agency of the country of export destination within thirty (30) working days as of the date of receiving such demand.

Too complex GSP rules of origin create obstacles for the developing country and LDCs to obtain facility of preferential tariff, since it would give the burden of extra cost on formalities and procedures to comply with the regulations. Therefore too rigid and detailed rules of origins could undermine the utilisation of GSP. Carrère et al. note that “[...] *benefiting from market access requires proving the origin which itself is costly and reduces the benefits from that market access [...]*”⁵⁰⁶. Inama has written on assessing the impact of rules of origin in the utilisation of trade preferences under the GSP.⁵⁰⁷

*[...] the fact that the utilisation rate is strictly linked to the origin requirements is very clear to beneficiary countries....In some cases, exporters may have not submitted the necessary documentation (such as a certificate of origin) to get preferential treatment because of lack of knowledge or incorrect information [...].*⁵⁰⁸

The roles of government trade institutions in beneficiary countries become crucial to ensure that their traders have sufficient information to obtain tariff facilities under the GSP scheme. Dissemination of GSP information in the beneficiary country is crucial since not all traders are aware of the tariff reduction given under the GSP scheme. Therefore, trade institutions in the beneficiary country are deemed as the core engine to drive GSP utilisation. The preference-granting country has designed its policy to simplify and relax the GSP rules of origin, however, the role of the beneficiary country institutions to deliver information, public services, and assistantship to the traders to access the GSP facility is much more significant. Lack of knowledge or incorrect information would be the common problem faced by local companies (SMEs) or local traders, which are located away from the centre of the central government institutions. Generally, beneficiary countries lack infrastructures in transportation and communication that causes the high cost fee for producers and traders to obtain documents of rules of origin.

⁵⁰⁶ See Cèline Carrère, Jaime de Melo, and Bolormaa Tumurchudur, 2008.

⁵⁰⁷ See Inama, Stefano., 2009, *Op. Cit.*, pp. 360-361.

⁵⁰⁸ See *Ibid.*, pp. 360-361.

Table 52. Utilisation of the Certificate of Origin Form A GSP to EU 27 2010.

YEARS	No.	EU 27 Member Countries Exports Destinations	Total Number of Certificate of Origin Form A	FOB USD
2010	1	Austria	1,739	34,041,903
2010	2	Belgium	24,994	788,675,704
2010	3	Bulgaria	648	32,280,437
2010	4	Cyprus	294	9,479,332
2010	5	Czech Republic	1,836	112,680,329
2010	6	Denmark	3,596	142,315,416
2010	7	Estonia	166	7,509,160
2010	8	Finland	1,556	51,797,100
2010	9	France	22,625	696,106,543
2010	10	Germany	43,413	1,535,349,783
2010	11	Greece	3,663	127,106,728
2010	12	Hungary	1,151	24,683,337
2010	13	Ireland	1,072	30,760,697
2010	14	Italy	19,798	2,142,747,345
2010	15	Latvia	287	9,599,409
2010	16	Lithuania	291	21,686,935
2010	17	Luxembourg	212	14,322,124
2010	18	Malta	132	2,556,844
2010	19	Netherlands	32,540	1,871,444,124
2010	20	Poland	4,118	172,445,481
2010	21	Portugal	1,817	79,044,658
2010	22	Romania	639	18,744,137
2010	23	Slovakia	1,594	70,705,002
2010	24	Slovenia	503	23,206,888
2010	25	Spain	12,793	732,019,888
2010	26	Sweden	3,862	128,104,996
2010	27	United Kingdom	29,084	1,055,749,511
Total CoO Form A EU GSP			214,423	9,935,163,811

Source: Directorate General of Export and Import Facilitation Ministry of Trade Republic of Indonesia May 2012.

Table 53. Utilisation of the Certificate of Origin Form A GSP to EU 27 2011.

YEARS	No.	EU 27 Member Countries Exports Destinations	Total Number of Certificate of Origin Form A	FOB USD
2011	1	Austria	1,883	102,834,263
2011	2	Belgium	26,679	899,592,205
2011	3	Bulgaria	540	30,141,020
2011	4	Cyprus	308	7,959,596
2011	5	Czech Republic	2,014	92,903,716
2011	6	Denmark	3,262	158,467,741
2011	7	Estonia	225	19,339,018
2011	8	Finland	1,458	59,422,981
2011	9	France	22,302	819,991,954
2011	10	Germany	43,497	1,849,691,986
2011	11	Greece	3,365	112,365,239
2011	12	Hungary	1,167	43,962,587
2011	13	Ireland	1,076	35,788,230
2011	14	Italy	20,001	1,953,901,938
2011	15	Latvia	358	22,022,141
2011	16	Lithuania	394	32,417,236
2011	17	Luxembourg	194	14,253,071
2011	18	Malta	138	2,935,554
2011	19	Netherlands	29,546	1,936,401,280
2011	20	Poland	4,588	218,294,024
2011	21	Portugal	1,462	113,827,840
2011	22	Romania	644	53,406,230
2011	23	Slovakia	1,244	46,309,576
2011	24	Slovenia	405	31,035,460
2011	25	Spain	13,151	840,156,762
2011	26	Sweden	3,673	136,909,207
2011	27	United Kingdom	28,054	1,017,381,986
Total CoO Form A EU GSP			211,628	10,651,712,841

Source: Directorate General of Export and Import Facilitation Ministry of Trade Republic of Indonesia May 2012.

VIII. e-Trade: e-government implementation to improve foreign trade services.

VIII.a. Idea of e-government.

Rapid developments in information and communication technology (ICT) creates challenges and opportunities for the government which demand transformation and innovation in public service delivery. From social changes and dynamicisation of world development emerges the need to reinvent government systems, which are aimed to deliver efficient and cost effective services, information and knowledge using ICT.⁵⁰⁹ Reinventing the government system is a sustainable effort to fulfil the obligations of the

⁵⁰⁹ See Zhiyuan Fang, *E-Government in Digital Era : Concept, Practice, and Development*, International Journal of The Computer, The Internet and Management, Vol. 10, No.2, 2002, pp. 1-22.

government as a provider of public services, which should meet the needs of the customer, not bureaucracy.⁵¹⁰

Nowadays, e-government is part of an organisational process including decision-making, supervising, planning, organising, coordinating, staffing effectively, and delivering public services to society properly.⁵¹¹ In this regard, Osterweil writes that the awareness of understanding and documenting organisational processes began before the existence of computers or other digital means.⁵¹² Max Weber identifies written documentation as one of the core characteristics of bureaucracy. Weber elaborates that the importance of written documentation because “it splits the working life from the private life of public officials”.⁵¹³ Documentation now becomes part of administration which is essential for the viability and development of the organisation.

The use of computers in government started right from when computers were first created, in fact, Curtin notes that the first mainframe computers in government agencies started to be introduced in the 1950s.⁵¹⁴ In the 1970s, literature on “IT in government” began to be developed.⁵¹⁵ In the early stages of development, computers more often dealt with internal use in the government, compared to today, where they are used for internal and external use, such delivering public services to citizens. As noted by Ho, recent e-government literature is more focused on external use.⁵¹⁶ The computing in government continues to evolve along with the development of technology.

The term “e-government” began to be used and promoted in the mid-1990s⁵¹⁷ when the Internet boom started⁵¹⁸. The use of the term became more popular after the Internet reached all levels of society.⁵¹⁹ The idea of e-government itself was brought up by Albert Arnold "Al" Gore Jr, the former United States Vice President (1993-2001). The concept of e-government was born from his vision of an automated public service delivery to the citizen. In this regard, the citizen was linked to all the various agencies of government to access all kinds of government services in an automated and automatic way. Al Gore considered that the completion of public service delivery to citizens depended on some factors such as information and communication networks to reduce time and costs, advance performance, speed of delivery, and effectiveness of implementation.⁵²⁰ In other words, e-government is how it brings citizens and the business community closer to their governments.⁵²¹

⁵¹⁰ See Osborne, David, and Gaebler, Ted., *Reinventing Government : How the Entrepreneurial is Transforming the Public Sector*.

⁵¹¹ See Shailendra C. Jain Palvia and Sushil S. Sharma, *E-Government and E-Governance: Definitions/Domain Framework and Status around the World*, available at : http://www.iceg.net/2007/books/1/1_369.pdf.

⁵¹² See Osterweil, Leon J., et.al, *Analyzing Processes for E-Government Application Development : The Emergence of Process Definition Languages*, Journal of E-Government, Vol. 1 (4) 2004, The Haworth Press, Inc, available at : <http://www.haworthpress.com/web/JEG>.

⁵¹³ See Weber, 1946; Osterweil, Leon J., 2004.

⁵¹⁴ See Curtin, Gregory G., *E-Government*, Manuscript accepted by Sage Publications for publication in the “Encyclopedia of Political Communications” E-Governance April 2007, School of Policy, Planning, and Development, available at : http://www.usc.edu/schools/price/bedrosian/private/docs/encyclopedia_of_political_communications.pdf.

⁵¹⁵ See Kraemer, et al, 1978; Danziger and Andersen, 2002; Thomas A. Horan and Åke Grönlund, *Introducing e-Gov: History, Definitions, And Issues, Communications of the Association for Information System*, available at : http://www.cips.org.in/public-sector-systems/Introducing_e_governance.pdf.

⁵¹⁶ See Ho, 2002; Thomas A. Horan and Åke Grönlund

⁵¹⁷ See Thomas A. Horan and Åke Grönlund.

⁵¹⁸ See Thomas A. Horan and Åke Grönlund.

⁵¹⁹ See Curtin, Gregory G., *E-Government*, 2007.

⁵²⁰ See Tamara Almarabeh, and Amer AbuAli, *A General Framework for E-Government: Definition Maturity Challenges, Opportunities, and Success*, European Journal of Scientific Research, ISSN 1450-216X Vol.39 No.1 (2010), pp.29-42, © Eurojournals Publishing, Inc. 2010, available at : http://www.eurojournals.com/ejsr_39_1_03.pdf, pp. 29.

⁵²¹ See Zhiyuan Fang, 2002, *Loc. Cit.*, p. 1-22.

This idea followed up by Vice President Al Gore on the National Performance Review, he placed a strong emphasis of the role of e-government in federal services.⁵²² Common people understood the concept of e-government as a transformational process in government, governance, politics, democracy and public management that associated with the application of information technology use.⁵²³

The application of information technology in all aspect of public administration migrate its position from supporting tool's to one of the major necessity. Structures and function of e-government not merely dealing with documentation but becomes more complex either technically or socially. These changes give influences in the public administration reforms, transformation of public services delivery, and the pattern of institutional partnership between (local) government, citizens, and their local communities.⁵²⁴

According to Molnar, public administration consist of two main areas, called as the service-side (or back-office) and the customer-side (or front-office). E-government is required to balance public administration working properly on both area's, especially on the distribution of public goods (the content) and administration (control). In this point, e-government running two functions. At the back office e-government functioned as service provider, which is responsible at renewal of the internal operation of public administration institutions. At the front office, e-government dealing with customers, which is functioned as communication tools connecting government institutions, the population and the business sectors.⁵²⁵

Front office services as an "interface" is handling direct interaction between public administration and customers, where the exchange of information takes place. Interface of e-government usually takes a form of web portal or software application. The back-office's tasks is serving the front-office, receiving and processing documents from the customers. In other words, the back-office's tasks are ensuring all the necessary conditions for integrated administration and carry out processing (workflow, integrated databases, electronic signature, data protection, data safety, etc), then to return the result to the front-office. In addition, the back office task also supporting the efficiency operation, management, and control of public administration.⁵²⁶ In this point, the back-office has multi tasking function that determines the speed, accuracy, and fluency of public services distributed by front office.

In the context of Indonesia's foreign trade facilitation services, the front office or interface of the trade service is the e-trade portal, such as Inatrade and e-ska, which is integrated into a single portal known as Indonesia's national single window (INSW). While, the back office services are carried out by the trade service unit (unit pelayanan perdagangan). This point will be discussed further in later in this chapter.

