# THE DEGENERALIZATION OF THE GENERALIZED SYSTEM OF PREFERENCES (GSP): QUESTIONING THE LEGITIMACY OF THE U.S. GSP

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## INTRODUCTION

In recent years, developing countries have expressed increasing frustration with their status in the international trade regime. The Doha Round of World Trade Organization (WTO) negotiations notoriously collapsed in September 2003 amidst developing-country dissatisfaction with proposed access to developed-country markets.[1] So, too, developing countries have criticized WTO rulings allowing developed countries to impose import restrictions based on environmental considerations.[2] Most recently, India challenged the



1. Stephen J. Glain, *For Poor Nations, a Pyrrhic Victory—Economists Say Show of Strength at WTO Summit Will Hurt in End*, BOSTON GLOBE, Sept. 16, 2003, at Fl. The WTO does not define "developing" or "developed country," and countries may choose to define themselves as one or the other. WTO, Who Are the Developing Countries in the WTO?, *at* http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm (last visited Mar. 6, 2005) (on file with the *Duke Law Journal*). However, international law commentators broadly define "developed countries" as the members of the Organization for Economic Cooperation and Development (OECD). *See, e.g.*, Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1338 (1996). "Developing" countries are, by default, all countries not part of the group of "developed" countries. *E.g.*, Andrew Guzman & Beth A. Simmons, *To Settle or Empanel? An Empirical Analysis of Litigation and Settlement at the World Trade Organization*, 31 J. LEGAL STUD. S205 app. C at S235 (2002). In contrast, "least-developed countries" are explicitly recognized as such by the United Nations. WTO, Least-Developed Countries, *at* http://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm (last visited Mar. 6, 2005) (on file with the *Duke Law Journal*).

2. *See* Donald McRae, *Trade and the Environment: Competition, Cooperation or Confusion?*, 41 ALTA. L. REV. 745, 757 (2003) (noting developing-country suspicion of developed countries' environmental concerns after the *Shrimp-Turtle* ruling, WTO Appellate Body Report on United States—Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R (Oct. 12, 1998), *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/58ABR.DOC, which authorized the United States to restrict the importation of shrimp harvested without adequate protections for sea turtles).

European Communities' (EC's) Generalized System of Preferences (GSP),[3] through which the EC offers preferential market access to the exports of developing countries. The international GSP framework, premised on the belief that preferential tariffs encourage export growth and facilitate economic development,[4] authorizes developed WTO members to provide developing countries with tariffs lower than the tariffs provided to other developed nations. As such, the GSP is the primary vehicle by which developed countries have implemented their commitment to "special and differential treatment" for developing countries.[5]

Over the course of the GSP's thirty-year existence, both developing countries and scholars have lamented developed-country efforts, especially the efforts of the United States, to differentiate among developing countries in granting GSP benefits.[6] Scholars contend that the threat of removal or reduction of GSP benefits eviscerates the very purpose of the GSP—providing incentives for

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3. WTO Appellate Body Report on European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/AB/R (Apr. 7, 2004) [hereinafter *EC—GSP Appellate Body Report*], *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/246ABR.doc.

4. *See* Abdulqawi A. Yusuf, *"Differential and More Favourable Treatment": The GATT Enabling Clause*, 14 J. WORLD TRADE L. 488, 492–93 (1980) (justifying the GSP on economic grounds).

5. "Special and differential treatment" is a cornerstone of the ongoing round of multilateral trade negotiations. *See* WTO, Doha Ministerial Declaration, WT/MIN(01)/DEC/1, para. 44 (Nov. 14, 2001) ("We reaffirm that provisions for special and differential treatment are an integral part of the WTO Agreements."), *available at* http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm.

6. *See, e.g.*, FRANK J. GARCIA, TRADE, INEQUALITY, AND JUSTICE: TOWARD A LIBERAL THEORY OF JUST TRADE 156–68 (2003) (concluding that egalitarian fairness principles, such as Rawls's "justice as fairness," oblige developed countries to provide unconditional and nonexclusive trade preferences to developing countries); ÇAGLAR ÖZDEN & ERIC REINHARDT, THE PERVERSITY OF PREFERENCES: GSP AND DEVELOPING COUNTRY TRADE POLICIES, 1976–2000, at 21 (World Bank Policy Research Working Paper No. 2955, 2003) (noting that the "political process leading to GSP decisions" prevents developing countries from building their export sectors for fear that preferences will be removed), *available at* http://econ.worldbank.org/files/23188_wps2955.pdf; Frank J. Garcia, *Trade and Inequality: Economic Justice and the Developing World*, 21 MICH. J. INT'L L. 975, 1033 (2000) (contending that it is morally unjustifiable for developed countries to terminate GSP preferences for political reasons); 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*, 4 CHI. J. INT'L L. 385, 395 (2003) (noting "persistent concern by developing countries about conditionality and selectivity in GSP schemes"); Peter Lichtenbaum, *"Special Treatment" vs. "Equal Participation:" Striking a Balance in the Doha Negotiations*, 17 AM. U. INT'L L. REV. 1003, 1015–16 (2002) (highlighting the detrimental effects of conditionality in the U.S. GSP).

developing countries to invest in industrial capacity.[7] Likewise, developing countries point to the obvious economic consequences of differentiation among GSP recipients; India's recent challenge to the EC's scheme was prompted by the $300 million that its exporters were allegedly losing annually because of the EC's more favorable GSP treatment for Pakistan.[8] Until recently, these criticisms fell on deaf ears, partly because developing countries did not dare officially challenge GSP schemes[9] and partly because developed countries firmly believed that differentiation was permissible.[10]

Much of the criticism of GSP schemes has focused on the U.S. GSP, which is the most conditional—and hence controversial—of any scheme. Differentiation in the U.S. GSP takes three forms: one, the United States provides more favorable preferences to groups of developing countries;[11] two, it withdraws GSP preferences entirely if developing countries fail to meet certain conditions;[12] and, three, it "graduates" beneficiaries from its GSP when those countries are sufficiently competitive.[13] In a recent ruling on the EC's GSP scheme,

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7. *See* GARCIA, *supra* note 6, at 157 ("[GSP] programs . . . are subject to periodic renewal, and within each program the beneficiaries must continually re-qualify for the preferences. This creates problems for business and investment planners on both sides of the preference."); ÖZDEN & REINHARDT, *supra* note 6, at 21 ("Since 'he who giveth may taketh away,' the non-guaranteed nature of GSP Preferences prevents the recipients from fully focusing on their export sectors.").

8. *See* MISSION OF INDIA TO THE EUROPEAN UNION, MONTHLY ECONOMIC REPORT FOR JANUARY, 2003, at 10 (2003) ("Pakistan's inclusion in the scheme costs India over $300 million a year in lost trade . . . ."), *available at* http://www.cii-eu.org/ecreports/jan2003.pdf.

9. *See* Kyle Bagwell et al., *The Boundaries of the WTO: It's a Question of Market Access*, 96 AM. J. INT'L L. 56, 71 (2002) (speculating that developing countries refrained from challenging GSP schemes to stay "on good terms" with donors).

10. *See* Robert Howse, *Back to Court After* Shrimp/Turtle*? Almost but Not Quite Yet: India's Short Lived Challenge to Labor and Environmental Exceptions in the European Union's Generalized System of Preferences*, 18 AM. U. INT'L L. REV. 1333, 1335 (2003) ("[I]t was . . . conventional wisdom that conditions . . . could be placed on voluntary and non-binding preferences granted to developing countries under the Generalized System of Preferences . . . .").

11. *See, e.g.*, 19 U.S.C. § 2466a (2000) (providing additional GSP benefits for eligible sub-Saharan African countries); *see also* Council Regulation 2501/2001, art. 10, 2001 O.J. (L 346) 1, 5 (authorizing additional GSP preferences for twelve countries participating in the EC's special arrangements to combat drug production and trafficking).

12. *See, e.g.*, 19 U.S.C. § 2462(b)(2)(A) (prohibiting the granting of U.S. GSP preferences to some Communist countries); *see also* Council Regulation 2501/2001, *supra* note 11, art. 26.1(c), 2001 O.J. (L 346) at 9 (withdrawing, on a temporary basis, preferences from countries failing to protect certain labor standards).

13. *See, e.g.*, 19 U.S.C. § 2462(e) (requiring the withdrawal of GSP benefits from countries that the World Bank designates as "high income" countries); *see also* Council Regulation

the WTO Appellate Body questioned the legitimacy of the first form of differentiation, concluding that developed countries may not discriminatorily provide additional GSP preferences to some GSP beneficiaries.[14] Although the Appellate Body did not rule on the remaining two types of differentiation—complete withdrawal of beneficiary status on the basis of certain conditions and the graduation of competitive beneficiaries—its reasoning nonetheless sheds light on the legitimacy of these types of differentiation in the U.S. GSP.

This Note develops the Appellate Body's reasoning with respect to all three types of differentiation in the U.S. GSP. From this reasoning, the Note derives a framework under which graduation and some conditionality mechanisms in the U.S. scheme are probably legitimate, whereas other conditionality mechanisms and discriminatory regional schemes are probably not. Part I describes the legislative history of the GSP system, focusing on the relevant legal instruments established in the United Nations Conference on Trade and Development (UNCTAD) and the General Agreement on Tariffs and Trade (GATT).[15] Part II outlines the U.S. GSP, emphasizing the mechanisms by which it provides additional preferences to regional groups, withdraws preferences entirely if countries fail to comply with certain conditions, and graduates recipients. Part III then summarizes the recent Appellate Body Report. Finally, Part IV proposes a framework for analyzing the legitimacy of regional preferences, conditionality, and graduation in the U.S. GSP.

## I. THE GENERALIZED SYSTEM OF PREFERENCES IN UNCTAD, THE GATT, AND THE WTO

The GATT international trade framework was founded on the twin pillars of nondiscrimination and reciprocity.[16] The cornerstone of

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2501/2001, *supra* note 11, art. 3, 2001 O.J. (L 346) at 2–3 (removing GSP eligibility in the EC scheme on the basis of World Bank classification and certain calculations).

14. *EC—GSP Appellate Body Report*, *supra* note 3, para. 190.

15. The GATT is the predecessor organization to the WTO, which was established in 1994. *See* Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS—THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1994), 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement] (establishing a new multilateral trading system encompassing the GATT).

