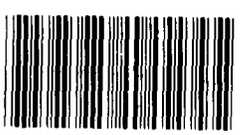
BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Trade Preference Program Decisions Could Be More Fully Explained



In a report on the first 5 years of operation of the Generalized System of Preferences, which permits some products from developing countries to enter the United States duty-free, the President announced that in the future he may use existing authority to ensure that greater program benefits accrue to the less well developed countries as well as to mid-level ones.

GAO sees this approach as a new and welcome departure from previous operation of the program and recommends ways to make the administration of the program more open.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report describes the administration of the Generalized System of Preferences for developing countries, suggests ways to improve management of the program, and assesses recent program changes to ensure that advanced developing countries' use of the preference does not damage the trading interests of the less developed.

We have not previously reviewed this trade preference program, and the issue of country eligibility has received considerable congressional attention.

We are sending copies of this report to the United States Trade Representative; Secretaries of Agriculture, Commerce, Defense, Interior, Labor, State, and the Treasury; Commissioner, U.S. Customs Service; Director, International Development Cooperation Agency; Chairman, U.S. International Trade Commission; Director, Office of Management and Budget; and cognizant congressional committees.

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

TRADE PREFERENCE PROGRAM DECISIONS COULD BE MORE FULLY EXPLAINED

D I G E S T

GSP.

The Generalized System of Preference program permits duty-free entry of selected products from 140 developing countries and territories; imports worth $6.3 billion received preference treatment in 1979. The duty foregone on these imports in that year was estimated at about $565 million. (See p. 1.)

The average tariff level on items receiving the preference is approximately 9 percent, but recently concluded multilateral trade negotiations will reduce the average tariff to 4.5 percent from 1980 to 1987. The magnitude of the duty-free entry benefit, spread over many beneficiaries, is relatively small, and the program to date has relatively little impact on the economic development of beneficiary countries although individual exporters and specific industries are helped. Parallel programs by other developed countries, however, contribute to the program's significance. (See p. 1.)

ADMINISTRATIVE FLEXIBILITY TO BE INCREASED

In the past, the program has been administered according to an "equal application principle," which meant that decisions to add or remove products from preference eligibility were applicable to all rather than some beneficiaries. The law gives the President authority to "withdraw, suspend, or limit * * *duty-free treatment * * * to any article or * * * any country" previously accorded the preference; but this authority has not been used to selectively limit product eligibility. (See pp. 5 and 9.)

An April 1980 Presidential report on the preference program's first 5 years announced that the equal application principle will be modified to allow for selective designation; product eligibility decisions may now take

into consideration a beneficiary's economic development level, its competitive position in that product, and the overall economic interests of the United States. GAO supports this change, which is designed to graduate advanced beneficiaries from the program on a product-by-product basis and shift increased benefits primarily to the least developed countries. (See p. 5.)

GAO tested the proposition that emphasis on increased flexibility should be extended to two additional aspects of the preference scheme--the use of the "competitive need" exclusion and the rules of origin. (See pp. 22 to 29 and 36 to 38.)

COMPETITIVE NEED EXCLUSION

Not all eligible imports may receive duty-free treatment. Products from a beneficiary are ineligible if in the previous calendar year they equalled 50 or more percent of total U.S. imports of that article or exceeded $41.9 million for 1979. This amount is adjusted annually in relation to changes in the gross national product. These competitive need limits are applied automatically to all beneficiaries regardless of their development level. However, the President may decide not to withdraw the preference from a country exceeding the 50-percent rule if the total export value of that article to the United States was less than $1 million in 1979 (adjusted annually to reflect U.S. gross national product change). Countries which exceed the established limits and fall below competitive need levels in subsequent years may be redesignated for duty-free treatment. (See pp. 18 to 22.)

RULES OF ORIGIN

Products need not be entirely manufactured in beneficiary countries to be eligible for trade preference treatment. The rules of origin consist of

--a value added rule which states that a beneficiary must add at least 35 percent of a product's value, and

--a direct consignment rule which states that articles must be "imported directly" into the United States.

Like the competitive need exclusion, the rules of origin components are established by law; the President does not have authority to alter them in relation to a beneficiary's development level. (See pp. 29 to 36.)

GAO found that no significant increase in preference benefits would accrue to mid-level and least developed countries if the competitive need exclusion and rules of origin were less stringently applied for them. (See pp. 29 and 38.)

PREFERENCE PROGRAM DECISIONMAKING

The President decides the eligibility of products for preference treatment upon the recommendation of the interagency Trade Policy Staff Committee, which is chaired by the Office of the U.S. Trade Representative. Domestic and foreign parties or individuals may annually petition the Staff Committee to change product eligibility. (See p. 46.)

Aside from the possible effect of preference treatment on domestic industry, GAO found that two of the factors influencing product eligibility decisions are:

--The constraining effect of the initial product list of over 2,700 tariff lines; that is, whether new information about the impact of beneficiary imports on domestic firms is credible enough to persuade the Government, in effect, to reverse itself in subsequent reviews.

--The interaction of several agencies with differing role perceptions (for example, the State Department, responding to beneficiaries' concerns, tends to support additions to the product list while the

Labor Department, responding to domestic concerns, tends to support removals). (See pp. 55 to 58.)

The U.S. Trade Representative does not fully explain to petitioners the basis of product eligibility decisions. The rationale for denying a petitioner's request are explained in brief general language unrelated to relevant parts of the preference program law, to the specific economic facts in a petition, or to the reason those facts failed to support the petitioner's argument. (See pp. 58 and 59.)

Petition-related recordkeeping at the Office of the U.S. Trade Representative is too informal. No minutes of interagency committee meetings are kept. Documents pertaining to individual petitions are not systematically collected or preserved, and complete documentary histories of each petition are not readily available. (See p. 58.)

Regulations do not clearly state the kind of information beneficiaries need to provide in support of their petitions. The regulations state that petitioners requesting that products be added to the product list (generally beneficiaries) should evaluate the impact the proposed petitions would have on the comparable U.S. industry. This requirement is beyond the capacity of many beneficiary governments and exporters; domestic petitioners should be better able to make this sort of evaluation. (See pp. 41 to 44.)

GAO believes that petitioners should be fully informed about the basis of the Government's product eligibility decisions. Adopting a policy of more complete disclosure should help petitioners to decide whether they should submit petitions in the first place or resubmit them when their requests are denied. Such a policy would also provide the basis for improving congressional oversight of the program; it is difficult to evaluate a program when information is either not available or inadequately preserved. (See p. 58.)

RECOMMENDATIONS

To ensure that the Congress can assess the results of the preference program changes announced in the President's April 1980 report, the U.S. Trade Representative should annually report on a product-by-product basis to the Congress on how these changes are (1) graduating advanced beneficiaries from the preference program and (2) redistributing benefits to mid-level and less developed developing countries. (See p. 15.)

To achieve the goal of fuller disclosure, GAO recommends that the U.S. Trade Representative:

--More fully explain to petitioners why their requests are denied.

--More fully explain the basis of all product eligibilty decisions in Federal Register notices of such decisions.

--Prepare for public use a collection of the Trade Representative's interpretations of the preference program law and its relationship to past eligibility decisions.

--Establish a records management system which preserves a complete documentary history of each petition.

--Begin keeping minutes of interagency meetings which discuss petitions.

