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The U.S. Generalized System of Preferences
Helping the Poor, But at What Price?

by Sallie James

Executive Summary

The preferential market access given by the United States to most developing countries through the Generalized System of Preferences yields real benefits for the covered countries and for U.S. consumers and firms importing the goods. Americans save hundreds of millions of dollars a year from duty-free imports, and many poor people abroad have benefited from preferential access to a rich market.

Against these benefits, Congress must consider the significant costs of unilateral preference programs—to the preference recipients themselves, to excluded developing countries, and to the world trading system in general—when the program expires at the end of this year.

Product exclusions, import limits that are triggered just when an exporter becomes successful, outdated eligibility criteria, and complex administrative and customs requirements all serve to limit the usefulness of the program to the ostensible beneficiaries and to U.S. consumers.

Trade preferences distort markets and discourage unilateral and multilateral trade liberalization: when beneficiary countries concentrate their efforts in preserving their preferential access rather than becoming competitive, it undermines efforts for multilateral trade liberalization and keeps them beholden to artificial arrangements and the whims of rich-country politicians.

The United States should not abandon its efforts to bring down global trade barriers through multilateral trade talks. In the meantime, however, unilateral reform is within reach. The expiration of the GSP at the end of 2010 provides a timely opportunity for the United States to correct the most egregious of the GSP's limitations and to move toward opening the U.S. market on a permanent and nondiscriminatory basis. That is surely the best way to encourage a more open, free, and prosperous global economy.

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Introduction

Since the mid-1970s, the U.S. government has maintained programs to benefit certain developing countries and aid their development through preferential access to the U.S. market. American companies can import products from beneficiary countries (i.e., those eligible for the special treatment afforded by the programs) at a lower than normal or zero rate of import duty. Making goods from beneficiary countries cheaper to import than those from non-eligible countries creates an incentive to buy from those countries covered by the program.

The largest of these unilateral trade preference programs, the Generalized System of Preferences, and a preference program benefiting countries in the Andean region (in the hope of steering those countries away from narcotics production and trafficking) called the Andean Trade Preference and Drug Eradication Act (ATPDEA) expire on December 31, 2010, so Congress must pass legislation to renew them before the end of the legislative year. In advance of the deadline for renewal, and after several years of tentative and ultimately unsuccessful efforts to reform the programs, lawmakers and interest groups are intensifying their advocacy efforts.

The GSP has provided some benefits to some people: most obviously the eligible industries in beneficiary countries but, also importantly, consumers of those products in the United States. Those benefits should not be overlooked.

More than temporary programs, however, what poor countries need most is a stable commercial environment that encourages investment. To the extent that preference recipients jealously guard their special access and resist global efforts to liberalize trade on a nondiscriminatory basis, unilateral preference programs can be counterproductive to achieving a more liberal global trade regime and a more stable and permanent path to economic growth.

The Aims and Limitations of Trade Preferences

Put simply, the rationale for preferential market access programs—whether by granting the privileged exporters' goods lower tariff rates, larger quotas, or a mixture of both—is to give an incentive to the home countries' firms and consumers to buy goods from the beneficiary countries. If an importer must pay a 10 percent tariff on a good from country A, but no import taxes on the same good from country B, then they will, other things being equal, purchase from country B.

Preferential access to a market may be granted as a result of a bilateral (or regional) trade deal between certain countries on a reciprocal basis, or on a non-reciprocal or unilateral basis in an effort to foster the preference recipient's economic development. In programs motivated by development concerns, like the GSP, selected products originating in developing countries are granted reduced or zero tariff rates compared to the rate that generally applies. Often, the least developed countries receive even further enhanced preferential treatment, for example by receiving preferential access for a wider coverage of products or even deeper tariff cuts. These unilateral preference programs, and in particular the United States' GSP, are the main focus of this paper.

Although the contribution of free trade to economic growth and development has long been acknowledged—and has, more recently, been explicitly recognized in Goal 8 of the UN's Millennium Development Goals, which calls for an "an open, rule-based, predictable, non-discriminatory trading and financial system"[1]—the idea of rich countries granting preferential market access to poorer countries' exporters is relatively new. The United Nations Conference on Trade and Development (UNCTAD) first formally recognized these schemes in 1968, by passing the so-called Resolution 21, which stated that

> . . . the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favor of the developing countries, including special measures in favor of the least advanced among the developing countries, should be:

(a) to increase their export earnings;
(b) to promote their industrialization; and
(c) to accelerate their rates of economic growth.[2]

It is important to note that it is not only the richest countries that offer preferential market access to poorer countries. Of the 13 development-based preferential programs currently registered with UNCTAD, 4 of them—those from Belarus, Estonia, Bulgaria, and Russia—are from non-OECD (Organisation for Economic Co-operation and Development, a group of high-income countries) members (the other 9 programs are those of Australia, Canada, the European Union, Japan, New Zealand, Norway, Switzerland, Turkey, and the United States).[3] The so-called Group of 77 developing countries also has an agreement among themselves, called the Global System of Trade Preferences, to provide each other with preferential access for a limited number of goods.[4]

Many countries, including developing countries, provide duty-free and quota-free access to goods from the very poorest countries. Part of the mandate of the current World Trade Organization round of trade talks, formally called the Doha Development Agenda, is to extend duty-free and quota-free access to the 33 WTO members that the UN has designated "Least Developed Countries" (there are 49 LDCs in total). LDCs are those that (a) have an average annual per-capita income under $750; (b) have lower levels of human development based on factors relating to health, nutrition, and education; and (c) are "economically vulnerable" because of factors such as their small size, susceptibility to natural disasters, and the volatility and/or instability of their export markets or production base.[5]

Most of the countries providing preferential market access to developing countries are also members of the WTO, which holds as a founding principle the concept of nondiscrimination. To this end, Article I of the General Agreement on Tariffs and Trade (GATT), Article II of the General Agreement on Trade in Services (GATS), and Article IV of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) embody the principle of most-favored-nation (MFN) treatment, which requires that WTO members treat imports from all other WTO members equally, for example by applying equal tariffs. Market access conditions granted to one member must be extended to all other members.