16. *See* General Agreement on Tariffs and Trade, Oct. 30, 1947, pmbl., 61 Stat. A-11, A-11, 55 U.N.T.S. 194, 196 [hereinafter GATT] (expressing the founding governments' desire to

the nondiscrimination principle is the Most-Favored-Nation (MFN) Clause of Article I:1 of the 1947 GATT Agreement, which mandates that all advantages granted to one country "be accorded immediately and unconditionally" to like products from other countries.[17] Despite the fundamental importance of Article I:1 to the GATT framework, the GATT members deviated from its requirements soon after the founding of the GATT[18] to provide special and differential treatment to developing countries.

Special and differential treatment, which WTO members have recognized as a key principle of international trade,[19] alters the foundational requirements of reciprocity and nondiscrimination for developing countries. On the one hand, developed countries have recognized that they "do not expect reciprocity for [tariff] commitments made by them in trade negotiations" with developing countries.[20] On the other hand, through the GSP, developed countries may favor developing countries in extending tariff preferences—that is, they may charge lower tariffs on imports from developing countries—notwithstanding the MFN obligation of Article I:1.[21] This Part outlines the evolution of the GSP and the legal instruments governing its implementation.

### *A. Origins of the Generalized System of Preferences*

In the 1960s, developing countries began advocating the establishment of a system of preferential tariffs to promote the development of infant industries in developing countries.[22] Because

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"enter[] into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce").

17. *Id.* art. I:1.

18. Lichtenbaum, *supra* note 6, at 1007.

19. *See* WTO Agreement pmbl. ("T]here is need for positive efforts designed to ensure that developing countries . . . secure a share in the growth in international trade commensurate with the needs of their economic development.").

20. GATT art. XXXVI:8. Article XXXVI was added to the GATT in 1965. Protocol Amending the General Agreement on Tariffs and Trade to Introduce a Part IV on Trade and Development, Feb. 8, 1965, 17 U.S.T. 1977, 572 U.N.T.S. 320.

21. Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries, Nov. 28. 1979, para. 1, GATT B.I.S.D. (26th Supp.) at 203, 203 (1980) [hereinafter Enabling Clause].

22. *See* Thomas R. Graham, *The U.S. Generalized System of Preferences for Developing Countries: International Innovation and the Art of the Possible*, 72 AM. J. INT'L L. 513, 514–15 (1978) (describing the first proposal for such preferences from Raúl Prebisch, Secretary General of UNCTAD).

developing-country markets were too small to support the development of manufacturing industries, these countries clamored for temporary preferential access to developed markets to nurture such industries.[23] At the First Session of UNCTAD in 1964, developed countries, led by the United States, opposed developing-country initiatives in support of such preferences.[24] By UNCTAD's Second Session (UNCTAD II) in 1968, however, the developed countries, including the United States, came to support the general principle of a system of preferences but did not agree on its details.[25] The UNCTAD II participants adopted Resolution 21(II), recognizing "unanimous agreement in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences which would be beneficial to the developing countries."[26] The Resolution established a Special Committee on Preferences to work out the details of this system.[27]

In the Special Committee, developed and developing countries negotiated the details of unilateral GSP schemes proposed by individual developed countries.[28] In 1970, the Committee adopted the Agreed Conclusions, confirming that the proposed schemes, as revised during the negotiations, were "mutually acceptable" to both

23. Anthony N. Cole, Note, *Labor Standards and the Generalized System of Preferences: The European Labor Incentives*, 25 MICH. J. INT'L L. 179, 188 (2003).

24. *See* Kelé Onyejekwe, *International Law of Trade Preferences: Emanations from the European Union and the United States*, 26 ST. MARY'S L.J. 425, 448 (1994) (describing developed-country opposition to the developing world's arguments for the establishment of preferential tariffs); Graham, *supra* note 22, at 516 (highlighting the United States' role in this opposition).

25. Onyejekwe, *supra* note 24, at 449. Two factors prompted the United States to support the concept of the GSP. One, it was facing increasing pressure from the Latin American countries to implement a preferential system similar to that of the EC. Graham, *supra* note 22, at 516. Two, it "saw in the GSP an opportunity to halt the trend towards cartelization of world trade through exclusive preferential arrangements." *Id.* at 516–17.

26. *Report of the United Nations Conference on Trade and Development on Its Second Session*, U.N. TDBOR, 2d Sess., Annex 1, Agenda Item 11, at 38, U.N. Doc. TD/97/Annexes (1968), *reprinted in* WTO Panel Report on European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/R (Dec. 1, 2003) [hereinafter *EC—GSP Panel Report*], *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/246R-00.doc, annex D-3, *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/246R-04.doc.

27. *Id.* para. 2.

28. For an overview of the content of the initial submissions, see generally R. Krishnamurti, *Tariff Preferences in Favour of Developing Countries*, 4 J. WORLD TRADE L. 447 (1970).

developed and developing countries.[29] The Agreed Conclusions also affirmed the legitimacy of several key principles of the schemes. First, they expressed the consensus that "all developing countries should participate as beneficiaries from the outset,"[30] with beneficiary status determined according to the principle of self-election.[31] Second, the Conclusions explicitly permitted a priori limitations on the quantity of goods that could be imported through the GSP.[32] Finally, the Conclusions acknowledged the temporary, nonbinding nature of the tariff preferences and conditioned the establishment of the system on obtaining the necessary GATT waivers.[33]

### *B. The 1971 Waiver Decision*

In 1971, the GATT members waived the MFN requirement for ten years "to the extent necessary to permit developed contracting parties . . . to accord preferential tariff treatment to products originating in developing countries . . . with a view to extending to such countries and territories generally the preferential tariff treatment referred to in the Preamble to this Decision."[34] The preamble described such tariff treatment as "a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries" as agreed to at UNCTAD II.[35] The preamble also recognized that the granting of tariff preferences was not a binding commitment on the part of the developed countries.[36]

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29. *Agreed Conclusions of the Special Committee on Preferences*, U.N. TDBOR, 4th Sess., 267th mtg., Annex 1, para. I.9, U.N. Doc. TD/B/330 (1970) [hereinafter Agreed Conclusions], *reprinted in* 10 I.L.M. 1083, 1084 (1971).

30. *Id.* para. II.1.

31. *Id.* para. IV.1. The principle of self-election means simply that countries will elect to be deemed "developing" for purposes of receiving GSP benefits. Onyejekwe, *supra* note 24, at 457. The principle assumes that countries will not make such an election without bona fide grounds for doing so. *Id*.

32. Agreed Conclusions, *supra* note 29, paras. III.1–4.

33. *Id.* para. IX.2.

34. Waiver Decision on the Generalized System of Preferences, June 25, 1971, GATT B.I.S.D. (18th Supp.) at 24 (1972) [hereinafter 1971 Waiver]. The waiver is generally understood to rest on GATT Article XXV:5, which authorizes waivers "[i]n exceptional circumstances," even though the waiver does not explicitly refer to this article. *See, e.g.*, Lorand Bartels, *The WTO Enabling Clause and Positive Conditionality in the European Community's GSP Program*, 6 J. INT'L ECON. L. 507, 512 (2003) (discussing the adoption of the 1971 waiver); Yusuf, *supra* note 4, at 491 (same).

35. 1971 Waiver, *supra* note 34, pmbl.

36. *Id*.

### *C. The Enabling Clause*

Faced with the upcoming expiry of the ten-year waiver, in 1979 the GATT members adopted the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (Enabling Clause).[37] The Enabling Clause permits preferential treatment for developing countries "[n]otwithstanding the provisions of Article I of the General Agreement."[38]

The central provision of the Enabling Clause is paragraph 2(a), which expressly authorizes the provision of tariff preferences to developing countries "as described in [the 1971 waiver], relating to the establishment of 'generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries.'"[39] This reference to the 1971 waiver, contained in footnote three, directly links the Enabling Clause to the GSP system initiated at UNCTAD II.[40] The Enabling Clause also authorizes several other types of preferential treatment, such as regional arrangements among developing countries to reduce tariffs,[41] special treatment for the least-developed countries,[42] and nontariff measures governed by instruments negotiated under the GATT.[43]

Several additional provisions of the Enabling Clause clarify the obligations of both developed and developing countries participating

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37. Enabling Clause, *supra* note 21.

38. *Id.* para. 1.

39. *Id.* para. 2(a) n.3.

40. Until the recent Appellate Body decision, *see supra* note 3, this linkage had fueled scholarly debate as to whether the 1971 waiver's preamble imposed binding conditions on GSP schemes. At least one commentator reasoned that footnote three's reference was merely aspirational. *See* Howse, *supra* note 10, at 1352–53 (interpreting the conditions as nonbinding); Howse, *supra* note 6, at 394 (same). In contrast, other commentators concluded that it was binding. *See, e.g.*, Bartels, *supra* note 34, at 520 (arguing that, although the preamble to the 1971 waiver was aspirational, the Enabling Clause converted these aspirational conditions into binding requirements); William J. Davey & Joost Pauwelyn, *MFN Conditionality: 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"*, *in* REGULATORY BARRIERS AND THE PRINCIPLE OF NON-DISCRIMINATION IN WORLD TRADE LAW 13, 24–25 (Thomas Cottier & Petros C. Mavroidis eds., 2000) (noting disagreement as to the nature of these conditions but pointing to the preamble of the 1971 waiver as an indication that they were binding); Yusuf, *supra* note 4, at 495 (asserting that developed countries offering preferences could neither discriminate among developing states nor demand reciprocal concessions).

41. Enabling Clause, *supra* note 21, para. 2(c).

42. *Id.* para. 2(d).