To clarify the kind of information that beneficiary petitioners should submit supporting their requests, the U.S. Trade Representative should amend the regulations by clarifying that foreign petitioners need not evaluate the impact of proposed additions to the product list on domestic industry. (See pp. 60 and 61.)

15 / 60/61

Tear Sheet

AGENCY COMMENTS

The U.S. Trade Representative comments, which included the views of various agencies that administer the preference program, were not received in time to fully incorporate them in this report. In general, however, the U.S. Trade Representative, while not accepting all of GAO's recommendations, did find that the report contained several constructive suggestions on the overall operation of the preference program. GAO has made no substantive changes to its conclusions and recommendations as a result of these comments. The comments are reproduced as appendix III.

Contents

ABBREVIATIONS

GAO	General Accounting Office
GSP	Generalized System of Preferences
LDDC	Less developed developing countries
UNCTAD	United Nations Conference for Trade and Development
USTR	United States Trade Representative

CHAPTER 1

INTRODUCTION

The U.S. Generalized System of Preferences (GSP) is a relatively small program that addresses issues of global wealth and poverty and the commitment by the United States to do something about the economic condition of developing countries. The U.S. program is today where it was 4 years ago when it began in 1976--caught in the crossfire between two sorts of good intentions--to assist economic growth in developing countries by granting trade preferences and to ensure by law that trade preferences do not injure the domestic producers of competing products. In the case of the American GSP, this means zero duty on otherwise dutiable imports, worth about $6.3 billion, or about 3 percent of total imports, in 1979. Exports from 140 beneficiary developing countries and territories (beneficiaries) currently are eligible for GSP under the U.S. scheme. The European Community's GSP imports were $4.4 billion, or 2 percent of their total 1977 imports. Comparable figures for Japan were $2.3 billion, or 3 percent of total imports in fiscal years 1977 and 1978.

The duty foregone by the United States through GSP imports was estimated at $565 million in 1979, since the average tariff level on GSP items is 9 percent. As a result of the now concluded Tokyo Round of Multilateral Trade Negotiations, this average tariff is being reduced to 4.5 percent from 1980 to 1987; this "erosion effect" on GSP is discussed in appendix II.

The dilemma posed by the U.S. program is not easy to resolve. The consequence is a program which struggles to be as cost-free as possible for domestic producers while still relevant to the needs of developing countries. The relevance of GSP for these economies as a whole is at best ambiguous. We discussed the program with exporters and government officials in six beneficiary countries. They generally did not attribute export growth or investment decisions to GSP; it was cited as a factor, but not an especially important one. These individuals told us that their trade with the United States is generally limited by factors outside the scope of the GSP program, including

--historical trading relationships with other developed countries,

--lack of export-oriented businessmen, and

--inability to meet the U.S. market's quality standards and large quantity requirements.

GSP's impact is sometimes more intensely felt at the level of individual firms. For example, an American businessman protests that in removing the duty on imported crabtraps the Government is an accomplice in the destruction of his small business. His petition to remove crabtraps from GSP is denied, however, on the grounds that imports are not large and that his problems appear to predate the program and, therefore, are not caused by the GSP concession. Crabtrap makers in the Far East consequently can continue duty-free exports of their product.

A manufacturer of small wooden sticks in Honduras, on the other hand, petitions the U.S. Government to add his product to the GSP list of eligible items. His petition is also denied because duty-free imports might injure small domestic manufacturers in an economically depressed state and a number of "advanced" beneficiaries are competitively exporting the petitioner's product without GSP. Import duties will continue to be assessed on small wooden sticks from Honduras and other developing countries.

These are two minor skirmishes in a larger struggle over who wins and loses in the shifting pattern of international trade between developed and less developed countries. GSP is a unilateral, nonreciprocal concession to the developing countries by the developed. Consequently, the developed countries define or regulate the conditions of international trade with trade preference programs like GSP when they decide which products are eligible for duty-free entry.

Our report is largely about the U.S. Government's regulatory role in GSP-related international trade. Any interested party may seek to add or delete products from eligibility by petitioning the Office of the United States Trade Representative (USTR). Petitions accepted for the annual review are considered first in the interagency GSP Subcommittee of the Trade Policy Staff Committee; dissenting agency members may appeal Subcommittee recommendations to the Staff Committee and subsequently to the Assistant Secretary-level Trade Policy Review Group, the cabinet-level Trade Policy Committee, or to the President. USTR chairs all these committees. When no additional review is necessary the USTR on behalf of the Trade Policy Staff Committee, makes the necessary recommendations to the President; most recommendations on petitions are decided at the Staff Committee level. Agencies which generally review GSP petitions are the Departments of Agriculture, Commerce, Defense, Interior, Labor, State, and the Treasury. The United

States International Trade Commission sits on the GSP Subcommittee as a nonvoting member and is required to give its advice on the probable economic effect of GSP on consumers and on domestic industries producing like or directly competitive articles.

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of this review was to evaluate the administration of the GSP program. We examined policy-related documents and interviewed officials at the Office of the United States Trade Representative and Departments of Agriculture, Commerce, Labor, State, and the Treasury. We also interviewed exporters, foreign officials, and U.S. Embassy personnel at Embassies and consulates in six beneficiary countries--Korea, Singapore, Malaysia, Thailand, Mexico, and Brazil. We selected these countries because they represented both advanced and mid-level beneficiaries with substantial GSP exports. Our objective was to determine what problems, if any, foreign businesses and U.S. Embassy and foreign government officials encounter with the program. Businesses contacted produce a wide variety of products and range from small companies to subsidiaries of transnational corporations.

To evaluate the administration's decisionmaking on petitions to add and delete products from GSP eligibility, we examined documents related to many of these cases at USTR. Of 254 petitions decided between 1976-79, we reviewed a total of 59 cases, including 12 from beneficiaries which we visited.

We attempted to assess how decisions on GSP petitions are made; it should be noted, however, that there is no documentary record of GSP Subcommittee meetings. Other records indicate the issues involved for particular petitions, but we could not always determine the impact that any given issue had on a decision.

We also reviewed information the administration collected for the President's recently completed report on the first 5 years of the U.S. GSP program. This included testimony from foreign governments, international organizations, U.S. business groups, and labor union representatives at the September 1979 public hearings on the general operation of the GSP before the GSP Subcommittee, and evaluations by U.S. Embassies of beneficiaries' experiences with GSP in several countries. We also reviewed GSP evaluations by several international organizations and statistical data on U.S. imports under GSP.

We did not evaluate U.S. Customs Service procedures at ports of entry for GSP imports, but did examine all applicable

laws and regulations pertaining to the program. We discussed entry procedures with the U.S. Customs Service and with several beneficiary exporters who experienced difficulties with the procedures.

AGENCY COMMENTS

The USTR comments, which included the views of concerned agencies that administer the preference program, were not received in time to fully incorporate them in this report. In general, however, the USTR, while not accepting all of our recommendations, did find that the report contained several constructive suggestions on the overall operation of the GSP program. We have made no substantive changes to our conclusions and recommendations as a result of these comments. The comments are reproduced as appendix III.

CHAPTER 2

GSP ADMINISTRATION RECENTLY MADE MORE FLEXIBLE

Title V of the Trade Act of 1974 (19 U.S.C. § 2461 et. seq.) requires the President to submit a "full and complete" report on the first 5 years of the GSP program. The report, completed in April 1980, 1/ establishes the goal that more GSP benefits should accrue to the less-developed developing countries (LDDCs), as well as some mid-level ones, and sets GSP administration on a new and more flexible course with the announcement of two improvements in the program.