Giving preferential treatment to certain countries, including on development grounds, obviously violates that principle. The WTO therefore allows its members to deviate from MFN treatment in favor of developing countries through a loophole known as the "enabling clause."[6] Formally titled the agreement on "Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries," the enabling clause was adopted as part of the Tokyo Round of multilateral trade negotiations in 1979 and was originally intended to last for 10 years. Paragraph 2(a) of the agreement, however, provided a legal basis for extension beyond the initial 10-year period and it has in fact served to make the enabling clause permanent as part of the GATT 1994, which established the WTO. Other preferential trade deals that violate the MFN principle, for example those establishing a free-trade agreement or customs union on a reciprocal basis, are allowed under the conditions imposed by Article XXIV of the GATT.

In an attempt to promote better integration of developing countries into the world trading system, the enabling clause also allowed developing countries to enter into preferential agreements with each other under conditions less stringent than those laid out in Article XXIV. For example, paragraph 2(c) of the enabling clause permits preferential arrangements among developing countries that do not cover "substantially all trade."

The exemption from MFN provided by the enabling clause also gave all countries granting these preferences significant leeway as to how they designed such schemes, specifying only that they should be "generalized, non-discriminatory and non-reciprocal" with respect to the beneficiary countries. In other words, the generalized system of preferences must be just

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that: general in nature, and not just targeted to a few chosen countries.

The degree to which preference-granting countries abide by the principles of a generalized system of preferences as originally envisaged by the UNCTAD declaration—especially with respect to conditionality and nonreciprocity—is a point of contention.[7] Certainly the United States GSP program has some questionable gaps and limitations in that regard.

The United States' Generalized System of Preferences

The United States currently provides GSP preferences for 131 countries and territories. To be eligible for the program, countries must meet a number of criteria. Most obviously, they must be developing countries. The United States excludes those countries defined as "high income" using the World Bank's benchmark, which is currently set at an average Gross National Income of $12,166 per year.[8] In practice, and as Table 1 shows, most of the top sources of GSP imports are relatively fast-growing and among the "richer" developing countries, with the exception of Angola and Equatorial Guinea, prominent because as LDC beneficiaries they get duty-free access for their oil exports.

In addition to specifying a maximum per capita annual income level, a few other conditions apply. Like many other rich countries' development-based preference programs, the U.S. GSP excludes some countries for geopolitical reasons. The United States currently excludes China and Vietnam, for example, on the basis of their communist regimes, and other countries such as Libya and Iran are ineligible because of their links to terrorist groups. Countries that have seized property of Americans without compensation, or those that fail to take steps to eliminate child labor, are likewise ineligible. Certain other geographical preference programs, such as the African Growth and Opportunity Act (AGOA), attach further conditions to their more generous market access offerings.

Table 1
Top Ten Sources of GSP Imports, 2009 (US$ millions)

Beneficiary country	Duty-Free U.S. imports under GSP	Total U.S. imports from beneficiary	Share of U.S. imports using GSP (%)
Angola[a]	4,142.4	9,305.8	44.5
Thailand	2,886.2	18,964.5	15.2
India	2,848.0	21,227.6	13.4
Brazil	1,977.8	19,612.0	10.1
Equatorial Guinea[a]	1,676.9	2,391.5	70.1
Indonesia	1,454.7	12,916.8	11.3
South Africa	742.3	5,876.7	12.6
Philippines	733.6	6,793.0	10.8
Turkey	644.4	3,648.8	17.7
Argentina	505.9	3,820.6	13.2
Top ten beneficiaries	17,612.3	104,557.2	16.8
All beneficiaries	20,259.0	241,495.9	8.4

Source: U.S. International Trade Commission.
[a] Denotes Least Developing Country, eligible for duty-free treatment on oil.

Zimbabwe, for example, lost its AGOA preferences because of its human rights violations, although it still receives preferences under the GSP.[9]

Almost 3,500 articles are eligible for duty-free treatment under the GSP (with a further 1,400 or so articles eligible for duty-free treatment if the exporter is an LDC beneficiary).[10] That represents about one third of the total number of products—sometimes called "tariff lines"—imported into the United States. The articles include mainly manufactured and semi-manufactured goods, and a limited number of agricultural goods (at least up to a certain quota) and fisheries goods that are not otherwise duty-free.

To receive GSP treatment, a product must meet the so-called "rules of origin" requirements that determine the product is indeed "made in country X." That is to prevent non-GSP countries from transshipping their exports through GSP beneficiary countries in order to evade the MFN tariffs that would otherwise apply. Rules of origin are defined by the WTO as "laws, regulations and administrative procedures which determine a product's country of origin." In the current era of complex—often global—supply chains, determining exactly where a product "comes from" is not simple. Indeed, one can make a good argument that origin is increasingly meaningless.[11] The origin of a product is, however, commercially and legally significant, as it determines the tariff—or lack thereof.

The WTO currently sets no rules dictating how its members must structure rules-of-origin when they offer unilateral preferential programs like the GSP, so countries have considerable discretion. To qualify for the American GSP and receive duty-free treatment, a qualifying product must be the "growth, product, or manufacture of a [beneficiary country], and the sum of the cost or value of materials produced in the [beneficiary country] plus the direct costs of processing must equal at least 35 percent of the appraised value of the article at the time of entry into the United States."[12]

There is some flexibility in applying that rule. GSP countries can include imported inputs as part of the 35 percent value-added requirement if they are "substantially transformed" into new and different inputs in the beneficiary country. (The usual standard for determining whether a product has been substantially transformed is to establish that it entered the country under one chapter of the Harmonized System of product classifications and exited the country under a different chapter). Countries that join the GSP as part of a regional association are considered as one country for rules-of-origin purposes, so that articles can enter the United States duty free if the combined value-added contribution of the two (or more) association members is more than 35 percent of the total product value.

The U.S. government limits the amount of imports for which a developing country beneficiary can receive GSP treatment (there are no limits if the beneficiary is an LDC). A beneficiary is considered to be sufficiently competitive in a given product, and therefore ineligible to receive GSP treatment on that product, if the annual imports from that country accounted for 50 percent or more of the total U.S. imports of that product; or if they exceed a certain statutory value ($140 million in 2010, increasing by $5 million annually). Those limits are called competitive need limits (CNLs), and they literally punish beneficiaries for their exporting success.

Competitive need limits literally punish beneficiaries for their exporting success.

The president has the authority to grant a waiver for a product that would otherwise be subject to a CNL, if he is determined that the waiver is in the "national economic interest of the United States."[13] A de minimus waiver may be granted when a beneficiary country otherwise breaches the 50 percent rule, but total U.S. imports of a product are sufficiently small ($20 million for 2010, increasing by $500,000 every calendar year). Waivers are also often granted in response to a petition from an interested party, although in that case the president is required to consider the extent to which the beneficiary provides access to its market for U.S. goods, and the protection they provide to U.S. intellectual property. It is also possible to secure waivers for imports of products no longer made in the United States.

