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INTERNATIONAL TRADE

Issues Concerning the Generalized System of Preferences Program

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INTERNATIONAL TRADE:
ISSUES CONCERNING THE GENERALIZED SYSTEM OF PREFERENCES PROGRAM

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The Generalized System of Preferences (GSP) Program is a unilateral program that extends duty-free entry to certain imports of developing countries. In 1992, $16.7 billion, or about 3 percent of total U.S. imports, entered duty free under GSP. Most GSP benefits go to the larger developing countries that can produce and export items that meet U.S. market demand. As a result, most GSP benefits accrue to fewer than 10 of the 145 beneficiary countries. Not all products that are eligible to enter the United States under GSP actually enter duty free, due to several program provisions that limit benefits. In 1992, while $35.7 billion in imports were eligible, only a little less than half received duty-free entry.

GAO has provided its draft report on GSP to the Office of the U.S. Trade Representative for review and comment. According to the draft report, the GSP Program has a generally well-structured administrative process for consideration of petitions to add products to or remove products from GSP coverage. However, GAO has identified some specific opportunities to promote better program administration by disseminating more information on the decision-making process, including providing guidelines for analysis, and by rejecting incomplete product petitions.

The program's country eligibility requirements, including the need to provide adequate and effective protection of intellectual property rights and to take steps to observe internationally recognized worker rights, have been contentious. GAO found that administering these "country practice" provisions within the annual review process designed for product petitions has resulted in certain administrative problems. Therefore, GAO has tentatively recommended specific ways to improve their administration.

Because GSP benefits are limited and declining, the program provides only a modest degree of leverage to encourage beneficiary country governments to change their country practices. Adding new provisions would reduce the leverage of GSP in achieving the objectives of the existing provisions. In addition, the Uruguay Round tariff reductions, if enacted, would decrease the value of the GSP duty-free benefit. These tariff reductions would, therefore, reduce U.S. leverage to demand compliance with GSP country practice requirements at a time when some U.S. policymakers are seeking to strengthen and expand such requirements.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to testify on our evaluation of the Generalized System of Preferences (GSP) Program and several matters for your consideration during program reauthorization. My statement is based on our forthcoming study of the GSP program. We have given a draft of this study to the Office of the U.S. Trade Representative (USTR) for their review and comments. We have conducted this study at the request of Senators Harris Wofford and Byron Dorgan and Representatives Steve Gunderson, William Hughes, David Obey, and Collin Peterson.

BACKGROUND

The GSP Program eliminates tariffs on certain imports from 145 eligible developing countries in order to promote development through trade rather than through traditional aid programs. In 1992, $16.7 billion, or about 3 percent of total U.S. imports, entered duty free under GSP. U.S. duties foregone on these imports were almost $900 million. However, the cost to the U.S. government is estimated at 75 percent of this amount due to certain tax revenue offsets, according to the Congressional Budget Office. The value of duties foregone would decrease with implementation of the estimated 40-percent tariff reductions negotiated under the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) for products eligible under GSP, if GATT implementing legislation is enacted. Reauthorization of the program, due to expire on September 30, 1994, provides an opportunity to consider the need for changes.

GSP DUTY-FREE BENEFITS DOMINATED BY RELATIVELY FEW BENEFICIARY COUNTRIES

We found that most GSP benefits go to the relatively small number of more advanced or larger developing countries that can produce and export items that meet U.S. market demands. Government officials and business representatives from the six beneficiary countries that we visited--Brazil, the Dominican Republic, Hungary, Malaysia, Thailand, and Turkey--told us that they have realized increased economic development as a result of GSP benefits, even though the level of development attributable to GSP cannot be precisely measured. An indicator of the value of the GSP Program to developing countries can be determined by examining the level and composition of duty-free shipments to the U.S. market.

Duty-free imports under the GSP Program have been dominated by a handful of countries. In 1992, 85 percent of duty-free imports under the GSP Program were from 10 countries. Mexico accounted for 29 percent of GSP duty-free imports, but was graduated from the program when the North American Free Trade Agreement was implemented on January 1, 1994. Other top shippers included Malaysia, Thailand, Brazil, and the Philippines. Most of the GSP

duty-free goods by value were industrial goods (such as electrical machinery and equipment), rather than agricultural goods.

Other duty preference options, such as the Caribbean Basin Economic Recovery Act, exist for some beneficiary countries. These options reduce duty-free shipments under the GSP Program. In 1992, $2.9 billion (8 percent) of all GSP-eligible imports entered the United States under a duty preference provision other than GSP. Together with the $16.7 billion that entered duty free under GSP, 55 percent of all GSP-eligible goods received duty-free entry.