--The President's statutory authority "'to withdraw, suspend or limit the application of the duty-free treatment' will be used to limit benefits for the more-developed beneficiaries in products where they have demonstrated competitiveness.* * *" This authority will also be used when products are added to the GSP eligible list.

--A "special effort will be made to include on the GSP list products of special export interest to low income beneficiaries, including handicraft items."

The report announced these changes virtually without comment; this chapter discusses their background and significance. The first improvement seeks to solve a problem which has concerned GSP officials for several years. Most GSP imports come from only five beneficiaries. Taiwan, Korea, Hong Kong, Brazil, and Mexico accounted for 68 percent of duty-free GSP imports in 1978, and the less developed countries for only 3 percent. The report says that these improvements are designed to "ensure that the most advanced beneficiaries' use of the program does not damage the trading interests of the less developed * * *." A number of decisions on product eligibility have had this unintended result.

1/Committee on Ways and Means, U.S. House of Representatives, "Report to the Congress on the First Five Years' Operation of the U.S. Generalized System of Preferences (GSP)" (Washington: Government Printing Office, Apr. 21, 1980).

TWO ASPECTS OF PROGRAM'S DESIGN CHANGED

To speak of "advanced" and "less developed" beneficiaries is a new and welcome departure. The design of the GSP program until now has been distinguished by a reluctance to make distinctions between the economic development level of GSP beneficiaries. GSP law (19 U.S.C. § 2461 et. seq.) defines only those countries that are not eligible for GSP. The administration noted during debate on the law that "neither U.S. governmental nor international agencies agree on objective criteria to define a developing country." The law's legislative history, however, includes the following caveat. "[S]ome countries now regarded as developing countries may reach a high enough level of development well before the end of the 10 years [GSP will terminate on January 3, 1985, unless renewed] to justify termination of preferential treatment to them." This "warning" raises the question of when does a developing country "graduate" and become a "developed" country. GSP law suggests general criteria for distinguishing beneficiaries by their development level. It says that in designating a beneficiary the "President shall take into account * * * the level of economic development of such country, including its per capita gross national product, the living standards of its inhabitants, and any other economic factors which he deems appropriate * * *."

The historical absence of distinctions among beneficiaries contrasts with the many and varied distinctions applied to products. That is where the emphasis was initially put when the program was designed. Product categories statutorily excluded from GSP due to their import sensitivity are

--textile and apparel articles subject to textile agreements,

--watches,

--import-sensitive electronic articles,

--import-sensitive steel articles,

--certain footwear articles,

--import-sensitive semimanufactured and manufactured glass products, and

--items subject to import relief.

An article also is excluded if it is determined to be "import-sensitive in the context of the Generalized System of

Preferences." As discussed in chapter 4, this phrase figures importantly in decisions on whether to add or delete products from eligibility.

Aside from these statutory exclusions, the existing product list, now containing over 2,800 tariff lines, is the result of selective designation decisions favoring manufactured goods over agricultural products. These decisions are generally justified on the grounds that GSP should assist beneficiaries to diversify their economies. As the President's report noted:

> "* * * the share of GSP duty-free imports in total U.S. agricultural imports has declined, from 4.4 percent in 1976 to 3.5 percent in 1978. The limited agricultural trade coverage of the U.S. program and the low share of GSP duty-free imports in total imports for most agricultural sectors has limited the GSP's impact on U.S. agriculture."

Most beneficiaries' exports to the United States are subject to the normal duty; only one quarter of them is even eligible for the tariff preference. About 37 percent enter duty-free because the normal tariff is zero or free under GSP. Table 1 compares beneficiary exports which are and are not eligible for GSP. Exports are ineligible because they are statutorily or administratively excluded or have never been requested for inclusion in the U.S. program.

The only device which has been used to date to make distinctions among beneficiaries is the so-called competitive need exclusion. Under this provision of the law, a beneficiary country loses its eligibility for duty-free treatment on a specific item when imports of the item from that country exceed 50 percent of total U.S. imports of that item during a calendar year. The President has authority to waive this rule for imports valued under a de minimis level ($1 million in 1979) or where no like or competitive product was produced in the United States as of January 3, 1975. The law also stipulates a maximum dollar limit ($41.9 million in 1979) for calendar year imports of a single GSP item from any beneficiary which if exceeded results in the loss of duty-free treatment for that item. Both the de minimis and dollar exclusion levels are adjusted annually to reflect growth in the U.S. gross national product. Reapplication of normal duties to items exceeding the 50 percent or maximum dollar limits occurs for an entire year following the year in which limits were exceeded. In subsequent years, if imports have fallen below the maximum limits, the President has discretionary authority to redesignate previously excluded items as eligible for duty-free treatment.

Table 1

1978 Total United States Imports from Beneficiaries
(Values in millions)

Beneficiary development level (note a)	NOT ELIGIBLE FOR GSP: Subject to normal duty — Value	Percent of total imports	NOT ELIGIBLE FOR GSP: Duty-free for developed and developing countries — Value	Percent of total imports	ELIGIBLE FOR GSP: GSP items subject to duty (note b) — Value	Percent of total imports	ELIGIBLE FOR GSP: GSP duty-free — Value	Percent of total imports	Value of total imports
Advanced	$17,574	59	$4,488	15	$3,433	11	$4,449	15	$29,945
Mid-level	3,331	36	4,337	47	1,007	11	577	6	9,251
Less-developed	721	34	1,137	53	96	5	170	8	2,124
Total (note c)	$21,641	52	$10,038	24	$4,537	11	$5,204	13	$41,420

Source: USTR, based on U.S. International Trade Commission and Commerce Department data.

a/For purposes of USTR's analysis, countries were divided on the basis of 1977 per capita gross national product into advanced developing countries (over $1,200), mid-level developing countries ($296-$1,200), and LDDCs (below $296). For a complete listing, see app. I. In the President's Report these figures were changed as follows: Advanced (over $1,100), mid-level ($300-1,100), and less-developed (below $300). The figures generally reflect 1978 per capita income figures. In this report, "less developed" and LDDCs are used interchangeably.

b/Primarily due to "competitive need exclusion" (see pp. 18-19) and failure to meet the "rules of origin" (see pp. 29-30).

c/Some beneficiaries are not grouped by development level due to insufficient data; value columns therefore do not add up to totals.

The President's Report recognizes that the lack of distinctions among beneficiaries by development level has been a problem; it says that, in making the previously mentioned improvements, the "President will take into account the development level of individual beneficiaries * * *." This partly means that the administration will use its selective redesignation authority in relation to a beneficiary's economic development level.

What we are calling the equal application principle is an additional feature of the program's design that is related to program improvements. A number of domestic petitioners requested in 1976 that product eligibility for a specific product be withdrawn from specific beneficiaries. These petitions were denied. The equal application principle was invoked; product additions or deletions should apply to all previously designated beneficiaries and not just to some. When a beneficiary requests the addition of a product to the eligibility list, it not only does so for itself but, tacitly, for all beneficiaries. GSP law does not require adherence to an equal application principle, but that is the way the program has been administered since its implementation in 1976.

Impact of beneficiary competitiveness on requests to add products to GSP

The equal application rule has proved troublesome. As a GSP agency memorandum noted in early 1978, "many products requested by middle level [beneficiaries] cannot be designated because of the dominant position of the most developed [beneficiary] countries * * * of the Far East." The following discussion of a 1977 petition demonstrates the impact that beneficiary competitiveness has had on requests to add products to GSP eligibility.