VIII.b. Advantages of e-government as a driving force implementation of good governance in the government.

E-government development finds its roots in the emergence of information society, which demands the government to improve its services in order to create a

⁵²² See Gore, 1993; Salem, 2003; Thomas A. Horan and Åke Grönlund.

⁵²³ See Curtin, Gregory G., E-Government, 2007.

⁵²⁴ See Szilard Molnar, *E-Government in the European Union*, Budapest, July, 2007, available at : http://www.ittk.hu/netis/doc/ISCB_eng/09_Molnar_final.pdf.

⁵²⁵ See *Ibid*.

⁵²⁶ See *Ibid*.

more competitive environment in the global community. In other words, information technology has a positive impact on the economic development of activities.⁵²⁷

E-government is widely believed as a driving force public service delivery enhancement through efficiency and transparency. The advantages of e-government are reducing the high cost bureaucracy, producing economic benefit, and enhancing government performance's, it has been explained by some writers such as, Palvia, et.al., Dada (2006), Middleton (2010), Tamara Almarabeh, et.al (2010), and DeBenedictis, i.e.

:

"[...] One of the benefits of E-government in developed countries is cost reduction in the transfer of information and online transactions [...]"⁵²⁸

"[...] E-government program seeks to achieve greater efficiency in government performance, through raising the performance of services for beneficiaries and investors from all segments of society easily and accurately and efficiently, to become a new type of performance of official governmental and governmental transactions. Online interactive services may include such facilities as petitioning, rate paying, licensing or information queries. There continues to be a diversity of implementation quality and levels for such services [...]"⁵²⁹

"[...] E-government initiatives aimed at raising the level of government performance in general, where the proper application of these initiatives lead to upgrade the governmental services provided to citizens and the private sector and enhance the effectiveness of government work internally, in addition to broadening the participation of citizens in decision-making process [...]"⁵³⁰

"[...] E-government facilitates provision of relevant government information in electronic form to the citizens in a timely manner; better service delivery to citizens; empowerment of the people through access to information without the bureaucracy; improved productivity and cost savings in doing business with suppliers and customers of government; and participation in public policy decision-making [...]"⁵³¹

"[...] E-government aimed to enhance and/or to transform the performance and accountability of government to be better, faster, and cheaper [...]"⁵³²

E-government is not just an interface for citizen to access the public services but it is also tools of social engineering of the information society. Fang (2002), emphasized the importance of e-government toward implementation of good governance principles, as follows:

"[...] E-government is more than a website, email or processing transactions via the internet. E-government becomes a natural extension of the technological revolution that has accompanied the knowledge society. The E-government added new concepts such as: transparency, accountability, citizen participation in the evaluation of government performance [...]"⁵³³

Furthermore, the essential task of government is governance that means their job's is regulating society. They defined e-governance as the transformation of governance processes resulted from the continual and exponential introduction into society of more advanced digital technologies.⁵³⁴ E-government provides many advantages for the government to carry out functions of governance in effective and

⁵²⁷ See Liza M. Lowery, *Developing a Successful E-Government Strategy*, Executive Director Department of Telecommunications & Information Services City/County of San Francisco, CA, available at : <http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan000343.pdf>, pp. 2.

⁵²⁸ See Dada, 2006; Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, p. 36.

⁵²⁹ See Middleton, 2007; Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, p. 29.

⁵³⁰ See Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, p. 31.

⁵³¹ See Shailendra C. Jain Palvia and Sushil S. Sharma, 2007. See also DeBenedictis, Andrea, et.al., *E-Government Defined : An Overview of the Next Big Information Technology Challenge*, available at : <http://www.zeang.com/robertfig/egov.pdf>.

⁵³² See DeBenedictis, Andrea, et.al.

⁵³³ See Mohammad, 2009; Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, pp. 30-31.

⁵³⁴ See Layne and Lee, 2001; Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, p. 36.

efficient way with higher quality of services and disseminating knowledge of technology to the wider community.

Curtin homologates that the use of ICT in e-government would facilitate better and more open government and governance. Using such technology governments operate more effectively and transparently, provide more and better information and services to the public, and increase participation of society as individuals or groups in their own governance.⁵³⁵ E-government also contributes to improve better relationship between citizens and government⁵³⁶, in terms of public services and social political aspects.⁵³⁷ E-government changes the entire range of the relationship public agencies have with citizens, companies and other governments. In this respect, e-government even goes so far as fundamentally changing the production process in which public services are produced and delivered.⁵³⁸ Molnar noted, according to the Commission's initiative, e-government must have three essential characteristics, i.e., :⁵³⁹

1. Open and transparent: public administration capable of comprehending citizens' expectations, and it is accountable and open towards democratic participation;
2. Cannot exclude anyone: user-centred public administration must reach everyone with personalised services;
3. Effective public administration: operates to use taxpayers' money in the most efficient way saving time and cost.

To sum up, the application of e-government is intended to improve the delivery of public services closer to the citizens/users, to enhance interactions with business and industry, society empowerment through the access of information, and to increase efficiency in government management. The outcome of the application of e-government is expected to reduce corruption through transparency and better good governance, revenue growth, more convenience, and greater coverage of service areas. In the area of trade, it is intended to reduce transaction costs, to harmonise and simplify formalities and procedures. In the context of international trade, e-government would accelerate integrations into the world trading system.

VIII.c. Definition of e-Government.

As noted above e-government is acknowledged as a bright contemporary concept including multifarious aspects of applications from a social, organisational, and technical viewpoint, thus, it creates various definitions among researchers and specialists. Borrowing the words from Tamara Almarabeh et al, e-government is about how the government organises itself, its administration, rules, regulations and frameworks set out to carry out service delivery and to co-ordinate, communicate, and integrate processes within itself.⁵⁴⁰

Palvia, et.al, describing e-government in broad definition as generic term for web-based services from agencies of local, state and federal governments, to deliver national or local government information and services via the internet or other digital means to citizens or businesses or other governmental agencies. ⁵⁴¹ While, Molnar defines e-government from the practical perspective as a new culture created from a comprehensive and radical transformation in the course to which public administrative organisations make use of all the possibilities of electronics in order to improve the

⁵³⁵ See Curtin, Gregory G., 2007.

⁵³⁶ See Zhiyuan Fang, 2002, *Loc. Cit.* pp. 1-22.

⁵³⁷ See Curtin, Gregory G., 2007.

⁵³⁸ See Leitner, 2003; Shailendra C. Jain Palvia and Sushil S. Sharma, 2007.

⁵³⁹ See Szilard Molnar, 2007.

⁵⁴⁰ See Tamara Almarabeh, and Amer AbuAli, 2010, *Loc. Cit.*, pp. 30-31.

⁵⁴¹ See Shailendra C. Jain Palvia and Sushil S. Sharma, 2007.

availability, quality and transparency of public services, and reducing the costs of public administration.⁵⁴² From the technical term, Fang define e-government as an integrated tool comprising three enabling sets of new technology, consists of infrastructure, exploitation of public portals and solution for public service delivery.⁵⁴³

There are various definitions about e-government made by international organization that covering range of aspects. United Nations defined e-government in less broad sense, as the use of information and communications technology (ICT) and its application by the government for delivering government information and public services to the people. According to Curtin, the United Nation definition is lack of social and political aspects since it is not taking into account social and political participation of citizen.⁵⁴⁴

According to the World Bank, e-government refers to the use by government agencies of information technologies (such as wide area networks, the Internet, and mobile computing) that have the ability to transform relations with citizens, businesses, and other arms of government. The outcome of such technology use is better delivery of government services to citizens, improved interactions with business and industry, citizen empowerment through information access, and more efficient government management. In addition, it is also deliver further benefit such as minimizing corruption, increased transparency, greater convenience, revenue growth, and/or cost reductions.⁵⁴⁵ The Working Group on e-government in the developing world defines e-government as the use of information and communication technologies (ICTs) to promote more efficient and effective government, to facilitate more accessible government services, allow greater public access to information, and make government more accountable to citizens.⁵⁴⁶ The European Commission defines e-government as tool that combines information technology, organisational changes and new skills in public administration, aimed to improve the quality of public services, reinforce the democratic process and support community objectives.⁵⁴⁷ OECD defines e-government as the comprehensive, smooth reorganisation of processes and endowing them with opportunities made possible by new technologies, whereby administrative and governmental tasks can be performed on the interfaces of agencies, citizens and politics, as well as within and between government agencies.⁵⁴⁸

From those various sources above, e-government is a multidiscipline field covering a range of aspects, mainly administration, political science, communications and media studies, law, public policy, engineering and computer sciences.⁵⁴⁹ Most of the definitions above also describe the application of e-government and its benefits to increase the people's welfare. To sum up "e-government" is defined as the use of information technology by government institutions/agencies with the purpose to transform relations with society, businesses, and other government institutions/agencies. For example, INSW is an e-trade service that integrates government agencies or Ministry lines. E-trade that serves the relation between central government and local government is the automation of certificates of origin (Ina-trade system). Both of these e-trade services (INSW and Ina-trade) also transform relations between government agencies/institutions with business actors/traders.

⁵⁴² See Szilard Molnar, 2007.

⁵⁴³ See Zhiyuan Fang, 2002, *Loc. Cit.*, p 1-22.

⁵⁴⁴ See Curtin, Gregory G., 2007. See also Shailendra C. Jain Palvia and Sushil S. Sharma, 2007.

⁵⁴⁵ See *Ibid.*

⁵⁴⁶ See Shailendra C. Jain Palvia and Sushil S. Sharma, 2007.

⁵⁴⁷ See Szilard Molnar, 2007.

⁵⁴⁸ See *Ibid.*

⁵⁴⁹ See Curtin, Gregory G., 2007. See also Shailendra C. Jain Palvia and Sushil S. Sharma, 2007.

VIII.d. Scope of e-government.

Commonly, the scope of e-government is classified into three forms that is government to government (G to G), government to business (G to B) and government to citizen (G to C). G to C provides services and facilitates communication between the government and citizens. G to B provides services and facilitates communication between the government and the business sector. G to G facilitates communication in intergovernmental and among government institutions. However, researchers and experts have number of ways to classify e-government services based on the use or function or cluster of users. Many variants of the e-government services are established along with social changes and customers demand. For instance Fang added two other forms of e-government, i.e., government to non-profit organisations (G to N) and government to employees (G to E). In the G to N, government provides information and communication to non-profit organisations, political parties and social organisations, and legislature. G to E is an initiative that facilitates the management of the civil service and internal communication with governmental employees, such as e-recruitment, e-office, e-career development and e-assessment.⁵⁵⁰

The resolution of the European Union describes that e-government consists of the following three main activities, i.e., the use of information and communication technology tools in public administration, modernisation of public administration, and dissemination of new tools and technologies through training to all stakeholders and citizens. There are six stages to build a system of e-government. Yet, each government agency has a different role in building such system. The degree of stages would depend on the capacity and capability of the related agencies. The first stage is very basic infrastructure such as the application of an internal network and the setting up of an email system. The second stage is enabling inter-organisational and public access to information. The third stage is authorisation of two-way communication. The fourth stage is allowing the exchange of value. The fifth stage is the application of digital democracy. The last stage is joined-up government.⁵⁵¹

According to Lowery, there are three key areas covered under e-government service, i.e., service provisions, digital democracy, and economic development.⁵⁵² These areas shall meet the needs of the customers that include individual, economic operators, stakeholders, and community. Curtin is dividing e-government into three main areas that is e-administration, e-services, and e-participation. E-administration is dealing with the internal mechanisms, formalities, procedures, and structures of government. Implementation of e-administration is purposed to improve efficiency of administrative processes, eliminating red-tape bureaucracy, and promote the transparency and accountability. Core of e-administration is streamlining and automating bureaucratic processes that previously use large amount of paper and human discretion, in this regard, the inputs, process and results accessible and easy to monitor by the public. E-administration focused on internal matters since it is mainly deals with the backend processes and internal structure of government. E-administration also associated with translating government documentation records into digital file, which available to be accessed through ICT tools.⁵⁵³

E-services defined as a tool that connecting the back-end processes with the end users, such as citizens, businesses community/economic operator, and other

⁵⁵⁰ See Zhiyuan Fang, 2002, *Loc. Cit.*, pp. 1-22.

