

The Political Economy of the EU GSP Scheme: Implications for Pakistan

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1. INTRODUCTION

The Generalised System of Preferences (GSP) is a system of generalised, non-reciprocal and non-discriminatory preferences beneficial to developing countries.¹ The primary aim of such a programme is to accelerate 'economic growth' in developing countries based on the development needs of a particular country. No doubt, the Doha Development Agenda, the most ambitious attempt so far, is aimed at ensuring that the issue of development is firmly at the core of the multilateral trading system (MTS). WTO Members have agreed that the new Round must establish rules that can foster development and enable developing countries to benefit from further trade liberalisation. The Doha Ministerial Declaration confirms the WTO Members' overall commitment,

...to continue to make positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. [It continues to confirm that]

...in this context, enhanced market access, balanced rules, and well targeted and sustained technical assistance and capacity building programmes have important roles to play [in order] to support domestic efforts to integrate

trade into national plans for economic development and strategies for poverty reduction.

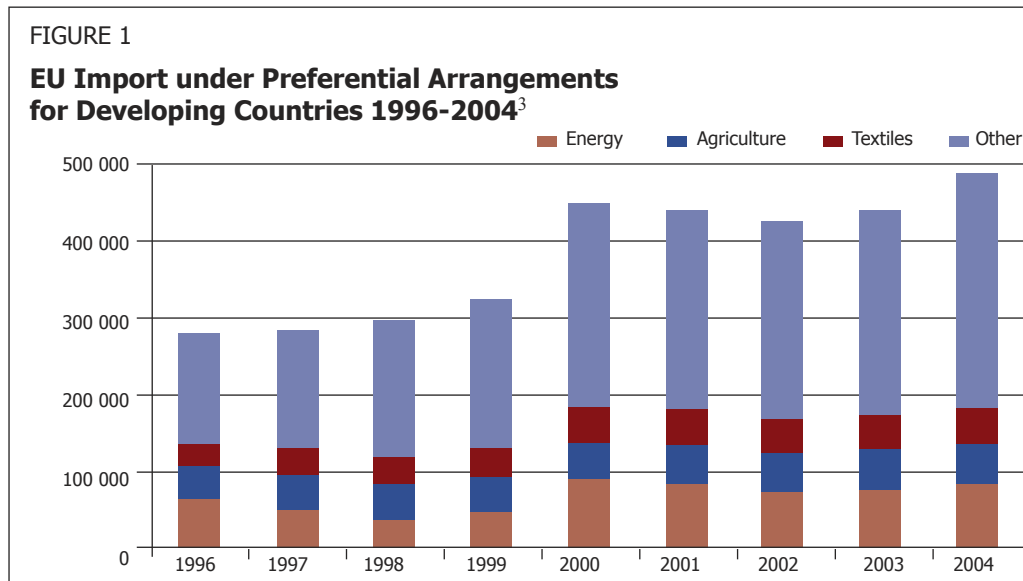
The GSP Schemes around the world feed 'development needs' primarily through preferential market access. There are several GSP schemes in the world though those of the US and EU stand out most distinctly. The European Union's GSP Scheme is the most effective of all current schemes considering the fact that the volume of imports to the EU from developing countries under the GSP is greater than the volume of imports under the US, Canadian and Japanese GSP systems combined. In 2003, EU imports under GSP totalled 52 billion. In comparison, under the equivalent American scheme — which is the world's second most widely used, GSP imports totalled 16 billion.² In the context of Pakistan, the EU GSP Scheme remains the most vital as Pakistan's preferences under the US GSP Scheme are rather limited due to the exclusion of the Textiles and Clothing (T&C) sector in the scheme and also owing to Pakistan's non-diversified export basket. The EU is therefore the most important preferential trade partner for Pakistan.

The EU absorbs one fifth of developing country exports. Forty percent of EU imports originate in developing countries. From the preferential imports under this regime in 2003, half were duty free and half were at a reduced duty. EU imports in 2003 under GSP amounted to 52 billion. In 2002, EU

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¹ See the GATT legal instrument pertaining to decision of the Contracting Parties, 25 June 1971.

² GSP: The new EU preferential terms of trade for developing countries - Brussels, 10 February 2005.



preferential imports from the LDCs under ‘Everything But Arms’ and the Cotonou Agreement countries (EBA and Cotonou) amounted to 126 billion. Figure 1 below highlights the gradual growth from 1996 to 2004 of EU’s import under preferential arrangements for developing countries.

2. THE LEGAL ENGINEERING OF THE NEW GSP PLUS SCHEME

The steady growth in preferential market access shown in Figure 1 above was witnessed under EU’s previous GSP Scheme applicable from 1995 to 2004 which however, has expired. The EU has introduced changes in its current GSP system and the new arrangement is applicable from 2006 to 2015. The *raison d’être* behind the transformation in the new scheme was primarily simplification,⁴ expanding the product coverage; focusing the benefits on those developing countries most in need; and setting up an additional GSP benefits scheme (GSP+) to encourage sustainable development. Presenting the new GSP system, EU Trade Commissioner, Pascal Lamy said:

‘The EU is already the world’s largest provider of trade preferences in favour of

developing countries — enabling us to import more than all other major developed countries put together. But we want to do even better, by focusing on the poorest and most vulnerable developing countries who most need trade preferences to access the EU market. I am also delighted that in today’s scheme, we are also making a sizeable and concrete down payment on sustainable development in our new GSP+ scheme’.

Under the new scheme, the five GSP arrangements have been reduced to three. The three core components include: a general arrangement (reduction of 3.5 percent over the normal customs duty for sensitive products, reduction of duties to zero for non-sensitive products), Everything but Arms, giving duty-free and quota free access for all products for the world’s 50 poorest countries, a new ‘GSP+’, giving tariff preferences to vulnerable countries who meet the new objective criteria for sustainable development and good governance (reduction to zero duty for a total of 7200 products).

The new scheme replaces the three former incentive schemes (drugs, social, and environment arrangements) by a new single scheme, namely, the ‘GSP+’ providing

³ In Euros, General Statistics and Development Statistics, EU Document 113540. www.europa.eu.int/com/trade

⁴ Simplification means reducing the five GSP arrangements to three separate arrangements.

special benefits for vulnerable countries that represent less than one percent, of EU imports under GSP and that accept the main international conventions on social, human rights, environmental protection and governance, including the fight against drugs. This re-engineering of the prevalent incentive schemes will have tough implementation concerns for many developing countries, although Pakistan is already facing severe implications due to graduation. Pakistan did not qualify the condition of representing less than one percent of EU imports. Only a threshold of minimum two percent could have qualified Pakistan for the Scheme. The Commission graduated Pakistani textiles and clothing to a higher level, deeming it undeserving of GSP support as these product groups had achieved sufficient competitiveness in exports.