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The Office of the U.S. Trade Representative conducts a review of the GSP program every year, recommending changes in response to petitions submitted by foreign firms and governments, or U.S. firms that benefit from the program. The president has the authority to conduct reviews outside of the annual review process, too, if he feels it is necessary.

In the most recent annual review, President Obama issued a proclamation to withdraw GSP benefits from some countries (e.g., duty-free treatment for imports of shrimp products and certain passenger tires from Thailand, and gold necklaces from India); to extend preferential treatment on, for instance, carnations from Colombia and silver jewelry from Thailand, and by adding certain frozen vegetables to the list of GSP-eligible goods; and to continue applying GSP treatment to more than 100 products from 19 GSP countries because imports of those goods exceed the usual CNLs by a small (de minimus) amount.

Legislators occasionally attempt to make changes too. This year, although the president denied the petition to remove certain sleeping bags from the list of GSP-eligible products, Rep. Robert Aderholt (R-AL) has since introduced the Save U.S. Manufacturing and Jobs Act (H.R. 5940) to remove them from the list by legislative means, on the grounds that sleeping bags should be considered textile goods (not included in GSP). Representative Aderholt's congressional district is, coincidentally, home to a sleeping bag manufacturing company called Exxel Outdoors Inc.[14]

In addition to these relatively minor, routine annual changes and product-level adjustments to the GSP, some advocacy groups and trade specialists have suggested broader reforms. These include revising the eligibility criteria (for example, by insisting on more stringent labor, environmental, and/or intellectual property rules in beneficiary countries); increasing the benefits available to LDCs; and changing the competitive need limits.

The political calculations around extending and reforming these programs are not straightforward. Indeed, the GSP, the ATPDEA, and the AGOA initially expired in December 2009, but Congress could not agree on elements of reform. At the last minute, Congress passed simple extensions and President Obama signed into law a bill extending them until December 2010. With the expiration of the latest extension imminent, it is worthwhile to consider the benefits of the GSP, as well as its limitations and costs.

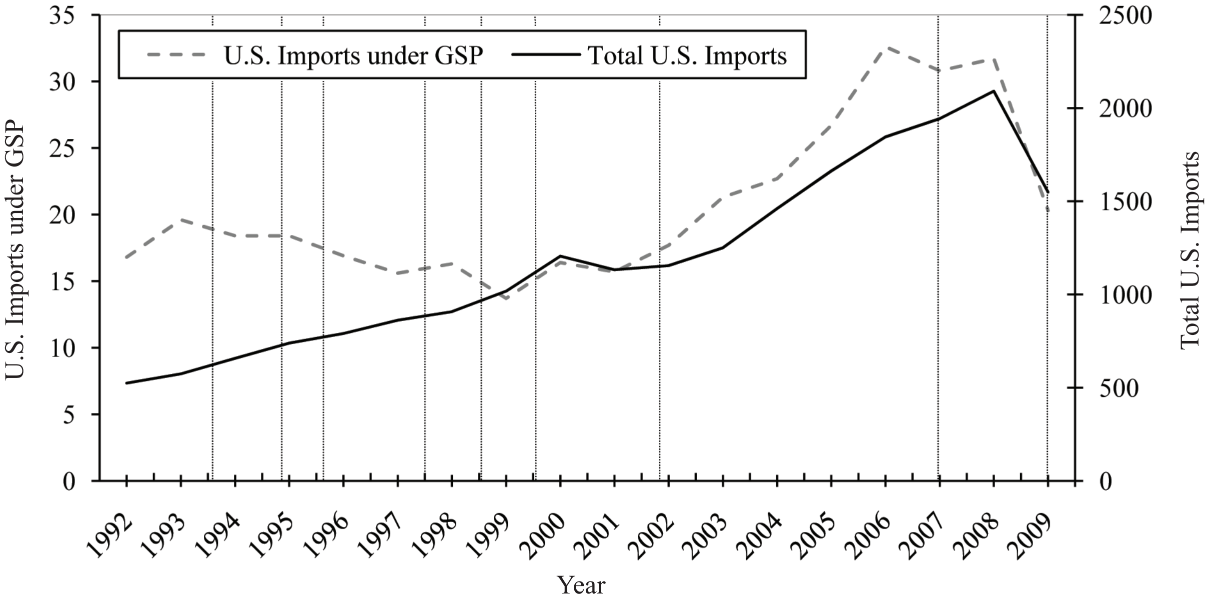
Real Benefits for Poor Countries and U.S. Consumers

That preference programs provide some benefits for some industries in the recipient countries is undeniable. By securing a U.S. government-created competitive "edge," those firms will be able to out-compete their nonpreferred competitors. Some advocates also point to the side effects of GSP preferences: that, by linking preferential access to the large and lucrative U.S. market, the GSP encourages beneficiaries to protect workers' rights and respect the intellectual property rights of Americans.[15]

The benefits of the GSP to eligible countries can be seen by observing the import data. Figure 1 is adapted from a chart by the Coalition for GSP and shows total U.S. imports and GSP imports from 1992 to 2009, with the GSP renewal dates marked by the vertical lines. At first glance, it would appear that the increase in GSP imports starting in the early 2000s reflects a broader trend of rising imports generally, suggesting that the program is not especially valuable. But a closer look reveals that, in fact, total imports were also rising in the late 1990s and early 2000s, when imports under the GSP were stagnant or even falling. The stark increase in GSP imports began just after Congress renewed the program for a period of five years in late 2001. Clearly importers and their suppliers abroad will take advantage of the program when they can have some certainty that it will continue.

In 2009, the GSP provided duty-free access for over $20 billion worth of imports (with a further $42 billion entering under other development-type preference programs such as AGOA and the program for Haiti). These imports included jewelry, chemicals, vehicle parts, and raw materials.

Figure 1
U.S. Imports under GSP vs. Total U.S. Imports (US$ billions)



Sources: Coalition for GSP; U.S. International Trade Commission Dataweb.
Note: Vertical lines mark GSP renewal dates.