⁵⁵¹ See Tamara Almarabeh, and Amer AbuAli, 2010, *Loc. Cit.*, pp. 30-31.

⁵⁵² See Liza M. Lowery, *Op. Cit.*, p. 2.

⁵⁵³ See Curtin, Gregory G., 2007.

government agencies. ⁵⁵⁴ E-services are consisting of four areas, where it is differentiated based on the cluster of customers and the needs of customers. First, e-service dealing with government and citizen (G to C) relationship becomes the main focus of e-service initiatives, which delivering the immediate and tangible benefits to individuals and government. E-service on G to C mostly dealing with the basic needs of the citizen related to public service access such as education, health, housing, insurance, consumer protection, etc. Second area's of e-service is dealing with business community, known G to B, which providing e-service to assist and to support economic operators in doing business. E-trade, e-procurement, and e-customs are type of services delivers in the area G to B. ⁵⁵⁵ In Indonesia e-trade service is implemented through Indonesian National Single Windows (INSW) System, which integrating government services to business community such as Inatrade system and e-custom into single entry and single exit. The G to B e-service is one of the most prominent projects in trade facilitations. It's promoting low cost transaction, business friendly environment, encouraged fair business practices and enhances competitiveness.

Third area's of e-service is dealing with the relations of government to government. The G to G defined as the use of ICT by different governmental bodies/agencies, for instance among government line ministries (INSW), central government and local government (e-ska), or among different states (ASW). It has purposes to share and/or centralize information, or to automate and to streamline intergovernmental business processes, such as regulatory compliance, efficiency on time and cost savings, and service improvement. The scheme of G to G requires sharing of electronic information and integration because it's integrating service delivery programs across government agencies and between levels of government.⁵⁵⁶It's believed that more better internal's e-service of the G to G could driving more improvement of external services, such as G to C and G to B.

The fourth area's of e-service is dealing with the relations of government to employees. The G to E refers to initiatives for internal purposes to integrate third-party services, such as allowing employees access to manage their benefits online to partake in tailored information related to the agency mission. ⁵⁵⁷ Among e-services the G to G is the large area and the most complex organizations, then followed by the G to B. The G to C is the "interface" of e-services that gone through a lot of challenges and pressures. ⁵⁵⁸

E-participation is mainly dealing with external focus, which includes formal interaction. E-participation is implemented on e-voting, formal participation tools (electronic input on policies, regulations and legislation), and more informal participation mechanisms (online citizen forums, direct access to government officials and policy makers). ⁵⁵⁹ E-Participation is associated with e-rule making, e-democracy, or e-regulations. E-participation aimed to promote the social empowerment of citizens and allow citizens to engage in the decision-making or participatory processes. The United Nations define the objective of e-participation to improve the citizen's access to information and public services; and promote participation in public decision-making that impacts the well being of society, in general, and the individual, in particular. ⁵⁶⁰

As explained above, e-trade as part of G to B is a form of application e-

⁵⁵⁴ See *Ibid.*

⁵⁵⁵ See Zhiyuan Fang, 2002, *Loc. Cit.*, pp. 1-22.

⁵⁵⁶ See *Ibid.*

⁵⁵⁷ See Curtin, Gregory G., 2007.

⁵⁵⁸ See DeBenedictis, Andrea, et.al.

⁵⁵⁹ See Curtin, Gregory G., 2007.

⁵⁶⁰ See *Ibid.*

government that connects the government to business community. Traditionally, the interaction between traders or business actors and government agencies/institutions is carried out in a government office. Along with ICT development, it is possible to bring service centres closer to the users (traders or business actors). Such centres may cover more services and integrate government agency services under one roof of e-services. E-trade allows businesses to transact with each other more efficiently (B to B) and brings customers closer to businesses (B to C), e-government is designed to make interactions between government and citizens (G to C), government and business enterprises (G to B), and inter-agency relationships (G to G) more friendly, convenient, transparent, and inexpensive.⁵⁶¹

VIII.e. E-Government in Indonesia.

As concluded from many definitions of e-government, it covers a wide range of aspects from a cultural, social, economic and technological viewpoint. In this regard, establishing e-government is not just merely converting the manual formalities and procedures into a digital and automatic system, but rather to change the mind set and social behaviour of stakeholders and its society (customers). It has to be noted that e-government, for most developing countries and LDCs is an expensive investment, however, it would deliver long run benefits to the economic development of a state. Tamara Almarabeh and Amer Abu Ali note that “government readiness” is not the only factor to affect the success of e-government systems. It is also necessary to make an appraisal of some factors that have a strong correlation within e-government such as society (customers), government institutional frameworks, human resources, existing budgetary resources, interdepartmental relationships, national infrastructure, economic health, education, information policies, private sector development, and others related issues.⁵⁶² These others factors may vary from one country to another country due to the different landscape of economic development. The United Nations divides the E-Government Readiness Index (EGDI) into three indexes, i.e. network, infrastructure, and human resources. Appraising these factors can help the government to define its strategy and grand design of e-government.

Curtin notes that some countries, in the mid-to-late 1990s, for instance the United Kingdom (UK), Canada, Australia, New Zealand and Singapore were recognised as the early adopters of the e-government system. Canada and the United Kingdom were credited in contributing to building e-government systems that promoted and facilitated e-participation. According to Curtin, South Korean and Estonia are considered as countries that have succeeded in implementing “comprehensive e-services”, applying e-democracy and e-participation tools that facilitate citizens to participate virtually in online cabinet (ministries) meetings.⁵⁶³ E-government has become a trend that has quickly spread globally, it is based on the fact that the growth of government managed websites are extremely high, with an increase from 142 government websites in 1995 to 50,000 government websites in 2001.⁵⁶⁴

In the fourteenth year after the fall of the New Order, Indonesia continues to carry out its reforms in all aspects, relating to politics, economy, social issues and bureaucracy. Some important issues were raised during the Reformation era, that is, bureaucratic reforms, openness, good governance, and combating corruption.

⁵⁶¹ See Definition of E-Government, <http://web.worldbank.org/piPK:216618~theSitePK:702586,00.html>

⁵⁶² See Al-Omari, 2006; Tamara Almarabeh, and Amer AbuAli, 2010, *Loc. Cit.*, p. 40.

⁵⁶³ See Curtin, Gregory G., 2007.

⁵⁶⁴ See Kumar, Vinod., et.al, Factors for Successful E-Government Adoption : a Conceptual Framework, Academic Conferences Ltd, available at : <http://www.sed.manchester.ac.uk/idpm/research/iGovWkPpr20.pdf>.

Accountability, responsiveness and transparency in public services have become the main features to achieve a “clean” government. Information and Communication Technology (ICT) is needed to implement these features in the daily activities of public services. The migration from manual services into ICT basis services was supposed to build a clean and transparent government capable of responding to the changes effectively, and to build a new dimension regarding organisation, management and processes with the aim of finally transforming the processes towards e-government. According to Haryono et al, the development of e-government in Indonesia is based on the following; a) supporting governmental change towards a democratic governance practice; b) supporting the application of authority balances between central and local government; c) facilitating communication between central and local governments; d) gaining openness; and e) transforming towards the information society era.⁵⁶⁵

From the development perspective, it should be taken into account that Indonesia has specific characteristics in terms of its geography, culture, dispersion of population and economic circumstances.⁵⁶⁶ Indonesia as the biggest archipelago island in the world has more than 17,000 islands with a population of more than 230 million, where the economic development gap is still high. This gap causes the different levels of information technology capabilities and accessibilities vary. People who live in major cities have more access to ICT compared to those who live in rural areas who may have difficulty accessing such technology.⁵⁶⁷ However, the use of technology products such as computers and other high-tech gadgets is becoming more common in society regardless of its social economy status. This situation has occurred along with the improvement of people’s standard of living, education (human development index), and household income. In the information society era, technology is no longer seen as a luxury but as a necessity to assist people in their daily activities. Trade liberalisation is one of many factors driving the fast development of information society, where it provides many choices of ICT products with various affordable prices and a range of performance. In short, trade liberalisation increases competitiveness in the area of ICT that has benefited society, where people can get affordable products with the lowest price. The features of public services in Indonesia were characterised by closed bureaucracy, excessive documentation, time consuming procedures, and corruption. These backgrounds became thoughtful consideration for the Indonesian government to transform its public service into e-government.

Since trade is one of the backbones of Indonesia’s national economy, the government services on trade urgently need addressing, especially regarding export-import facilitation. E-trade is a manifestation of e-government that connects Government to Business. E-trade provides e-public services on trade sectors. There are five priority programmes, which are the key programmes of Indonesia’s national ICT development, including e-government, e-infrastructure, e-industry, e-learning, and e-commerce.⁵⁶⁸

⁵⁶⁵ See Haryono, Tisyo., and Widiwardono, Y. Kristianto., *Current Status and Issues of E-Government in Indonesia*, available at : <http://www.aseansec.org/13757.htm>.

⁵⁶⁶ See e-Government Development in Indonesia, e-Government Workshop, Doc No. telwg29/EG/04, Submitted by: Indonesia, APEC Telecommunications and Information Working Group, the 29th Meeting, 21-26 March 2004, Hong Kong, China, available at : <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN017960.pdf>.

⁵⁶⁷ See Haryono, Tisyo., and Widiwardono, Y. Kristianto.

⁵⁶⁸ See e-Government Development in Indonesia, e-Government Workshop, Doc No. telwg29/EG/04.

VIII.f. Legal framework of e-government.

Democratic reforms that are primarily based on great demand for transparency and openness have contributed to the emergence of information society. Transformation of the centralised system into a decentralised system has brought an essential demand to the delivery of public services closer to the people by implementing good governance principles. Indonesia's National ICT vision is *"to bring into reality a modern information society, prosperous and highly competitive, with strong support by ICT"*.⁵⁶⁹

To provide the legal framework for the implementation of e-government the Indonesian government issued two Presidential Directives. Presidential Directive No. 6/2001 on Telecommunications (Telecommunications, Media and Information) enclosing a five-year National Information and Communications Technology Action Plan for Indonesia. Presidential Directive No. 3/2003 concerning National Policy and Strategic Development of E-government. Both of these Presidential Directives are used as a guidelines for the implementation of e-government at central and regional levels. The rapid development of ICT usage in business, such as e-commerce, has brought a demand of legal certainty for such activities. Therefore, the government of Indonesia established Law No. 11/2008 on Information and E-Commerce. To ensure transparency and public participation in the development process, the Indonesian government also issued Law No. 14/2008 concerning Openness of Public Information.

By the issuance of Presidential Directive No. 6 /2011, e-government is officially started to be used in the public administration. This legal framework's mandated the government of Indonesia to usage ICT's for supporting implementation of good governance in the public services delivery. There are some strategic plans prepared to develop e-government, i.e.,:⁵⁷⁰

- a) Developing a good service system with reasonable cost, with focuses to extend and to improve the quality of information and communication networks; to build the information portals and integrated public services; to build the electronic document management system, standardization and information security system.
- b) Developing management system of central and local government, with focuses to improve the quality of services needed by the community, to manage the changes, to enforce the leadership and to improve the regulation products.
- c) Optimizing the use of information technology, with focuses building the interoperability, standardization and procedure of electronic document management system, information security, basic application (e billing, e reporting) and to develop intergovernmental network.
- d) Improving the participation of private sector and information technology industry with focuses to use the expertise of the private sector, to encourage participation of private sector and small industries.
- e) Developing man-power's capacity in the central and local government, with objectives to develop ICT culture in government institutions, to optimize the use of ICT training facilities, to extend the use of ICT for distant learning, and to put ICT as input for school curriculum and to improve the quality of teaching.