The appreciable provision in the new GSP is that it will apply for three years without any changes, including graduation. Pakistan faced difficulties in the annual graduation process of the previous GSP, which created problems for both Pakistani exporters and EU importers. The new basic GSP incorporates nearly 300 additional products and will be withdrawn for certain product groups for one or several countries — when these products are competitive on the Community market and no longer need the GSP. A very specific feature of the new GSP Scheme is Regional cumulation. Regional cumulation of the EU GSP Scheme is primarily an instrument designed to encourage regional cooperation among those countries which are beneficiaries of both GSP and EC Rules of Origin, primarily implying that garment manufacturers in countries like Bangladesh could use fabrics from India, or Pakistan - i.e., from another SAARC country. EU's thinking is that regional cumulation should be enhanced to allow members of a regional group (i.e. ASEAN, SAARC) to make better use of the

preferences and comparative advantages, thus promoting regional cooperation.

3. PAKISTAN, POVERTY AND GSP

Five categories of goods, namely, cotton yarn, garments and hosiery, cotton cloth, raw cotton and rice still account for 80 percent of export earnings of Pakistan. Table 1 below shows Pakistan's core export basket. A basic analysis of the T&C sector of Pakistan underlines the importance of the sector to the social and economic welfare of the country. The overall share of the T&C sector in the total exports of the country is more than 69 percent whereas the share of the sector in the total manufacturing of the country is 46 percent. On the whole textile exports are worth US\$ 8.4 billion, with a share in the GDP of 8.5 percent. The Five-Year Investment in the T&C sector for the years 1999-2004 is a substantial total amount of US\$ 4.5 billion. In addition, an important highlight of the sector is that its share in generation of employment in the country equals 38 percent.⁵

A contribution measuring 38 percent of the employment ratio is a substantial addition by the T&C sector to the economy of the country. The value added sector that provides the maximum number of jobs and better margins, contributes as low as nine percent to the GDP. This low contribution to the GDP in addition to other factors is attributable to a lack of high quality skills development and skills up-gradation. While the T&C value added garments contributes far less than the potential, the number of units in the value added garment sector, is the highest. In the large mills sector the number of spinning units is 459 with 9.59 million spindles and about 146640 rotors. The total number of composite units are about 56, independent weaving units are about 140 with 23652 shuttles without looms and the total number of finishing units are 106. Compared to all

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⁵ Textile Commissioner's Office.

TABLE 1
Key products of Pakistan's Export Basket⁶

Year/Month	Raw Cotton	Cotton Fabrics	Cotton Yarn & Thread	Knitwear	Bed-wear	Woollen Carpets	
1999-00	3760.8	56757.2	55551.4	45913.1	36757.1	13200.4	
2000-01	8072.5	60485.6	62954.8	53201.6	43649.8	16424.7	
2001-02	1502.1	69296.9	57165.3	52089.6	56383.6	14976.9	
2002-03	2872.6	78665.4	54342.0	67033.7	77633.0	12689.8	
2003-04	2741.5	98542.2	64868.0	84014.8	79666.0	13173.4	
2004	Jan.	153.3	8511.6	6886.2	7212.4	7019.9	1049.1
	Feb.	180.1	8019.8	5916.4	5381.7	6065.9	839.6
	Mar.	198.0	9460.0	6194.3	6474.4	7206.9	1270.4
	Apr.	358.5	9370.3	5993.8	7255.6	8165.9	1540.2
	May	216.7	8873.6	5221.4	7978.1	6241.3	923.2
	Jun.	177.2	10068.1	4894.2	9480.1	7269.0	1375.3
	Jul.	75.4	9032.1	4230.6	10984.5	7360.2	1364.2
	Aug.	126.7	8168.0	3448.8	13198.6	3770.7	927.1
	Sep.	228.8	6976.5	4690.5	9952.8	4741.4	1010.0
	Oct.	625.9	8828.1	4762.4	5898.0	5893.8	1094.6
	Nov.	1172.9	7064.3	5246.3	5375.6	4349.5	1542.1
	Dec.	1509.2	8433.1	5733.6	7385.3	6767.7	1603.2
2005	Jan.	1038.8	10081.7	4821.6	6326.1	6682.2	1613.1
	Feb.	542.0	9421.2	5853.0	5664.9	7849.7	932.4

these numbers, the highest number of units are in the clothing sector, which is about 600 units.⁷ Despite the highest number of units and employment opportunities in the clothing sector, the investments are lowest in the sector, as low as 4.8 percent compared to spinning that attracted an investment of 47 percent.

The clothing sector is the single largest source of industrial employment in the country, employing mainly men (87 percent) in sewing, with women working in trimming and packing, which is a little above 23 percent.⁸ Its labour costs are among the world's lowest, but the quality and productivity are

also generally low. Pakistan has an established industry, which adds value at all levels from cotton onwards to made-ups. A broad Policy Framework Textile Vision 2005 aims at making Pakistan a more viable, stronger and much more competitive textile industry, especially at the value added stages. For this, over US\$ 2 billion have been invested over the last three years of restructuring of the textile industry as a whole. Emphasis is being laid on increasing the share of downstream industry in the over all textile exports of the country, meaning greater value addition. Both vertically integrated units or specialised mills have demanded consistent quality across huge

⁶ www.epb.gov.pk

⁷ Textile Commissioner's Office.

⁸ There is no specific source of these figures, numbers vary distinctly from different sources, therefore the above reflects a mean analysis of the situation through industry interviews.

volumes of single items of clothing, which can only be procured with skilled workforce.

In Pakistan, an estimated 30 percent of the T&C sector's workforce, which is three million workers, is female. This ratio, though higher than the national average of 15 percent female workers, is far lower than that of other South and Southeast Asian countries. According to the Government of Pakistan's report to the world conference of women in Beijing, it is evident that 'women and girls in poor households bear a disproportionately high share of the burden of poverty. Women face barriers owing to limited education and training opportunities.' The report goes on to highlight that limited access to social services and restricted mobility are further constraints, in addition to lack of education and training. A basic analysis shows that trained women in the clothing sector will be a significant asset for the industry in Pakistan. While on the one hand, training will boost growth through quality skills, it will inherently help the cause of women's development through industry-driven garmenting skills.

From 1999 to 2004 Pakistan experienced a fall in the exports of raw cotton, whereas exports of fabrics, knitwear and bed wear including garments increased tremendously as a result of the EU's GSP Scheme. However, this steady non-fluctuating growth from 2001 to 2004 is experiencing a decrease in the first quarter of 2005. While there has been a growth of more than 11 percent in yarn and fabrics, exports from Pakistan have witnessed a fall of 10 to 15 percent in knitwear and bed wear.

There is an across the board decrease of Pakistani exports of T&C in the EU market. An analysis of the EU GSP utilisation rate underlines the importance of preferential market access for this highly volatile economy Table 2 below depicts GSP utilisation rates for Pakistan, undoubtedly the only figures worth mentioning are Chapter 61, 62 and 63. The year for the utilisation rate is 2002.