43. *Id.* para. 2(b).

in GSP schemes. Paragraph 3(c) requires that preferential treatment for developing countries "be designed . . . to respond positively to the development, financial and trade needs of developing countries."[44] Similarly, developed countries may not seek concessions inconsistent with the needs of developing countries[45] and may not use preferences "to create undue difficulties for the trade of any other contracting parties."[46] In contrast, as their economies develop, developing countries are expected to "participate more fully in the framework of rights and obligations under the General Agreement."[47]

## II. THE U.S. GENERALIZED SYSTEM OF PREFERENCES

As of 2002, sixteen countries had implemented GSP schemes.[48] The U.S. GSP was enacted in the 1974 Trade Act, which authorizes the president to eliminate tariffs on imports from eligible developing countries.[49] In designating eligible products and countries, the president is to consider four overarching factors: the anticipated effect on the economic development of the country in question, the extent to which other developed countries are granting such preferences, the impact on U.S. producers of like products, and the competitiveness of the beneficiary country.[50]

The U.S. scheme limits the products eligible for GSP treatment. In 2000, only 47 percent of imports from GSP beneficiary countries received preferential access under the GSP.[51] All eligible articles receive duty-free access,[52] but certain import-sensitive products, such

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44. *Id.* para. 3(c).

45. *Id.* para. 5.

46. *Id.* para. 3(a).

47. *Id.* para. 7. Commentators argue that this provision justifies the "graduation" of high-income developing countries from GSP schemes. *See, e.g.*, JOSEPH A. MCMAHON, AGRICULTURAL TRADE, PROTECTIONISM AND THE PROBLEMS OF DEVELOPMENT: A LEGAL PERSPECTIVE 129–30 (1992). For examples of graduation mechanisms in GSP schemes, see *infra* note 92 and accompanying text.

48. The sixteen countries are Australia, Belarus, Bulgaria, Canada, the Czech Republic, the EC, Hungary, Japan, New Zealand, Norway, Poland, the Russian Federation, the Slovak Republic, Switzerland, Turkey, and the United States. U.N. Conference on Trade & Dev., About GSP, *at* http://www.unctad.org/Templates/Page.asp?intItemID=2309&lang=1 (last visited Mar. 6, 2005) (on file with the *Duke Law Journal*).

49. Trade Act of 1974, Pub. L. No. 93-618, §§ 501–505, 88 Stat. 1978, 2066–71 (1974) (codified as amended at 19 U.S.C. §§ 2461–2467 (2000)). For a detailed discussion of the enactment of the U.S. GSP, see generally Graham, *supra* note 22.

50. 19 U.S.C. § 2461 (2000).

51. ÖZDEN & REINHARDT, *supra* note 6, at 5.

52. 19 U.S.C. § 2461.

as some textiles, watches, footwear, and certain electronic, steel, and glass products, are excluded from eligibility.[53] Furthermore, the Trade Act imposes "competitive need limitations" that effectively serve as quotas, cutting off preferential treatment when a beneficiary's annual exports of a product reach a predetermined level.[54]

The three main forms of differentiation—the provision of additional preferences to regional groups of beneficiaries, the withdrawal of preferences on the basis of certain criteria, and the "graduation" of competitive countries—are prominent in the U.S. scheme. This Part explores the mechanisms by which the U.S. GSP implements each type of differentiation.

### *A. Regional Preferences*

The U.S. GSP provides additional preferences to some recipients primarily by means of three regional programs: the Caribbean Basin Initiative (CBI),[55] the Andean Trade Preference Act (ATPA),[56] and the African Growth and Opportunity Act (AGOA).[57] All three programs provide duty-free access for some products that are excluded from the general GSP scheme.[58] CBI, which is limited to twenty-seven beneficiary countries,[59] attempts to achieve a "stable

53. *Id*. § 2463(b)(1). In contrast, the EC scheme provides duty-free access to nonsensitive imports and a reduction in tariff rates to some import-sensitive products. Council Regulation 2501/2001, *supra* note 11, art. 7.1–.2, 2001 O.J. (L 346) at 3.

54. 19 U.S.C. § 2463(c)(2). Competitive need limitations may be waived to further national economic interests or to maintain "a historical preferential trade relationship" between the United States and a beneficiary country. *Id.* § 2463(d). These limitations implement the a priori limitations agreed to in the Agreed Conclusions. *See supra* note 32 and accompanying text.

55. Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, §§ 201–231, 97 Stat. 369, 384–98 (1983) (codified as amended in scattered sections of 19 U.S.C., 26 U.S.C., and 33 U.S.C.).

56. Andean Trade Preference Act, Pub. L. No. 102-182, §§ 201–208, 105 Stat. 1233, 1236–44 (1991) (codified as amended at 19 U.S.C. §§ 3201–3206 (2000)).

57. African Growth and Opportunity Act, Pub. L. No. 106-200, §§ 101–131, 114 Stat. 251, 252–75 (2000) (codified as amended at 19 U.S.C. §§ 2466a, 3701–3741 (2000)). For criticism of all three regional preference programs, see generally GARCIA, *supra* note 6, at 162–65.

58. *See* 19 U.S.C. § 2466a(b)(1) (authorizing duty-free access for products excluded under the general GSP scheme so long as they are not import-sensitive when imported from sub-Saharan Africa); *id*. § 2703 (authorizing duty-free access for all Caribbean products other than certain textiles, footwear, tuna, petroleum, watches, and leather goods); *id.* § 3203(b)(1) (permitting duty-free access for, *inter alia*, footwear, petroleum, watches, and handbags from the Andean countries).

59. *Id.* § 2702.

political and economic climate in the Caribbean region."[60] ATPA's purpose is more narrow—to "creat[e] viable alternatives to illicit trade in coca"[61]—but, like CBI, its preferences are available to only a select group of countries: Bolivia, Ecuador, Colombia, and Peru.[62] AGOA trade preferences, which aim to promote "stable and sustainable economic growth and development in sub-Saharan Africa,"[63] are available to forty-eight African countries.[64] The United States obtained waivers of its GATT obligations for the CBI[65] and ATPA programs,[66] but the waiver for ATPA expired in 2001.[67] No waiver has been approved for AGOA.[68]

In addition, the United States favors the least-developed countries, which receive duty-free access for an additional 1770 articles excluded under the general scheme[69] and are exempt from competitive need limitations.[70] The Enabling Clause permits such special treatment for the least-developed countries.[71]

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60. Caribbean Basin Economic Recovery Expansion Act of 1990, Pub. L. No. 101-382, § 202, 104 Stat. 655, 655 (1990).

61. Andean Trade Promotion and Drug Eradication Act, Pub. L. No. 107-210, § 3102, 116 Stat. 1023, 1023 (2002).

62. 19 U.S.C. § 3202(b)(1).

63. *Id.* § 3701(a).

64. *Id.* § 3706.

65. WTO, Caribbean Basin Economic Recovery Act—Renewal of Waiver, WT/L/104 (Nov. 24, 1995), *available at* http://docsonline.wto.org/DDFDocuments/t/WT/L/104.WPF.

66. WTO, United States-Andean Trade Preference Act—Decision of 14 October 1996, WT/L/184 (Oct. 14, 1996), *available at* http://docsonline.wto.org/DDFDocuments/t/WT/L/184.WPF.

67. *See id.* para. 1 (extending the waiver until December 4, 2001).

68. *See EC—GSP Panel Report*, *supra* note 26, annex E (listing all waivers that the WTO had approved before the EC-India Panel ruling), *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/246R-05.doc.

69. OFFICE OF THE U.S. TRADE REPRESENTATIVE, U.S. GENERALIZED SYSTEM OF PREFERENCES GUIDEBOOK 1 (1999), *available at* http://www.ustr.gov/assets/Trade_Development/Preference_Programs/GSP/asset_upload_file333_5430.pdf; *see also* 19 U.S.C. § 2463(a)(l)(B) (authorizing duty-free access for products from least-developed countries that are ineligible for such treatment under the general scheme).

70. 19 U.S.C. § 2463(c)(2)(D).

71. *See* Enabling Clause, *supra* note 21, para. 2(d) (permitting "[s]pecial treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries").

### *B. Conditionality*

All GSP schemes condition preferences to some degree[72] in the form of either "positive" or "negative" conditionality. Positive conditionality is the practice of granting additional concessions to developing countries that fulfill prescribed criteria;[73] positive conditionality affects preferences offered to countries that are already GSP beneficiaries. For instance, the EC provides additional reductions in GSP tariffs to countries that take prescribed legislative steps to protect fundamental labor rights.[74] 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.[75] As such, negative conditionality affects the designation of beneficiary status.

The U.S. GSP, which has received the most ardent criticism,[76] primarily employs negative conditionality; instead of granting additional preferences to specific developing countries, it withdraws GSP preferences from countries that do not meet certain conditions. Some conditions trigger mandatory withdrawal or denial of GSP benefits,[77] whereas others are discretionary factors for consideration in determining beneficiary status.[78] The conditions generally fall into three overarching categories: (1) political conditions, (2) human rights conditions, and (3) conditions related to U.S. economic interests.

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72. *See* Howse, *supra* note 10, at 1359 ("All GSP schemes contain elements of selectivity and conditionality . . . .").

73. Diego J. Linan Nogueras & Luis M. Hinojosa Martinez, *Human Rights Conditionality in the External Trade of the European Union: Legal and Legitimacy Problems*, 7 COLUM. J. EUR. L. 307, 309 (2001).

74. Council Regulation 2501/2001, *supra* note 11, arts. 8.1(a), 14–20, 2001 O.J. (L 346) at 4, 6–7.

75. *See* Linan Nogueras & Hinojosa Martinez, *supra* note 73, at 309 (analyzing human rights conditionality in EC trade practice); *see, e.g.*, 19 U.S.C. § 2462(b)(2)(A) (prohibiting U.S. GSP preferences for some Communist countries); Council Regulation 2501/2001, *supra* note 11, art. 26.1(c), 2001 O.J. (L 346) at 9 (allowing the temporary withdrawal of preferences from countries that fail to protect certain labor standards).

76. *See* MCMAHON, *supra* note 47, at 142 ("The most controversial approach to beneficiary selection has been taken by the United States."); *see, e.g.*, ÖZDEN & REINHARDT, *supra* note 6 (criticizing the U.S. GSP).

77. *See* 19 U.S.C. § 2462(b)(2) ("The President shall not designate any country a beneficiary developing country . . . if any of the following applies . . . .").

78. *See id.* § 2462(c) ("In determining whether to designate any country as a beneficiary developing country . . . the President shall take into account . . . .").

