NOTE FOR INFORMAL MEETING OF GOVERNMENT REPRESENTATIVES ON PREFERENCES

1. The present note has been drawn up with a view to facilitating exchange of views at the informal meeting so that some guide lines may emerge for the discussion in the Working Party on Preferences when it re-assembles on 21 October.

2. The terms of reference of the Working Party on Preferences are "to study the following proposals and report to the CONTRACTING PARTIES at their twenty-first session:

(a) the granting of preferences on selected products by industrialized countries to less-developed countries as a whole; and

(b) the granting of preferences on selected products by less-developed countries to all other less-developed countries."

The proposals before the Working Party derived from paragraph 24 of the Conclusions of Ministers (MIN(63)7) in which Ministers "agreed that contracting parties should give urgent consideration to the adoption of other appropriate measures (i.e. measures other than those proposed in points (i) to (vii) of the Programme of Action) which would facilitate the efforts of less-developed countries to diversify their economies, strengthen their export capacity and increase their earnings from overseas sales. In this connexion it was suggested that one of the measures which should be studied promptly would be the accordance of preferential treatment to the semi-manufactured and manufactured goods exported by less-developed countries."

3. The Working Party has held three meetings, from 7 to 11 October 1963, from 11 to 18 December 1963, and again during March 1964.

A. Tariff Preferences by Developed Countries in favour of Less-Developed Countries

4. Proposals for the establishment of tariff preferences by developed countries in favour of less-developed countries have been discussed both in GATT and at the United Nations Conference on Trade and Development.
5. It is urged by the less-developed countries that the diversification of production and expansion of export earnings of countries in their position cannot be brought about through the multilateral reduction of tariff and other trade barriers alone, and that special measures in the shape of preferential tariffs for exports of less-developed countries are necessary. The following are the more important of the points made:

(i) Because of inadequate infra-structure, low productivity and other dis-economies characterizing production and sales organization in less-developed countries, such countries tend generally to be higher cost producers and exporters of industrial goods than the developed countries. Further, many of their industries are new and need "infant industry" protection, in export as well as domestic markets, until they have had time to establish themselves on a competitive basis.

(ii) The reduction or elimination of tariffs on a most-favoured-nation basis does not adequately enlarge opportunities for industrial exports of less-developed countries in the markets of the developed countries. Firstly, while the reduction or elimination of tariffs on a most-favoured-nation basis might improve the competitive position of less-developed countries in relation to domestic producers in the importing country, it does not do so in relation to producers in the exporting developed countries. Secondly, exporters in developed countries, because inter alia of their better sales organization, are in a better position than exporters in less-developed countries to benefit from multilateral tariff reductions. Finally, the fact that less-developed countries have a very small share in exports of most industrial products means that they tend to benefit little from most-favoured-nation tariff reductions, since the benefit of such reductions is normally distributed according to the present distribution of trade.
(iii) The relatively minor or insignificant share of less-developed countries in manufactured imports into industrial markets should make it feasible to reduce tariffs in relation to these countries to a greater extent than may be possible in regard to such imports generally.

(iv) Even though the price advantage derived from a preference in an export market may be small it will enhance the attractiveness of the export sector in the less-developed countries, encourage efforts to gear production more closely to opportunities in export markets and permit some reduction in the present reliance by these countries on export incentives or subsidies. An important side effect would be the inflow of foreign investment resources to industries with export potential. Apart from their influence on price margins, preferential tariffs would have an important impact on the psychological climate for the export effort in less-developed countries.

(v) The post-war trading system did not rule out a measure of discrimination in the use of payments and quota restrictions by certain countries in the interests of their economic reconstruction and balance of payments. An element of preference in favour of less-developed countries in the tariff policies of developed countries would be justifiable on similar grounds.

(vi) While the less-developed countries recognize the importance of the most-favoured-nation rule, they point out that there are at present a large number of deviations from the most-favoured-nation rule in the shape of various free-trade areas arrangements as well as restricted preferential arrangements between developed and developing countries. In actual practice, these arrangements in their view greatly limit the scope and content of the most-favoured-nation rule and its application to international trade flows. The pressures to deal with the special problems of less-developed countries through special arrangements are likely to grow. A multilaterally negotiated system of preferences which operates in conformity with rules and procedures accepted by the international community would help to restore the most-favoured-nation
principle to its proper position in international trading relations and make possible a larger measure of discipline in international trade than exists at present.

6. Certain developed countries do not accept the case for granting preferences to less-developed countries. The main points made by the former countries in this connexion are that:

(i) the average incidence of tariffs on industrial products in developed countries does not exceed 15-20 per cent. Assuming that the Kennedy negotiations result in a reduction of existing tariffs by 30-50 per cent, the average margin of preferences available to less-developed countries will be not higher than 10 per cent in most cases and could be considerably less than 10 per cent in many instances even if the preferential duty was fixed at the nil rate;

(ii) this margin would be too small to give a decisive advantage to less-developed countries in foreign markets. On the other hand a formidable range of legal and administrative problems will be involved in the establishment and operation of a preferential tariff system;

(iii) the items in which a preferential margin of 5 per cent or 10 per cent could make a substantial difference would be those in which less-developed countries have already achieved some success in organizing production and marketing and in which they already enjoy some competitive advantage. Pressures for excluding these items from preferential treatment or for imposing restraints where the preference results in large inroads into the domestic market of the developed countries, are likely to prove irresistible.