Democratic trade analyst and advocate of preference programs Edward Gresser points out that those imports bring important benefits for poor people abroad. In Thailand, for example, silver jewelry makers employ tens of thousands of people countrywide, including in poor rural areas, to sell to the U.S. market duty-free.[16]

Although it is self-evident that providing duty-free treatment on some goods will benefit the covered industries in developing countries, let's not forget the significant benefits for Americans. By reducing the prices of imported goods, the GSP puts money in the hands of American consumers, increasing their purchasing power. The U.S. Chamber of Commerce estimates that three-quarters of U.S. imports under the GSP program are raw materials, components, and other inputs used by U.S. firms, which help them stay competitive.[17]

The United States has a generally open trade policy, with a simple average tariff (i.e., the sum of all tariffs divided by the number of tariff lines) of 3.5 percent and a trade-weighted average tariff (total tariff revenue divided by the value of imports) of 2.2 percent. Almost 50 percent of manufactured products, and just over one third of agricultural products, are imported duty-free on an MFN basis.[18] But there are significant tariff peaks in the schedule, and a range of other trade barriers like antidumping orders that keep import prices higher than they would be in a free market. The average tariff on imported footwear and leather products is, according to the U.S. International Trade Commission, 10 percent,[19] with some types of shoes attracting a tariff of 48 percent.[20] Americans paid a (trade-weighted) average 11.4 percent tariff on apparel imports in 2007. That average obscures even higher taxes for individual products, such as the 28.6 percent women paid for imported woven man-made fiber pants.[21] In theory, tariff peaks should represent valuable opportunities for exporters and importers to trade those products duty-free under the GSP program, but as we will shortly see there are important gaps in the program that prevent those opportunities from being realized.

Table 2
Top 20 Duty-Saving GSP Imports, 2009

	Value (US$ millions)	Share of total GSP imports (%)	Value of duties saved (US$ millions)
Petroleum and oils	6,481.5	32.0	9.1
Pearls, stones, and jewelry metals	1,268.4	6.3	71.4
Electrical machinery and equipment	1,220.5	6.0	37.5
Machinery and mechanical appliances	1,063.8	5.3	32.2
Plastics and plastic articles	880.6	4.4	43.2
Rubber and rubber articles	872.3	4.3	38.9
Vehicles and vehicle parts	677.3	3.3	17.2
Organic chemicals	630.6	3.1	30.9
Iron or steel articles	548.8	2.7	21.4
Aluminum and aluminum articles	499.5	2.5	19.5
Wood and wood articles	432.2	2.1	21.6
Optical, photographic, and similar instruments	382.2	1.9	12.9
Sugar	378.9	1.9	14.4
Prepared vegetables, fruits, or nuts	376.4	1.9	26.1
Iron and steel raw materials	311.2	1.5	8.4
Inorganic chemicals and precious metals	283.4	1.4	11.1
Miscellaneous edibles	258.7	1.3	15.7
Stone, plaster, and cement articles	252.4	1.3	12.9
Copper and copper articles	184.3	0.9	3.8
Animal or vegetable fats and oils	179.5	0.9	9.0
Total, 20 main products	17,182.7	84.8	457.3
Total, all GSP products	20,259.0	100.0	584.4

Source: U.S. International Trade Commission Dataweb and Census Bureau.

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Despite its significant limitations, the GSP saved Americans hundreds of millions of dollars last year by allowing them to import products duty-free. Table 2 shows the top 20 duty-saving opportunities afforded by the GSP last year. From jewelry parts ($71.4 million) to vehicles and vehicle parts ($17.2 million), rubber products ($38.9 million), and the $3.8 million saved on copper and copper products, American consumers and manufacturers saved a total of more than $584 million in 2009 thanks to the GSP.

These savings—and billions more besides—would naturally obtain from unilateral liberalization in the United States, too, of course, so the savings in Table 2 can be thought of as largely stemming from trade diversion (discussed below). In the context of the protectionist status quo, though, the GSP clearly yields benefits.

Ironically, the largest product class of GSP imports saved Americans very little. Almost a third of the imports entering under the GSP in 2009 were oils and petroleum products from LDCs who, unlike the relatively more developed "developing country beneficiaries," are eligible for duty-free treatment on those energy products. But petroleum and related products are subject to very small, fixed-dollar-amount-per-unit ("specific") duties in any case. So while they are far and away the largest single product grouping to be imported under the GSP, the total savings represented by importing them duty-free is relatively small: Americans saved only $9.2 million in duties from GSP oil imports in 2009.[22]

The additional application of CNL waivers can provide an extra source of savings on—or even access to—otherwise difficult-to-source goods, especially in the important case of natural resources. For example, a South Carolina–based manufacturer testified earlier this year that a CNL waiver enabled his company to continue importing lithium, a valuable and relatively rare mineral, from Argentina. Natural resources are not always evenly distributed around the world—nearly all U.S. imports of lithium are sourced from either Chile or Argentina—and so when it looked as though the 50-percent-of-U.S.-imports threshold might be breached and tariffs would start to apply, a CNL waiver kicked in, helping the manufacturer to stay competitive.[23]

The Coalition for GSP, a Washington-based advocacy group, takes the enlightened position that the benefits to U.S. consumers—particularly U.S. businesses using GSP-covered products as inputs—are a key benefit of the program. While touting the development benefits of trade preferences, the Coalition has the explicit goal of reminding lawmakers that Americans gain from the lower prices and increased choice that come from lower trade barriers. That sets them apart from many of the other groups advocating for extending the GSP.

The Office of the U.S. Trade Representative, to its credit, also draws attention to the benefits to American producers and consumers from the GSP program. Indeed, the first item on its fact sheet on the GSP is entitled "GSP Creates American Jobs and Keeps U.S. Companies Competitive" and touts the many benefits of lower import barriers. Those include lower prices on consumer goods, particularly for American families on a budget, and cost savings for U.S. companies—especially small businesses and manufacturing firms—looking for cheaper inputs.[24] (If only the U.S. Trade Representative would strike that import-friendly tone all the time.)

During congressional testimony earlier this year, the Coalition for GSP made an important point regarding the success of the GSP and other preference programs:

> Preference programs succeed in their primary goal—promoting growth in developing countries through trade—only if U.S. companies find them attractive to incorporate into their sourcing and investment/production plans. U.S. companies will do so only if the benefits of the preference programs contribute positively to their "bottom lines," if the programs can be relied upon, and if the rules and regulations associated with claiming program benefits are not so complicated as to be more trouble than the benefits are worth.[25]

The devil of this well-intentioned program is, apparently, in the details.

The Limitations and Costs of the GSP

That there are real benefits to be gained from having preferred access to a rich-country market is obvious and nontrivial. But the significant costs of these programs—to the preference recipients themselves, to excluded developing countries, and to the world trading system in general—are not always immediately apparent.