TABLE 2
Pakistan GSP Utilisation Rate 2002

HS Chapter	Total Imports from Benef.	Imports Dutiable	Imports GSP-Covered	Imports GSP-Received	Utilis. Rate (percent) (=10/9)
61	270,837	270,837	270,851	236,689	87.4
62	421,474	421,474	421,436	391,922	93.0
63	590,208	585,670	585,599	549,639	93.9

Notes: Chapter 61: Art of apparel & clothing access, knitted or crocheted.
Chapter 62: Art of apparel & clothing access, not knitted/crocheted
Chapter 63: Other made up textile articles; sets; worn clothing, etc.⁹

In all the three HS Chapters, Pakistan's utilisation rate was above 80 percent, going higher than 93 percent in textile made-ups (Chapter 63).

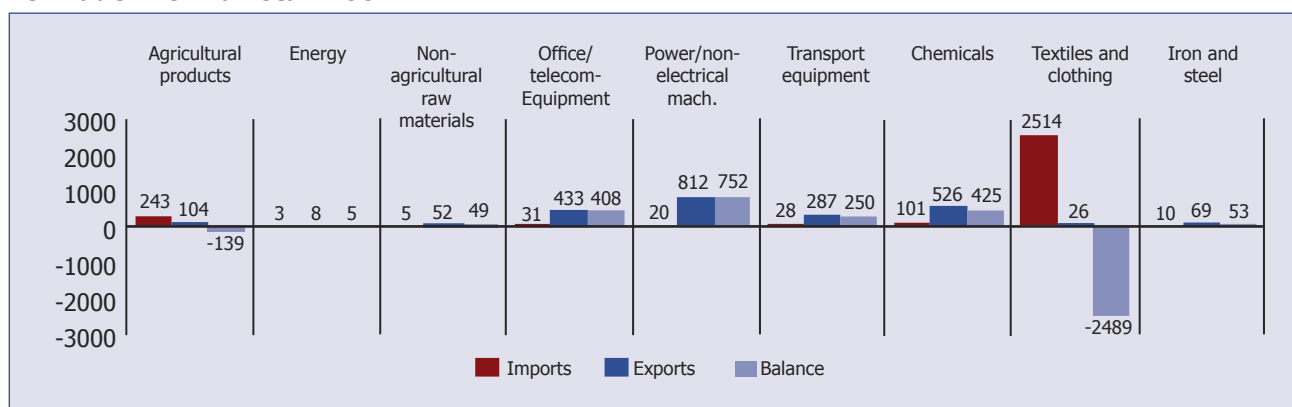
This high GSP utilisation rates in Chapters 61, 62 and 63 are not only a sign of increased market access during 2001-2004, but rather these indicate the investments and employment generation that took place in Pakistan during this era. During 2002-2004, Pakistan gained substantially from the special incentive for drugs. The falling export in the T&C sector in 2005 is an outcome of the combination of quota removal and the withdrawal of the special incentive scheme on drugs for Pakistan. The falling exports in the labour-intensive clothing sector have led to serious concerns over employment in the coming years. It is feared that the fall of exports in a high most performing sector of the economy might culminate in a colossal reversal of the economic growth of the country.

In 2002, the total labour force was about 41 million. By 2007, another seven million persons will enter the labour force. With the current high levels of unemployment, (7.8 percent) and underemployment it will be a challenge to absorb all the new entrants in the local labour market, especially in the wake of falling exports. Pakistan's poverty reduction

⁹ UNCTAD Trade Statistics Department, www.unctad.org.

FIGURE 2

EU Trade with Pakistan 2004¹⁰



programme¹¹ is based upon the expectations of a kick-start to the national industry ‘by inducing growth of the national economy and rapid socio-economic uplift, with a focus to generate employment (about 1 million jobs) and help revive industry, boost production and consumption of cement, steel and brick, thus contributing to poverty alleviation’. The Three-Year Plan for 2001-04 emphasises a five-point agenda including economic reforms, creation of physical assets for the poor, social assets for the poor, social safety nets and governance. Pakistan is therefore in dire need of economic reform in terms of initiating institutionalised political and economic dialogue for ‘preferential market access’. However, preferential market access comes with its drawbacks, the most conspicuous being non-tariff barriers i.e., anti dumping proceedings against GSP covered products. Report of anti dumping investigations against Pakistan’s cotton bed linen and ethyl alcohol (GSP covered products), have damaged the preferential market access.

4. FALL IN EXPORTS ANTI-DUMPING DUTIES ON PAKISTAN’S BED LINEN — A GSP COVERED PRODUCT

Pakistan’s two key products, cotton bed linen and ethyl alcohol performed exceptionally well

in the EU market under the GSP preferential regime. However, than performance has been restricted by anti dumping investigations, causing both success stories to turn bitter. Textile exports from Pakistan, in general, and value-added textile exports, in particular, suffered a drastic set back as a result of the 11 September 2001 attack in USA. The decision of the Government of Pakistan to join the international coalition in the fight against terrorism was based on principles, irrespective of the immediate consequence for the economy of the country. However, in order to strengthen Pakistan so that it could play its role effectively, both the US and EU offered aid packages.

Under the EU package, all value-added exports from Pakistan i.e. ready-made garments, finished fabric and knitwear were exempted from import duty with effect from 1 January 2002. The export quota of Pakistan for textile and clothing was increased by 15 percent with effect from 1 December 2001 and the anti-dumping duty of 6.4 percent levied on the import of bed linen from Pakistan was terminated. The package made Pakistan eligible for the new GSP scheme applicable to countries combating drugs. As a result of this concession, Pakistan improved its access to the EU market. The applicable tariffs in

¹⁰ EU Trade Document 111553 - DG Trade March 2005.

¹¹ These are, the ten-year National Development Plan (2001-2011) and the Three-year rolling Poverty reduction Plan (2001-2004).

clothing and textiles were reduced by 5 to 25 percent, beginning 2002 to 2004. There was a five percent reduction across the board compared with tariffs in 2001. The EU Trade Commissioner, Pascal Lamy, while presenting the Package to EU Council of Ministers and the European Parliament, declared:

‘We have made these negotiation a top priority because Pakistan is in an exceptional situation. We have targeted those areas where Pakistan can benefit most, namely clothing and textiles. Trade is a weapon of peace. Through trade and the fostering of greater economic ties with Pakistan, the EU can contribute to alleviating in some measure its current difficulties.’

As a direct result of the concessions provided by the EU, a surge in bed linen exports to the EU was witnessed. The value of bed linen exports to the EU increased to more than US\$ 350 million, which is approximately 26.52 percent of the value of total exports from Pakistan in the year 2002-2003. However, following this increase the EU imposed a 13.1 percent anti-dumping duty on Pakistani bed linen effective from 18 March 2004. In addition to the imposition of the anti dumping duties, Pakistan also failed to qualify for EU’s new GSP plus scheme, hence *inter alia* losing the 12.8 percent benefit of the special drug incentive also. In total, the booming bed linen export will suffer at the cost of an approximately 25 percent duty on the product. All this happened in the wake of Commissioner Lamy’s affirmation that Pakistan is in an ‘exceptional situation’ and that the EU shall contribute to alleviating, in some measure, its current difficulties through the lifting of all import duties.