Political conditions prohibit granting GSP treatment to countries that are Communist,[79] belong to a commodity cartel,[80] or aid terrorists or fail to support U.S. efforts to combat terrorism.[81] The human rights conditions exclusively concern labor standards; countries that fail to afford internationally recognized worker rights or to eliminate the worst forms of child labor are ineligible for GSP benefits.[82] "Internationally recognized worker rights" include the right of association, the right to organize and bargain collectively, the prohibition of forced labor, a minimum age for the employment of children, and the maintenance of acceptable work conditions.[83] The International Labor Organization (ILO) has recognized all but the maintenance of acceptable work conditions as "fundamental."[84]

A country's failure to protect the economic interests of U.S. exporters or investors may trigger mandatory or discretionary withdrawal of GSP benefits. For example, countries that provide preferential access to products of another developed country are ineligible for GSP treatment.[85] Additionally, GSP treatment may be withdrawn on a discretionary basis because of unfair export practices,[86] the existence of trade-distorting investment measures,[87] or failure to protect intellectual property rights.[88] Countries are ineligible for preferential access if they nationalize property owned by U.S. citizens or entities without providing "prompt, adequate, and effective compensation,"[89] or if they fail to recognize or enforce arbitral awards favoring U.S. citizens or entities.[90]

79. *Id.* § 2462(b)(2)(A).
80. *Id.* § 2462(b)(2)(B).
81. *Id.* § 2462(b)(2)(F).
82. *Id.* § 2462(b)(2)(G)–(H).
83. *Id.* § 2467(4).
84. ILO Declaration on Fundamental Principles and Rights at Work, 86th Sess., para. 2 (June 18, 1998), 37 I.L.M. 1233, 1237 (1998) [hereinafter ILO Declaration].
85. 19 U.S.C. § 2462(b)(2)(C).
86. *Id.* § 2462(c)(4).
87. *Id.* § 2462(c)(6).
88. *Id.* § 2462(c)(5).
89. *Id.* § 2462(b)(2)(D).
90. *Id.* § 2462(b)(2)(E).

### *C. Graduation*

For purposes of GSP schemes, a country's status as "developing" is generally governed by the principle of self-election.[91] However, the U.S. GSP mandates the "graduation" of countries that have reached a certain level of development[92] on the theory that such countries no longer need preferential treatment to compete in developed markets.[93] The United States measures a country's level of development primarily by reference to World Bank calculations,[94] although it may also consider certain discretionary factors.[95]

## III. THE APPELLATE BODY REPORT: THE MEANING OF "NON-DISCRIMINATORY"

Despite longstanding dissatisfaction with aspects of many GSP schemes, until 2002 developing countries had refrained from challenging the schemes' validity.[96] The landscape changed dramatically when India requested the establishment of a panel to review the EC's GSP system.[97] Before the WTO Dispute Settlement

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91. *See* Onyejekwe, *supra* note 24, at 457 (noting developed-country agreement to the principle of self-election).

92. *See* 19 U.S.C. § 2462(e) ("graduating" countries that the World Bank has designated as "high-income" countries). By 2002, thirty-six countries had been graduated from the U.S. GSP. ÖZDEN & REINHARDT, *supra* note 6, at 5. The EC GSP, which graduates countries that have met certain requirements for three consecutive years, is another example of a mandatory graduation scheme. *See* Council Regulation 2501/2001, *supra* note 11, art. 3, 2001 O.J. (L 346) at 2–3.

93. *See* MCMAHON, *supra* note 47, at 129–30 (explaining that developed countries have read the Enabling Clause to permit the graduation of successful GSP beneficiaries).

94. 19 U.S.C. § 2462(e).

95. *See id.* § 2462(c) (allowing consideration of factors such as a country's desire to participate, a country's level of economic development, and a country's participation in other GSP schemes).

96. Bagwell et al., *supra* note 9, at 71.

97. Request for the Establishment of a Panel by India, European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/4 (Dec. 9, 2002), *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/246-4.doc; *see also* Request for Consultations by India, European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/l (Mar. l2, 2002) [hereinafter Request for Consultations by India], *available at* http://docsonline.wto.org/DDFDocuments/t/G/L/521.doc. India initially challenged not only the Drug Arrangements but also the special incentive arrangements for labor and the environment. *See* Request for Consultations by India, *supra*, paras. 1–2. India later limited its arguments to the Drug Arrangements. *EC—GSP Panel Report*, *supra* note 26, para. 1.5. Brazil had previously requested consultations concerning the EC's GSP program but did not subsequently request the establishment of a panel. *See* Request for Consultations by Brazil, European Communities—Measures Affecting Soluble Coffee,

Body,[98] India challenged the legitimacy of the EC's Drug Arrangements, through which twelve countries qualified for duty-free access on products for which other GSP beneficiaries, such as India, received only tariff reductions.[99] A WTO Panel ruled in favor of India on December 1, 2003, proclaiming that virtually no differentiation of any kind was permissible under the Enabling Clause.[100] On April 7, 2004, the WTO Appellate Body affirmed the Panel's ruling that the Drug Arrangements were invalid but modified much of the Panel's legal analysis,[101] leaving open the possibility that the Enabling Clause permits some differentiation.[102]

The Appellate Body expressly limited its analysis to the question of whether a donor country may discriminate among developing countries that are already beneficiaries under its GSP,[103] declining to examine whether donor states can employ conditionality to exclude some developing countries entirely or graduate countries from their GSP schemes.[104] Nonetheless, its ruling sheds light on how it might approach such questions in the future. This Part briefly summarizes the EC-India dispute, the Panel's ruling, and, most importantly, the

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WT/DS209/1 (Oct. 19, 2000), *available at* http://docsonline.wto.org/DDFDocuments/t/G/L/399.doc.

98. The Dispute Settlement Body administers the dispute settlement process in the WTO. Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, art. 2, WTO Agreement, Annex 2. Parties with complaints as to another party's WTO obligations may request the establishment of a panel composed of three "well-qualified governmental and/or non-governmental individuals." *Id.* arts. 6, 8. Appeals may be brought to the Appellate Body, a standing body of seven individuals, three of whom serve on any given case. *Id.* art. 17. Appellate Body reports are automatically adopted by the Dispute Settlement Body unless there is a consensus not to adopt a report. *Id.*

99. *See EC—GSP Panel Report*, *supra* note 26, para. 4.38 (arguing that the Drug Arrangements rendered Indian textile exporters less competitive than their Pakistani counterparts receiving the additional preferences); *see also* Council Regulation 2501/2001, *supra* note 11, arts. 10, 25, 2001 O.J. (L 346) at 5, 8 (authorizing duty-free access for exports from twelve countries that otherwise would qualify for a simple tariff reduction under the general GSP scheme). The EC had requested a waiver for the Drug Arrangements, but no action had been taken on the waiver request. *See* Request for a Waiver, New EC Special Tariff Arrangements to Combat Drug Production and Trafficking, G/C/W/328 (Oct. 24, 2001) (requesting a waiver from Article I), *available at* http://docsonline.wto.org/DDFDocuments/t/G/C/W328.doc.

100. *See EC—GSP Panel Report*, *supra* note 26, paras. 7.176–.177 (noting that the Enabling Clause permits only two types of differentiation—a priori limitations and special treatment of the least-developed countries).

101. *EC—GSP Appellate Body Report*, *supra* note 3, para. 190.

102. *See id.* paras. 142–67 (explaining the meaning of "non-discriminatory").

103. *Id.* para. 128.

104. *See id.*

Appellate Body's ruling. Part IV then analyzes the ruling's broader ramifications for the U.S. GSP.

### *A. Basis for the Dispute: The EC's Drug Arrangements*

Under its GSP program, the EC provides duty-free access for nonsensitive products and reduced tariff rates for sensitive products from all GSP recipients.[105] It operates, however, three incentive arrangements that further reduce or eliminate tariffs on some sensitive products for certain countries—a form of positive conditionality.[106] The special incentive arrangements for protection of labor rights and the environment are available to all beneficiaries demonstrating adherence to international labor standards or international standards concerning sustainable management of tropical forests.[107] The preferences under the incentive arrangement to combat drug production and trafficking—the subject of the EC-India dispute—are limited by regulation to only twelve countries.[108]

Motivating India's challenge were the more beneficial tariff preferences that Pakistani exporters were receiving under the Drug Arrangements.[109] Before the Panel and Appellate Body, India argued that the Drug Arrangements violated the EC's MFN obligation[110] and

105. Council Regulation 2501/2001, *supra* note 11, art. 7.1–.2, 2001 O.J. (L 346) at 3.

106. For a discussion of positive conditionality, see *supra* note 73 and accompanying text. In July 2004, the European Commission proposed a simplified GSP program combining the three incentive arrangements into a unified "GSP+" program, which would provide incentives to "countries that accept the main international conventions on social rights, environmental protection and governance, including the fight against drugs production and trafficking." Press Release, European Commission, Developing Countries: Commission Unveils System of Trade Preferences for Next Ten Years (July 7, 2004), *available at* http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/860&format=HTML&aged=1&language=EN&guiLanguage=en; *see also* 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, COM(2004) 461 final at 8, 9–10 (proposing the same system). The new GSP scheme would take effect in 2006.

107. Council Regulation 2501/2001, *supra* note 11, arts. 8, 14, 21, 2001 O.J. (L 346) at 4, 6, 7.

108. *Id.* art. 10, annex I, 2001 O.J. (L 346) at 5, 13–18. The twelve countries are Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru, and Venezuela. *Id.* annex I, 2001 O.J. (L 346) at 13–18.

109. *See EC—GSP Panel Report*, *supra* note 26, para. 4.38 ("[I]n the case of the tariff preferences accorded to textiles and clothing products from Pakistan, the true 'donor' countries are India and other developing countries that compete directly with Pakistan's exports to the European Communities.").