The Indian Government petitioned to add padlocks to GSP. Two issues were apparently relevant in this case--the products' alleged import sensitivity and the competitiveness of several Asian beneficiaries.

Beneficiary countries in 1977 accounted for about 68 percent of total padlock imports, which were valued at $2.4 million. Taiwan accounted for about 41 percent and Hong Kong about 26 percent of total imports, while India's were negligible. A supporting petition said that India's 1976 production of locks generally was about $6.8 million, with exports to countries other than the United States totaling about $4 million. The same petition noted that the European Community grants GSP to locks. U.S. 1976 production of padlocks was estimated at between $50 million to $70 million.

A GSP official called padlocks "one of the more logical products for GSP," indicating that the evidence concerning their alleged import sensitivity was not especially compelling. The official noted that Korea, Taiwan, and Hong Kong accounted for most of the imports and that their share of the U.S. market may have some bearing on the decision. In a close vote, India's petition was first approved in the GSP Subcommittee and then denied on agency appeal in the Trade Policy Staff Committee.

It is not clear from available documents whether this petition was decided on the grounds of import sensitivity, and/or because some Far Eastern beneficiaries were competitive exporters of padlocks without GSP. In referring to this and several other cases, however, a later GSP agency memorandum noted:

> "It has become clear the past two years [1976 and 1977] * * * that we have been restrained from designating a rather large number of products because of the dominant position in the American market of one or more of the major [beneficiary] suppliers. Thus, many were denied duty-free treatment because of the import sensitivity caused by a few."

These cases raised the question at the time of their consideration of whether the equal application principle should be abandoned. GSP law authorizes the President to "withdraw, suspend, or limit the application of the duty-free treatment * * * with respect to any article or with respect to any country * * *." Thus, the GSP agencies apparently had the legal authority in the padlocks case to selectively deny GSP eligibility for Taiwan and Hong Kong. As a 1977 GSP agency memorandum said, selective denial would be consistent with the graduation principle, since the greater competitiveness of certain Asian beneficiaries results in few opportunities for other developing countries. Another GSP agency memorandum offered, however, a "warning" and defense of the equal application principle, stating:

> "The proposal that designations or removals of products could be selective, rather than extended to all [beneficiaries], would cause more political problems [than] it would solve, as we would be besieged by domestic requests to remove one or two countries for various products and by foreign governments complaining about discrimination.

GSP was designed to provide benefits to all [beneficiaries] not excluded by competitive need, rather than to allocate benefits amongst the needy and competitive."

Having rejected selective designation in the padlocks case, the GSP agencies might have made padlocks eligible to all beneficiaries on the assumption that competitive need would eventually eliminate Taiwan, whose 1977 exports were 41 percent of total U.S. imports.

Apparently unwilling to decide between these two alternatives, the GSP agencies took the third course and denied the petition.

The administration's report has resolved the issue posed by the padlock and other cases; the equal application principle will be modified in favor of selective designation. The report says that in using his selective designation authority the President "will take into account the development level of individual beneficiaries, their competitive position in the product concerned and the overall economic interests of the United States." The report does not discuss the relationship among these three variables, particularly the first two.

Petitions have been received from advanced beneficiaries requesting the addition of products for which they did not have established competitive positions compared to middle income beneficiaries.

Singapore and the Philippines petitioned in 1978 to add cane furniture to the eligible product list. Singapore's 1977 cane furniture exports to the United States amounted to about $47,000, a 16 percent decrease from the previous year. This amount was approximately one percent of 1977 imports of this item. Singapore noted in its petition that "exports of cane furniture to Australia, Japan, the [European Community], and the Nordic Countries are entitled to GSP. * * * Singapore has * * * been able to increase its exports of cane furniture to the [European Community] as a result of GSP."

In denying both petitions, the administration said that "on the basis of recent trade data * * * Singapore and other GSP beneficiary countries are competitive in the U.S. market in this product. GSP beneficiary countries have accounted for 80 percent of the U.S. import market in recent years." Import sensitivity in the GSP context was not cited as a contributory reason for the denial. The only apparent reason was beneficiary competitiveness without GSP.

While it is arguable whether Singapore's cane furniture is as competitive in the U.S. market as that which accounts for the 80 percent market share cited by the administration, this petition raises the question of the scope of the selective designation principle. According to a GSP official, selective designation will not necessarily be used exclusively in relation to advanced beneficiaries. The official said that for specific products it is possible, although not likely, that a less advanced beneficiary might selectively lose GSP benefits while an advanced but less competitive one would not. On the basis of another petition, cane furniture was added to the GSP product list, effective March 30, 1980.

Eligibility of handicraft textiles has been a problem

The administration's report says that a "special effort" will be made to add handicraft and other unspecified items of export interest to low income beneficiaries to the GSP list. The report, however, does not say why such an effort is needed. Some of the relevant petitions we reviewed provide the background to this improvement.

The issue of handicraft eligibility tends to center on whether handicraft textiles can be added to the GSP list. This problem cannot be resolved by using the selective designation authority in GSP law. Rather, the administration would have to find a way to disentangle handicraft textiles from the textile exclusion; the law says that "textile and apparel articles which are subject to textile agreements" are "import-sensitive" and, therefore, not eligible for GSP. Imports of textile products are regulated by the Multifiber Arrangement, and specific bilateral quantitative restraints have been negotiated with a number of countries within the Multifiber Arrangement framework.

The following petition raises the question of how a "textile article" is defined and the scope of the textile exclusion; it also demonstrates the rather complex, even tortuous, decisionmaking on otherwise "humble" products.

An importer of Taiwanese artificial flowers, composed in part of manmade textile material, petitioned in 1976 to have this product added as a GSP-eligible item. The U.S. Customs Service had previously ruled that the assembly method of these flowers differed from similar products, thus precluding entry under a tariff number which is eligible for GSP. The petition resulted because of Custom's decision to classify the product under a tariff number not eligible for GSP.

Since there was no apparent domestic production, silk flowers were not thought to be import sensitive in the GSP context. An International Trade Commission official said, however, that silk flowers are import-sensitive textile articles and thus, presumably, not eligible for GSP.

Another GSP official disputed this view, noting that the Multifiber Arrangement says that the category of "textiles" is limited to "tops, yarns, piece-goods, made-up articles, garments, and other textile manufactured products (being products which derive their chief characteristics from textile components) * * *." The official questioned whether silk flowers "derived their chief characteristics from textile components." He noted that artificial flowers composed of textile material but made differently from those which the petitioner imported receive GSP under a different tariff number.

The petitioner's newly assigned tariff number was a large "basket" category of over 50 items, including such diverse articles as tents, safety belts, shoe buffers, and typewriter ribbons; some of these items, like tents, were considered import sensitive. If the petitioner's silk flowers were granted GSP, the other items in the tariff category also would be eligible.

The administration resolved this case in favor of the petitioner by removing silk flowers from the basket category and creating a new tariff number. In granting duty-free treatment, a GSP agency noted in a memorandum that "it is not necessary to reach the larger question of whether other articles subject to the Multifiber Arrangement but not to restraints under bilateral agreements would be eligible for GSP designation."

While the relationship of silk flowers to the textile exclusion language of GSP law proved tractable to a solution, handicraft textiles have until now proved less so.