Just like bilateral or regional preferential trade deals, unilateral preference programs are inherently discriminatory: by taxing imports from some countries at a different rate than those from others, they skew incentives to buy from certain chosen countries. Indeed, that is

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Table 3
U.S. Imports by Treatment, 2009

Program	Total (US$ billions)	Share (%)
General (MFN)	**1,247.0**	**80.5**
FTAs	**240.0**	**15.5**
NAFTA	219.6	14.1
Other FTA partners	20.6	1.3
Preferences	**62.0**	**3.9**
GSP	20.2	1.3
Caribbean programs (CBI/CBTPA)	2.2	0.1
Andean programs (ATPA/ATPDEA)	9.7	0.6
AGOA	28.1	1.8
Mid-East program (QIZ)	1.4	0
Total	1,549.0	100

Source: International Trade Commission Dataweb.

the point of the programs. That creates benefits for the consumers and producers of the covered goods, but leaves outsiders—some of whom may be as poor if not poorer than the programs' beneficiaries—out in the cold.

International trade theory has long recognized that, in addition to potentially harming a poorer outsider, so-called trade diversion harms the domestic economy if it imports from a less-efficient but lower-taxed trade partner at the expense of a more-efficient, but higher-taxed trade partner. When a country applies the same tariff to all trade partners it will always import from the most efficient producer. Ed Gresser rightly points out that the negative unintended effects of trade diversion are difficult to predict and observe.[26]

Empirically, the trade figures suggest that the success of the program has been mixed at best. Although the GSP beneficiary countries make up more than half of America's trade partners by number, imports under the GSP account for less than 1.5 percent of total U.S. imports by value, as shown in Table 3. Most U.S. imports, in other words, enter on an MFN basis (80 percent) or as a result of a reciprocal preferential trade agreement (e.g., the North American Free Trade Agreement, or NAFTA). The GSP, at least as it currently functions, is not a significant source of imports.

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The program is not even a significant source of imports from GSP beneficiaries: only 8.4 percent of U.S. imports sourced from GSP-eligible countries enter under the GSP[27] with the remaining entering the United States paying MFN rates (which are admittedly sometimes zero), or under other preference programs such as AGOA. Taking into account all preference programs, and the fact that many MFN tariffs are zero, that leaves just fewer than 38 percent of imports from GSP beneficiaries still subject to tariffs.[28]

The fact that trade entering under the GSP is relatively minor—as a share of total U.S. imports, and as a share of U.S.-bound exports of GSP beneficiaries—is not necessarily a sign that the beneficiaries are commercially or logistically unworthy of the program. The relatively poor showing of GSP beneficiary countries in the import figures can be explained largely by the way the program is structured and, relatedly, by the type of products beneficiary countries produce and export.

First and most significantly, the GSP excludes whole swaths of products, mainly simple manufactured goods. About two-thirds of U.S. tariff lines are ineligible for GSP treatment. Many of the ineligible products are labor-intensive textile and less labor-intensive but nonetheless important agricultural goods in which relatively labor-abundant developing countries have a comparative advantage. Unfortunately, politically powerful U.S. producers ensure that these exclusions persist, thereby robbing the program of much of its potential value. Even in the wake of the recent devastating floods in Pakistan, U.S. textile groups were urging the administration not to expand preference programs to Pakistan by cutting textile tariffs.[29] The U.S. sugar lobby has been tremendously successful—if that's the correct word—in seeing off threats to the high sugar tariffs that keep the U.S. market protected from competition.

There is some hope for exporters and U.S. consumers of textiles and apparel: although the GSP is prohibited by law from giving treatment to most textiles, the AGOA and Haiti programs have closed some of those gaps by including some textile and apparel products. But those imports are subject to caps, and are subject to complicated rules of origin and U.S.-input requirements that inhibit the usefulness of the program and add to importers' costs.[30]

Other significant product exclusions in the GSP, many of which are subject to relatively high MFN tariffs, include home linens, watches, footwear, handbags, luggage, tableware and flat goods, glass, work gloves, and other leather clothing goods. Other products determined to be "import-sensitive," such as steel, glass, and electronics, are also ineligible.[31]

Some products, although eligible for GSP rates in general, are ineligible if they come from certain countries. Beef from Argentina or dried lentils from India, for example, are not eligible for GSP preferences because they are so competitive.[32] Those imports enter the United States at the MFN rate. As discussed above, punishing truly competitive exporters by removing their preferences just when they become competitive is damaging to U.S. consumers and distorts the economies of the erstwhile beneficiaries by encouraging the shifting of resources away from their most competitive sectors.

In addition to the total "graduation" of a country out of the GSP when its gross national income reaches the critical level, as discussed earlier, the president has the discretion and authority to graduate a country if they are sufficiently competitive across a range of exports. The four Asian tigers—Hong Kong, South Korea, Taiwan, and Singapore—were graduated by this method in 1989, even though they had not technically reached the "high-income" threshold.[33] One may reasonably ask whether the program in some senses provides a *disincentive* to development at the margin.

Second, as the Trade Partnership, a Washington-based think tank, points out, many GSP beneficiaries are also eligible for duty-free treatment under other preference programs (such as the Caribbean Basin Initiative) that cover many of the same products as the GSP but have longer authorization periods and are therefore more reliable programs under which U.S. importers can source products.[34] Products that are eligible for GSP treatment therefore enter the United States under, and show up in the import figures for, those other programs.

Third, even when the program structure is not stacked against them, the administrative requirements place heavy burdens on importers of GSP products. The rules of origin for the U.S. GSP, while relatively simple compared to some other rich-country development-based schemes, still add significantly to trading costs and are in some respects a nontariff barrier to trade. Recent studies have shown that restrictive and cumbersome rules of origin are in some cases (especially in the European Union) so high that importers prefer to pay MFN tariffs just to avoid the compliance costs.[35]

When the program is temporary, and benefits can be withdrawn at any time and for almost any reason as long as the "general" nature of the program is maintained, adminis-

Even when the program structure is not stacked against them, the administrative requirements place heavy burdens on importers of GSP products.

trative and cost burdens imposed by the program become especially important. Temporary programs simply won't encourage long-term investment in the beneficiary countries because the policy environment is not stable. As we saw in Figure 1, when firms and importers can be surer of the policy environment, use of the program expands.