110. *Id.* paras. 4.8–.14.

were not justified by the Enabling Clause.[111] India read footnote three of the Enabling Clause, which refers to "the establishment of 'generalized, non-reciprocal, and *non-discriminatory* preferences beneficial to the developing countries'"[112] in the 1971 waiver, to impose binding requirements on GSP donors, and it interpreted "non-discriminatory" to require that all developing-country beneficiaries receive the same preferences.[113] According to India, paragraph 2(a), by describing preferences "beneficial to *the* developing countries," confirms that donors must provide the same treatment to all developing countries.[114]

In response, the EC asserted that the reference to "non-discriminatory" in footnote three of the Enabling Clause does not require developed countries to provide identical tariff treatment to all beneficiaries.[115] Instead, it argued, developed countries may differentiate among "developing countries which, according to objective criteria, have different development needs."[116] Hence, the EC contended, the Drug Arrangements were justifiable under the Enabling Clause because they were based on "an overall assessment of the gravity of the drug problem in each developing country made in accordance with objective, non-discriminatory criteria."[117]

### *B. The Panel Ruling*

The Panel not only found the Drug Arrangements discriminatory and, hence, invalid but also condemned virtually any and all differentiation in GSP schemes, obliterating developed countries' assumptions about their ability to condition GSP benefits. As a threshold matter, the Panel concluded that the Enabling Clause is an

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111. *Id.* paras. 4.31–.41. India argued that the Enabling Clause should be construed as an exception to Article I:1. *Id.* paras. 4.27–.28.

112. *Id.* para. 4.31 (quoting Enabling Clause, *supra* note 21, para. 2(a) n.3).

113. *Id.* para. 4.33.

114. *Id.* para. 4.35.

115. *Id.* para. 4.47. Before raising its Enabling Clause arguments, the EC first argued that the Enabling Clause is not an exception to Article I:1 but rather an "autonomous and permanent right." *Id.* para. 4.42.

116. *Id*.

117. *Id.* para. 4.75. The EC also asserted as a defense GATT Article XX, arguing that the Drug Arrangements were "necessary for the protection of human life or health." *Id.* para. 4.91. The EC did not appeal the Panel's ruling on this issue. *See EC—GSP Appellate Body Report*, *supra* note 3, para. 78 (listing the issues that the EC appealed). Further discussion of this defense is outside the scope of this Note.

exception to Article I:1, as India had argued.[118] Consequently, the Panel held that the EC bore the burden of asserting the Enabling Clause as a defense and of proving the Arrangements' compatibility with the Clause.[119]

Because the Drug Arrangements were "accorded only on the condition that the receiving countries [were] experiencing a certain gravity of drug problems," the Panel found that they were not "unconditional" as required by Article I:1,[120] which the Panel interpreted as meaning that tariffs must "not [be] limited by or subject to any conditions."[121] For this reason, the Panel proceeded to analyze the EC's affirmative Enabling Clause defense.

The Panel first focused its Enabling Clause analysis on paragraph 2(a) and footnote three to that paragraph,[122] which together authorize preferential tariff treatment as described in the 1971 waiver. It also considered paragraph 3(c),[123] which mandates that GSP schemes "respond positively to the needs of developing countries."[124] Finding the text of these provisions vague, the Panel turned to the Agreed Conclusions, which it regarded as "preparatory work" for the Enabling Clause.[125]

According to the Panel, the Agreed Conclusions reflected a comprehensive understanding that all developing countries were to receive preferential treatment on an equal basis.[126] Because the parties to the Conclusions had envisioned only two types of differentiation—a priori limitations and preferential treatment for the

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118. *EC—GSP Panel Report*, *supra* note 26, paras. 7.35–.39; *see supra* note 111 (summarizing India's argument).

119. *See id.* para. 7.42 (requiring the EC to invoke the Enabling Clause as an affirmative defense and placing the burden of proof under the Enabling Clause on the EC).

120. *Id.* para. 7.60.

121. *Id.* para. 7.59. The Panel grounded this assertion on the ordinary meaning of the word "unconditional." *Id*.

122. *See id.* para. 7.65 ("The main issue disputed by the parties is whether the Drug Arrangements are consistent with Paragraph 2(a) of the Enabling Clause, particularly the requirement of 'non-discriminatory' in footnote 3 to this subparagraph.").

123. *Id*.

124. Enabling Clause, *supra* note 21, para. 3(c).

125. *EC—GSP Panel Report*, *supra* note 26, paras. 7.78–.86; *cf.* Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, art. 31(2)(a), 1155 U.N.T.S. 331, 340 [hereinafter Vienna Convention] ("The context for the purpose of the interpretation of a treaty shall comprise . . . any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty . . . .").

126. *EC—GSP Panel Report*, *supra* note 26, para. 7.144.

least-developed countries[127]—the Enabling Clause permitted no other differentiation.[128] Similarly, because the parties had agreed to "the levels of product coverage and depth of tariff cuts," the Panel declared that "GSP schemes providing for lesser product coverage or depth of tariff cuts" would be illegitimate, even though this issue was not before the Panel.[129] In light of its conclusion that GSP schemes must consider the needs of every developing country without differentiation,[130] the Panel declared the Drug Arrangements invalid.[131]

### *C. The Appellate Body Ruling*

Although the Appellate Body also found for India, ruling that the Drug Arrangements violated Article I:1 and the Enabling Clause, it reined in the Panel's broad condemnation of virtually all differentiation in GSP schemes.[132] Significantly, it left open the possibility that other forms of positive conditionality—if based on objective criteria—might be legitimate.

Like the Panel, the Appellate Body commenced its analysis by examining the relationship between Article I:1 and the Enabling Clause. It, too, ruled that, because the Enabling Clause permits "differential and more favourable treatment" *notwithstanding* Article I:1, the Clause constitutes an exception to Article I:l's MFN

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127. *See id.* paras. 7.106–.115 (recognizing the validity of a priori limitations and special treatment for the least-developed countries).

128. *Id.* para. 7.116. In its discussion of the meaning of nondiscrimination, the Panel made broad findings on issues not implicated in the dispute. For example, it found that, for a developed country to comply with paragraph 3(c)'s requirement that it respond to the needs of developing countries, it would have to provide a "level of product coverage and depth of tariff cuts in general . . . no less than the level and depth offered and accepted in the Agreed Conclusions." *Id.* The Appellate Body later recognized that the Panel "implicitly made findings on issues that were not before it." *EC—GSP Appellate Body Report*, *supra* note 3, para. 128.

129. *EC—GSP Panel Report*, *supra* note 26, para. 7.95. Developed countries must have found this conclusion especially startling, given that the parties to the Agreed Conclusions recognized the nonbinding nature of GSP schemes. *See supra* note 33 and accompanying text.

130. *EC—GSP Panel Report*, *supra* note 26, para. 7.105.

131. *Id.* para. 7.177.

132. Consequently, the EC welcomed the Appellate Body Report, despite technically losing the dispute. *See* Press Release, European Commission, WTO India—GSP: WTO Confirms Differentiation Among Developing Countries Is Possible (Apr. 7, 2004) ("[The] decision makes it clear that we can continue, to give trade preferences to developing countries according to their particular situation and needs, provided this is done in an objective, non-discriminatory and transparent manner." (quoting EC Trade Commissioner Pascal Lamy)), *available at* http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/476&format=HTML&aged=1&language=EN&guiLanguage=en.

requirement.[133] In clarifying the relationship between Article I:1 and the Enabling Clause, the Appellate Body put forth a succinct test for the legitimacy of a provision allegedly taken under the Enabling Clause. First, "a dispute settlement panel should . . . examine the consistency of a challenged measure with Article I:1."[134] Only if the measure is inconsistent with Article I:1 is it necessary to consider whether the Enabling Clause justifies the measure.[135] In this case, however, the Appellate Body proceeded directly to the second step of this test because the EC had not appealed the Panel's ruling that the Drug Arrangements violated Article I:1.[136]

The Appellate Body's analysis of the Drug Arrangement's conformity with the Enabling Clause turned on the nature of footnote three[137]—referring to the "generalized, non-reciprocal and non-discriminatory preferences" described in the 1971 waiver[138]—and the meaning of "non-discriminatory" therein.[139] The Appellate Body ruled, over the objections of the EC, that footnote three, through its reference to the 1971 waiver, "imposes *obligations* that must be fulfilled for preferential tariff treatment to be justified under paragraph 2(a)."[140] It grounded this conclusion on the French and Spanish versions of the Enabling Clause, which permit preferential tariff treatment "in accordance" with the GSP "as defined" in the 1971 waiver.[141] The French and Spanish versions, the Appellate Body found, confirm that footnote three imposes "obligatory" conditions.[142]

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133. *EC—GSP Appellate Body Report*, *supra* note 3, para. 90. The Appellate Body noted, however, that the Enabling Clause "encourage[s] [WTO members] to deviate from Article I," suggesting "special status . . . in the WTO system." *Id.* paras. 110–11 (emphasis omitted). Consequently, the Appellate Body ruled that India was responsible for initially alleging inconsistency with the Enabling Clause, even if the ultimate burden of proof rested with the EC. *Id.* para. 118. This author is unaware of any other exceptions for which a complaining party bears the burden of alleging inconsistency with an exception. India had alleged inconsistency with the Enabling Clause in its written submissions and had therefore fulfilled this requirement. *Id.* para. 122.

134. *Id.* para. 101.

135. *Id*.

136. *See id.* para. 78 (listing the issues that the EC appealed).

137. *See id.* paras. 129–31 (explaining that India's claim was "limited to the consistency of the Drug Arrangements with . . . footnote 3").

138. Enabling Clause, *supra* note 21, para. 2(a) n.3.

139. *EC—GSP Appellate Body Report*, *supra* note 3, para. 131.

140. *Id.* para. 148 (emphasis added).

141. *Id.* para. 147. For a brief exposition of scholarly debate on whether footnote three imposes binding obligations, see *supra* note 40.

142. *EC—GSP Appellate Body Report*, *supra* note 3, para. 147.

Having concluded that footnote three requires that GSP preferences be "non-discriminatory," the Appellate Body considered the meaning of this term. Here, the Appellate Body disagreed with the Panel's interpretation, ruling that the nondiscrimination requirement does not prohibit "treating different developing-country beneficiaries differently."[143] In so ruling, the Appellate Body concurred[144] with the EC's interpretation of "non-discriminatory" as permitting differentiation "between developing countries which have different development needs."[145] It premised this ruling on three considerations.