The investigation on the EC bed linen case gave rise to some important issues questioning the political economy of the EU GSP. In addition to being a GSP covered product, it was important to note that the increase of imports of bed linen from Pakistan

for the period under investigation was much less when compared to the imports of other countries into the EU. Imports from Poland increased by 99 percent (from 4,677.4 to 9,307.7 tonnes), imports from Turkey increased by 65 percent (from 13,412.2 to 22,082.7 tonnes), imports from Romania increased by 62 percent (from 3,179.9 to 8,342.7 tonnes) and imports from the People’s Republic of China increased by 58 percent (from 2,842.1 to 4,479.6 tonnes). However in comparison to this, the EU market share held by Pakistani producers/exporters (21 percent) was much lower than the overall increase of the market share of imported bed linen (46.3 percent) or the increase of the market share of Romania (116.3 percent) or Poland (64 percent). From an export of 245 million in 1996, exports of bed linen rose to 533 million in 2003, which was 18 percent of the total textile exports of the country, rising from eight percent in 1996. Table 3 below highlights the steady non-fluctuating growth in bed linen exports from 1996 to 2003.

While the growth rate of the exports of bed linen from Pakistan were preferentially considered, growth in imports of bed linen from other countries into the EU was not examined. The submissions of Pakistani manufacturers pertaining to production cost were rejected by the EU team during a survey

TABLE 3
Growth of Pakistan Bed Linen as a Covered Product¹²

Year	Imports to EUR-15 (in euros)
1996	245,505,650
1997	284,178,360
1998	307,745,310
1999	367,566,960
2000	381,694,120
2001	401,129,640
2002	502,079,860
2003	533,532,900

¹² www.epb.gov.pk

of the sample bed linen units and the prices of bed linen in the local Pakistani market were not cross examined. Bed linen export prices were based on calculations of deemed profit margin of only 3.5 percent; on the other hand, a profit margin of 6.5 percent was taken for the EU industry. The issue was challenged in the reply to the injury statement but was not upheld during the proceedings.

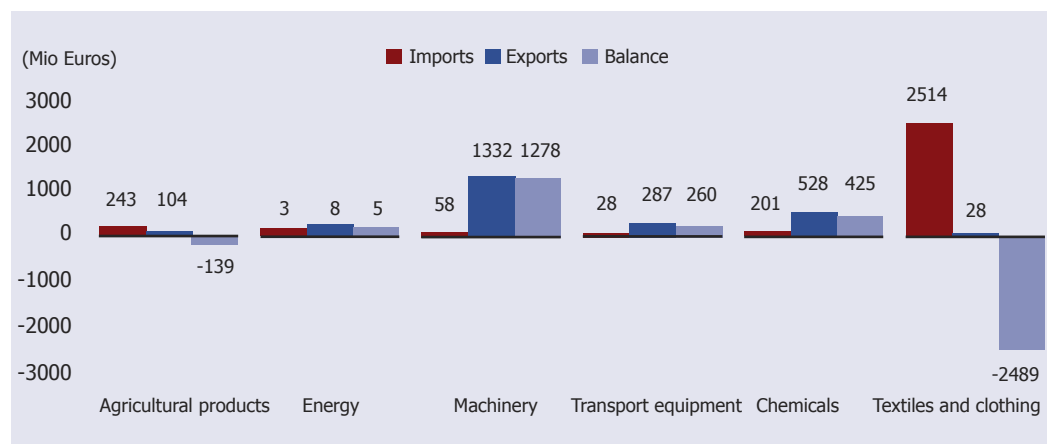
The surge of imports of bed linen from Pakistan during 2002 was facilitated by the EU concession granted to Pakistan, the benefit of a duty-free access under the anti-dumping GSP special regime. It was therefore obvious that the increase was not due to dumped prices but to the withdrawal of previously existing import duties. It was interesting to note that most of the companies listed as complainants in the EC bed linen investigation were buyers of bed linen from Pakistan and their balance sheets showed no signs of suffering from the harsh conditions of the market. Most companies who also happened to be complainants boasted of stable results i.e., Dewerchin: ‘the company is enjoying even greater success and its bed linen is now positioned at the top

end of the range.’¹³ Joseph Hacot says that its ‘savoir-faire convinced leading distance selling companies, hypermarkets and buying offices.’¹⁴ Hacot et Colombier is proud to be ‘the market leader.’¹⁵ While these promotional statements cannot be substantive validations, however, it was clear that steady growth in production of developing country textiles and clothing product lines, was not concentric to the high-end types of products manufactured by most of the complainant companies, who turn around and complain against their own manufacturers.

Additionally, while it was important to reiterate Commissioner Lamy’s words — Pakistan was a special circumstance country — it should have also been considered that Pakistan is a heavy importer of machines, dyes and chemicals from the EU countries. Figure 3 below shows machinery, transport equipment and chemicals as the core imports from the EU.

In brief, with the imposition of duties and the loss of the GSP plus Pakistani bed linen manufacturers are struggling to survive the quota free era with the following problems:

FIGURE 3
EU Merchandise Trade with Pakistan by Product 2004¹⁶



¹³ http://www.obcebdbh.be/import_en/info-center/beci_views/2000/b142/part3_en.html

¹⁴ http://www.cotonflor.com/joseph-hacot/double_joseph.htm.

¹⁵ http://www.cotonflor.com/hacot&colombier/double_hacot&col.htm

¹⁶ Source: EU Trade Document 111553 – DG Trade, March 2005.

- Withdrawal of concession of 12 percent custom duty previously allowed under GSP drug regime.
- Imposition of 13.1 percent anti-dumping duty in the EC Bed linen case.

With about a 25 percent burden of duties, the export of cotton bed linen from Pakistan is relatively displaced and is likely to suffer more in the coming years. There was an offer from the EU for a 35,000 tonnes yearly quota for the export of bed linen to the EU states, whereas, Pakistan's export of bed linen to the EU member countries was in the range of around 60,000 tonnes. Pakistan did not accept the request for the 35,000 tonnes of yearly quota, but figures show declining exports of Pakistan's bed linen to the EU. Similar to the scenario of the bed linen antidumping duties, the rise of Ethyl Alcohol (EA) exports and the subsequent antidumping investigation of the product is another GSP withdrawal casualty, in line with unjustified barriers to trade.

5. IMPLICATIONS FOR PAKISTAN OF THE EU DRUG ARRANGEMENT SAGA AT THE DSB/AB

The EC anti-dumping investigation against Pakistani bed linen was combined with the withdrawal of the Drug Arrangements under the GSP Scheme of the European Communities. The case brought before the Dispute Settlement Board (DSB) by India, challenged Council Regulation (EC) No. 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004.¹⁷ As a result of the said Regulation, the tariff reductions accorded under the Drug Arrangements to the 12 beneficiary countries were greater than the tariff reductions granted under the General Arrangements to other developing countries, in respect of products that were included in the Drug Arrangements but not in the General Arrangements. The 12

beneficiary countries were granted duty free access to the European Communities' market, while all other developing countries must pay the full duties applicable under the Common Customs Tariff.