The Guatemala Export Promotion Center petitioned in 1977 to add several handloomed folklore textile articles to the GSP eligibility list. At issue in the case was whether certified handloomed and folklore articles were subject to the "textile agreements" language of GSP law. The Multifiber Arrangement provides that it shall not apply to developing country exports of general handicraft textiles, provided such products are properly certified under arrangements established by the trading countries concerned. Guatemala did not have such a certificate, and some GSP officials argued that if its products were properly certified it could receive GSP. Certified items could receive GSP under a different tariff number and not be counted

against the textile quota established by the Multifiber Arrangement.

The unresolved policy problem concerned conflicting interpretations of GSP law: can a product which is covered by the Multifiber Arrangement generally but not by a restricting bilateral arrangement receive GSP? The GSP agencies were divided on this issue. Some believed that the textile language of GSP law referred to the Multifiber Arrangement generally and, thus, the question of specific bilaterals did not apply. These agencies held that all wool, cotton, or manmade fiber articles, including handicraft articles, are statutorily excluded from GSP. Other agencies held that handicraft textile items can legally be considered for GSP.

The Guatemalan petitions were officially denied because "textile articles [are] generally * * * considered to be import sensitive in the U.S., particularly at a time when many textile duties are being lowered in the U.S. as a result of the Multilateral Trade Negotiations." The items were also denied because lack of consensus on the policy question made it necessary to deny all petitions requesting the addition of any article subject to the Multifiber Arrangement. According to a GSP official, handicraft textile petitions will continue to be decided on a case-by-case basis. The official said that there is no general policy to include them; rather, a "special effort" will be made to do so if possible.

CONCLUSIONS

We believe the administration's decision to use the President's statutory authority to "withdraw, suspend or limit the application of the duty-free treatment" is a reasonable solution to the problem inherent in the so-called equal application principle where, in the past, some developing countries' products were denied duty-free treatment because of the import sensitivity caused by a few countries.

It is not clear, however, that the administration's action will, in the words of the President's Report, "help shift the overall share of benefits from the more to the less advanced and less competitive developing countries." Products from the LDDCs previously denied GSP eligibility may now be accorded duty-free treatment, but such action would not represent a "shift" in the sense of diverting trade from the more to less advanced unless the latter were able to increase their exports as a result of GSP.

The very poorest beneficiaries, at least, are currently incapable of exporting large amounts or varied types of goods to the United States under GSP. A USTR ranking of beneficiaries according to development level showed 1978 duty-free exports 1/ from advanced developing countries to be $4.547 billion, mid-level $485 million, and LDDCs $170 million.

The difference between what Hong Kong and Mali exported to the United States GSP duty-free in 1978--$537 million versus $59,000--shows the great difference in export capability between developing countries near the two extremes of the development scale. Changing the GSP program to benefit LDDCs through selective product designation probably would not help a country like Mali which has so little to export to the United States ($441,000 in 1978), 65 percent of it entered duty-free without GSP. What was true for Mali was true for LDDC beneficiaries as a whole. Most of their exports to the United States also entered duty-free without GSP (54 percent in 1978); only 5 percent of their total 1978 GSP eligible exports failed to receive the tariff preference. As the President's Report cautions, although LDDC beneficiaries have realized some benefits from GSP, their lack of productive capacity and the exclusion of many labor-intensive products prevent them from being major beneficiaries of the program.

Because the administration's changes to the program represent a basic departure from past administrative practice, we believe the consequences of these changes should be regularly reported to the Congress so that it can assess their impact and possible need for further change.

RECOMMENDATION TO USTR

We recommend that the United States Trade Representative, as part of the "Annual Report of the President of the United States on the Trade Agreements Program," include an analysis of how the changes announced in the President's April 1980 GSP Report are, on a product-by-product basis, (1) graduating advanced beneficiaries from the GSP program and (2) redistributing benefits to mid-level and less developed developing countries.

1/ These figures are from the President's Report, p. 41, and represent a revision of the figures in table 1 of our report.

CHAPTER 3

PROBLEMS ENCOUNTERED WITH GSP BY BENEFICIARY COUNTRIES

The administration has decided to differentiate aspects of the GSP program in relation to beneficiaries' development levels. It is limiting differentiation to product designation decisions. Extending it to other aspects of the U.S. program, like the competitive need exclusion and the rules of origin would require an amendment to GSP law. This chapter discusses these two features of the program in terms of beneficiaries' concerns and tests the proposition held by some that the exclusion and rules also should be differentially applied according to a beneficiary's development level.

We conclude that further differentiation or indexing would have no significant impact on the export opportunities of mid-level and LDDC beneficiaries.

One group that has emphasized the need to help the LDDCs by modifying elements of various GSP schemes is the U.N. Conference for Trade and Development (UNCTAD), a group of mostly developing countries organized to represent their interests. It has urged donor countries to (1) decrease the scope of safeguards designed to protect domestic industries, such as the competitive need exclusion, and (2) liberalize the so-called rules of origin.

Several developed countries modified their GSP schemes by granting special provisions to the LDDCs. Norway, for example, grants duty-free treatment to all LDDC products. The European Economic Community since 1977 also has tailored GSP benefits for LDDCs by

--eliminating the duty on all GSP-eligible agricultural goods (under its program some of these products were dutied at a lower than normal rate),

--abolishing all quantitative limitations usually applied to imports of industrial GSP commodities, and

--including selectively raw coffee and dried grapes on the eligibility list.

The United States also recognized, even before the administration's recent report, that its trade policy toward LDDCs

should be more lenient than for advanced developing countries. A 1977 State Department paper, for example, states that the Government:

> "recognize[s] that it might be desirable to give some form of special treatment to [LDDCs] in the U.S. GSP. In practice, where U.S. legislation currently allows some administrative discretion * * * we have redesignated [in relation to the competitive need limits] all eligible [LDDCs] and will probably continue to do so. Other possible favorable treatment such as giving the President the authority to waive the competitive need exclusions for the [LDDCs] would require new legislation."

The Organization for Economic Cooperation and Development also recognized the trend toward special treatment and stated in a 1977 paper:

> "But the facts prove that the general trend is towards a differentiation in the preferential systems according to the degree of competitiveness of the beneficiaries. It is unlikely that this trend could be reversed. One of the major elements of the GSP of the 1980s is likely to be this possibility of differentiation."

The International Association of Machinists and Aerospace Workers (AFL-CIO), testifying in September 1979 on the first 5 years of the GSP program, also supported increased differentiation.

> "Once a country becomes eligible for graduation, its benefits under GSP can be phased out over two or three years * * *. [I]t would be reasonable to phase out eligibility by lowering the competitive need value limit by one-half (for a two-year phase-out) or by one-third (for a three-year phase-out) of the limit existing at graduation in each succeeding year * * *
>
> "[A] two-tier system could be established and separate rules applied to imports from the least developed countries."

A 1979 UNCTAD review of GSP noted, however, that:

> "In the application of competitive need exclusions, the tendencies towards graduation and differentiation among developing countries are becoming more pronounced. The rationale for this differentiation is to reserve preferential access for products of less developed or noncompetitive developing countries. In fact, these limitations serve primarily as an additional protective device from preferential imports in general."

But in response to a 1979 State Department request to evaluate Thailand's experience with the program, a Thai Government official seemed to endorse differentiation, stating:

> "The beneficiary countries would better benefit from the U.S. preferential market advantages if other suppliers of like products from more advanced developing countries were to be excluded on the basis of the competitive need criteria."