First, the Appellate Body consulted footnote three's reference to "generalized" preferences as context for interpreting "non-discriminatory," observing that the term "generalized" requires that GSP schemes be "generally applicable."[146] It noted that, in the context of the initial GSP negotiations, the "generalized" requirement was designed "to eliminate existing 'special' preferences that were granted only to certain designated developing countries."[147] Finding that the "generalized" requirement sufficed to prevent the reinstatement of such special preferences, the Appellate Body inferred that a nondiscrimination requirement encompassing identical tariffs to all participants would provide little additional value.[148]

Second, and most importantly, the Appellate Body relied on paragraph 3(c), which provides that GSP treatment "shall . . . be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries."[149] This provision suggests an obligation to respond positively to such needs,[150] which, as the Appellate Body observed, may vary from country to country and over time.[151] The Appellate Body qualified this

143. *Id.* para. 162. Recall that the Panel had held that the same preferences must be provided to all developing countries. *See supra* note 128 and accompanying text.

144. *See EC—GSP Appellate Body Report*, *supra* note 3, para. 162 (authorizing differentiation among developing-country beneficiaries).

145. *Id.* para. 149.

146. *Id.* para. 156.

147. *Id.* para. 155.

148. *See id.* para. 156 (criticizing the Panel's conclusion that allowing differentiation would "result [in] the collapse of the whole GSP system" (alteration in original) (quoting *EC—GSP Panel Report*, *supra* note 26, para. 7.102)).

149. *Id.* para. 157 (quoting Enabling Clause, *supra* note 21, para. 3(c)).

150. *Id.* para. 158.

151. *Id.* para. 160.

finding in two respects. First, the existence of "development, financial [or] trade needs" must be based on "objective standards," such as needs laid out in multilateral instruments.[152] Second, a GSP response to such needs must be "positive," that is, "consisting in or characterized by constructive action or attitudes."[153]

Finally, the Appellate Body found support for its conclusion in the object and purpose of the WTO Agreement, which provides that there is "need for positive efforts designed to ensure that developing countries . . . secure a share in the growth in international trade commensurate with the needs of their economic development."[154] According to the Appellate Body, this language bolsters the conclusion that development needs may vary across countries.[155]

Although the Appellate Body concluded that the Enabling Clause permits "the possibility of additional preferences for developing countries with particular needs,"[156] it ultimately deemed the EC's Drug Arrangements invalid.[157] The ruling suggested that "the problem of illicit drug production and trafficking" might constitute a development need;[158] in this case, however, the Appellate Body found that the Drug Arrangements provided no "objective criteria" by which countries with similar drug problems could qualify for the preferences.[159] Consequently, the EC failed to demonstrate that the Drug Arrangements were nondiscriminatory.

## IV. ARE U.S. GSP PREFERENCES "GENERALIZED, NON-RECIPROCAL AND NON-DISCRIMINATORY"?

The Appellate Body ruling, though binding only as to the EC's Drug Arrangements, holds serious ramifications for the U.S. GSP. The most fundamental ramification is clear: the preferences provided under the U.S. GSP must be "generalized, non-reciprocal, and non-discriminatory."[160] The exact meaning of these requirements,

152. *Id.* para. 163.

153. *Id.* para. 164.

154. *Id.* para. 168 (quoting WTO Agreement pmbl.).

155. *Id.* para. 169.

156. *Id*.

157. *Id.* para. 189.

158. *Id.* para 180; *see id.* (asserting that the Drug Arrangements would be valid only if the preferences were provided to "all GSP beneficiaries . . . similarly affected by the drug problem").

159. *Id.* para. 183.

160. Enabling Clause, *supra* note 21, para. 2(a) n.3.

however, is vague. The Appellate Body's ruling turned solely on the meaning of "non-discriminatory," and, because the EC's Drug Arrangements were obviously subjective in nature, the Appellate Body did not explore in detail what sorts of objective criteria would render preferences nondiscriminatory. Nonetheless, the ruling provides a starting point for interpreting these requirements and suggests that some parts of the U.S. GSP are probably illegitimate.

This Part proffers a framework for analyzing consequences of the footnote three requirements for the key assumptions underlying the U.S. GSP. It first considers the requirement most thoroughly examined by the Appellate Body—nondiscrimination—and demonstrates that the U.S. regional GSP schemes are likely illegitimate absent waivers. It then considers the murkier question of whether the United States may condition beneficiary status, analyzing such conditions under both Article I:1 and the "generalized" requirement of the Enabling Clause. Here, this Part suggests that conditionality based on objective criteria to which developing countries have agreed in another context is likely valid. Finally, it demonstrates that the U.S. graduation mechanism would probably pass scrutiny under the Appellate Body's analysis.

### *A. Discrimination: The Likely Illegitimacy of the Regional GSP Schemes*

The Appellate Body helpfully distinguished between differentiation among countries that are beneficiaries of a GSP scheme and complete denial of GSP beneficiary status.[161] The Appellate Body's analysis applies only to differentiation among beneficiary countries. In the context of the U.S. GSP, such differentiation occurs almost exclusively by means of the regional GSP schemes: the Caribbean Basin Initiative (CBI), the Andean Trade Preference Act (ATPA), and the African Growth and Opportunity Act (AGOA).[162]

The regional schemes, which are similar to the EC's Drug Arrangements in that they provide extra preferences to select groups

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161. *See supra* notes 103–04 and accompanying text.

162. For an explanation of the regional schemes, see *supra* Part II.A. Of course, the U.S. scheme also distinguishes between developing-country and least-developed country beneficiaries, but this distinction is explicitly authorized in the Enabling Clause and is not discussed further in this Note. *See* Enabling Clause, *supra* note 21, para. 2(d) (authorizing special treatment for the least-developed countries); *supra* Part II.A.

of countries, likely fail the nondiscrimination requirement. Regional preference schemes are not per se invalid under the Appellate Body's analysis: if a region has an objective development need unique to that region, GSP schemes presumably can differentiate to take account of that need. In the U.S. scheme, however, there are no objective criteria, other than geographic ones, for selecting beneficiary countries; all three schemes are limited by statute to a closed universe of beneficiaries.[163]

The regional schemes reveal the importance of responding to a widely recognized, "particular" development, financial, or trade need.[164] ATPA arguably responds to a particular need—the elimination of drug production—although it lacks criteria by which to identify countries experiencing this need.[165] In contrast, the goals of CBI and AGOA—economic development and stability—are not particular because they merely reflect the underlying goals of the GSP system in general. Given that all GSP beneficiaries are underdeveloped, it would be impossible for the United States to devise objective criteria based on "general" development needs that would differentiate CBI and AGAO recipients from others.[166] Thus, for a regional GSP scheme to pass scrutiny under the Enabling Clause, it must respond to a particular need and must identify countries based on objective criteria. Because the U.S. schemes fail this test, they are discriminatory and require waivers.[167]

### *B. Conditionality: The Possible Legitimacy of "Mutually Acceptable" Conditions*

The more daunting question is to what extent the United States may refuse to grant beneficiary status to countries that do not comply with certain conditions. The ramifications of the Appellate Body's

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163. *See EC—GSP Appellate Body Report*, *supra* note 3, para. 183 (criticizing the Drug Arrangements for failing to specify criteria that would allow other "similarly affected" developing countries to qualify for the additional preferences); *supra* notes 59, 62, 64 and accompanying text.

164. *See EC—GSP Appellate Body Report*, *supra* note 3, para. 163 (noting that "[b]road-based recognition of a particular need" could constitute an objective criterion).

165. *See supra* notes 61, 156 and accompanying text.

166. To clarify, the problem is that the United States provides additional benefits to some regional groupings, not that regional groupings exist per se. Presumably, if the United States provided the same benefits to all similarly situated GSP beneficiaries but did so through regional GSP schemes, this approach would not be discriminatory.

167. There is a waiver in effect for CBI. *See supra* note 65 and accompanying text.

ruling for this type of negative conditionality are much less clear. The legitimacy of U.S. conditionality depends on several factors, some of which the Appellate Body did not discuss in its analysis limited to the nondiscrimination requirement. First, the condition must be analyzed in the context of Article I:1 because if it does not violate Article I:1 there is no need to resort to the Enabling Clause for justification. Second, if the condition is invalid under Article I:1, its consistency with the Enabling Clause's "generalized" requirement must be examined. This second step entails analysis of what constitutes "development, financial and trade needs"[168] beyond the analysis that the Appellate Body provided. Finally, it is possible that some other WTO provision or international instrument might validate the condition.

1. *The Meaning of "Unconditionally" under Article I:1.* In describing the rule-exception relationship between the Enabling Clause and Article I:1, the Appellate Body put forward a threshold inquiry:

> [A] dispute settlement panel should, as a first step, examine the consistency of a challenged measure with Article I:1, as the general rule. If the measure is considered at this stage to be inconsistent with Article I:1, the panel should then examine, as a second step, whether the measure is nevertheless justified by the Enabling Clause.[169]

In other words, if the challenged measure is consistent with Article I:1, there is no need to examine it under the Enabling Clause.

The MFN Clause of Article I:1 requires that "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country . . . be accorded immediately and *unconditionally* to the like product originating in or destined for the territories of all other contracting parties."[170] The Appellate Body did not define "unconditionally" because the EC had not appealed the Panel's ruling that the Drug Arrangements violated the MFN obligation of Article I:1.[171] The Panel had defined "unconditionally" as "not limited by or subject to

168. *EC—GSP Appellate Body Report*, *supra* note 3, para. 163 (quoting Enabling Clause, *supra* note 21, para. 3(c)).

169. *Id.* para. 101.

170. GATT art. I:1 (emphasis added).

171. *EC—GSP Appellate Body Report*, *supra* note 3, para. 124 n.259.

any conditions,"[172] which presumably would render any condition imposed on the granting of a tariff preference per se invalid.[173]

The Appellate Body has yet to clarify the scope of Article I:1's "unconditionally" requirement. In *Canada—Autos*,[174] the Appellate Body ruled that Article I:1 prohibits both de jure and de facto discrimination.[175] Thus, an origin-neutral condition (one that is not de jure discriminatory), such as the measure in *Canada—Autos*,[176] violates Article I:1 if it results in de facto discrimination.[177] Indeed, the Appellate Body stated that the purpose of Article I:1 is "to prohibit *discrimination* among like products originating in or destined for different countries,"[178] emphasizing that an advantage granted to one member must be granted to "*all other Members.*"[179]

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 labor standards, apply to all potential beneficiaries. Consequently, the conditions violate Article I:1 only if they are de facto discriminatory. *Canada—Autos* suggests that conditionality in GSP schemes would constitute de facto discrimination, because those countries failing to meet a given condition would not receive the advantage. However, the precise

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172. *EC—GSP Panel Report*, *supra* note 26, para. 7.59.