The core issues raised before the Appellate Body (AB) included first, whether the 'special arrangements to combat drug production and trafficking' which are part of Council Regulation (EC) No. 2501/2001 are inconsistent with Article I:1 of the General Agreement on Tariffs and Trade 1994 (the 'GATT 1994'), second, whether the European Communities failed to prove that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause, based on the Panel's findings that the term 'non-discriminatory'¹⁸ of the Enabling Clause requires that, pursuant to schemes under the Generalised System of Preferences ('GSP'), 'identical tariff preferences' be provided to all developing countries without differentiation, and the term 'developing countries'¹⁹ of the Enabling Clause means 'all' developing countries, except as regards the implementation of a *priori* limitations.

The AB offered a detailed jurisprudence on positive efforts and negative conditional ties of the EU GSP Regulation especially the Drug Arrangement. The AB disagreed with the argument that the Enabling Clause, like the 1971 Waiver, is a decision to permit developed countries to afford preferential tariff treatment to imports from developing countries so that the multilateral trading system can provide equivalent benefits to developing and developed countries. It allowed the developed countries to offer more favourable tariff treatment to exports from developing countries, with the expectation that the exercise of the right would result in development and an increase in exports from developing countries. The preferences authorised under the Enabling Clause are a continuation of the 'positive efforts designed

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¹⁷ Official Journal of the European Communities, L Series, No. 346 (31 December 2001).

¹⁸ In footnote 3 to paragraph 2(a) of Enabling clause.

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to ensure that developing countries, and especially the least-developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development'.²⁰ In other words, allowing for more specific treatment carved according to the needs analysis of a particular country.

The Appellate Body recognised that legal relationships can differ from, and can be more complex than, the traditional general rule (e.g., Article I or III) — exception (e.g., Article XX or XXIV) relationship i.e. EC – Hormones²¹ and Brazil – Aircraft.²² However, the AB disregarded the argument that the relationship between the Enabling Clause and Article I is not a general rule-exception relationship, The Enabling Clause remains in the nature of a waiver from developed countries obligations under Article I, which implies that the Enabling Clause permits a series of individual, preferential measures each of which contributes to the goal of better market access for exports from developing countries. Enabling Clause is in other words more like the group action contemplated by Article II of GATT 1994, requiring no waiver, unlike individual action described in many provisions of the WTO agreements.

In addition to the jurisprudence on the modalities of the drug regime, the AB also expressed its view on the negative and positive conditional ties entailed in EU's previous GSP Scheme. The negative conditionality included factors like money laundering, fraud in rules of origin, unfair trade practices, export of goods made by prison labour, involvement in slavery or forced labour and ineffective customs control on drugs. Under the positive conditionality programme, additional tariff preferences were incorporated on all products as long as they comply with core labour

standards, and on tropical timber products if they comply with international standards concerning sustainable management of forest products.

After the decision of the WTO Appellate Body (AB) on European Community (EC) conditions for the granting of tariff preferences to developing countries (WT/DS246/AB/R), EU's approach witnessed a huge change and an attempt has been made to convert the negative conditional ties into positive. This conversion is not without loopholes and hard implications for countries like Pakistan that were previously receiving preferences under the negative conditional ties. On the face of it, one core implication is that the new GSP scheme has been designed to include more non-trade issues. This means a lot of difficulties for countries like Pakistan who will have to invest massive amounts in soft-infrastructure, regulations, capacity building and trade facilitation. Also non-trade issues are always a hard negotiation bargain for developing countries who neither have the capacity nor the requisite culture to implement such requirements.

In order to become eligible for tariff preferences under the positive conditionality programme, a country has to incorporate the international agreement or convention on which the conditionality is based in its domestic legislation, and effectively implement this legislation. While the EU has successfully increased the scope of the GSP positive conditional ties, it will not be easy for developing countries to perform the rather expansive list of international agreements or conventions. For example, the EU has included 27 new positive conditional ties in its system, which will be effective from 1 January 2006. These deal with conventions such as minimum age for admission to employment, abolition

²⁰ Preamble, Agreement Establishing the World Trade Organisation

²¹ Appellate Body Report, EC – Hormones. In both EC – Hormones and EC – Sardines, the Appellate Body found no general rule-exception relationship even though the word 'except' was used in both Article 3.1 of the SPS Agreement and Article 2.4 of the TBT Agreement. As stated by the Appellate Body in EC – Hormones, Article 3.1 'simply excludes from its scope of application the kinds of situations covered by Article 3.3' Appellate Body Report, EC – Hormones, para. 104.

²² Appellate Body Report, Brazil – Aircraft.

of forced labour, human rights, sustainable development and good governance. All these conditional ties are positive in nature and according to AB's ruling; the EU is well within the legal parameters. Nevertheless, the political economy of the new GSP scheme is much tilted in favour of the donor and much too rigorous for the beneficiaries.

In addition, to the ratification of the 27 conventions, a key uncertainty relates to the definition of 'effective implementation of the legislation'. Incorporation of the relevant principles of international law in domestic legislation is an objective assessment and therefore factually verifiable. However, how does one verify whether or not a country is effectively implementing its legislation? Being a subjective issue it can be easily manipulated for the sake of political expediency. In other words, inclusion of non-trade interests supported by the open ended test of effective implementation will be a loose end favouring political manoeuvring. Also positive conditional ties may be a good incentive for countries to ratify many important international conventions, however, in practice most of the developing world would not be able to implement these conventions due to their constrained resources.

6. DISTRESS DUE TO 'GRADUATION' – PAKISTAN'S 'DEVELOPMENT NEED' AND THE GSP PLUS

A question that is inherently subjective is how to determine the development need of a particular conditionality in a particular country, i.e. did Pakistan qualify for the GSP plus as a beneficiary owing to its development need or was the graduation formula applied on Pakistan's non-diversified economy justified? From January 2005, Pakistan's textile and clothing will no longer enjoy the benefit of reduced duty under GSP in the EU because the European Commission graduated Pakistani textiles and clothing to a higher level, deeming it undeserving of GSP support due to its having achieved sufficient competitiveness

in the exports. At present, Garments face a duty of 25 percent and fabrics/made-ups of 12 percent. In addition, there is a 13 percent anti-dumping duty on bed linen. These duty rates have made Pakistani textiles and clothing extremely un-competitive in the European market from January 2005 onwards. Pakistan should have made a case of non-diversified economy before the EU. Pakistan's case could have been strengthened based on the European Commission's July 7th Communication 2004. In principal, Pakistan under various paragraphs of the July Communication could have argued:

- (a) According to para 6.2 of the Communication from the Commission dated 7 July 2004, the GSP benefit should be offered to countries that are LDCs, as well as those that are low income, land-locked and '...those whose economies are not at all diversified. This goes in particular for the textile and clothing industry...' A case could have been made that Pakistan's economy is not diversified as textile and clothing exports account for 68 percent of its export, and the country is particularly vulnerable because of this dependence on one commodity.
- (b) In para 6.4, the Commission states that the current criteria of graduation will be replaced by simplified criteria so that the new system will graduate only groups of products with reference to the Combined Nomenclature. Thus, '...Small beneficiaries, competitive for just a few products, or groups of products would under no circumstances be graduated solely on the basis of those few products.' Under this criteria Pakistan certainly had an argument, because it is strong in the fabric and made ups sector, but weak in the woven garments and value-added technical and synthetic textiles sectors.
- (c) Para 6.5 states that instead of the previous subjective and negative conditionalities the new GSP plus will cater to positive conditions wherein the simplified system whereby the actual performance in areas

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like labour protection, environment and combating drugs and terrorism, can be quantified and evaluated. The government will need to show in this case that not only has it ratified numerous international conventions, it has also introduced legislative measures to implement these conventions through appropriate laws. This would be especially important in the context of laws to protect women and children, minorities and other disadvantaged groups, as well as those concerning drugs and terrorism.