Based on Presidential Directive No. 3/2003 concerning National Policy and Strategic Development of E-government, it setup e-government strategy consists of :

- a) Developing reliable, trust and affordable public services;
- b) Organization, management system and business process reform;
- c) Optimal use of ICT;
- d) Public - private partnership;

⁵⁶⁹ See *Ibid.*

⁵⁷⁰ See Haryono, Tisyo., and Widiwardono, Y. Kristianto.

- e) Human resource development and increase society e- literacy;
- f) Realistic and measurable implementation plan;

The implementation of e-government is one of the tools of bureaucratic reform. E-government is expected to accelerate institutional reforms, improving professionalism and accountability of civil servants, and to reduce corruption in bureaucracy. According to Effendi, the important element in bureaucratic reform is the change in mind-set and culture-sets and the development of work culture.⁵⁷¹ Based on the State Ministry of the Empowerment of State Apparatus Regulation No. PER 15/M.PAN/7/2008, bureaucratic reform is defined as:

"[...] effort to reform and fundamentally change the system of government administration in order to realise good governance [...]."

It has to be noted that transparency and the right to obtain information are two of the characteristics of good governance, while, the main objective of bureaucratic reform is the implementation of good governance.⁵⁷² The UNDP defines good governance as *"[...] among other things, participatory, transparent and accountable [...] effective and equitable...promoting the rule of law...ensuring that political, social and economic priorities are based on broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources [...]"*. The OECD notes that good governance *"[...] encompasses the role of public authorities in establishing the environment in which economic operators function and in determining the distribution of benefits as well as the relationship between the ruler and the ruled [...]"*. The World Bank associates good governance with *"[...] predictable, open and enlightened policy making; a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law [...]"*.⁵⁷³ Heeks notes the advantage of good governance such as cost saving, time saving, boundary-breaking, better decisions, changed behaviour of public servants, changed behaviour of public sector clients, and empowerment.⁵⁷⁴

There are three key elements that need to be applied to guarantee the implementation of good governance, consisting of internal rules and restraints, "voice" and partnership, and competition. Each of these elements is implemented into public service delivery. Internal rules and restraints are applied by internal accounting and auditing systems, independence of the judiciary and the central bank, civil service and budgeting rules). "Voice" and partnership are implemented through public-private deliberation councils, and service delivery surveys to solicit client feedback. The competition element would cover competitive social service delivery, private participation in infrastructure, alternative dispute resolution mechanisms, and outright privatisation of certain market-driven activities. According to the World Bank's Corruption study for Europe and Central Asia, there are five dimensions of good governance i.e. public sector management, competitive private sector, structure of government, civil society participation and voice, and political accountability.⁵⁷⁵ The Indonesian National flagship strategy on e-government is *"[...] utilising ICT as the basis*

⁵⁷¹ See Effendi, T, *Agenda Strategis Reformasi Birokrasi Menuju Good Governance*, Jurnal Negarawan No 02, November 2006; Ambar Sari Dewi, *The Role of Local e-Government in Bureaucratic Reform in Terong, Bantul District, Yogyakarta Province, Indonesia*, Internetworking Indonesia Journal, Vol.3/No.2 (2011), available at : http://www.internetworkingindonesia.org/Issues/Vol3-No2-Fall2011/ijj_vol3_no2_2011_dewi.pdf, pp. 49-51.

⁵⁷² See Ambar Sari Dewi, 2011, *Op. Cit.*, pp. 49-51.

⁵⁷³ See <http://web.worldbank.org/0,20513159~pagePK:34004173~piPK:34003707~theSitePK:497024,00.html>

⁵⁷⁴ See Okhman, A, *Potret dan Hambatan E-Government di Indonesia*, Jurnal Inovasi Online, Vol.11/XX/Julii Edition 2008, <http://io.ppijepang.org/article.php?id=263>, accessed in July 2010; Ambar Sari Dewi, 2011, *Op. Cit.*, pp. 49-51.

⁵⁷⁵ See <http://web.worldbank.org/0,20513159~pagePK:34004173~piPK:34003707~theSitePK:497024,00.html>

for re-engineering government administration at central, provincial and local levels and in the delivery of government services, seeking to build modern ICT enabled administration throughout Indonesia that will deliver world class information and services to all Indonesian citizens [...].⁵⁷⁶

It is believed that transparency and accountability principles, which is an essential part of good governance, can be carried out properly in public service delivery through e-government operations. Therefore, all e-government operations must be designed to support the creation of clean, transparent and credible government. However, Heeks notes that e-government is only an instrument, while ensuring the implementation of transparency and accountability requires more than just employing technology.⁵⁷⁷

VIII. g. Obstacles and challenges in the implementation of e-government.

Limitations in the ICT infrastructure are considered as one of the obstacles hampering economic development in Indonesia. According to ITU, lack of ICT inhibits the economic development programme.⁵⁷⁸ ICT infrastructure is also considered as one of various other crucial factors hampering the implementation of e-government in Indonesia. The E-Government Workshop identified challenges in the development and implementation of e-government such as budget and financial constraints, human resources, telecommunication infrastructure constraints, low computer penetration, low internet penetration, regulatory environment, organisational culture and design, and e-leadership.⁵⁷⁹ While, Tamara Almarabeh et al. identify a number of challenges and obstacles that have been encountered in building the e-government system, covering a range of aspects, such as infrastructure development, law and public policy, e-literacy, accessibility, trust, privacy, security, transparency, interoperability, mapping and assessing existing record systems, records management, permanent availability and preservation, education and marketing, public/private competition/collaboration, and workforce issues.⁵⁸⁰ With regard to causes of failure of e-government implementation, Danish Dada writes about *"the failure of e-government in developing countries"*, stating that "the problem that often arises with developing countries is that there is frequently a mismatch between the current and future systems, due to the large gap in the physical, cultural, economic, and various other contexts between the software designers and the place it is being implemented".⁵⁸¹ However, the government of Indonesia has made a series of efforts to promote e-government development in the area of awareness building, human capacity building/increasing society e-literacy, regulatory framework and policies, and telecommunication infrastructure.⁵⁸² The implementation and development of e-government could also accelerate integration with the world trading system and global communities.

⁵⁷⁶ See e-Government Development in Indonesia, e-Government Workshop, Doc No. telwg29/EG/04,

⁵⁷⁷ See Okhman, A, 2010; Ambar Sari Dewi, 2011, *Op. Cit.*, pp. 49-51.

⁵⁷⁸ See Basri, Faisal and Munandar, Aris., *Lanskap Ekonomi Indonesia : Kajian dan Renungan Terhadap Masalah-Masalah Struktural, Transformasi Baru, dan Prospek Perekonomian Indonesia*, Edisi Pertama, Cetakan ke-1, Kencana Prenada Media Group, Indonesia, 2009, p. 178.

⁵⁷⁹ See e-Government Development in Indonesia, e-Government Workshop, Doc No. telwg29/EG/04.

⁵⁸⁰ See Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, p. 32.

⁵⁸¹ See Dada, 2006; Tamara Almarabeh, and Amer AbuAli, 2010, *Op. Cit.*, p. 34.

⁵⁸² See e-Government Development in Indonesia, e-Government Workshop, Doc No. telwg29/EG/04.

VIII.h. E-Trade as an effective trade facilitation in exports: connecting central and local governments to integrate, harmonise and synergise foreign trade services.

E-trade is one of the priorities in Indonesia's e-government programme. Indonesia's e-trade is known as InaTrade, and is an online public service related to import-export licensing operated under the Ministry of Trade. Inatrade was officially implemented on 10 August 2010, beginning the new era of public services in import-export licensing.⁵⁸³ As regulated under Ministry of Trade Regulation No. 28/M-DAG/PER/6/2009,⁵⁸⁴ Inatrade was established with the purpose to support the ASEAN Single Window and National Single Window, therefore, it applied single entry and single exit point principles. Through an electronic system traders can easily submit their import-export licence requests. In other words, traders do not need to physically present themselves at the government agencies and directly deal with bureaucrats. It is expected that such system could reduce bribery and corruptions in import-export licensing. Inatrade has fundamentally transformed procedures of issuing licensing through web-based services, which is easier, faster, and more efficient. Specifically, the Ministry of Trade elaborates the purposes of the establishment of Inatrade, as follows:

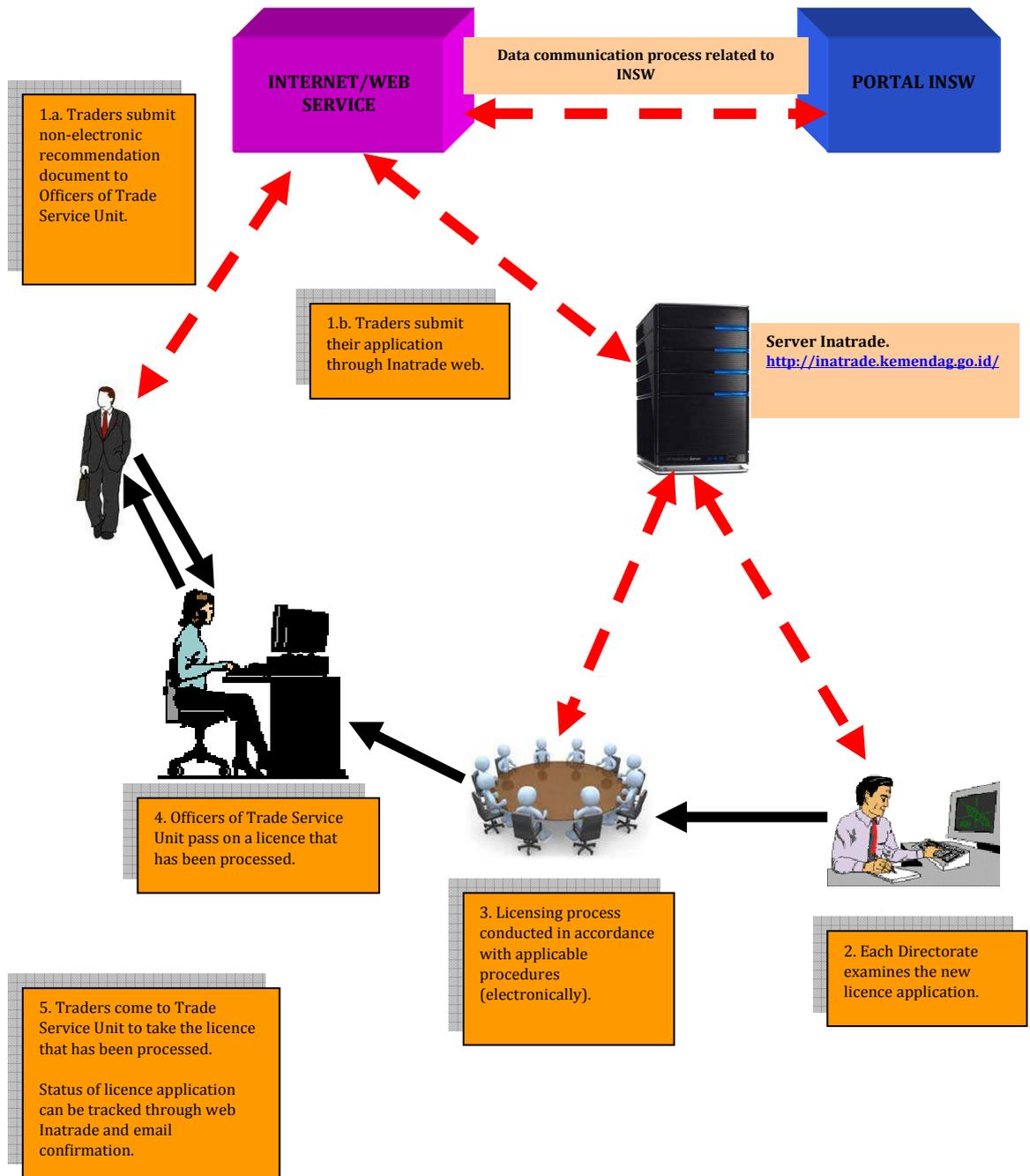
1. To support the implementation of the National Single Window and ASEAN Single Window.
2. To provide online services on import-export licensing, which are simpler, easier, and faster.
3. To help traders control their licensing submission process through document tracking.
4. To reduce excessive documentation on submitting licensing.
5. To provide better monitoring on import-export procedures.
6. To build a database for import-export licensing.
7. To provide automation of document verification as it is connected to the Government Agencies related to import-export.
8. To provide speedy customs clearance.