LIMITATIONS ON GSP BENEFITS ARE SIGNIFICANT

Not all products that are eligible to enter the United States under GSP actually enter duty free, due to several program provisions that limit benefits. In 1992, while $35.7 billion in imports were eligible under the program, $16.7 billion, or 47 percent, actually received duty-free entry into the United States under GSP. About $16 billion, or 45 percent, of GSP-eligible imports entered with duties. (Another 8 percent of GSP-eligible imports entered duty free under other tariff preference programs.) "Administrative exclusions" (discussed below) accounted for the largest share, 56 percent, of these imports that entered with duties. "Competitive need limit exclusions" (imposed because a country exceeds a limit on import levels) accounted for about 42 percent, and "product graduations" (exclusions from GSP because the country is competitive in shipping that product to the U.S. market) for 2 percent. The relative importance of administrative exclusions should diminish with Mexico's graduation from GSP, since 67 percent of these administrative exclusions were attributable to Mexico. Also, competitive need limit exclusions have been growing quickly for other beneficiary countries such as Malaysia and Thailand.

Administrative exclusions can result when products fail to meet U.S. requirements that (1) the beneficiary country's export contain at least 35-percent domestic content and (2) the product be shipped directly from the beneficiary country. Some trade experts have criticized the beneficiary country domestic content, or "rule of origin," requirement for GSP for lack of predictability. They claim that it is not always clear as to which parts and components in a product imported by the United States can count toward meeting the required 35-percent domestic content. Beneficiary country exporters often have no way of knowing whether their exports will meet the rule of origin requirements until U.S. Customs makes a determination. The U.S. Customs Service is currently considering changing the rule of origin system to one that would be more predictable and simpler to administer, using a "change of tariff classification" system such as that adopted in the North American Free Trade Agreement.

The change of tariff classification system confers country origin when imported materials, parts, and components are used to make a new product that falls under a new tariff heading. However, even such a new rule of origin approach would not be problem free. It could make compliance more difficult for GSP beneficiary countries due to the extensive documentation requirements necessary to establish a change of tariff classification, according to an International Trade Commission official.

In addition, importers have criticized another aspect of the rule of origin that does not allow U.S. source material to be considered in meeting the domestic content requirements. Importers have suggested that U.S. components be allowed to apply toward the 35-percent requirement. We agree that GSP items should not be penalized for having U.S. content. Congress may want to consider whether to alter the GSP rule of origin so that items are not penalized for having U.S. content. Other U.S. trade laws provide precedents for (1) including U.S.-origin content of imported goods as part of the exporting country's content and (2) exempting the U.S.-origin content of imported goods from U.S. tariffs.

Other program limitations involve competitive need limits and product graduations. Competitive need limit exclusions are automatically triggered for a country's product when a legislative ceiling on either the dollar value or share of U.S. imports from a country is exceeded in a calendar year. These exclusions accounted for $6.7 billion, or 42 percent, of all exclusions in 1992 and grew rapidly for top shippers like Malaysia and Thailand. Competitive need limit exclusions are based on the assumption that export competitiveness has been demonstrated. However, external factors that may have little to do with the competitiveness of a particular beneficiary country's industry can affect U.S. import levels during the 1-year period used to trigger an exclusion. We found that in a majority of cases examined, a loss of GSP status due to a competitive need limit exclusion was immediately followed by a loss of import market share (although a direct causal relationship could not be established). In addition, the schedule for implementing these exclusions allows beneficiary country exporters and U.S. importers only a few months' notice to adjust business plans before losing GSP benefits.

In reauthorizing the GSP Program, Congress may want to consider altering the competitive need limit process by, for example, extending the amount of time before exclusions under competitive need limits are implemented. This would allow for a more thorough assessment of the competitiveness of the affected imports and permit affected industries more time to adjust.

As for product graduations, in 1992, 2 percent of all exclusions, valued at $276 million, were due to permanent product graduations

from the program. Product graduations are discretionary and are implemented after assessing a beneficiary country's competitiveness for a particular product, usually at the request of U.S. producers.

PROCESS TO REVIEW PRODUCT PETITIONS GENERALLY WELL STRUCTURED, BUT SPECIFIC CONCERNS REMAIN

The GSP Program has a generally well-structured administrative process for consideration of petitions to add products to or remove products from GSP coverage. The interagency structure of the GSP Subcommittee[1] (a working group of the Trade Policy Staff Committee) and its consensus decision-making process are designed to ensure that the program's goals are balanced to provide benefits to beneficiary countries while taking care not to unduly harm domestic interests. The annual review process provides for consideration of all interested parties' views. However, we have identified some specific opportunities to promote better program administration such as (1) by disseminating more information on the decision-making process, including guidelines for analysis; and (2) by rejecting incomplete product petitions.