In addition to offsetting graduation through the above-mentioned facts, Commissioner Lamy's analysis about Pakistan should have been highlighted, 'Pakistan is a special situation' country. Clearly, Pakistan's special circumstances arise principally due to her difficult geography, sitting in the arms of war torn tribal Afghanistan alongwith having Kashmir Jihad Movement in the North, the country has survived in the face of the menace of drugs and terrorism.

Pakistan was *inter alia* included in the Drug arrangement of the EU like the other beneficiaries of the Arrangement. With the increase of poppy cultivation in Afghanistan, Pakistan continues to face drug trafficking problems. Eighty percent of all heroin in Europe and 50 percent of the world's supply originated from Afghanistan. In 2002, Pakistan seized a total of 9.5 tonnes of heroin — the largest annual seizure of heroin by any country in the world. The European Communities recognised at the time that the instability in Afghanistan invariably led to greater drug trafficking through Pakistan. Most of the poppy cultivation in Afghanistan is located in areas contiguous to the tribal belt of Pakistan. Eliminating the cultivation in the poppy belt also meant fighting with a lot of unemployment. The preferential

measures under the arrangement contributed to the goal of better market access for exports from Pakistan, it led to an increase of exports worth US\$ 300 million and job creation for more than 100,000.²³ Additionally, Pakistan made efforts to provide alternative sources of income, to a vast majority of those possibly tempted by drug trafficking. The clampdown on drugs had a devastating effect, in a country where the average monthly salary is around US\$ 5, smallholders could make up to US\$ 500 a year from the cultivation of poppies.²⁴ However, not only Pakistan continues to fight drugs and its ancillary employment problems, it is also standing ground in the wake of a tough geography, the next war to be fought is against terrorism. This also calls for reviewing Pakistan's current needs analysis against its resolution to fight terrorism.

Terrorism thrives in much of the world — not only in lingering conflicts, but also in areas where the State fails to provide basic services, especially education. In many rural areas of Pakistan, free government schools are not available. By educating, clothing, housing, and feeding the poorest for free, the *madrasas*²⁵ fill a desperate need. Many families receive financial assistance from the *madrasas* for sending their children, while *madrasas* also serve the society by educating the poor, however, there are some organisations preaching extremism in the guise of *madrasas*. Poverty remains at the core of this problem and only increased employment generation with a diversified manufacturing base through market access can be a panacea. The only way out for the country to avoid falling prey to the agenda of the terrorists is — employment generation. The positive efforts required against drugs and terrorism are the dire development needs for Pakistan, which cannot be met by the country alone. Hence the need for international efforts to assist Pakistan to come out of extremism.

²³ Pakistan Ready Made Garments Manufacturers Exporters Association – PRGMEA Secretariat.

²⁴ Reported in Pakistan's submission to the DSB in the European Community (EC) conditions for the granting of tariff preferences to developing countries.

²⁵ Please note the reference to Madrasas here implies only those religious schools that give terrorist training in the guise of religious education.

7. LOSING LIVELIHOOD: QUANTIFYING THE LOSS OF EU'S GSP PLUS TO PAKISTAN'S CLOTHING SECTOR

Pakistan's non-diversified economy is dependant on the T&C sector, the total share of the sector in Pakistan's export is more than seventy percent, wherein the clothing industry has a share of 33 percent of the total exports. The total employment generated by the sector is about 30 percent of the total employment generation of the country. With this heavy dependence on a single sector, Pakistan's T&C share in the EU market is 1.87 percent. Figure 3²⁶ below shows the contribution of the T&C sector to Pakistan's economy.

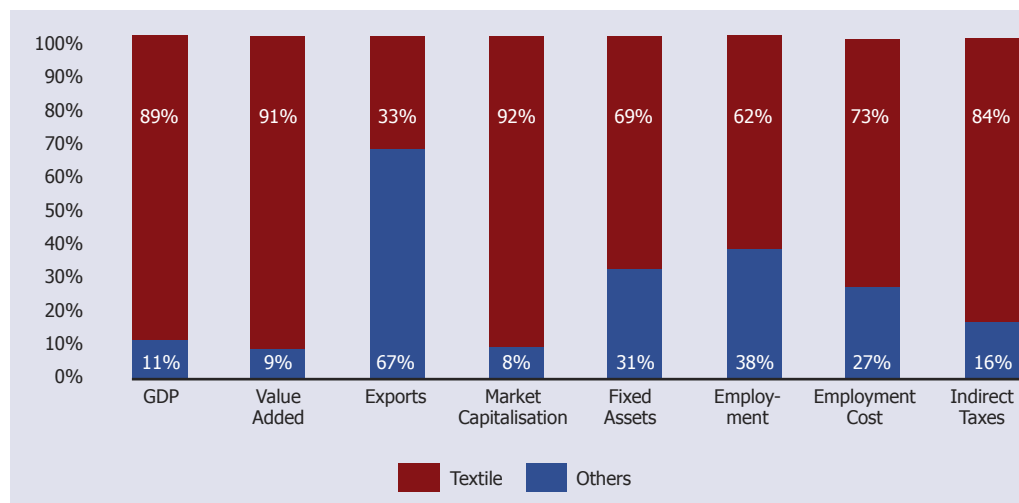
The economic justification of the T&C industry for the year 2003-04 shows the high dependency of Pakistan's economy on this sector. The sector's share in total exports is 69 percent with a 46 percent share in the country's total manufacturing. The overall T&C exports are worth US\$ 8.4 billion, while the five yearly investment in the sector for the years 1999-2004 amounted to US\$ 4.5 billion, it has a 38 percent share in the total employment generation; contributing 8.5 percent to the GDP. The core competitors

of Pakistan in the T&C sector in the EU are China, Bangladesh, India, and Sri Lanka. Figure 4 below shows China taking the lead with a market share of above 20 percent followed by Bangladesh six percent. While India enjoys a five percent market share, Pakistan and Sri Lanka have a percentage of less three percent, respectively. As a result of the Drugs Arrangement, the T&C exports of Pakistan grew post 2001, at a steady and non-fluctuating pace in the EU market. Exports of T&C from Pakistan almost doubled from 480 million to 810 million in the two years, 2002-04, as can be seen in Figure 5 below.²⁷