During the now concluded Tokyo round of the Multilateral Trade Negotiations, the United States recognized the principle that LDDCs should not be held to the same rules as other countries and, during these talks, it ceded special tariff concessions to them. The United States implemented full tariff reductions, effective January 1, 1980, for non-import-sensitive exports from the LDDCs instead of phasing them in over a 7-year period, as it will for the other countries with whom it negotiated.

COMPETITIVE NEED EXCLUSION

The competitive need exclusion is a "safeguard" mechanism that automatically limits GSP imports. It is based on the assumption that, by definition, exports exceeding certain established amounts are competitive in the U.S. market. If a single country's shipments of an article exceed the established limits in one year, they are assessed the normal duty for the following year.

The two competitive need limits remove an article from GSP eligibility if U.S. imports in the previous year exceed either

--50 percent of total U.S. imports of that article (the "50 percent rule"), or

--an absolute dollar amount adjusted annually to reflect change in the gross national product (the "dollar rule," $41.9 million for 1979).

Loss of GSP is automatic and applies regardless of a beneficiary's development level. The 50-percent rule is waived for products which the U.S. International Trade Commission has determined were not produced in the United States on January 3, 1975. The President may decide, however, not to withdraw GSP from a country exceeding the 50-percent rule if the total export value of that article to the United States was less than $1 million in 1979 (adjusted annually to reflect U.S. gross national product change). The de minimis provision was enacted on July 26, 1979, (effective April 1, 1980) to allow countries to retain GSP for products whose export values are small and presumably not capable of injuring domestic economic interests. Wood tool handles from Malaysia worth $23,000 were denied GSP treatment in 1979, for example, because Malaysia supplied 62 percent of total U.S. imports of that product.

When a beneficiary's product is found ineligible for GSP under the competitive need exclusion, the normal duty rate is fully assessed in the following year on all imports to the United States of the item from the affected country. If a beneficiary's exports of an article exceed either of the two competitive need limits but fall below them in a subsequent year, the article may be redesignated as eligible for GSP.

The competitive need exclusion primarily causes otherwise eligible exports to lose GSP; table 2 shows the magnitude of this loss during 1976-78 and table 3 shows the development level of countries which lost GSP in 1978.

The countries with the largest volume of GSP eligible exports to the United States--the more advanced beneficiaries--were also, not surprisingly, the ones most affected by the competitive need exclusions. Aside from this "expected" result, table 3 also reflects perhaps two unexpected ones--the relatively high percentage of (1) LDDC exports subject to the 50-percent limitation and (2) mid-level exports affected by the absolute dollar limitation.

Two-thirds of the $37 million worth of LDDC exports subject to the 50-percent rule (about $24 million) consisted of Haitian baseball equipment. Most of the remaining amount (about $11 million) consisted of several Indian goods, mainly handloomed fabrics.

Table 2

U.S. Imports from Beneficiaries Subject to Competitive Need Exclusions
(values in millions)

Calendar year	Subject to 50-percent rule		Subject to dollar limitation		
	Value	Percent of total GSP eligible imports	Value	Percent of total GSP eligible imports	Total GSP eligible imports
1976	$ 693	11	$1,172	18	$6,530
1977	837	11	1,966	26	7,678
1978	1,009	10	2,208	23	9,741

Source: Same as table 1.

Table 3

1978 U.S. GSP Imports Subject to Competitive Need Exclusions by Development Level of Beneficiaries
(values in millions)

Beneficiary development level (note a)	Subject to 50-percent rule		Subject to dollar limitation		
	Value	Percent of total GSP eligible imports	Value	Percent of total GSP eligible imports	Total GSP eligible imports
Advanced	$852	11	$1,480	19	$7,882
Mid-level	120	8	728	46	1,583
Less developed	37	14	(b)	(b)	266

Source: Same as table 1.

a/Some beneficiaries are not grouped by development level due to insufficient data.

b/Negligible

Mid-level country exports subject to the dollar rule consisted of sugar from the Philippines and seven Latin American countries ($383 million or 53 percent) and copper from Chile, 1/ Zambia, and Peru ($313 million or 43 percent). The other 4 percent consisted of almost $32 million worth of cocoa butter from the Ivory Coast.

The dollar rule has an ambiguous effect on countries that export agricultural commodities and raw materials, that often depend heavily on such products to earn foreign exchange, because it can exclude GSP for these goods. Zambia's 1978 copper exports, for example, comprised about 93 percent of its GSP-eligible exports; the entire amount was denied GSP by the dollar limit. Zambia, in fact, failed to receive GSP for the rest of its eligible exports as well. Several sugar exporting countries also had very large proportions of their total GSP-eligible exports excluded by the safeguard. In 1978, Guyana had 75 percent excluded, the Philippines 71 percent, Nicaragua 68 percent, Peru 52 percent, and El Salvador 50 percent. On the average, sugar accounted for 77 percent of their total exclusions.

The loss of GSP, however, does not necessarily mean a decline in exports, and even when a decline does occur, GSP loss may not be the reason for it. The impact of loss is also related to the difference between the normal and zero duty rate; when the difference is small, the impact is presumably less severe.

The exclusion from duty-free treatment by competitive need for copper, sugar, baseball equipment, handloomed fabrics, and cocoa butter from these beneficiaries occurred in either 1976 or 1977 depending on the product. Subsequent 1977 and 1978 exports reveal a mixed picture. Copper exports from Chile and Peru increased by 62 and 31 percent, respectively, while Zambian copper exports fell by 12 percent. Sugar exports declined from Nicaragua, Peru, and the Philippines but increased from El Salvador and Guyana. Sugar from four of these countries plus eight others was redesignated in 1980. The Philippines, however, was not eligible to be redesignated. Cocoa butter from the Ivory Coast declined by 11 percent, but

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1/ On the basis of data in the President's Report, Chile is classified as an "advanced" beneficiary (See app. I). On the basis of its 1977 per capita income ($1,166), Chile was classified as a mid-level beneficiary in the data we received from USTR (See table 1, note a).

Haitian baseball equipment increased by 41 percent, and three types of Indian handloomed fabrics increased by an average 19 percent. The normal duty rate for these products varies from 1.3 percent for copper to 13 percent for one kind of handloomed fabric.

A less ambiguous consequence of the exclusion was cited by several Korean businessmen who told us that GSP was instrumental in increasing canned clam exports. When their product lost eligibility, they said, 4 out of 20 companies went bankrupt because their American buyers refused to pay higher prices. Korean clam exports declined by 36 percent between 1977 and 1978; the normal duty rate is 14 percent.

Applicability of development level indexing to competitive need

The following aspects of the competitive need exclusion are possible candidates for indexing. Our test of the proposition that differentially applying the competitive need exclusion would increase benefits for mid-level and LDDC beneficiaries is limited, however, to an analysis of indexing the 50-percent and dollar rules.

--Applicability to countries: The automatic use of competitive need for some countries could be relaxed; a decision on whether or not to impose it might be made after mutual consultations with the affected beneficiary government. These consultations might explore the possibility of extenuating circumstances which would postpone or preclude the necessity of using the exclusion.

--50-percent rule: The amount of duty-free exports of an item allowed under the rule could be increased or decreased in relation to a beneficiary's development level.

--Absolute dollar criterion: The permissible value of duty-free exports per article could vary according to development level.