The implementation of Inatrade is expected to bring some benefits, such as speeding up customs clearance; improving product competitiveness in the international market; reducing bureaucratic formalities and procedures in export-import licensing and customs; enhancing transparency; preventing rent seeking behaviour and bribery (authority abuse); improving information access of export-import policy; and creating measurable costs for traders.

⁵⁸³ See Pelayanan Online Inatrade Resmi Dibuka, available at : <http://inatrade.kemendag.go.id/index.php?module=login&action=lihatBerita&id=36&rd=13781>, last accessed : 28 May 2012.

⁵⁸⁴ See Concerning terms of service on licensing of export and import using electronic system of Inatrade in the framework of INSW.

Figure 43. Process of Inatrade:



IX. The Indonesia National Single Window (INSW) as a comprehensive improvement trade facilitation service.

IX.a. The urgency comprehensive trade facilitation at the national level: Indonesia's Trade Potential.

The Indonesian National Single Window (INSW) is Indonesia's national system that allows a single submission of data and information, single and synchronous processing of data and information, and the creation of single decision-making for custom release and clearance of cargoes.⁵⁸⁵

The urgency of the establishment of INSW involves some aspects relating to economics, law, politics, and socio-culture. Regarding economics, INSW has been designed based on the efficiency principle to reduce the high cost economy of trade, specifically transaction costs. Relating to the legal aspects, INSW is expected to be able to provide legal certainty on providing services for cross-border trade procedures. To guarantee legal certainty the proper implementation of good governance principles within INSW is needed. The adherence of good governance principles is most likely to eradicate corruption. INSW is also regarded as the reform of public services on foreign trade services.⁵⁸⁶

From the political aspect, INSW plays a strategic (important) role for Indonesian economic operators, especially for those whose are located faraway from the public service facilities. Politically, implementation of INSW brings the public service closer to people. It also delivers public service equally to the people. In this regard, the portal of INSW is expected to be an effective media to deliver information related to cross border trade to stakeholders and economic operators.⁵⁸⁷ The INSW Portal is defined as a system that performs the integration of information related to the handling of customs documents and expenditures, which ensures data security and information also integrating information flow and processes between internal systems automatically, which includes the system of customs, licensing, ports/airports, and other systems related to the handling of customs clearance documents and the release of goods.⁵⁸⁸

With regard to the socio-cultural aspect, it is believed that INSW can change government agencies culture and attitude by migrating manually handled public services into e-trade services. ICT application in the INSW minimises bribery and rent seeking behaviour in the services and licence system of foreign trade.⁵⁸⁹

Related to this aspect two theories prevail. The first theory is "*social changes as causes of legal changes*". Vago writes that the law could respond to social changes over decades or even centuries. He takes an example from the industrial revolution, where changes induced by the invention of the steam engine or the advent of electricity were gradual enough to make legal responses valid for a generation. In terms of INSW, the establishment of the INSW regime is analogous to making social changes in the bureaucracy attitudes that tend to corrupt.⁵⁹⁰

In the words of Loth and Ernst "[...] *technological changes leading to legal changes abound [...]*".⁵⁹¹ According to Vago "[...] *many sociologists and legal scholars argue that*

⁵⁸⁵ See According Article 1 paragraph 2 President Regulation No. 10/2008.

⁵⁸⁶ See INSW Preparation Team, Indonesia National Single Window, Submitted by : Indonesia, 2009/SCCP/SWWG/WKSP4/016, Asia-Pacific Economic Cooperation, Single Window Working Group Capacity, Building Workshop 4 Singapore 6-8 April 2009.

⁵⁸⁷ See *Ibid.*

⁵⁸⁸ See Article 1 paragraph 3 President Regulation No. 10/2008.

⁵⁸⁹ See INSW Preparation Team.

⁵⁹⁰ See Vago, Steven., *Law and Society*, Third Edition, Prentice Hall, Englewood Cliffs, New Jersey, 1991, p. 217.

⁵⁹¹ See Loth and Ernst, 1972; Vago, Steven., 1991, *Op. Cit.*, p. 218.

technology is one of the great moving forces for change in law [...].⁵⁹² Thus Miller notes that law is influenced by technology in at least three ways:⁵⁹³

[...] the most obvious is technology's contribution to the refinement of the legal technique by providing instruments to be used in applying law. A second, no less significant, is technology's effect on the process of formulating and applying law as a result of the changes technology fosters in the social and intellectual climate in which the legal process is executed. Finally, technology affects the substance of law by presenting new problems and new conditions with which law must deal [...] (Stove, quoted by Miller, 1979:14)".

The implementation of INSW is considered as part of public service reform by migrating manually handled services into automation services using ICT. The development of ICT has transformed information society and its demanding changes on public service delivery. Therefore, the establishment of acts on e-government would be very urgent in the near future. Quoted from Vago, "*[...] change in law may be induced by a voluntarily and gradual shift in community value and attitudes [...]*" and "*[...] change in social conditions, technology, knowledge, values, and attitudes, then, may induce legal change [...]*". In this regard, "*the law is reactive and follows social changes*" and "*changes in law are one of many responses to social change*". The legal response depends on the political will of the authority and whether it is responsive to meet the demands of social change or not. In addition, the legal response needs a back up from sovereignty to operate its norms effectively. Therefore, a new law in response to a new social or technological problem is expected to provide a solution to those problems.⁵⁹⁴ In this respect, the INSW regime is the response to the problem of ineffective bureaucracy, low transparency, high cost economy and other related problems in foreign trade procedures.

The second theory places law as a tool of social challenge, which means that enactment and implementation of laws have been used intentionally to induce social changes in society. Since Roman times, major ages of social changes and mobility have usually involved great use of law and of litigation.⁵⁹⁵ According to Aron, law is an important tool of social change.⁵⁹⁶

Joel B. Grossman and Mary H. Grossman consider law as a desirable, necessary, and a highly efficient means of inducing change, preferable to other instruments of change.⁵⁹⁷ While, the famous article, "Law and Social Change", written by Dror, argues that "*[...] law plays an important indirect role in social change by shaping social institutions, which in turn have a direct impact on society [...]*".⁵⁹⁸ In this regard, the establishment of the INSW regime is expected to shape trade institutions to boost foreign trade and increase economic growth of society.

The electronic system⁵⁹⁹ application in the framework of INSW is regulated by President Regulation No. 10/2008 in order to provide legal certainty and protection from any fraud or system irregularities in the electronic procedures of customs and licences related to export and import.⁶⁰⁰ This regulation is also used as the guidance for

⁵⁹² See Vago, Steven., 1991, *Loc. Cit.*, p. 218.

⁵⁹³ See Miller, 1979: 4-14; Vago, Steven., 1991, *Loc. Cit.*, p. 218.

⁵⁹⁴ See Vago, Steven., 1991, *Op. Cit.*, pp. 217-219.

⁵⁹⁵ See Vago, Steven., 1991, *Op. Cit.*, p. 219

⁵⁹⁶ See Aron, 1989:85-114; Vago, Steven., Vago, Steven., 1991, *Op. Cit.*, p. 220.

⁵⁹⁷ See Joel B. Grossman and Mary H. Grossman, 1972, *Op. Cit.*, p. 2; Vago, Steven., 1991, *Loc. Cit.*, pp. 217-219.

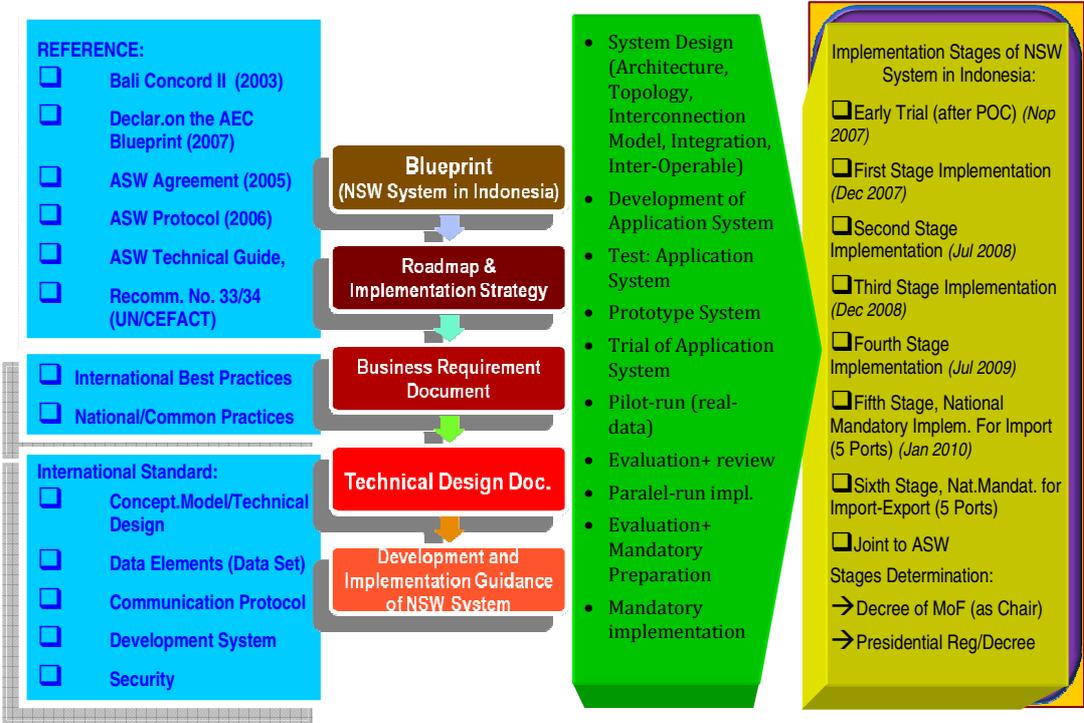
⁵⁹⁸ See Dror, 1968:673; Vago, Steven., 1991, *Loc. Cit.*, pp. 217-219.

⁵⁹⁹ See According Article 1 paragraph 1 President Regulation No. 10/2008, "[...] electronic system defined as a system to collect, to prepare, to store, to process, to analyze, and to disseminate information electronically [...]"

⁶⁰⁰ See Article 2 paragraph 2 President Regulation No. 10/2008. See also See Article 3 paragraph 1 President Regulation No. 10/2008. The handling of customs documents and licensing services related to export activities and / or imports carried out through INSW.

the development and implementation of the INSW system.⁶⁰¹ The Regulation states clearly the spirit of establishment of INSW which is designed to enhance national competitiveness, to facilitate trade in the global competition, to guarantee flow of the export-import goods and to reduce transaction costs.

Figure 44. Overall development stages of INSW.⁶⁰²



IX.b. Stakeholders on INSW.

Each National Single Window has its own scheme of line ministries or government agencies involved in the system. Stakeholders in the INSW consist of government agencies and users (economic operators). There are eight government agencies that engage in the INSW, i.e, Ministry of Trade, Food and Drug Agency, Fishery Quarantine, Plant and Animal Quarantine, Ministry of Health, Ministry of Industry, Nuclear Energy Regulatory Agency, and Directorate General of Post and Telecommunication. While economic operators cover all importers, customs brokers and selected exporters. According to the regulation, these stakeholders are also included as the users of INSW.⁶⁰³ The users of INSW would be granted access to the INSW portal.