173. *See* WorldTradeLaw.net, Dispute Settlement Commentary (DSC): Panel Report, European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries 20, *at* http://www.worldtradelaw.net/dsc/panel/ec-preferences(dsc)(panel).pdf (last visited Mar. 6, 2005) (on file with the *Duke Law Journal*) (observing that the Panel's "broad" interpretation apparently makes all conditions invalid).

174. WTO Appellate Body Report on Canada—Certain Measures Affecting the Automotive Industry, WT/DS139, 142/AB/R, para. 78 (May 31, 2000) [hereinafter *Canada—Autos Appellate Body Report*], *available at* http://docsonline.wto.org/DDFDocuments/t/WT/DS/139ABR.doc.

175. *Id*.

176. In *Canada—Autos*, Canada provided import duty exemptions to manufacturers that had established a certain level of production in Canada. *Id.* paras. 7–9. The list of manufacturers eligible for this exemption was closed in 1998. *Id.* para. 9. The effect of the measure was to extend the exemption to a small group of mostly American manufacturers and their related companies. *See id.* para. 71 (listing General Motors, Ford, Chrysler, and Volvo as the sole beneficiaries of the import duty exemptions).

177. *Id.* para. 78.

178. *Id.* para. 84 (emphasis added); *see also* Davey & Pauwelyn, *supra* note 40, at 41 (proposing a de facto discrimination test on the basis of the "object and purpose of" Article I:1). One observer suggests that the plain text of Article I:1 might support such an interpretation of "unconditionally," arguing that "'unconditionally' could be viewed as part of the non-discrimination requirement." WorldTradeLaw.net, *supra* note 173, at 21.

179. *Canada—Autos Appellate Body Report*, *supra* note 174, para. 79.

meaning of de facto discrimination remains unclear.[180] In *Canada—Autos*, it was virtually impossible for all exporters to comply with the origin-neutral condition in question.[181] Thus, the condition was bound to result in de facto discrimination, even though it was not facially discriminatory. 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 fulfill.[182] For instance, the United States might contend that conditioning GSP beneficiary status on fundamental labor standards recognized by the ILO[183] is not discriminatory because all WTO members have committed themselves to these fundamental standards.[184]

Hence, developed countries might argue that the crux of the de facto discriminatory inquiry should be whether all countries are equally situated to comply with a provision. The factual limitations of *Canada—Autos*—the complete inability of some manufacturers to comply with the origin-neutral condition—make it difficult to anticipate the Appellate Body's response to this argument. Given the strict language of *Canada—Autos*,[185] it is questionable whether the Appellate Body would agree with this analysis. If the Appellate Body did not agree, a developed country would have to justify conditionality in GSP schemes exclusively under the Enabling Clause.

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180. *See* Lother Ehring, *De Facto Discrimination in World Trade Law: National and Most-Favoured-Nation Treatment—Or Equal Treatment?*, 36 J. WORLD TRADE 921, 922 (2002) ("What exactly amounts to an illegal *de facto* discrimination . . . is unclear and the topic of intense debate.").

181. *See supra* note 176.

182. As one scholar puts the question, "In the event that some imports from one Member enjoy an advantage under objective, origin-neutral conditions, can another Member always claim this advantage for its like exports which do not meet these objective conditions?" Ehring, *supra* note 180, at 930.

183. *See supra* notes 82–84 and accompanying text.

184. *See* Bartels, *supra* note 34, at 524–26 (arguing that a measure imposing standards cannot be de facto discriminatory if all countries are bound to such standards, as in the case of the ILO fundamental principles); *see also* WTO, Singapore Ministerial Declaration, WT/MIN(96)/DEC, para. 4 (Dec. 13, 1996) [hereinafter Singapore Declaration] ("We renew our commitment to the observance of internationally recognized core labour standards."), *available at* http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm; Howse, *supra* note 10, at 1357 (noting that all WTO members are "indirectly" committed to the ILO fundamental labor standards through the Singapore Declaration).

185. *See, e.g.*, *Canada—Autos Appellate Body Report*, *supra* note 174, para. 79 ("The words of Article I:1 refer not to . . . like products from *some* other Members, but to like products originating in or destined for '*all other*' Members.").

2. *"Generalized."* In the event that a GSP condition is deemed invalid under Article I:1, the developed country nonetheless can attempt to justify it under the Enabling Clause. Here, as indicated by the Appellate Body, the relevant question is the meaning of "generalized" in footnote three; the Appellate Body found that "the term 'generalized' requires that the GSP schemes of preference-granting countries remain generally applicable."[186] As such, the term manifests the negotiating parties' intent "to eliminate existing 'special' preferences that were granted only to certain designated developing countries."[187] This interpretation of "generalized" comports with the negotiating history in UNCTAD II, in that the Agreed Conclusions explicitly noted that donor countries would "in general" choose beneficiaries on the principle of self-election.[188]

That preferences must be "generally applicable" does not necessarily preclude donors from imposing conditions on the receipt of such preferences. To understand the precise nature of this requirement, one must look to the rest of the Enabling Clause—especially paragraph 3(c)—for context, just as the Appellate Body did in interpreting "non-discriminatory."[189] The Appellate Body found that paragraph 3(c) authorizes, and indeed requires, developed countries to "respond positively" to "development, financial and trade needs" assessed according to "an *objective* standard."[190] Two inquiries arise from this conclusion: one, "What is a positive response?" and, two, "What are objective standards?"

The most obvious problem with the U.S. scheme of conditionality under the Appellate Body's analysis is that it might not constitute a positive response. Unlike the EC GSP, which offers the prospect of additional preferences as an incentive, the U.S. GSP removes preferences in the event that a developing country fails to meet certain conditions. The Appellate Body defined "positively" as "consisting in or characterized by constructive action or attitudes."[191] According to the Appellate Body, this suggests that actions such as conditionality must aim at "*improving* the development, financial or

186. *EC—GSP Appellate Body Report*, *supra* note 3, para. 156.

187. *Id*. para. 155.

188. Agreed Conclusions, *supra* note 29, para. IV.1; *see also supra* note 31 (explaining the principle of self-election).

189. *EC—GSP Appellate Body Report*, *supra* note 3, para. 130.

190. *Id.* paras. 162–63.

191. *Id.* para. 164 (quoting 2 SHORTER OXFORD ENGLISH DICTIONARY 2293 (W.R. Trumble & A. Stevenson eds., 5th ed. 2002)).

trade situation of a beneficiary country," and that the need in question must be one that "can be effectively addressed through tariff preferences."[192] Given that the Drug Arrangements constituted positive conditionality, the Appellate Body did not consider whether negative schemes such as the U.S. GSP could constitute a positive response.

Because the Appellate Body's analysis with respect to this point is underdeveloped, it is impossible to predict whether the United States would survive a challenge on this ground. Nevertheless, there are plausible arguments that the United States might make in its defense. The United States could argue that, in threatening to revoke GSP preferences in response to certain conditions, its goal is, in effect, to improve the development situation of developing countries. It might point to the pervasiveness of negative conditionality in GSP schemes as evidence of consensus that negative conditions are effective in fueling improvements in developing countries.[193]

Assuming that the United States successfully framed its negative conditionality as a "positive" response, it also would have to demonstrate that such conditions are based on objective criteria. The Appellate Body suggested that "[b]road-based recognition of a particular need, set out in the *WTO Agreement* or in multilateral instruments adopted by international organizations" might constitute such criteria.[194] The Appellate Body suggested that "the problem of illicit drug production" might constitute a development need,[195] but it had no occasion to interpret this requirement further because the EC's Drug Arrangements were clearly *not* based on objective criteria.[196]

Understanding the objective-criteria requirement necessitates further elaboration on what sorts of multilateral instruments reflect broad-based recognition. Presumably, institutions to which nearly all countries are parties—such as the United Nations, the International Monetary Fund, or the World Bank—are sufficiently international in scope to qualify under the Appellate Body's test. There is little in the

192. *Id*.

193. The Vienna Convention on the Law of Treaties stipulates that the subsequent practice of parties to a treaty is relevant to the treaty's meaning. Vienna Convention, *supra* note 125, art. 31(3)(b), 1155 U.N.T.S. at 340.

194. *EC—GSP Appellate Body Report*, *supra* note 3, para. 163.

195. *Id.* para. 180.

196. *Id.* paras. 181–83.

Appellate Body's analysis, however, to clarify what institutions beyond these clear-cut examples might qualify. For instance, it is arguably unfair to hold developing countries to standards adopted by organizations such as the Organization of Economic Cooperation and Development (OECD), to which most developing countries are not parties.

Footnote three of the Enabling Clause proves instrumental in elucidating the objective-criteria requirement. The footnote requires that GSP schemes be "[a]s described" in the 1971 waiver,[197] which describes preferences not only as "generalized, non-reciprocal, and non-discriminatory" but also as "mutually acceptable."[198] Thus, it appears that all elements of GSP schemes, including conditionality, must be "mutually acceptable" to both developed and developing countries. In the case of standards developed by international organizations to which the objecting developing countries are not parties, such as the OECD, conditions based on such standards would not be "mutually acceptable" and should be invalid.

Importantly, the 1971 waiver refers to "mutually *acceptable*," not "mutually *accepted*," preferences. Thus, developing countries need not have explicitly agreed to a certain condition in the context of a GSP scheme;[199] the condition need only be acceptable—that is, "capable or worthy of being accepted"[200] by developing countries. The United States might thus contend that, when developing countries have agreed to comply with certain standards outside the GSP context, the conditioning of GSP preferences on adherence to those standards is "mutually acceptable" and would satisfy paragraph 3(c).

This reasoning might justify certain conditions in the U.S. GSP. For example, the United States might justify its labor standards on the grounds that developing countries have already committed

197. Enabling Clause, *supra* note 21, para. 2(a) n.3.

198. 1971 Waiver, *supra* note 34, pmbl.