It is estimated that every export worth 4100 to the EU, generated employment for one person. In other words a 330 million incremental export to EU within the next three years would mean job creation for 483,000 workers. In the spinning sector, every investment worth Euro 700 million will generate employment for 30,000 workers in the country. Similarly, every investment worth Euro 700 million in a clothing-manufacturing unit will generate employment for 600,000 workers.²⁸ However, it can happen only if Pakistan puts its domestic economic reform and external political dialogue in correct

FIGURE 4

Contribution of T&C Sector to Pakistan's Economy



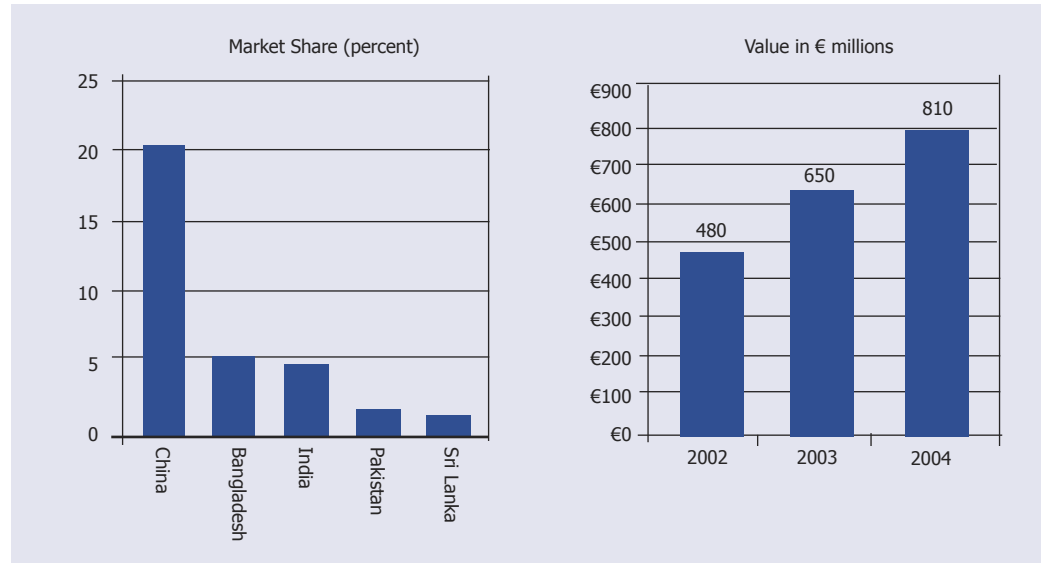
²⁶ Pakistan Textile Commissioners Secretariat.

²⁷ PRGMEA Secretariat Karachi.

²⁸ All calculations have been done by PRGMEA Secretariat.

FIGURE 5 & 6

EU Imports from Asia EU Imports from Pakistan



shape and succeeds in gaining preferential treatment.

The loss of the GSP, the phasing out of the quotas from January 2005, the non-diversified export basket within the T&C sector are already hurting Pakistan's economy and the sector itself. The first quarter of 2005 is showing signs of a reversal of the growth process of the T&C sector of Pakistan. This reversal is most distinct in the EU market. Table 4 and Table 5²⁹ below, depict the increase in Pakistani exports in garments into the EU market, however this is no more the case and the figures have fallen at an average of 10-15 percent across board.

For example, categories 6106, 6103 and 6207 have shown non-fluctuating growth since 1996 to 2004. In category 6106, Pakistan witnessed a growth from 4.4 million to 12 million. Similarly in category 6103, Pakistan had an increase in exports from 7.3 million in 1996 to 20 million in 2003. But the scenario has changed and as mentioned earlier products like bed wear and knit have decreased in the first quarter of 2005. There has been a closing down of many SME units especially in knit garments which will result

in an anticipated loss of employment of about 100,000 jobs in the next three years.³⁰

8. WILL EU'S REGIONAL CUMULATION FOR SAARC COUNTRIES HELP PAKISTAN'S EXPORTS?

The EU under its new rules of origin has expanded the scope of regional cooperation, which applies to member of RTAs. Compliance with rules of origin can seriously affect the sourcing and investment decisions of companies; therefore, regional cumulation provisions have been introduced to reduce the constraining effect of the current rules of origin. Though they still hamper the choice of sourcing, however, in case of EU's regional cumulation for SAARC countries, the region is likely to benefit.

In Pakistan, textiles and apparel producers have varying interests. The basic textile producers are likely to benefit from the regional cumulation, but this might not be the case for the apparel producers. However, the textile industry sources believe that the new rules if implemented would dislocate textile made-ups and garment industries

²⁹ <http://mkaccdb.eu.int/cgi-bin/stb/stat/>

³⁰ The calculations are based on analysis during the course of meetings with the private sector.

TABLE 4

Trade in Women's or Girls' Blouses, Shirts and Shirt-blouses, Knitted or Crocheted (HS4 6106)

Year	Imports to EUR-15 (in €)	Exports from EUR-15 (in €)
1996	4,392,910	2,730
1997	5,550,330	3,110
1998	5,531,040	19,700
1999	4,201,260	6,880
2000	3,348,180	1,840
2001	3,516,530	0
2002	8,690,180	2,890
2003	11,963,100	3,440

from Pakistan to Bangladesh and Sri Lanka. Bangladesh being an LDC will enjoy duty free access in the EU. Similarly, Sri Lanka would benefit under the CSR rules of the EU. While Pakistani coarse count yarns and woven fabric is likely to sell well in the regional market due to its high quality however, according to most garment producers the thrust of EU's new rules towards regional cumulation will have some negative implications on Pakistan's garments and textile made-ups exports. Not only leading to the loss of markets but also weakening the sector's employment generation capacity and will render thousands jobless.³¹ Pakistan's FTA with Sri Lanka and improved trade with Bangladesh will lead to tremendous increase in export of yarn and fabrics to both countries. While increasing its basic textiles exports in the region, Pakistan will substantially benefit from the import of fine count yarns and fabrics from India. But Pakistan and India will have to improve their bilateral trade relations to benefit from such regional integration. There was an additional proposal for super cumulation of SAARC and ASEAN rules of origin. This proposal

³¹ This was reconfirmed by personal interviews with Garment Manufacturers in Lahore and Karachi namely Scantex and Angora.

³² KSA Technopak India, at the Cotton USA Asia Dubai.