⁶⁰¹ See Article 2 paragraph 2 President Regulation No. 10/2008.
⁶⁰² Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).
⁶⁰³ See Article 1 paragraph 10 President Regulation No. 10/2008. The users of INSW covering the government agency that issued licence related to export/import, Directorate General of Customs, traders (exporters/importers), shipping agencies, and Service Provider of Customs and Clearance.

Figure 45. The first government agencies integration.⁶⁰⁴



Figure 46. INSW integrated government agencies system interoperability.⁶⁰⁵



⁶⁰⁴ Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).

⁶⁰⁵ See *Ibid.*

Table 54. The issuing of import licence government agencies.⁶⁰⁶

No	Government Agencies	Imp-Exp. Licensing	Recommendation
1	Ministry of Trade	X	
2	Fishery Quarantine	X	
3	Animal Quarantine *	X	
4	Plantation (Quarantine *)	X	
5	Food & Drugs Control	X	
6	Ministry of Industry		
7	Ministry of Energy	X	X
8	Nuclear Control NA	X	X
9	Ministry of Forestry	X	
10	DG of Post & Teleco	X	
11	Ministry of Agriculture	X	X
12	Ministry of Health	X	
13	National Police	X	
14	Ministry of Environment	X	X
15	Ministry of Defence		X
16	Ministry of Transport.	X	
17	Central Bank (BI)		X
18	Customs (DGCE)	--	--

IX.c. Features of INSW as an instrument of trade facilitation.

In agreement with its purpose to simplify the formalities and procedures on export and import, therefore, INSW has the motto of “consistency, transparency, simplicity, and efficiency”. The features and facilities that are provided by INSW must be able to translate such motto into practice of public services. For that reason, the system of INSW must provide features and facilities, covering:

1. *Tracking and tracing of documents.*
2. *Compatibility with the ASW system.* The communication facility with the ASEAN Single Window (ASW) system.
3. *Network Security.* Related to electronic transactions from/to INSW portal.
4. *Log Audit Trail.* Function to record the details of transaction e.g. uploading, downloading, cancelling, editing, deleting and submitting/transmitting information
5. *Uploading and Downloading.* Function on INSW system and allocated for smart clients to update the regulations and to table references.
6. *Data Extraction, Transformation, Loading.* This facility is used to process the data automatically to records in the database portal.

Audit trails that result from the electronic security process system function as a tracking system towards progress of the process in the INSW.⁶⁰⁷ Through the audit trail, traders (exporters/importers) can control their document process remotely by using the ICT interface, anytime and anywhere. The electronic data exchange in the INSW is categorised as a legal conduct.⁶⁰⁸ Therefore, all the processes and procedures of the INSW system have to ensure legal certainty to avoid any legal fraud that might cause losses for the parties concerned.⁶⁰⁹

⁶⁰⁶ See *Ibid.*

⁶⁰⁷ See Article 1 paragraph 9 President Regulation No. 10/2008.

⁶⁰⁸ See Article 1 paragraph 8 President Regulation No. 10/2008.

⁶⁰⁹ See Article 11 President Regulation No. 10/2008.

Figure 47. Features, functions, and facilities: INSW Portal.⁶¹⁰

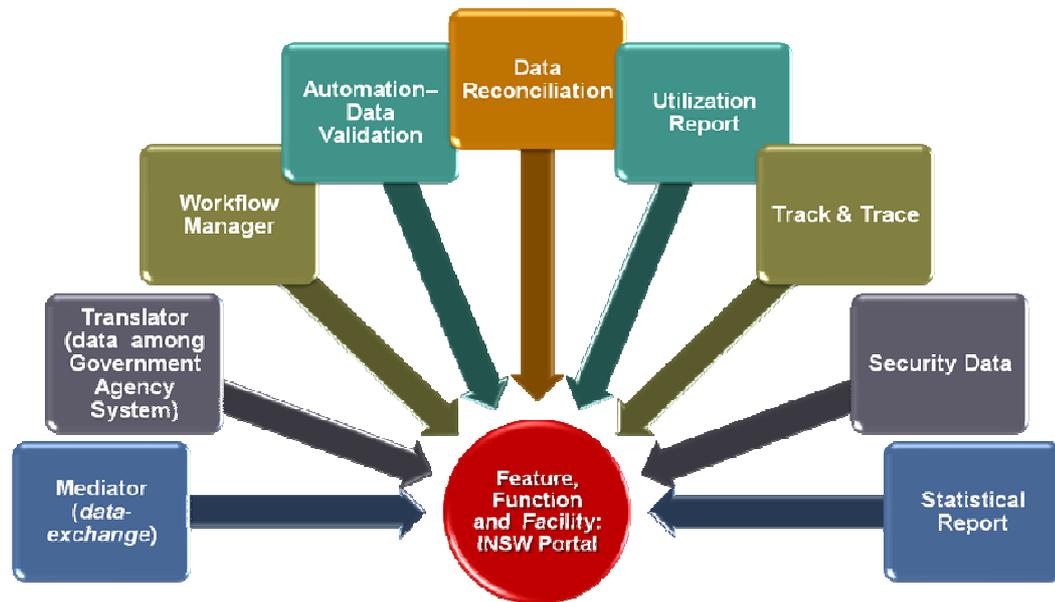


Figure 48. INSW e-Collaboration.⁶¹¹

INSW INDONESIA NATIONAL SINGLE WINDOW

TRANSPARENCY
CONVENIENCE
EFFICIENCY
SIMPLICITY

User login : admininsw [19 Januari 2011 10:19:23]
Hari ini : 19 Januari 2011 10:50:18

User Management | Import | Ekspor | Manifest | A S W | Change Password | Sign Out | Link

Penindakan dan Penyidikan (P2) | Licensing Hub | Browse Dan Tracking | Data Master | UNEDFACT | Pos Tarif | Evaluasi NSW | Report Laporan | WS send PIB

View Dok. Perijinan | Realisasi Perijinan | Dok Perijinan Trader (import) | Edit Dok.Perijinan | Pengecualian Depdag | Stat. Perijinan

SKA INSW

Pencarian Berdasarkan
COO No
COO Date
Original Country

Print	COO No	COO date	Consignee Form	Consignee To	Original Country	Destination Country	Discharge Port	Vessel Name	Departure Status
	KL-250797-U-143889	14-JAN-11	ENDEKA CERAMICS SDN. BHD. LOT 52855, PERSEKIDAN BUNGA TANJUNG 2 SENAWANG INDUSTRIAL PARK 70450 SEREMBAN, NEGERI SEMBILAN	PT. KIA SERPIH MAS JL. RAYA HARBOORING KM 51.9 LIMUSUNGGAL CILEUNGSI BOGOR JAWA BARAT	MY-MALAYSIA	ID-INDONESIA	IDJKT-JAKARTA / PASAR IKAN CMA CGM AEGEAN DB075R		12-JAN-11
	KL-577797V-143898	14-JAN-11	COSMO SCIENTEX (M) SDN BHD JALAN UTAS 15/7 40700 SHAH ALAM SELANGOR	PT. INTEGRATED LOGIXSTREAM GRAHA INDRAMAS, 8TH FLOOR Jl. AIP II K.S. TUBUN RAYA NO.77 JAKARTA 11410	MY-MALAYSIA	ID-INDONESIA	IDJKT-JAKARTA / PASAR IKAN CMA CGM AEGEAN V.DB075R		12-JAN-11
	KL-112531-W-143897	14-JAN-11	O.Y.L. MANUFACTURING COMPANY S/B LOT 60334, PERSEKIDAN BUKIT RAHMAN 3 TAMAN PERINDUSTRIAN BUKIT RAHMAN PUTRA, 47000 SUNGAI BULOH, SELANGOR	PT. TATASOLUSI PRATAMA JALAN KAYOON 42-44 RT 001, RW 005 EMBONG KALIASIN	MY-MALAYSIA	ID-INDONESIA	IDJKT-JAKARTA / PASAR IKAN CTP GOLDEN V.032E		13-JAN-11
	KL-112531-W-143893	14-JAN-11	O.Y.L. MANUFACTURING COMPANY S/B LOT 60334, PERSEKIDAN BUKIT RAHMAN 3 TAMAN PERINDUSTRIAN BUKIT RAHMAN PUTRA, 47000 SUNGAI BULOH, SELANGOR	PT. TATASOLUSI PRATAMA JALAN KAYOON 42-44 RT 001, RW 005 EMBONG KALIASIN	MY-MALAYSIA	ID-INDONESIA	IDJKT-JAKARTA / PASAR IKAN CTP GOLDEN V.032E		13-JAN-11
	KL-250797-U-143890	14-JAN-11	ENDEKA CERAMICS SDN. BHD. LOT 52855, PERSEKIDAN BUNGA TANJUNG 2 SENAWANG INDUSTRIAL PARK 70450 SEREMBAN, NEGERI SEMBILAN	PT. ANGSA DAYA JL. MANGGA DUA RAYA BLOK F-2 NO.3-5, JAKARTA 10730	MY-MALAYSIA	ID-INDONESIA	IDJKT-JAKARTA / PASAR IKAN CMA CGM AEGEAN DB075R		12-JAN-11
	KL-636775T-143889	14-JAN-11	ST. GOSWAM CONST. PRODUCTS (M) S/B No. 1, JALAN SULTAN MOHAMAD 4 KAWASAN BANDAR SULTAN SULEIMAN 42000 PORT KLANG, SELANGOR	CV KHARISMA JAYA Jl. WILHEM ISKANDAR NO.5 COMP. IMPERIAL COURT LK XI INDRA KASIH	MY-MALAYSIA	ID-INDONESIA	IDBLW-BELAWAN	RBD ESPERANZA V.036E	13-JAN-11
	KL-510079U-143859	17-JAN-11	HIRO FOOD PACKAGES MANUFACTURING SB LOT 10, JALAN 11JK 26/5	PT. DIAN SAUSAPOR LESTARI Jl. PERSATUAN GURU NO. 9 (CITING TINUR)	MY-MALAYSIA	ID-INDONESIA	IDJKT-JAKARTA / PASAR IKAN HANSA TRONDHEIM V. 73/E		16-JAN-11

IX.d. The role of InaTrade in the INSW.

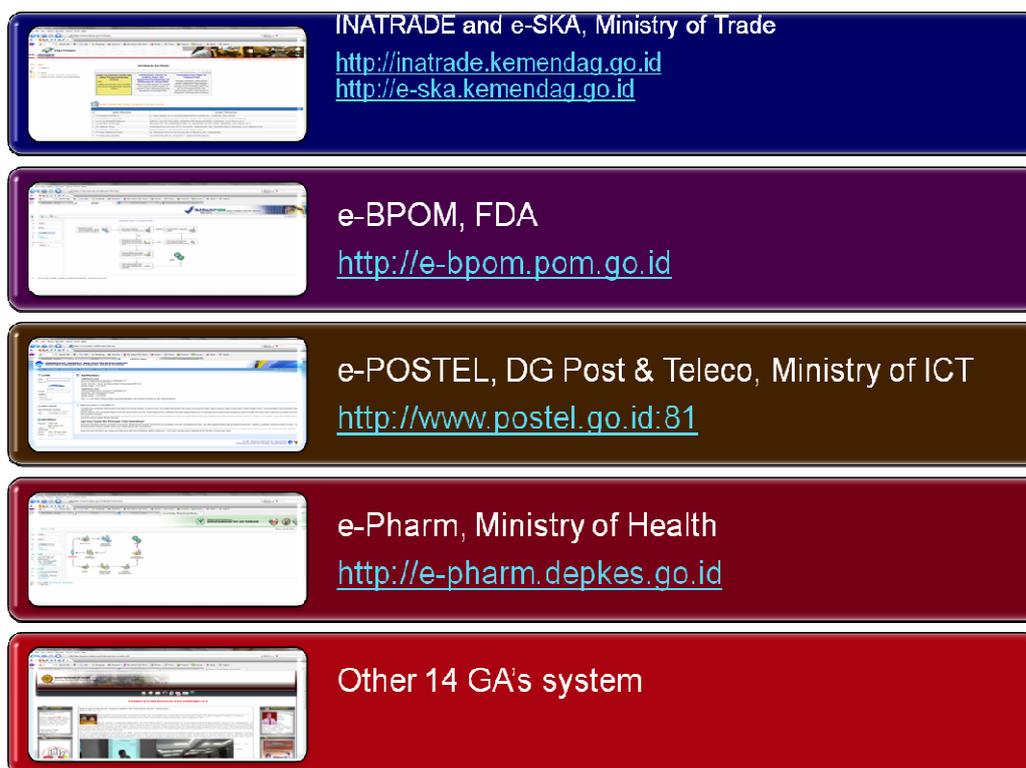
The terms of service on the licensing of exports and imports using the electronic system of Inatrade in the framework of the INSW are regulated by Ministry of Trade

⁶¹⁰ Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).