--The de minimis figure: The amount could also vary by development level. An internal USTR analysis using 1978 data indicates, however, that benefits resulting from an increased de minimis figure would largely accrue to advanced beneficiaries. With a $4 million de minimis, for example, Mexico would receive GSP for 17 products worth $30 million over what it would receive with a $1 million de minimis;

India and other LDDC beneficiaries would not benefit from a de minimis higher than $2 million. India would receive GSP for 6 products worth $7 million over what it would receive with a $1 million de minimis.

--Applicability to exports: The loss of GSP could apply to a variable percentage of beneficiary exports of an item that exceeded a competitive need limit during the previous year. (At present, the normal duty is assessed on all such exports.)

--Phaseout of GSP: For LDDCs a competitive need exclusion could trigger a phaseout of GSP (lasting from 2 to several years, according to development level); the imposition of the normal duty would thus take place gradually.

--Duration of competitive need exclusion: Products from LDDCs that exceed the competitive need limits could lose duty-free treatment for some portion of a year.

--Special provisions for one or two product exporters: Competitive need exclusions could be waived, wholly or in part, for beneficiaries that have one product that represents 100 percent or close to 100 percent of their total exports to the United States.

--Guaranteed waiver from competitive need: LDDC and mid-level beneficiaries could receive guarantees that all products newly included on the GSP-eligible list would be exempt from competitive need for a number of years.

Potential for further efforts to redistribute GSP benefits

Indexing the competitive need exclusion is congruent with the administration's recently announced intention of selectively designating products and with a more general trade policy of granting special and differential treatment to some developing countries, especially LDDCs. Accelerated graduation from GSP benefits would doubtlessly occur if the 50-percent rule and dollar amount were lowered for the advanced countries. It is not clear whether the consequence of graduation is a redistribution of benefits to the LDDCs, since, as we have already noted, they have relatively little to export.

Indexing the two competitive need limits in relation to beneficiaries' development levels would (1) increase the volume of exports from mid-level and LDDC beneficiaries that qualifies for GSP and (2) decrease the volume from advanced beneficiaries. Table 4 shows the approximate volume of changes in 1978 GSP trade that would result from indexing the 50-percent and dollar rules.

Table 4
Approximate Results of Indexing
Competitive Need Exclusion (note a)

	50-percent rule (note b)				Dollar rule			
Indexing technique	Change from 50% to	Number of products (Additional	Number of countries benefits)	Value (millions)	Change in 1978 dollar limit (Amount of increase)	Number of products (Additional	Number of countries benefits)	Value (millions)
Increasing for mid-level beneficiaries (note c)	60%	3	3	$ 21.4	50% (to $55.8 million)	2	2	$ 86.8
	70%	7	5	85.3	100% (to $74.4 million)	3	2	156.7
	80%	10	6	104.0				
	90%	11	7	107.6	To allow GSP for all mid-level products (note d)	4	5	505.4
	100%	13	8	112.8				
	(Additional benefits)							
Increasing for LDDCs	60%	0	0	$ 0	No additional benefits possible			
	70%	1	1	6.1				
	80%	2	2	30.6				
	90%	3	2	32.2				
	100%	7	2	38.6				
	(Loss of benefits)				(Loss of benefits)			
Decreasing for top 5 advanced beneficiaries (note e)	40%	32	5	$297.8	Decrease limit to $25 million (note f)	13	3	$405.6

a/ Although table is based on 1978 trade data, it does not depict competitive need loss in that year. Competitive need involves selecting products in one year that will be excluded from GSP the next year. Table shows products exported in 1978 that would have triggered competitive need exclusions in 1979 had limits been set at indicated levels. Figures showing additional benefits are calculated cumulatively; for example, a 70-percent limit for mid-level countries would add 4 products from 2 countries worth $63.9 million over what they would gain from a 60-percent limit.

b/ Table includes no exports valued under $1 million but subject to the 50-percent rule. Had change made to GSP law in 1979 been applied to these exports, they could have been exempted from competitive need.

c/ Figures for mid-level countries do not include Chile or Turkey exports. Although these countries were classified as mid-level in USTR data we received in September 1979, they were subsequently classified as advanced countries in the President's Report on GSP. Mid-level figures include Indonesia, which was not a GSP beneficiary in 1978 but was in 1980.

d/ Dollar limit would have to be raised to $158.9 million to allow GSP for the largest mid-level export denied GSP by 1978 dollar limit. With this new limit, sugar from the Philippines and the Dominican Republic and copper from Zambia could have received GSP.

e/ Taiwan, Korea, Hong Kong, Mexico, and Brazil.

f/ Represents the dollar rule used on Jan. 1, 1976, when imports first received GSP.

Table 4 shows that increasing the values in the two competitive need rules would benefit mid-level beneficiaries more than LDDCs. Fully indexing the 50-percent limit could increase mid-level exports by about $113 million but benefit LDDCs by only $39 million. The effect of indexing this rule is even greater when applied to the advanced countries. The table shows that a change in the 50-percent rule by 10 percentage points yields a loss of benefits of about $298 million for the top 5 advanced countries and a total gain of about $21 million for all mid-level countries. Indexing the dollar rule also produces changes in exports relative to a beneficiary's development level. The loss of advanced country benefits exceeds the gain in mid-level benefits which, in turn, exceeds that of less-developed beneficiaries; this reflects the differences in export capacity of the three categories.

Increasing the 50-percent rule for mid-level and LDDC beneficiaries

The primary effect of indexing in these cases is to increase possible duty-free exports of mid-level and less-developed countries. It is possible, however, that this increase would, as a secondary effect, divert GSP trade from other beneficiaries. The redistributive effects of indexing diminish when one mid-level or less-developed country increases its GSP exports while other similarly categorized countries collectively decrease theirs by a greater amount.

Conversely, the redistributive benefits of indexing improve when mid-level or LDDC exports increase while advanced or nonbeneficiary exports decline.

In the cases below, the trade effects might result in a trade diversion from one or more of the top beneficiaries.

--Articles of shell from the Philippines were denied GSP because they comprised 68 percent of U.S. shell imports. An increase in the 50-percent rule to 70 percent would increase eligible Filipino exports and might divert trade from Taiwan, Korea, Mexico, and Hong Kong, which accounted for about 19 percent of U.S. imports.

--An increase in the limit to 75 percent would have allowed Indonesian wood veneer panels to receive GSP while possibly diverting exports from Taiwan (20 percent of U.S. imports) and Brazil (2 percent).

--An increase in the rule to 80 percent would make Haitian baseball equipment eligible for GSP; export trade might be diverted from Taiwan and Korea, which held about 7 and 6 percent, respectively, of the U.S. import market.

On the other hand, changes in the 50-percent rule might result in diverting exports from other mid-level and less-developed countries.

--An increase in the limit to 55 percent would allow the Philippines to ship lumber under GSP, but it might divert trade from Malaysia, whose lumber exports were about 35 percent of U.S. imports.

--Thai rubies and sapphires could receive GSP if the limit were raised to 70 percent, but this might divert trade from Sri Lanka and India, whose exports together comprised about 14 percent of U.S. imports. (On the other hand, Hong Kong's exports also accounted for about 6 percent.)

--An increase in the limit to 80 percent would allow bananas from the Philippines to receive GSP, but might divert trade from Honduras, the second biggest beneficiary exporter, with about 13 percent of the import market.