TABLE 5

Trade in Men's or Boys' Suits, Ensembles, Jackets, Blazers, Trousers, Bib and Brace overalls, Breeches and Shorts (other than swimwear), Knitted or Crocheted (HS4 6103)

Year	Imports to EUR-15 (in €)	Exports from EUR-15 (in €)
1996	7,358,170	17,360
1997	6,748,710	26,830
1998	5,827,260	63,550
1999	6,989,230	25,990
2000	8,866,470	19,650
2001	7,846,580	10,030
2002	13,261,540	20,030
2003	19,988,570	17,170

which was rejected by India and Pakistan, as it would have led to a lot of dumped and devalued import of basic textiles from ASEAN countries, especially Indonesia. The following Table 6 shows Pakistan's low competitive rating in the T&C sector. An analysis of the first eight ratings depicts Pakistan as the least competitive compared to regional players like China, India, Indonesia, Thailand and South Korea.³²

9. WAY FORWARD

There are several steps that Pakistan should take urgently to ensure survival in the fierce competition of the globalised economy. Public-private partnership will have to serve as the converters, helping to plug in domestic manufactured product lines into international markets. In other words, the public sector should do a needs analysis of the private sector exportable products and a joint effort should be made in marketing and market access promotion through research-based business advocacy. Pakistan's economic dependency on IMF loans till 2002 and

TABLE 6
Competitiveness Rating of T&C Manufacturing Countries

	Raw Cotton MMF Production Cultivation	Availability of Converting (Spg & Wvg) Technology	Conversion Cost	Country Stability/Private Sector Growth	Points Gained on all Factors	Overall Ranking
China & HK	5	5	4	5	500	1
India	5	4	4	5	400	2
Indonesia	4	3	5	3	180	3
Turkey	4	3	3	5	180	3
Thailand	3	3	4	4	144	5
South Korea	5	3	2	4	120	6
NAFTA	5	3	2	4	120	6
Pakistan	3	3	4	3	108	8
Brazil	3	3	3	4	108	8
Taiwan	5	3	2	3	90	10
CIS	3	3	4	2	72	11
Other European	2	3	4	3	72	11
Egypt	2	2	5	3	60	13
Bangladesh	2	1	5	3	30	14
CBI countries	2	1	3	4	24	15
Sri Lanka	1	1	4	4	16	16
Spain	2	1	2	4	16	16
Romania	1	1	4	4	16	16
Cambodia	1	1	5	2	10	19
Vietnam	1	1	5	2	10	19

the post 2002 development of the export basket and the manufacturing base, require a focussed external trade policy to secure market access backed by export competitiveness and improved productivity. The following considerations are the way forward, namely:

- The negotiations at the European Commission for the GSP plus status for Pakistan provide several lessons. The foremost lesson is all preferential negotiations will be based on 'reciprocity'. While there could be an expectation of preference due to Pakistan's special circumstances, in no case should the negotiation chip be dependant on this fact alone. Pakistan will have to pursue a reciprocity-based formula for negotiations with all preferential trade partners. In order to encourage reciprocal

models of negotiations, Pakistan should design detailed sector-to-sector and market-specific roadmaps and strategies. Detailed strategies anchored in data will give the negotiators the confidence to talk on more give-and-take frontage. In this regard, business advocacy cannot be stressed enough. Businesses in Pakistan should educate the government on their preferences for the multilateral and preferential negotiation table. In other words, the Government of Pakistan will have to think like a business CEO and the private sector will have to be a trade negotiator.

- It should be remembered that all LDCs GSP (EBA) is more favourable than other preferences, although associated with more restrictive requirements; also for

non-LDCs, regional agreements are more favourable than GSP. Pakistan should therefore consider areas other than GSP arrangements for closer economic ties with the EU and other trade partners. A bilateral textiles agreement would fill in the anxious need for market access. For this purpose, various sector-specific bilateral agreements should be considered with non traditional partners, such as India. Bilateral investment treaties with India and Malaysia concentrating on investments and services must be pursued. At the same time, Pakistan should consider negotiating an FTA with Bahrain and Bangladesh. Bahrain's trade arrangements with the US will be a boost for Pakistan's clothing sector whereby export of Pakistan value added goods given a final shape in Bahrain can be exported to the US under the US Bahrain FTA T&C provisions. On the other hand, Bangladesh's booming clothing industry, is in desperate need of basic textiles i.e. coarse count yarns and woven fabric, this will lead to a huge growth in Pakistan's basic textiles export.

- Pakistan should focus on diversification of the export box; however, prime concentration should be on the T&C sector. Pakistan should not be concerned so much about the weak preferential market access pockets, instead the industry should concentrate on addressing key challenges i.e. for example: lack of skilled labour, low quality of cotton, continued focus on low value added production, a narrow product base, reliance on cotton and failure to shift production to man-made fibres, and lop sided investment on upstream sectors rather than downstream sectors garments. Pakistan's fabric unit prices are among the lowest in the world, with the vast majority of exports consisting of coarse and medium fabric varieties. But there is a serious need to improve the quality of the fabric especially in the wake of EU regional cumulation of Rules of

Origin. The liberalisation under NAMA negotiations on the multilateral level will erode the preferential treatment in the long run, hence the need to concentrate on competitiveness.

- Regulations are oriented towards basic textiles: yarn and fabric; however, value addition is not receiving the requisite support. The weakest links in the production chain are in the downstream parts of the industry with the greatest export potential, such as clothing. But small units dominate the clothing sector with little access to modern machinery and know-how. There is a need to re-orient the small units into clusters and re-engineer policy in favour of value addition. The Textile Vision 2005 was a good roadmap for basic textiles including made ups; however, there is a serious need for a Vision document for the clothing industry and the Ministry of Textiles and Clothing should work on this agenda.
- Pakistan should also consider vertical integration at a national level as opposed to the enterprise level. Vertical integration at a national level would mean putting in place enterprises specialising in the various processes of the supply chain either yarns, fabrics, dyeing, printing, garmenting, etc. This is unlike enterprise vertical integration where the manufacturing unit caters for yarns, fabrics, etc. inhouse within one company. Pakistan is neither India or China nor Bangladesh; therefore Pakistan's survival in the T&C industry would be dependant on niche products rather than efficiency practices. While producing a pair of good quality jeans efficiently will be the norm; however, there is a need to create specialised and niche product lines. In the wake of the post consumerism trends, Pakistan will have to cater to non-price factors of competitiveness. The average margins in the sector are likely to be decreased, but what will achieve a "margin plus"

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in the sector is innovation and services. Services would imply adding a service to the product as in helping the buyer run the fabric by fabric producers in the first one week of the purchase of the fabric. Innovation and services are necessary for Pakistan to create a niche for itself leading to integration of buyer resources into the supply chain management. This would mean carving innovative marketing and designing techniques which are jointly carried out by the manufacturer and the buyer.

- In the wake of the 11 September events, Pakistan needs to strengthen its lobbying and image building activities. There has been a huge loss of customers due to the adverse publicity in the international media about Pakistan being in the war zone and being disturbed by internal agitations. There is a need to bring foreign buyers back into Pakistan through institutionalised image building and lobbying in the traditional and non-traditional markets. In addition to trained commercial counselors in

local missions, the industry should set up independent offices in Brussels and Washington for direct contact. The model of external relations pursued by the CII, Confederation of Indian Industries should be examined.

- Pakistan has had hard experiences in trade remedy actions against its products; the country should make provision to monitor prices and costs. The price monitoring should, foremost, be chased in the T&C sector; it is a very high-risk industry and many SME manufacturing units close down without being noticed. An exit policy for such manufacturing units is therefore very crucial. The government should also attempt to revive some of the sick industries either through re-engineering them into new sectors or concentrating on cluster development. Cluster development is a suitable *modus operandi* for the SME; a one window package for market intelligence, new investment trends and B2B services on subsidised rates will help the SME to reach the global market.