In testimony a few years ago, the Coalition for GSP acknowledged the costs imposed by rules-of-origin requirements, and how they relate to long-term business decisions:

> It is not uncommon for U.S. importers to conclude that the paperwork involved in ensuring that a product complies with the preference program's rules of origin represents a "cost"—and a risk if U.S. Customs finds the evidence insufficient—that is not worth the effort. When the whole cost package is evaluated—purchasing from a preference country with duty savings but risk associated with demonstrating that the rules of origin have been met, versus purchasing from a non-preference country that offers less risk, higher cost (from duties) but better quality or delivery certainty—the latter supplied often wins the order.[36]

The cost-benefit calculation for any given importer will no doubt be very different when the MFN tariffs are high, and therefore the benefit from duty-free imports relatively large, compared to a situation when the duty is only a very small percentage of the product's total cost. But in the new era of global supply chains and tight margins, those costs are increasingly pertinent.

Fourth, eligible countries are still vulnerable to traps set by other U.S. trade barriers. A recent example is passenger tires from Thailand. When the U.S. International Trade Commission ruled in September 2009 that Chinese passenger tires were harming the interests of U.S. tire producers, President Obama imposed tariffs of 35 percent on Chinese tires. U.S. tire importers started sourcing their tires from other countries, including Thailand, instead. As a result of the increase in imports of tires from Thailand, the CNL was breached and Thailand lost its GSP access for its tires, which now face the MFN rate of 4 percent.

Fifth, and this applies to any trade liberalization or negotiation program, the GSP represents needless government intervention. Every new unilateral preference program brings with it a new bureaucracy to implement the program, monitor and report on it, and deal with ongoing concerns. This leads to more regulation and more complexity. For example, the requirement for annual reviews is a time- and resource-consuming activity for the U.S. government and for U.S. and foreign beneficiaries. It is not immediately obvious that these costs, combined with the unseen costs of trade diversion noted above, are outweighed by the benefits of the program.

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Sixth, there is a risk that the existence of preference programs sends a misleading and ultimately damaging signal to developing countries about the source of gains from trade. The programs are a good public relations exercise for the rich countries who employ them, even as the programs are, as we have seen, structured in a way to pose minimal threat to powerful special interests at home.[37] The benefits from these PR moves may be eroding in the face of growing global awareness of the distortions caused by rich country barriers and subsidies, but the programs essentially send the message that opening domestic markets to competition is a generous "concession," rather than a favor to our own consumers and national interest.

Worse, the programs perpetuate the not entirely accurate idea that high tariffs are an evil imposition of the rich world upon the poor. To be sure, there are significant and damaging distortions in the world trading system as a result of rich countries' barriers and subsidies, and those distortions are long overdue for serious reform. But these are often relatively small compared to the barriers to trade imposed by poor countries against each other. In reality, many of the highest tariffs on developing country exports are applied by other developing countries in a case of beggar-thy-poor-neighbor.

Table 4
Applied Import Tariffs on Developing Country Exports of Selected Tropical Products,[a] 2006 (%)

Product	Developed countries	Developing countries
Coffee, roasted	1.14	22.56
Black tea (packages <3kg)	0.45	19.72
Cocoa beans, raw or roasted	0.00	5.13
Raw sugar, cane	17.76	25.04
Raw sugar, beet	45.67	24.78
Palm oil, crude	2.40	15.09
Natural rubber	0.00	4.05
Cotton yarn	1.10	8.16
Cotton fabric	1.51	13.47
Jute and other textile-based fibers	0.00	6.08
Logs, tropical hardwoods	0.00	5.43
Brazil nuts	0.27	18.97
Soya beans	0.75	20.66
Bananas	10.33	30.45
Pineapples	4.15	23.71

Source: MacMap (2006), table adapted from Sushil Mohan, "Reforming Agricultural Trade among Developing Countries," *World Trade Review* 6, no. 3, Table 6, p. 406.
[a] Includes ad valorem equivalent of specific tariffs, and preferences where relevant. Tariffs are weighted average.

Table 4 compares rich- and poor-world average tariffs on a range of tropical products. Only in the case of some forms of sugar were developed country tariffs higher than those in developing countries. Cato policy analyst Marian Tupy noted a similar trend in manufactured goods trade, too, and found the average tariff rates in developing countries are more than three times higher than developed countries' average tariffs. Developing countries also initiate more antidumping actions than do developed countries.[38] Preference programs and special and differential treatment provisions in multilateral trade negotiations enable developing country trade regimes to escape much-needed scrutiny and reform.

Finally, the broader, more systemic costs imposed on the open global economy should be kept in mind. There is some evidence to suggest, for example, that countries remaining in the GSP have less-liberal trade policies than those dropped from the program. Moreover, the greater the export dependence on U.S. GSP preferences, the greater the resistance to trade liberalization.[39] Because the political economy of international trade policy is such that countries often find it easier to liberalize when they do so in concert with others, the GSP could be seen as part of the Gordian Knot in which trade negotiators find themselves.

Concerns over losing privileged access to developed-country markets as general tariff rates come down lead to the somewhat perverse situation of some poor countries being *opposed* to permanent trade liberalization through multilateral means. If a country lowers its general MFN rate of a GSP product from say, 10 percent to 2 percent, then the benefits of getting duty-free

Preference programs and special and differential treatment provisions in multilateral trade negotiations enable developing country trade regimes to escape much-needed scrutiny and reform.

Preference programs can encourage countries to produce according to the artificial signal of preferences, rather than what a free market would dictate.

access to that country erode (that's why this effect is called "preference erosion.") Prominent trade economist Jagdish Bhagwati calls preferences a "wasting asset" from the beneficiaries' point of view.[40]

Preference erosion pits developing countries against each other in multilateral negotiations, because the same reductions in MFN tariffs that erode beneficiaries' preference margins may help their perhaps equally poor brethren in an "outside" country. Developing country groups have provided an unfortunate but instructive example in the Doha round: there was significant overlap between the list of tropical products for which eight Latin American countries sought especially rapid and significant liberalization during the Doha round talks, and the list of items the African, Caribbean and Pacific Group of States (ACP) wanted shielded from multilateral tariff liberalization because of concerns about preference erosion.[41]

Preference programs can encourage countries to produce according to the artificial signal of preferences, rather than what a free market would dictate. Certain developing countries were worried about losing tariff preferences for bananas during the long-running trade dispute between Ecuador, which wanted to see lower tariffs on its banana exports, and the EU, under pressure to maintain high MFN tariffs on bananas in order to preserve the preference margins of their former colonies and overseas territories in the ACP. The ACP countries argued that bananas were so important to their economies that to see those preferences eroded by multilateral liberalization would cause economic devastation, and even political instability.[42]

Aside from the irony of countries arguing against improved market access opportunities, it is worth noting that the ACP countries were more concerned about maintaining their market share in a product in which they were at a competitive disadvantage compared to their Latin American competitors than in diversifying into other products and services. The EU preferences were, in that sense, proving a disincentive to innovate and diversify.