⁶¹¹ See *Ibid*.

Regulation No. 28/M-DAG/PER/6/2009.⁶¹² The idea of integrating Intrade into the INSW system is to deliver a public service on exports and imports to traders according to affectivity, efficiency and transparency principles. Intrade is an online service on the licensing of exports and imports provided by the Ministry of Trade.⁶¹³ The users of Intrade cover private legal persons, legal entities, companies/enterprises, government institutions, which submit their requests for the licensing of exports and imports.⁶¹⁴

Figure 49. The government agencies integrating into INSW ⁶¹⁵



IX.e. Improvement of good governance on foreign trade services through INSW.

Implementation of INSW should be seen as a good opportunity for the fundamental reform on public services, particularly to provide transparency and excellent service on exports-imports. The INSW system is designed to simplify business processes in which public services on exports-imports will become simpler, faster and more effective. With regard to the hierarchical bureaucracy chains, such as local autonomy, the establishment of INSW is intended to harmonise and synchronise the procedures and formalities in exports-imports related to the issuing of permit licences and certificates of origin. Therefore, overlapping on issuing licences allows bureaucracy constraints and corruption to be avoided.

Practically speaking, INSW fundamentally changes and totally transforms government agencies that are related to exports and imports. The existence of one

⁶¹² See Trade Minister Regulation No. 28/M-DAG/PER/6/2009.

⁶¹³ See Article 1 paragraph 5 Trade Minister Regulation No. 28/M-DAG/PER/6/2009.

⁶¹⁴ See Article 1 paragraph 6 Trade Minister Regulation No. 28/M-DAG/PER/6/2009.

⁶¹⁵ Cited from National Single Window (NSW) System, History, Establishment, Development & Implementation in Indonesia, Presented on Indonesia Trade Facilitation Policy Studies Forum held by Ministry of Foreign Affairs and Ministry of Trade of the Republic of Indonesia in Jogjakarta Plaza Hotel, 12 July 2012 (attended directly by the researcher).

single national portal on exports and imports is the reflection of the successful integration of government agencies e-data and information. Government agencies are recommended to provide the service level for stakeholders through the Service Level Arrangement (SLA) in order to deliver a transparent service and guarantee legal certainty.⁶¹⁶ For instance, the management of Inatrade in delivering its service must implement SLA to guarantee transparency and legal certainty in the procedures of exports and imports.⁶¹⁷

IX.f. The role of INSW in the utilisation of GSP

As described before, INSW is as a system that enables “single submission of data and information, single and synchronous processing of data and information and single decision-making for customs release and clearance of cargo”. There are four principles attached to the implementation of INSW, i.e.:

1. One single National Portal, with one Web-address (Internet) which is officially applied to carry out all kinds of transactions related to “trading & logistic” activities.
2. National Portal, which functions as a “Messaging-Hub”, connecting all related stakeholders (government agencies and traders).
3. Authorisation of licensing, permits & recommendation of exports-imports remains within the authorisation of each government agency.
4. Output of licensing, permits & recommendation from government agencies shall be uploaded or transmitted electronically to the database of the national portal, therefore customs are allowed to give approval in a timely manner (for customs clearance & release).

As previously mentioned, INSW is a fundamental reform of public services, therefore, it is not an easy change due to some challenges that need to be addressed with extra effort. First, the change-management process due to transformation from the manual system into an electronic and automatic system. Second, necessary reforms of the laws and regulations, especially in the area of public services, to support the automation process and guarantee transparency. The existing laws and regulations considered are not in line with the INSW system. Third, the need to improve capability and capacity of the bureaucracy of human resources who are able to operate the INSW as a public portal.

X. The trade policies of the Indonesian Government in maximising the utilisation of the EU’s GSP scheme.

In 2009 Indonesia’s economic performance showed a growth of 4.5%, supported by an export performance at the amount of 116.5 billion USD with a trade surplus of 9.6 billion USD. In January 2009, Indonesia’s export performance reached 9.2 billion USD and its growth was 47.6% higher than in January 2008. It was claimed as the highest growth in Indonesia’s export history.

Since GSP is a unilateral preference that is granted autonomously and is non-reciprocal, no negotiations were carried out between the preference-granting country and the beneficiary country. In the framework of EU GSP utilisation, the Indonesian government has no specific agreement or policy. However, in general terms, the Indonesian government’s trade policies have been focused to enhance its trade services through the adoption of international standards and international best practice. It is aimed to increase Indonesia’s export performance by maximising utilisation of tariff preferences. According to the Ministry of Trade, Indonesia enjoyed

⁶¹⁶ See Article 10 paragraph 4 President Regulation No. 10/2008.

⁶¹⁷ See Article 1 paragraph 11 Ministry of Trade No. 28/M-DAG/PER/6/2009.

nine international trade preferences, consisting of the *Generalised System of Preferences* (GSP); *Handicraft Preferences*; *Global System of Trade Preferences* (GSTP); *Common Effective Preferential Tariff/ASEAN Trade in Goods Agreement for ASEAN Free Trade Area* (CEPT/ATIGA-AFTA); *ASEAN China Free Trade Area* (ACFTA); *ASEAN Korea Free Trade Area* (AKFTA); *Indonesia Japan Economic Partnership Agreement* (IJ-EPA); *ASEAN India FTA* (AIFTA); and *ASEAN Australia New Zealand FTA* (AANZFTA).

Although the GSP was established based on non-reciprocal principles, this does not mean that the GSP is a “free gift”. The Enabling Clause enabled the possibility for the preference-granting country to establish “standards” with the purpose of responding positively to the “*development, financial and trade needs*” of the beneficiary country. To ensure the implementation of the non-discriminatory principle, therefore, such standard must be established based on objective principles. The standard is used as a tool to ensure the GSP scheme is delivered properly and benefits the targeted group.

To promote the utilisation of GSP requires cooperation and synergism efforts between the preference-granting country and the beneficiary country. The UNCTAD resolution 96 (IV) 1976 mentioned additional measures to increase utilisation of preferences, as follows:

“[...] efforts should be made by all preference granting countries and beneficiary countries to increase, as much as possible, the degree of utilisation of the different schemes of generalised preferences by all appropriate means [...]”⁶¹⁸

Indonesia as the beneficiary of GSP in which 40% of its total import to the EU is qualified under the GSP scheme. In addition, EU 27 is the fourth major trade partner and second biggest major export partner for Indonesia.⁶¹⁹ EU GSP is an opportunity for Indonesian traders to strengthen their competitiveness and penetrate EU market access. Capturing such opportunity, the Government of Indonesia has built up policies to increase utilisation of GSP. Some commitments have been issued by the Government of Indonesia to boost export performance through enacting laws and regulations that facilitate foreign trade. On 12 July 2012, the Policy Analysis and Development Agency of Indonesia’s Ministry Foreign Affairs held the Forum of Foreign Policy Studies on “trade facilitation priorities in Indonesia”. This forum involved the Ministry of Trade, Directorate General of Customs, INSW Agency, the business community and academicians. The government of Indonesia expressed its commitment to improve competitiveness and accelerate integration of Indonesia in the global value chain (global value chains), through reforming some regulations related to foreign trade. Law and policy reforms on foreign trade have the purpose to enhance related public services on foreign trade that involve related line ministries and various government agencies. The set of regulations on establishing INSW is a serious commitment of the government of Indonesia to increase utilisation of the generalised system of preferences. More specifically those commitments have been implemented in some concrete steps, as follows:

1. Service reforms in particular export trade through Inatrade.
2. Optimising the utilisation of granting preferences such as GSP via e-SKA that can be accessed more easily, quickly, and have a wider range.
3. Export-import licensing system integration with line ministries such as customs, ministry of health, and the ministry of agriculture.
4. Delegation of authority on foreign trade from the centre to the regions in the framework of regional autonomy.

⁶¹⁸ See Commentaries on the ILC’s Draft Articles, 1978, *Op. Cit.*, p. 64.

⁶¹⁹ Cited from EU Trade Statistic, available at : http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113391.pdf, last accessed : 15 June 2012.

5. Improved skills and knowledge through training exporters.
6. Socialisation of e-government services related to export-import Inatrade, e-ska, and INSW.
7. Dissemination and dissemination of information about exports and imports.
8. Bureaucratic reform trade with the implementation of e-Government, human resource capacity building and advocacy exporter.
9. Communication between the central and local governments.
10. Bilateral communication between Indonesia and the EU.

In the regard of advocacy, the Ministry of Trade of the Government of Indonesia gives assistantship and/or advocacy on export difficulties faced by exporters. For instance, legal aid is given to help exporters deal with the problems occurred related to the rules and regulations and administrative procedures. To avoid trade fraud the Indonesian government, through its line ministries and agencies, controls and monitors the issuance and usage of certificates of origin. Strengthening coordination between central government and regional government to avoid the overlap of authority and reducing barriers to trade due to the decentralisation of authorities. The government of Indonesia promotes the enhancement of export competitiveness through export facilitation, export diversification, the strengthening of export product quality, trade promotion, trade diplomacy, and trade defence.

Trade facilitation plays a strategic role in increasing export performance through the integration and automation of the formalities and procedures of foreign trade. Therefore, the Indonesian Ministry of Trade has developed online electronic trade services, which are integrated in the web-portal called "Inatrade". As mentioned above, Inatrade is an e-trade service providing e-licensing of exports-imports. It is integrated into the Indonesia National Single Windows (INSW) at national level and ASEAN Single Window (ASW) at regional level. Broadly, the Single Window system is built to improve efficiency in trade through the acceleration of good flows, validity and real-time data transaction. With regard to supporting such system, the Indonesian Ministry of Trade established the Trade Service Unit in which services are manually carried out on the "single entry and single exit point" without direct face to face meeting between applicants (traders) and authority officials. The establishment of the Trade Service Unit aimed to provide trade services that were more predictable, transparent, efficient, and in order (good trade governance).

In order to develop export growth, the government of Indonesia focuses its efforts to increase diversification on export commodities and export market diversification. The Government of Indonesia stressed its programmes on the improvement of the human resource capacity of exporters, the enhancement of the web based enquiry system, market intelligence, and trade promotion. Improvement of market intelligence is deemed as the crucial tool to boost export performance by providing information on strategies of market penetration overseas.

International trade cooperation is directed to promote and to secure global market access, to secure trade policies, to enhance economic partnerships and strategic bilateral trade, to promote participation and leadership in multilateral and regional fora.

Indonesia's multilateral approach is directed to succeeding the Doha Development Agenda (DDA) that would benefit Indonesia, for instance increasing trade capacity building, securing national interests on agricultural and food security, and eliminating barriers to trade.

XI. Does the European Union's Generalised System of Preferences affect the implementation of good governance in Indonesia's foreign trade policies?