Among the information that petitioners said they would find useful are definitions of key statutory criteria to make decisions on whether to add products to or remove products from GSP coverage. The GSP statute does not define such key criteria as "import sensitivity" or "sufficient competitiveness." Some petitioners have complained that the lack of definition for these criteria allow subjective decision-making on product additions and removals. However, we believe these criteria would be difficult to quantify for use in every case because they are highly qualitative and judgmental. Most observers we talked with said that an attempt to define these criteria statutorily would result in overly rigid definitions that could hamper achievement of program objectives. The GSP Subcommittee has developed some informal guidelines but has not published them. We believe that USTR should make public the guidelines the GSP Subcommittee uses in analyzing product petitions.

We found, based on a review of the decision-making process for 45 case studies, interagency decision documents, and interviews with GSP Subcommittee members, that most petitions have not been controversial and have been routinely decided based on their economic merit. However, we also found that the more controversial the case and the higher in the trade policy structure the case was elevated in order to reach consensus, the

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[1]The GSP Subcommittee is chaired by the Office of the U.S. Trade Representative and consists of members from the Departments of Agriculture, Commerce, the Interior, Labor, State, and the Treasury.

more other policy factors became determinative. Fifteen percent of the cases in two review cycles we analyzed had been identified by the Subcommittee as controversial and elevated for resolution.

The GSP Subcommittee has not issued public explanations of program decisions, although by regulation it will respond to a written request for information from petitioners. However, foreign and domestic participants told us that many parties were unaware of their right to request and receive such explanations. We believe that USTR should indicate clearly in Federal Register notices of final decisions on GSP petitions that petitioners can obtain a written explanation of any decision.

Another opportunity to improve the GSP Program's administration would be to refuse to accept incomplete petitions for product additions. GSP product-addition petitions require detailed information such as (1) actual production figures and capacity utilization, and their estimated increase with GSP; and (2) exports to the United States in terms of quantity, value, and price, and considerations that affect the competitiveness of these exports relative to exports by other beneficiary countries. The GSP Subcommittee has on occasion accepted for review product-addition petitions that did not provide all required information, if the Subcommittee believed the petition might have had merit and the petitioner had made a good faith effort to obtain the information. Although this practice is allowed by the regulations, it places domestic producers at a disadvantage in raising objections. Domestic producers complained that acceptance of incomplete petitions effectively shifted the burden of proof on whether to accept a product from the petitioner to those opposing the petition. A new product in the program may be shipped by any beneficiary country, and there may be few sources of information on potential suppliers among beneficiary countries. We believe that USTR should accept only product petitions that include all required information.

Also related to the process of administering product-addition petitions is the "3-year rule." GSP's 3-year rule, which prohibits rejected product-addition petitions from being refiled until 3 years have passed, protects U.S. industry from repeatedly having to come to the defense of their products in program proceedings. Waiver of this rule during the 1991 Special Review for Central and Eastern Europe initiated by the administration undermined the credibility of the program with affected domestic industries. Representatives of these industries said the waiver caused an unfair burden on them by reconsidering the addition of products that had just been rejected. USTR has taken the position that the Trade Policy Staff Committee has the right to waive the 3-year rule since it is its own procedural rule, and the rule did not vest a right in any party. Further, the GSP Director pointed out that the regulations allow the Trade Policy Staff Committee to self-initiate cases "at any time," which can

have the same effect. Domestic industries have argued for codifying the 3-year rule with no possibility of a waiver in the GSP statute. However, codifying the 3-year rule alone may not necessarily guarantee strict application of the 3-year rule if the administration still retains the ability to self-initiate cases. If Congress considers codifying the 3-year rule, and a provision disallowing its waiver, in the GSP statute, it should recognize that the Trade Policy Staff Committee's authority to self-initiate cases can have the same effect. Congress may want to consider stipulating whether or not self-initiation of cases should be allowed where it would have the effect of waiving the 3-year rule.

A major concern raised by the requesters of this report was whether it is appropriate and legal to offer different benefits to the various beneficiary countries under a generalized system, which in spirit is like the most-favored-nation principle[2] central to the GATT system. Program benefits are generally extended equally to all beneficiary countries. In some circumstances, however, when a beneficiary country is considered to be sufficiently competitive for a particular product without the GSP benefit, the benefit may be removed. Such permanent product graduations are made at the discretion of the President. We concur with the position taken by USTR that the GSP statute gives the President authority to make such decisions for differential treatment.