Ultimately, the long-term solution for the development of markets for items from poor countries is to ensure the conditions in those countries are optimal for rewarding hard work and ingenuity, and to enable them to be globally competitive. A recent example is instructive. Pop singer Bono and his wife started a clothing line (Edun) to revitalize the clothing industry in sub-Saharan Africa. But problems with quality have meant that now about 70 percent of the clothing line is sourced from China. According to a recent *Wall Street Journal* article, the brand's owners are realizing that, ultimately, for a product to compete in the global economy, it needs to meet the demands of the market:

> Edun . . . launched to great fanfare but quickly ran into problems with sourcing and delivery. Shipments from Africa arrived late, and retailers complained about the clothes' design and fit, leading to poor sales. Last year, the collection was carried at just 67 stores globally, down from hundreds in 2006. The "sustainability of the product doesn't have any value unless the fashion is correct," says Ron Frasch, president and chief merchant at Saks, which dropped the line several seasons ago.[43]

All the preferential access in the world will not make products competitive as long as the quality is not what consumers demand, or the supply is not reliable. And those sorts of problems can be fixed only at the country level.

GSP advocate Ed Gresser sums it up well:

> Trade policy itself has limits. The best-designed trade policy—preference, FTA, multilateral agreement or other option—will fail as a development tool without peace and political stability, universal education, an effective rule of law, and functioning internal markets and safety nets. Here aid can often help, but responsibility lies ultimately with the governments of developing countries [themselves].[44]

Cato scholar Marian Tupy, writing in the context of sub-Saharan African development, likewise points to the crucial role of developing countries' governments:

> Blaming African poverty on forces beyond the control of Africa's political elites takes the spotlight away from decades of failed economic policies, wholesale looting of Africa's wealth, and loss of countless lives to political repression and ethnic conflicts. . . . In order to escape poverty, [sub-Saharan African] countries must begin by liberalizing their trade with one another and with the rest of the world . . . regardless of what the developed world does . . . [but] the benefits of trade liberalization will be severely restricted unless trade opening is accompanied by far-reaching economic and political changes on the African continent.[45]

Although countless studies have shown the importance of free trade and open markets in promoting prosperity, unilateral preference programs offered by rich countries to the poor are clearly insufficient for development. That may at first blush seem discouraging, but the positive corollary is that creating the conditions for economic development is largely within the power of developing countries themselves, should they choose to seize the opportunity.

Recommendations and Conclusion

It is clear that the GSP is in need of reform. Product exclusions; anti-competitive limits on imports that are triggered just when an exporter becomes successful; outdated eligibility criteria; and complex administrative and customs requirements all serve to limit the usefulness of the program to the ostensible beneficiaries and to U.S. consumers.

Ideally, the United States, as the world's largest economy and a global proponent of open markets and globalization, should open its markets to all goods from all countries on a permanent, nondiscriminatory basis.[46] Moreover, its status as a global leader in trade talks gives it a chance to use its considerable international diplomatic power for good. Encouraging other big traders, including fast-growing developing countries, to follow the U.S. lead by opening their own markets would enhance global growth and development and improve the United States' standing in the world.

At a minimum, the United States should be more active in the Doha round of multilateral trade talks if unilateral liberalization is politically too difficult. An often overlooked but potentially valuable part of the Doha round is the negotiations to improve so-called trade facilitation, which aims at lifting administrative burdens imposed when goods cross national borders. Liberalization in this area could go a long way to lifting some of the logistical hurdles to freer trade, many of which are particularly acute in developing countries. Countries should and can do a lot to remove many of these burdens unilaterally, of course, but once again a multilateral context may help to overcome domestic political resistance to reform.[47]

Given the slow pace of the Doha round, and the urgent need for reforms to the GSP as it stands now, Congress can take several steps in the meantime to improve the ability of poor countries to develop through increased trade with the United States. To the extent that poorer countries of the world should be granted special privileges on the basis of their development status, solutions exist to minimize the costs associated with unilateral preferences.

If the optimal solution of total unilateral trade liberalization is not feasible, and if the Doha round does not bear fruit, that does not preclude more limited reforms that are less politically contentious and that don't require the cooperation of other countries. First, the federal government could give benefits to U.S. firms and citizens, to some of the world's poorest people, and to its own international reputation by immediately treating, on a most-favored-nation basis, goods of special interest to poor countries and low-income consumers. The U.S. tariff code is especially regressive in this regard, because tariffs are highest on lower-end goods made by

The federal government could give benefits to U.S. firms and citizens and to some of the world's poorest people by eliminating tariffs on goods of special interest to poor countries.

poor people abroad and consumed by lower-income Americans.[48] In addition, the U.S. should grant 100 percent duty-free, quota-free (DFQF) access to all least developed countries, immediately. The United States grants DFQF access presently for only 97 percent of tariff lines. The fact that the remaining 3 percent of products are mainly textiles and agriculture, two areas where developing countries are relatively competitive, is telling. AGOA provides some access for textiles, but opening up the U.S. textile and apparel market to the more competitive firms from Asia is, apparently, a bridge too far for the U.S. textile lobby and, it must be said, some African LDCs benefiting from AGOA preferences.

The United States is not alone in limiting its DFQF program. The declaration at the Hong Kong meeting of WTO trade ministers to provide DFQF access "on a lasting basis" to all LDC members upon implementation of the Doha round agreements had a get-out clause: "Members facing difficulties at this time to provide market access as set out above shall provide duty-free and quota-free market access for at least 97 per cent of products originating from LDCs, defined at the tariff-line level, by 2008 or no later than the start of the implementation period."[49] That declaration reflects consensus of the membership as a whole, including some poor countries trying to protect their privileged access or otherwise concerned about increased competition.[50] Regardless of which countries or lobby groups are behind the push for thinly veiled targeted exclusions and a failure to commit to binding the increased access (as opposed to the vaguer promise to provide it "on a lasting basis"), these carve-outs give ammunition to those who contend the world trading system has inherent protectionist biases against truly free trade.