There are some key points that need to be noted in the rules and regulations of granting EU GSP, particularly related to trade facilitation, where it has a strong relation to optimising trade preference utilisation. EU GSP provides standards related to trade facilitation, and requires the beneficiary country to comply with such standards. Regarding the standards, the granting of tariff reduction under the EU GSP scheme is emphasised on the application of "trade governance". Application of trade governance is aimed to ensure that the goals of GSP are achieved properly. In this regard, the term "governance" refers to the requirement that needs to be complied by the beneficiary country to facilitate its utilisation of the GSP scheme by its traders.

According to Hall, trade should deliver prosperity not only to the "triumphant" traders or economic actors but also to economic development on the whole, thus, good governance must be applied to ensure such trade advantage is distributed properly for everyone. Therefore, good governance is in line with the Bentham theory on the utilitarian principle, where trade law and its policies must be directed for the happiness of the greatest number. In this regard, as written by Hall, GATT originally had a highly utilitarian purpose, as stated on the objectives to raise standards of living and to ensure full employment by "*developing the full use of the resources of the world*" and growing trade. Further it recognised the particular needs for a trading system to help increased development efforts of the poorer countries by noting "*that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development.*" Under WTO, trade has been rolled into one package as a tool to achieve sustainable development, boosting development in LDCs and recognising the different needs of countries at different stages of development.⁶²⁰

Borrowing the words from Hall, governance is defined as "*the mechanisms used to ensure that a system or regime advances smoothly and effectively towards the goal it has set for itself and can deal efficiently and justly with the issues that arise along the way*". Governance is functioned to ensure the system works properly, effectively and efficiently by attaining the objectives that have been set up. Good governance contains three essential elements, including transparency, participation, and accountability. Application of the transparency principle is crucial since open and up to date information is very important in doing business and in decision making. In the application of trade facilitation (INSW and ASW), the transparency principle plays a significant role in which "*people affected by decisions have timely access to accurate and up to date information on the issue, as well as information on the positions and proposals of the different parties*". Access of up to date information is necessary related to the GSP scheme given that it is characterised as unilateral preferences that might change at anytime. Participation is defined as the "*right to take part in the debate or decision making process links to the extent a stakeholder has interests at play or will be affected by the decisions*". In the case of GSP, participation and cooperation of the stakeholders and

⁶²⁰ See Jagdish Bhagwati, Arvind Panagariya, and T. N. Srinivasan, Lectures on International Trade, 2nd ed., Cambridge, MA: The MIT Press, 1998; Edward D. Mansfield and Brian M. Pollins, eds., Economic Interdependence and International Conflict: New Perspectives on an Enduring Debate, Ann Arbor: University of Michigan Press, 2003; Oli Brown et al., eds., Trade, Aid, and Security : An Agenda for Peace and Development, Sterling, VA: Earthscan, 2007; Robert O. Keohane and Joseph S. Nye, Power and Interdependence , 2nd ed., Glen-view, IL: Scott Foresman and Company, 1989. Box 14–1 draws on U.N. Economic and Social Commission for Asia and the Pacific, "What Is Good Governance?" at www.unescap.org, undated; see also Philippe Sands, Lawless World, Penguin Books, London, 2006, Chapter 1; Mark Halle, *New Approaches to Trade Governance; State of the World: Innovation for Sustainable Economy*, 25th Anniversary Edition, The Worldwatch Institute, 2008.

economic operators from the preference granting countries and beneficiary countries its common objectives need to be achieved.

Accountability is defined when *“decision makers and the regime itself are answerable for their actions, decisions, and compromises in terms of the stated goals and objectives as well as any statements and declarations they make about their actions and decisions”*. In the context of bureaucracy, the World Bank accountability is defined as a benchmark to ensure that actions and decisions taken by public officials are subject to oversight in order to guarantee that government initiatives meet their stated objectives and respond to the needs of the targeted community, by this means contributing to better governance and poverty reduction. In other words, every decision and action taken by the government and its officials must be measurable in accordance with the existing rules. According to the World Bank, accountability consists of two different stages, i.e., answerability and enforcement, different institutions of accountability might be in charge for one of these stages or both of these stages. Answerability refers to the obligation of the government, its agencies and public officials to provide information about their decisions and actions and to justify them to the public and those institutions of accountability tasked with providing oversight. Enforcement suggests that the public or the institution responsible for accountability can sanction the offending party or remedy the contravening behaviour.⁶²¹ In addition, Hall states that firm goals, objectives, and priorities are a foundation of good governance application.⁶²²

Compared to others GSP systems, according to the Directorate General Export and Import Facilitation Ministry of Trade, the EU GSP is more emphasised on trade governance in its procedures of granting trade preferences. For instance, related to the withdrawal of GSP, when the exporter from a beneficiary country allegedly conducts non-compliance to the regulation it will not directly be punished, but the EU authority will carry out communications then enquire by involving authorities in the beneficiary country. To enhance the EU GSP scheme modalities to be more predictable, transparent, and stable, therefore, trade governance should be applied to ensure goals of such preferences benefit the development of the beneficiary country. The implication of trade governance requires the beneficiary country to take some policies and measures in order to comply with the regulation so that it will boost exports to the EU market. The EU GSP regulation demands the government of beneficiary countries to implement good governance in export formalities and procedures, especially related to the issuing of certificates of origin.

The rules and regulation on GSP issued by the EU indirectly encourage the beneficiary countries to apply good governance principles in export formalities and procedure processes. This policy is aimed to drive the beneficiary to enhance its trade services and infrastructure.

⁶²¹ See Accountability of Governance, available at: <http://siteresources.worldbank.org/AccountabilityGovernance.pdf>.

⁶²² See Mark Halle, 2008.

CHAPTER VI

Conclusion

The EU GSP is designed by emphasising the implementation of good governance in formalities and procedure. This policy is applied to ensure that such norms are implemented properly within the GSP scheme. The EU GSP requires beneficiary countries to provide minimum trade facilitation standards. In the GSP regulation the good governance principle is not implied explicitly, however, there are some provisions that are related to formalities and procedures, which are the embodiment of good governance. For instance, the provisions that regulate fraud of rules of origin that requires beneficiary countries concern the provision of cooperation, investigation, and/or verification, the application of good governance implicitly applied during the process of decision making. The application of good governance in foreign trade formalities and procedures can gradually enhance trade governance in the beneficiary country, which is expected to produce boosts in exports. The EU GSP is designed to provide a more transparent, predictable and stable scheme.

ASEAN is the third largest trading partner of the EU and the EU is the second largest trading partner for ASEAN. Yet, this trade relationship is asymmetric, because ASEAN exports to the EU are larger than ASEAN imports from the EU. This has made the EU market play an important role for ASEAN exports. ASEAN is not included in any other PTA, therefore, GSP is the only trade preferential scheme granted by the EU to ASEAN member states. The GSP scheme is expected to help ASEAN export products compete in the “sensitive” and “semi-sensitive” EU market. Therefore, GSP has played an important role in its contribution to strengthen cooperation between the two regions. The Cooperation Agreement between the “Member Countries of ASEAN and European Community in 1980” is the cornerstone of ASEAN-EU cooperation, which laid down the fundamental basis of trade facilitations that is useful to help improve GSP implementation in ASEAN. The cumulative rules of origin provisions under the GSP scheme have been applied to ASEAN imported products since 1975. The cumulative origin has promoted trans-national export-oriented production within the regions to facilitate closer economic integration, particularly to attain a single market and production base. Cumulative origin is an opportunity to increase GSP utilisation among ASEAN countries. Restrictive rules on origin, low quota provisions, and high administrative costs incurred upon beneficiaries are identified as factors that have caused low utilisation of GSP. ASEAN demanded the EU to remove or relax its tariffs and NTB and to streamline its administrative procedures. ASEAN requested efficiency improvements and excessive bureaucracy reductions that were imposed on ASEAN’s export products.

Since its establishment, ASEAN has not intended to be a supranational organisation, therefore ASEAN has no “supranational institution”. ASEAN has evolved into a regional trade block through AFTA, which was finalised by the completion of the AEC. Many efforts have been made to improve ASEAN internal and external trade, either through agreements or through commitments between member states and/or third states. The implementation of the agreements and commitments into the national policies are member states’ sovereignty. ASEAN has made commitments to encourage the establishment of institutions of trade facilitation at the regional level. Yet those commitments are not easy to be fully

implemented due to the existence of economic development diversities and national policies among ASEAN member states. There are some points that need to be underlined as the challenges in the integration of ASEAN trade facilitation, which include:

1. Development of trade facilitation at the regional level has evolved slowly due to the difficulties to achieve a meeting of minds among the member states.
2. Issues on market intelligence and trade competition are very sensitive and potentially impede integration of the trade facilitation system into the regional system.
3. Disparities of economic development influence the capability of each member state to provide infrastructures on trade facilitation. To reduce the gap of such disparities ASEAN needs to set a minimum standard that should be provided by member states to support the single system.
4. A range of arrangements granted through the GSP scheme to ASEAN member states bring about differences on product coverage and depth of tariff cuts. In the near future, due to the amendment on the graduation mechanism provisions on the GSP proposal, the member states, which include upper-middle-income countries, will be excluded from the scheme. Thus, this may lead to disagreement on whether to hold onto the GSP scheme or start FTA negotiations.

For Indonesia, GSP has been placed as the prominent trade preference in the trade relationship with the European Union. EU GSP has been extended to Indonesia for almost 40 years, and it has undergone many enhancements along with changes of EU trade policies with developing countries, especially ASEAN countries. Likewise with Indonesia's trade facilitation policies, many changes have been made, which have been influenced by the policy of the regime in power. In spite of such facts, Indonesia currently continues to improve its trade facilitation services with the purpose to be able to participate in global competition. During economic crisis recovery, Indonesia made giant leaps, by transforming its centralised system into a decentralised system. Based on its character, the changes were very fast and drastic with some economist referring to this as the "big bang" phenomenon. The scope of decentralisation that has been implemented by Indonesia covers a wide range of areas as well as trade sectors.

Indonesia's decentralisation system is designed to enhance the role of local government in providing trade facilitation services, especially for local traders. Inherently, the basic idea behind the decentralisation system is to bring public service delivery closer to the customer (community). Red tape bureaucracy is also expected to be cut, as well as reducing transaction costs, increasing openness and transparency, and adherence of good governance principles in public services. On the other hand, decentralisation is considered as controversial because it has been done in haste and is not well prepared. Nowadays, decentralisation takes the blame because it increases the corruption of the local elite and creates more difficulties in bureaucracy.

Finally, this study suggests recommendations for the stakeholders in ASEAN to strengthen regional trade facilitations in order to increase ASEAN external trade with the EU, especially to encourage the maximum utilisation of EU GSP by ASEAN member countries. For the acceleration of ASW into full operation, more communications, coordination, and information dissemination among member states are required. These keys areas could help ASEAN member states become aware of their potential size,

especially in the cumulative of origin in which ATIGA provides facilitation of common preferential trade until zero tariffs.

This study provides some recommendations for the Government of Indonesia to maximise utilisation of the EU GSP facility. First, related to local autonomy, in this regard, the Indonesian government needs to strengthen harmonisation rules and regulations to avoid any bureaucratic difficulties that lead to high cost transactions by traders. Second, the Government of Indonesia needs to promote the implementation of good governance in foreign trade services through single window services with wider access across the country. It is important to establish communication and cooperation with related institutions of the EU in assisting and advocating traders to utilise GSP properly. In addition, dissemination of information on the GSP benefits traders and stakeholders and is important to encourage them to utilise such facility in their exports. In anticipation of the application of Regulation (EU) No. 978/2012 by 1 January 2014, the Government of Indonesia has to prepare its institutions and economic operators, through information dissemination, improvement of good governance in foreign trade services, the strengthening of its export product competitiveness and improvement of its infrastructures.

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