COUNTRY PRACTICE PETITIONS ENGENDER CONTROVERSY

When the GSP Program was reauthorized in 1984, new "country practice" eligibility criteria were added. These criteria included requirements that beneficiary countries provide adequate and effective protection of intellectual property rights (IPR) and take steps to observe internationally recognized worker rights. IPR refers to legal rights and enforcement associated with patents, copyrights, and trademarks. Petitions to suspend benefits to beneficiary countries that do not meet these criteria for country practices can be filed as part of the annual review process for GSP eligibility.

There is a split in opinion about the desirability of country practice provisions concerning IPR and worker rights. Beneficiary countries and many trade experts we talked with objected to the presence of country practice provisions in the GSP Program. They said that these conditions contravene the original spirit of GSP, which was to be a trade assistance

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[2]The most-favored-nation principle is embodied in article 1 of GATT and provides that countries grant each other treatment as favorable as they give to any country in the application and administration of import duties.

program that required no reciprocity on the part of the recipient country. Other countries' GSP programs do not have such conditions. While United Nations officials, beneficiary country officials, and many trade experts we talked with acknowledged that IPR and worker rights are important issues, they said these concerns should be addressed in other forums. To a significant degree, we also found a greater acceptance of IPR as a trade issue in contrast to worker rights, which was not generally accepted as a trade issue by those we interviewed. However, advocates of these provisions maintain that the GSP Program's objective of aiding economic development should not be carried out without parallel development of adequate IPR and worker rights standards. They argue that promotion of these rights is important to sustainable economic growth in developing countries.

Administering the IPR and worker rights provisions of GSP within a review process designed for product petitions has resulted in certain administrative problems. Country practice cases are fundamentally different from product cases, since they involve adherence to international standards of behavior rather than evaluation of trade flows. The rigidity of the annual review cycle, where all petitions must be filed by the June 1 deadline or wait until the next review, is not well suited to dealing with IPR- or worker rights-related events. These events can precipitate crises at any time during the year. We believe that country practice cases could be better addressed with separate time frames and review procedures that better fit their different dynamics. Further, acceptance of emergency petitions for review out of cycle when events warrant such action, as well as for expedited review, could improve the timely consideration of and, potentially, the more effective responsiveness to these provisions.

In addition, the GSP law and regulations do not specify the program's policies and standards for accepting country practice petitions for review. The GSP Subcommittee has internal policy guidelines, but few of these have been made public. We believe that USTR should make public the guidelines used in deciding whether or not to accept country practice petitions for full review.

Worker rights advocates have said they disagree with GSP policies (1) classifying certain offenses as human rights issues outside GSP purview and (2) requiring presentation of substantially new information for reconsideration of denied petitions. As currently administered, this "new information" standard has prevented further review of worker rights cases in which a beneficiary country's promised progress in improving worker rights stopped after the GSP review was concluded with a finding favorable to the country. We believe USTR should revise the new information standard to allow acceptance of petitions demonstrating a lack of promised progress.

Finally, the only available sanction in GSP country practice cases is suspension from all GSP benefits. A policy of graduated sanctions, such as suspension of one or more industry sectors rather than the entire country, would provide greater flexibility and could improve the effectiveness of these provisions in encouraging changes in country behavior. We believe USTR should expand the range of sanctions that can be taken when beneficiary countries have not met GSP country practice standards in order to include partial sanctions when appropriate.

The differing expectations held by GSP officials and IPR and worker rights advocates are at the root of much of the controversy over administration of country practice provisions. GSP officials generally said that these provisions have been used and have leveraged results from beneficiary countries to the extent possible, given other trade and foreign policy concerns. However, IPR and worker rights advocates said they wanted country practice cases more vigorously prosecuted and sanctions more frequently exercised. Worker rights advocates were particularly concerned. While IPR advocates have more powerful trade law remedies they can pursue, worker rights advocates must depend on the GSP provisions to trigger actions under most of the worker rights provisions in U.S. trade law.

Because GSP benefits are limited, and would decline if the GATT Uruguay Round agreement is enacted, the program provides only a modest degree of leverage to encourage beneficiary country governments to change their country practices. Proposals to add new country practice provisions during program reauthorization, particularly for environmental protection purposes where there are no international standards, were opposed by most GSP trade experts and program participants we interviewed. Because it was beyond the scope of this review, we did not interview representatives of environmental groups. However, we believe that adding new provisions would reduce the leverage of GSP in achieving the objectives of the existing provisions by diluting them with other requirements. Furthermore, if too many conditions are imposed, beneficiary countries may feel the compliance burden is too great. They may then be willing to forgo all benefits, thereby eliminating whatever leverage currently does exist in the program. It should be noted that tariff reductions negotiated in GATT, if implemented, will reduce the value of the GSP's tariff preference by 40 percent and, therefore, the incentive for beneficiary countries to participate in the GSP program.

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Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I will be pleased to try to answer any questions you may have.

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