The WTO must be vigilant against so-called "safeguards": they should not, for example, extend to allowing developing countries to increase barriers to imports that reflect normal market growth.

Second, and recognizing that "special and differential treatment" for developing countries may unfortunately be with us for a while, U.S. trade negotiators should endeavor to limit any such treatment in the Doha negotiations (and subsequent trade rounds) to longer phase-in periods for tariff cuts or, perhaps for LDCs at least, delayed implementation. The WTO must be vigilant against so-called "safeguards": they should not, for example, extend to allowing developing countries to increase barriers to imports that reflect normal market growth.

Third, U.S. farm policy—and that of several other large rich economies such as the EU and Japan—has been rightly accused of unfairly distorting global agricultural markets. Developing countries are in some senses correct to feel they cannot compete with the rich world's producers or, more accurately, their ready access to their governments' treasuries. The experience of Brazil's emergence as an agricultural powerhouse provides something of a counterweight to the assertion that developing countries are forever at a disadvantage, but the rich world's subsidies to its farmers are a significant barrier to free trade, as well as a fiscal affront to their taxpayers.

Cotton is a common example of how developed country farm subsidies harm the interests of some of the world's poorest farmers, and for good reason. A 2007 study for Oxfam America by University of California economists estimated that the elimination of U.S. cotton subsidies would increase the world price of cotton by between 6 and 14 percent, increasing the household income of poor West African cotton-producers by 2.3 to 5.7 percent, or an extra $46 to $114 per household per year.[51] Despite multiple clear rulings from the WTO that its cotton subsidies were against the rules, not to mention injurious to the interests of other cotton exporters, the United States has so far chosen to settle the dispute by paying Brazilian cotton farmers almost $150 million annually. Complying with a WTO ruling by, essentially, paying a bribe is a shameful blight on the record of a founding member of the WTO ostensibly committed to the rule of law and an open global economy. Ending cotton subsidies, and those going to other farm products, is an immediate and significant step the United States can and should take, to the benefit of its taxpayers and poor people abroad.

The long-term solution to development through trade is to open American markets to goods from around the world on a permanent, unilateral basis. By opening up to trade in a nondiscriminatory manner, the need for dedicated bureaucracies and complex laws is reduced. And by making the openness permanent, exporting firms abroad can be assured that their access to the U.S. market, while not guaranteed given the dynamism of the global economy, would at least be on a level playing field with other nations. Those changes would give American firms and consumers undistorted, permanent, and transparent access to the most efficient supplier, access that would not depend on the changing whims of Congress.

Notes

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2. United Nations Conference on Trade and Development website, "About GSP," http://www.unctad.org/Templates/Page.asp?intItemID=2309&lang=1.

3. Ibid.

4. The list of preferences can be found at the Global System of Trade Preferences (GSTP) website at http://www.unctadxi.org/templates/Page____6206.aspx. The GSTP does not strictly meet the conditions for violating GATT Article I, discussed below, but was granted a waiver by the enabling clause (also discussed below).

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6. Nonmembers, such as Russia, obviously require no such permission from the WTO to run their preference schemes as they see fit.

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12. Office of the United States Trade Representative, *U.S. Generalized System of Preferences (GSP) Guidebook*, p. 13.

13. U.S. Trade Act of 1974 (19 USC 2463[d]), http://www.ustr.gov/trade-topics/trade-development/preference-programs/generalized-system-preferences-gsp.

14. Press release from the office of Congressman Robert B. Aderholt, "Aderholt Authors Bill to Protect Textile Jobs in North Alabama," July 30, 2010, http://aderholt.house.gov/index.cfm?sectionid=20&sectiontree=6,20&itemid=1040.

15. Testimony of Jeffrey S. Vogt, American Federation of Labor and Congress of Industrial Organizations, before the U.S. Senate Finance Committee hearing on "U.S. Preference Programs: Options for Reform," March 9, 2010.

16. Testimony of Edward Gresser, p. 6.

17. Letter from R. Bruce Josten of the U.S. Chamber of Commerce to the Members of the United States Congress supporting renewal of the Generalized System of Preferences (GSP) and the Andean Trade Preference Act (ATPA) for Colombia and Peru, September 27, 2010, http://www.uschamber.com/issues/letters/2010/letter-supporting-renewal-generalized-system-preferences-gsp-and-andean-trade-pr.

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19. U.S. International Trade Commission, "The Economic Effects of Significant U.S. Import Restraints: Sixth Update 2009," Investigation no. 332–325, August 2009, Table 1.1.

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27. The Trade Partnership.

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29. Letter from textile and cotton producers to United States Trade Representative Ron Kirk and Secretary of State Hillary Clinton, September 1, 2010, http://www.nationaltextile.org/library/roz/letter_2010_09_01.pdf.

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37. The high tariffs on textiles and agricultural goods in rich countries is not wholly a result of deliberately targeted protectionism: agriculture was not part of the GATT/WTO architecture until 1995 and, as Jagdish Bhagwati points out, developing countries were largely exempt from the tariff cuts precipitated by previous multilateral trade negotiations, so richer countries concentrated their liberalization efforts in areas of export interest to themselves (machinery, chemicals, and industrial products other than textiles and clothing). Jagdish Bhagwati, "Trading for Development: Poor Countries *Caveat Emptor*," http://www.columbia.edu/~jb38/papers/pdf/Economist_June_10_Revised_Final.pdf, p. 5.

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40. Bhagwati, p. 10

41. "AG: Members Trying to Bridge Gaps on Tropical Products, Preference Erosion," *Bridges Weekly Trade News Digest* 10, no. 18 (May 2006), http://ictsd.org/i/news/bridgesweekly/6316/.

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43. Rachel Dodes, "Out of Africa, Into Asia," *Wall Street Journal*, September 10, 2010, http://online.wsj.com/article/SB10001424052748704358904575478310504593870.html?mod=WSJ_hpp_MID

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44. Testimony of Edward Gresser, p. 14.

45. Tupy.

46. The focus of discussion here on goods trade is not an indication that services trade liberalization is unimportant, or that developing countries—new as they are to services trade—could not take advantage of trade preferences in service industries. In principle, it should be possible to give developing country service providers preferential access to the U.S. market. But the nature of services trade barriers—they are more about domestic regulations and less about border taxes—means reducing them would involve many different regulatory agencies in a more complex process than for goods trade liberalization. Moreover, it would likely involve a liberalization of immigration policy that unfortunately does not appear to have significant political support. These special features of services trade liberalization are not excuses for inaction, of course.

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