199. The developing countries did agree to one condition in the U.S. GSP in the Agreed Conclusions—that preferences would not be extended to countries granting "reverse" preferences to other developed countries. *See* Graham, *supra* note 22, at 519 (stating that the modified U.S. submission to the Special Preferences Committee provided that preferences would be withdrawn for countries imposing "reverse" preferences, unless those countries assured the United States that they would phase out the reverse preferences); *see also* 19 U.S.C. § 2462(b)(2)(C) (2000) (codifying this condition). This condition would clearly be "mutually acceptable" and should arguably be valid, notwithstanding that it does not "respond positively to a development, financial [or] trade need." *EC—GSP Appellate Body Report*, *supra* note 3, paras. 162–63.

200. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 6 (10th ed. 1996).

themselves to fundamental labor standards, and that such conditions are consequently "acceptable" to developing countries.[201] Conditioning GSP benefits on combating terrorism also might be legitimate because there exist numerous treaties obligating states to oppose terrorism.[202] Likewise, the United States might plausibly argue that conditioning GSP benefits on the provision of compensation for nationalized property of U.S. citizens[203] is mutually acceptable because all countries are committed to this standard under customary international law.[204] Finally, conditions based on the WTO Agreement itself, such as conditions dealing with trade-distorting investment measures[205] or the failure to protect intellectual property rights,[206] would seem valid under the Appellate Body's analysis of objective standards. In contrast, the United States would be unable to point to international instruments requiring developing countries to support U.S. efforts to combat terrorism[207] or to refrain from Communist forms of government;[208] these conditions would thus fail the objective-criteria test. Of course, this step of the analysis is dependent on a finding that negative conditionality constitutes a positive response, which, as this Note demonstrates, the Appellate Body Report did not clarify.

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201. For a discussion of these labor standards in the context of Article I:1, see *supra* notes 183–84 and accompanying text. *See also* WorldTradeLaw.net, Dispute Settlement Commentary (DSC): Appellate Body Report, European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries 13, *at* http://www.worldtradelaw.net/dsc/ab/ec-preferences(dsc)(ab).pdf (last visited Mar. 6, 2005) (on file with the *Duke Law Journal*) (contending that the Appellate Body's approach permits the imposition of "conditions [that] have the potential to be fulfilled," which include ILO labor standards).

202. For a list of such treaties, see U.S. Dep't of State, International Conventions and Other Treaties Relating to Terrorism, *at* http://www.state.gov/r/pa/ho/pubs/fs/6093.htm (last visited Mar. 6, 2005) (on file with the *Duke Law Journal*).

203. 19 U.S.C. § 2462(b)(2)(D).

204. *See* Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474, 475 (1991) ("[I]nternational tribunals have repeatedly held that international law requires full compensation for expropriations of foreign property."). Along these lines, conditionality with respect to enforcement of arbitral awards could be "mutually acceptable" if the developing country bound itself to enforce such awards. *See* 19 U.S.C.§ 2462(b)(2)(E) (barring beneficiary status for countries "fail[ing] to act in good faith in recognizing as binding or in enforcing arbitral awards in favor of United States citizens").

205. 19 U.S.C. § 2462(c)(6).

206. *Id.* § 2462(c)(5).

207. *See supra* note 81 and accompanying text.

208. *See supra* note 79 and accompanying text.

3. *Other Grounds for Justifying Conditionality.* Although the primary focus of this analysis is the legitimacy of conditionality under Article I:1 and the Enabling Clause, it merits mention that developed countries might have other instruments at their disposal to justify the imposition of conditions on GSP benefits. First, other WTO provisions might justify conditionality or discrimination in GSP schemes. It is clear that developed countries could obtain waivers for preferential schemes that would otherwise violate Article I:1 and the Enabling Clause.[209] In fact, with respect to the EC's Drug Arrangements, the Panel noted that a waiver would bring the EC into compliance with its GATT obligations.[210] It is also possible—though less certain—that a developed country could justify conditionality or discrimination in a GSP scheme through other exceptions to Article I:1. For example, the EC originally asserted as a defense GATT Article XX, which permits deviations from Article I:1 to protect human life or health.[211] Neither the Panel nor the Appellate Body discussed the extent to which Article XX could excuse GSP schemes that were inconsistent with the Enabling Clause. If Article XX can justify discriminating among all countries, however, it potentially justifies discriminating among a subset of those countries (i.e., developing countries).

A second, more complicated possibility is that a separate legal instrument negotiated outside the WTO framework could authorize conditionality within the context of the GSP. Suppose, for instance, that the United States concluded a trade agreement with a developing country in which the developing country agreed that GSP preferences would be revoked if it failed to adhere to certain criteria. Naturally, the United States would argue that this agreement precluded the developing country from challenging the legitimacy of such conditionality within the WTO framework. The extent to which non-WTO law may be invoked successfully to defend a violation of a WTO provision is unresolved.[212] This Note does not examine the

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209. *See* GATT art. XXV:5 (permitting GATT members to waive the GATT obligations of member countries "in exceptional circumstances" by a two-thirds vote); s*ee, e.g.*, Caribbean Basin Economic Recovery Act—Renewal of Waiver, *supra* note 65 (authorizing differential treatment under the Caribbean Basin Economic Recovery Act until December 31, 2005).

210. *EC—GSP Panel Report*, *supra* note 26, para. 8.3.

211. *Id.* para. 4.91.

212. *See* Joost Pauwelyn, *How to Win a World Trade Organization Dispute Based on Non-World Trade Organization Law? Questions of Jurisdiction and Merits*, 37 J. WORLD TRADE 997, 997–98 (2003) (noting that, although Panels and the Appellate Body have often referred to non-

issues underlying the debate but merely posits this as a potential basis for justifying conditionality under the GSP.

### *C. Graduation: A Legitimate Response to "Development Needs"*

Although the Appellate Body explicitly noted that it was not ruling on the legitimacy of "the EC's mechanisms for the graduation of developing countries,"[213] its analysis of the Drug Arrangements nonetheless intimated that graduation mechanisms are permissible as a general matter. In its discussion of the "development, financial and trade needs" of developing countries, the Appellate Body looked to paragraph seven of the Enabling Clause, which confirms the expectation that the beneficiary countries' "capacity to make contributions or concessions under the GATT will 'improve with the progressive development of their economies.'"[214] In recognizing that development will not occur "in lockstep" for all beneficiaries, the Appellate Body suggested that the Enabling Clause permits the graduation of high-performing countries.[215]

Of course, that graduation is likely permissible as a general matter does not signify that any and all graduation schemes are valid. Any measure taken under the Enabling Clause must comport with paragraph 3(c), requiring developed countries to "respond positively to the development, financial and trade needs of developing countries."[216] Given that such needs must be evaluated on the basis of objective criteria,[217] the decision to graduate a country from the GSP because it no longer has development needs should also be based on objective criteria. The Appellate Body provides as examples of such

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WTO law when interpreting terms in WTO agreements, they have not determined when non-WTO law might constitute a defense to a violation of WTO provisions). *See generally* JOOST PAUWELYN, CONFLICT OF NORMS IN PUBLIC INTERNATIONAL LAW: HOW WTO LAW RELATES TO OTHER RULES OF INTERNATIONAL LAW (2003) (concluding that a defendant should be able to invoke non-WTO norms as defenses to WTO violations); John O. McGinnis, *The Appropriate Hierarchy of Global Multilateralism and Customary International Law: The Example of the WTO*, 44 VA. J. INT'L L. 229, 231 (2003) (arguing that customary international law should not trump WTO and other multilateral agreements); Pauwelyn, *supra*, at 1019–28 (proposing four situations in which non-WTO law might prevail over WTO law).

213. *EC—GSP Appellate Body Report*, *supra* note 3, paras. 128–29.

214. *Id.* para. 160 (quoting Enabling Clause, *supra* note 21, para. 7).

215. *Id.* para. 161.

216. Enabling Clause, *supra* note 21, para. 3(c).

217. *EC—GSP Appellate Body Report*, *supra* note 3, para. 163.

objective criteria "the WTO Agreement or . . . multilateral instruments adopted by international organizations."[218]

The U.S. graduation mechanism, which relies on the World Bank's designation of countries as "'high income' countr[ies],"[219] is, quite plausibly, based on such objective criteria. Although this designation is not formally adopted by World Bank members, the international community widely recognizes it as a development benchmark.[220] More importantly, nearly all WTO members are also members of the World Bank. Consequently, World Bank classifications should qualify as objective criteria, and the U.S. graduation mechanism should be valid under the Appellate Body's reasoning.

## CONCLUSION

Although the developed countries technically lost round one in a possible long-term fight over GSP schemes, many aspects of the Appellate Body Report favor developed countries, particularly in comparison to the overly strict Panel Report.[221] The Appellate Body's emphasis on responding to objectively determined development needs leaves open the possibility that some differentiation in GSP schemes is consistent with the Enabling Clause. Nonetheless, the report opens the door for developing countries to challenge regional differentiation, conditionality, and graduation not based on "[b]road-based recognition of a particular development need."[222] The Appellate Body did little to clarify what such broad-based recognition might entail. This Note argues that the Appellate Body should rely on the "mutually acceptable" language in the 1971 waiver to limit development needs to those about which developing countries have agreed in some international context. Otherwise, the question of what constitutes a development need could be left to the discretion of the

218. *Id*.

219. *See* 19 U.S.C. § 2462(e) (2000) ("graduating" countries that the World Bank has designated as "high income" countries).

220. For example, the EC's graduation mechanism also incorporates the World Bank standards. *See* Council Regulation 2501/2001, *supra* note 11, art. 3.1, 2001 O.J. (L 346) at 2 ("A beneficiary country shall be removed from Annex I where . . . the country is classified by the World Bank as a high-income country . . . .").

221. *See supra* note 132 (reporting the EC's positive response to the Appellate Body Report).

222. *EC—GSP Appellate Body Report*, *supra* note 3, para. 163.

Appellate Body, threatening to undermine developed- and developing-country efforts to identify joint development priorities.

In the context of the U.S. GSP, this analysis signifies that regional differentiation is probably illegitimate but that graduation is quite probably legitimate. The murkiest question is whether the United States may condition the receipt of GSP preferences altogether. Both Article I:1 and the Enabling Clause might sustain some—but not all—conditions in the U.S. scheme, depending on how the Appellate Body would resolve certain key issues. Although the Appellate Body Report has no formal consequences for the U.S. GSP, the U.S. scheme is vulnerable to future challenges from developing countries that, like India, are dissatisfied with their current place in the international trading system.