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INTERNATIONAL TRADE

Reauthorization of the Generalized System of Preferences Program

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INTERNATIONAL TRADE:
REAUTHORIZATION OF THE GENERALIZED SYSTEM OF PREFERENCES PROGRAM

SUMMARY OF STATEMENT BY ALLAN I. MENDELOWITZ, MANAGING DIRECTOR
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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 1994, $18.4 billion, or about 3 percent of total U.S. imports, entered duty free under GSP.

In a recent report assessing the GSP Program, International Trade: Assessment of the Generalized System of Preferences Program (GAO/GGD-95-9, Nov. 9, 1994), GAO found that 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 identified opportunities to improve program administration.

The program's country eligibility requirements, including protection of intellectual property rights and taking 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 resulted in certain administrative problems. GAO recommended specific ways to improve their administration.

Because GSP benefits are limited and declining, the program provides only modest leverage to encourage beneficiary country governments to change their country practices. Adding new provisions would reduce the leverage of GSP in achieving the existing objectives. In addition, the Uruguay Round tariff reductions are expected to decrease the value of the GSP duty-free benefit by an estimated 40 percent. This will further reduce U.S. leverage to demand compliance with GSP country practice requirements.

GAO raised three matters for congressional consideration during GSP Program reauthorization deliberations. First, Congress may wish to consider altering the competitive need limit process that caps allowable import levels by, for example, extending the amount of time before exclusions are implemented to allow for more thorough assessments and allow affected industries more time to adjust. Second, Congress may also wish to consider whether to alter the GSP rule of origin so that items are not penalized for having U.S. content. Third, if Congress considers whether or not to incorporate the 3-year rule restricting product rereviews, and a provision disallowing its waiver, in the GSP statute, it should recognize that the Trade Policy Staff Committee's regulatory authority to self-initiate cases can have the same effect. Congress may wish 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.

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 your deliberation on the program's reauthorization. My statement is based on our recent report on the program, International Trade: Assessment of the Generalized System of Preferences Program (GAO/GGD-95-9, Nov. 9, 1994).

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,[1] 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 was estimated at 75 percent of this amount due to certain tax revenue offsets, according to the Congressional Budget Office. The value of duties foregone is expected to decrease with full 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. Reauthorization of the program, due to expire on July 31, 1995, provides an opportunity to consider the need for changes.

GSP DUTY-FREE BENEFITS DOMINATED BY RELATIVELY FEW BENEFICIARY COUNTRIES

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. Further, we found that most GSP benefits have gone to the relatively small number of more advanced or larger developing countries that can produce and export items that meet U.S. market demands.

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-eligible and duty-free

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[1]During our study, 1992 data were the most recent available for analysis. In 1993, $19.5 billion in imports entered GSP duty-free, while $41.1 billion in imports were eligible. In 1994, after graduation of Mexico from the program, $18.4 billion entered duty-free, while $29.2 billion in imports were eligible.

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

Other duty preference options exist for some beneficiary countries, such as the Caribbean Basin Economic Recovery Act, that 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 56 percent of these imports that entered with duties. "Competitive need limit exclusions" (imposed because U.S. imports of a country's product exceeded a limit on U.S. import levels for that product) 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) accounted 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 because 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 was considering, in 1994, changing the rule of origin system to one that would be more predictable and simpler to administer. It would use a "change of tariff classification" system such as that adopted in the North American Free Trade Agreement. This system confers country origin when imported materials, parts, and components are used to make a new product that would fall under a new tariff heading. Although more predictable, such a new rule of origin approach could be

more difficult for beneficiary countries to comply with due to the extensive documentation requirements necessary to establish change of tariff classification, according to an International Trade Commission official.

In addition, importers have criticized the current rule of origin, which requires that at least 35 percent of the product must originate or be substantially transformed within the beneficiary country, because it does not allow U.S.-source material to count in any way 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 wish to consider whether to alter the GSP rule of origin so that items are not penalized for having U.S. content. For example, any U.S.-origin value of a shipped item could be subtracted from the total value of the item before the 35-percent beneficiary country origin value added is calculated.

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 a country's 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 37 of the 57 cases examined, a loss of GSP status due to a competitive need limit exclusion was immediately followed by a loss of import market share. 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 considering whether to reauthorize the GSP Program, Congress may wish 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 allow 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[2] (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 transparency and 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 strengthening information requirements for acceptance of product petitions.

Among the information that petitioners said they would find useful are definitions of key statutory criteria used in making decisions on whether to add products to or remove products from GSP coverage. The GSP statute does not define key decision-making criteria such as "import sensitivity" or "sufficient competitiveness." This has led some petitioners to complain that the 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 recommended that USTR make public the guidelines the GSP Subcommittee uses in analyzing product petitions, with the stipulation that the guidelines provide a framework for, but do not limit the extent of, the Subcommittee's analysis.

We found, based on a review of the decision-making process in 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 more other policy factors became determinative. Fifteen percent

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[2]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.

of the cases we reviewed had been identified by the Subcommittee as controversial and had been 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 recommended that USTR indicate clearly in Federal Register notices of final decisions on GSP petitions that petitioners can write to request a written explanation of any decision.

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 was allowed by the regulations, it placed 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. GSP product-addition petitions were required to provide 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. We recommended that USTR modify GSP regulations to specify a mandatory core of information required for acceptance of product petitions.

Also related to the process of administering product-addition petitions is the "3-year rule." GSP's 3-year rule, prohibiting 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. Representatives of affected domestic industries told us that waiver of this rule during the 1991 Special Review for Central and Eastern Europe initiated by the administration undermined the credibility of the program. The representatives said the waiver caused an unfair burden on them by reconsidering the addition of products that had just been denied. USTR has noted that the Trade Policy Staff Committee has the right to waive the 3-year rule since it is the committee's 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 by regulation to self-initiate cases. Therefore, if Congress considers whether or not to incorporate the 3-year rule, and a provision disallowing its waiver, in the GSP statute, it should recognize that the Trade Policy Staff Committee's regulatory authority to self-initiate cases can have the same effect. Congress may wish 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 issue raised by the requesters of our report was whether it is legal to offer different benefits to the various beneficiary countries under a generalized system, which in spirit is like the most-favored-nation principle[3] central to the GATT system. Program benefits are generally extended equally to all beneficiary countries due to this principle. 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. 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 program that required no reciprocity on the part of the recipient country. Other countries' GSP programs do

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[3]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.

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 they should be addressed in other forums. However, advocates of these provisions maintained 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 argued that promotion of these rights is important to sustainable economic growth in developing countries.

Administrative difficulties have resulted from adding consideration of country practice petitions to the existing annual review process designed for product petitions. 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 recommended that USTR review country practice petitions on a separate and more flexible time frame from product petitions that better fits 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. Therefore, we recommended that USTR accept emergency petitions for expedited review out of cycle, when warranted by events.

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 recommended that USTR 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 recommended that USTR clarify the "new information" standard in the GSP regulations to indicate that failure of a beneficiary country to fulfill the promises of progress that were instrumental in the decision to deny a

petition would constitute substantial new information that could be the basis for acceptance of a petition.

Finally, the only sanction available 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 recommended that USTR take all steps necessary to expand the range of sanctions that can be taken when beneficiary countries have not met GSP country practice standards 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 of its limited benefits, the GSP 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 during program renewal would reduce the leverage of GSP in achieving the objectives of the existing provisions. 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 the existing leverage in the program. In addition, the tariff reductions negotiated in GATT are expected to reduce the value of the GSP's tariff preference by an estimated 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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