(iv) the most-favoured-nation rule has played a fundamental rôle in the establishment of a non-discriminatory multilateral system of trading relationships. The establishment of a new system of tariff preferences would undermine and delay progress towards reduction of barriers on a worldwide basis and create pressures from protectionist interests for discrimination on various grounds which in the long run might cause serious injury to the interests of the less-developed countries;
(v) in the circumstances, the less-developed countries should concentrate on securing the multilateral reduction or removal of tariff and other barriers to exports of industrial products in which they have an actual or potential interest and on improving their capacity to benefit from such reductions instead of attempting to introduce a new element of discrimination in trading practices which would make it more difficult to deal with discriminatory measures which are directed against their trade.

7. Some industrialized countries, while accepting that the granting of new preferences could make a positive contribution to the aims laid down by Ministers felt it would be necessary to have a more clear picture of what exactly was proposed before a judgement could be made as to whether the advantages which the preferences might bring to the less-developed countries were real enough to justify a breach of the most-favoured-nation rule.

8. A number of other developed contracting parties agree that tariff preferences can serve as a useful instrument for expanding and diversifying the export earnings of less-developed countries. It is common ground between these countries and the less-developed countries that:

(i) the creation of new preferences in favour of less-developed countries should be negotiated and supervised through an international body in accordance with agreed rules and procedures;

(ii) any new preferences should be limited in time and should run only for the period for which special assistance to less-developed countries in building up their exports is needed;

(iii) in any new scheme of preference, safeguards should be provided against trade diversion or extensive disruption of the domestic market;

(iv) any new scheme of preferences should deal satisfactorily with the rights and benefits derived by less-developed countries from existing preferential arrangements.
Some industrialized countries have emphasized that the granting of new preferences should not interfere with the general movement towards the reduction of barriers to trade on a most-favoured-nation basis. The less-developed countries have not dissented from this view.

9. However, important differences of approach between the developed countries who might be prepared to accept a new system of preferences and the less-developed countries exist. Thus the less-developed countries have pressed:

(i) that preferences should be established over the entire range of industrial products in which they have an actual or potential interest as exporters with a minimum of exceptions;

(ii) that these preferences should be extended uniformly to all less-developed countries without discrimination. At one stage some less-developed countries had urged that the preferences should be adjusted to take into account the differences in levels of development among less-developed countries. At the UNCTAD meeting, the less-developed countries agreed on a committee recommendation urging that preferential treatment be extended to all developing countries in a non-discriminatory manner, differences arising from different levels of development being dealt with through means other than the discriminatory use of preferences;

(iii) that the margin of preference should as far as possible be uniform for broad groups of products.

10. As against this, the developed countries who have indicated that they are willing to consider a scheme of preferences prefer a commodity-by-commodity approach which would:

(i) limit preferences to products in regard to which they have a useful and essential role to play in improving export potential and helping to develop competitive sales;

(ii) provide for selection of products through negotiations between developed and developing countries. In addition the Brasseur proposals envisage:
(a) the application of preferential treatment on the basis of the competitive position of a particular industry in individual less-developed countries and the special needs and requirements of each such country;

(b) the limitation of the preference to ensure that the markets of the importing developed countries are protected from disruption;

(c) the adjustment of the period of the preference in accordance with the needs of individual industries in individual countries.

11. It would appear from the above that further discussion of this question could most usefully concentrate on the following points:

   (i) The circumstances, if any, in which the grant of preferences for exports of less-developed countries should be permitted. It would be necessary to consider, in particular, criteria relating to the products which might be covered, and the countries to which preference should be given.

   (ii) The legal provisions on this question which it would in the light of (i) be necessary to include in the Agreement; how far such provisions should specify criteria on such points as the period and depth of preference, and how far should these points be left for the negotiating procedures referred to in (iii).

   (iii) The negotiating procedures which should be established for making use of new provisions and to ensure that the interests of all substantially interested parties are taken into account.

   (iv) The safeguards which are required if tariff preferences for less-developed countries are to serve as an effective instrument for promoting the expansion and diversification of their export capacity and export earnings without creating the problems and difficulties which have been pointed out.
B. Establishment of preferences between less-developed countries

12. The proposal for establishment of preferences between developing countries has not been discussed in any detail until now. The UNCTAD has adopted two recommendations on promotion of trade between developing countries which support the exchange of preferences between these countries. The United States has reserved its position on one of these recommendations on the ground that tariff preferences between less-developed countries should be established only on a regional basis. It has been suggested that the provisions of Article XV of the Havana Charter provide an adequate point of departure for this purpose. In order to achieve progress it seems necessary to secure agreement on the following points:

(i) the purposes and objectives which the exchange of preferences between less-developed countries should serve;

(ii) the conditions under which the establishment of such preferences can be accepted and the basis on which negotiations to this end can take place between less-developed countries;

(iii) the legal provision which needs to be made in the GATT.