Data on 1978 import shares shows only one case for which indexing the 50-percent rule to benefit LDDCs would result in possible trade diversion from a mid-level or other less-developed beneficiary. Indian buffalo leather would receive GSP if the limit was raised to 70 percent; this might divert trade from Thailand, which accounted for 23 percent of U.S. imports in 1978.

Increasing the dollar rule for mid-level beneficiaries

In contrast to conflicting secondary effects from indexing the percentage rule for mid-level beneficiaries, an increase in the dollar limit would generally increase the redistributive impact of indexing. The only four products for which mid-level countries would receive GSP by indexing the dollar limit are discussed below.

--An increase in the 1978 dollar limit of 50 percent (from $37.2 million to $55.6 million) would

allow cocoa from the Ivory Coast to receive GSP. Brazil--the biggest beneficiary exporter ($74.4 million in 1978)--might, as a result, find itself less competitive.

--Peru could receive GSP for a certain type of copper with a $55.8-million limit. Trade might be diverted from Chile, an advanced beneficiary.

--For another copper product, Peru could receive GSP if the 1978 dollar limit were doubled to $74.4 million. Some trade might be diverted from Chile and Zambia, which collectively account for 47 percent of the import market. Zambia's copper could receive GSP only if the 1978 limit had been over $80.2 million, more than twice the limit then in effect.

--Sugar from the Dominican Republic and the Philippines could benefit from indexing the dollar rule only if it were increased about 295 and 427 percent, respectively, an unlikely event in view of domestic price support policy.

Lowering the competitive need limits for five advanced beneficiaries

The five leading beneficiaries would lose GSP benefits worth about $703 million if the competitive need limits were lowered to 40 percent and $25 million. If this decline were not offset by increases from other beneficiaries, their share of 1978 GSP duty-free imports would have declined from 68 to 63 percent. Their share would decline to 55 percent if all of this amount was diverted to other beneficiaries.

There are two possible secondary effects from lowering the limits for the five countries. The redistributive effect increases when a decline in their exports is accompanied by an increase in those from mid-level or less-developed countries. The effect diminishes when the decline is accompanied by an increase in exports from other advanced countries.

One of the top five beneficiaries is the leading competitor for 24 of the 45 products for which the five countries would lose GSP if the two limits were lowered by the amount indicated on table 4. In addition, an advanced beneficiary other than the five major ones is the leading competitor for five products. This demonstrates the difficulty of redistributing GSP benefits by indexing competitive need for graduation purposes.

There are, however, six products worth $46 million in which some trade might be diverted to a mid-level or less-developed beneficiary. Cocoa butter from the Ivory Coast ($32 million), pipe tools from India ($6.6 million), and magnetos from Haiti ($4 million) account for most of this amount. The other three items are selected linen products from India and the Philippines, cast-iron fittings from India, and softwood dowel rods from Honduras. The last product would only be eligible if the 50-percent rule had been raised to 55 percent in 1978.

In eight cases, there is no significant redistributive impact from lowering the two limits for advanced countries, because there is either no significant beneficiary competitor or each beneficiary not already subject to competitive need has less than one percent of U.S. imports.

Conclusion

The President's Report states that existing statutory authority "to withdraw, suspend or limit the application of the duty-free treatment" will be used when products are added to the GSP eligible list. The authority may also be used to remove advanced developing countries' products from eligibility.

Changing the competitive need exclusion potentially would affect only a few products from a few mid-level countries and LDDCs. Redefining "competitiveness" for five advanced beneficiaries probably would not significantly divert trade from them to the less advanced.

RULES OF ORIGIN

The rules of origin in the American GSP program consist of the following interrelated parts which must be satisfied before an eligible product can receive duty-free treatment: (1) the value-added rule which states that a beneficiary must add at least 35 percent of a product's appraised value and (2) the direct consignment rule which states that articles must be "imported directly" into the United States. The rules recognize that export articles need not be entirely manufactured in beneficiary countries in order to be eligible for GSP. On the other hand, they are supposed to preclude eligibility for products merely transiting through beneficiaries or only slightly altered by them.

The value-added rule is designed to allow goods that are not entirely the product of the beneficiary country to receive GSP. Imported material can count toward the required value-added content if it is "substantially transformed" into a new

and different article of commerce that is then used as a component in manufacturing the end product. U.S. regulations say that the value-added rule is satisfied when the following proportion exceeds 35 percent.

$$\frac{\text{cost or value of local material or "substantially transformed" imported components} + \text{direct cost of processing operations}}{\text{appraised value of the entire product}}$$

Beneficiaries' problems with value-added rule

Beneficiary exporters and government officials told us that they experienced the following problems with the value-added rule.

--Uncertainty over included and excluded local content cost.

--Uncertainty over how to calculate the product's total value.

--The alleged inequity of requiring firms that produce multiple product lines to perform separate calculations for each product.

--Unreasonable burdens on small, unsophisticated producers.

--Exclusion from the 35-percent calculation of the value of goods imported from the United States as a GSP donor country.

The first two problems result from uncertainty about the precise elements comprising the three parts of the value-added formula. U.S. regulations which define them in detail probably are not readily available to many exporters. Even those who are aware of the elements express confusion about what is allowable in calculating the percentage; a Singapore subsidiary of an American firm, for example, told us that it was unsure whether administrative overhead could be considered part of local cost.

An UNCTAD official testifying in the 1979 administration hearing on the first 5 years of GSP said:

> "manufacturers and exporters still are not very clear what could be included in the calculation of the direct cost of processing operations when determining the 35% minimum domestic input."

Latin American beneficiaries suggested in a 1978 meeting of government experts on GSP that the law "be interpreted more flexibly; making it possible to include management costs in the producing country within the total of operating costs."

The appraised value part of the value-added formula has also caused difficulties for beneficiary exporters. They have little way of knowing what this term means because it is applied at the time of entry into the United States and is not necessarily the same as the item's value at the time of shipment. Government officials in Malaysia told us that their exporters generally have difficulty understanding the relationship between their costs and the U.S. Custom's determination of a product's value. Both the Taiwanese and Hong Kong Governments have noted the same problem; the latter, noting "certain difficulties" with the program, said in 1979 that:

> "Since the 'appraised' value is not available to Hong Kong, calculation of the cost percentage by manufacturer and the [government] has to be based on the ex-factory price. This is bound to be different from the 'appraised value' assessed by the U.S. Customs. [Certificate of Origin forms] issued in good faith are sometimes rejected simply because the two governments are adopting different criteria."

The Trade Agreements Act of 1979 changed the basis of appraised value; the new valuation system uses transaction value, that is, the price actually paid or payable for the goods with additions for certain items such as selling commissions, packing costs, and certain costs of materials and services not reflected in the price paid or payable for the goods. If the value cannot be determined using the transaction value method, it must be determined by one of four alternative methods. The United States is applying the transaction value method on a "free on board" (f.o.b.) basis.

The need to calculate the value-added percentage for each type of product also causes problems for manufacturers

who export many different variations of the same product line. Jewelry exporters in Malaysia and Thailand, for example, told us they make hundreds of slightly different rings and bracelets, each type requiring a separate value-added calculation. Thailand's 1978 eligible GSP jewelry exports to the United States were $7.7 million; 82 percent of this amount actually received GSP, while 18 percent did not because of apparent failure to apply for GSP status or inability to meet the rules of origin requirements.

Officials of a Singapore firm told us that each of the several hundred machined spare parts they export requires a separate value-added calculation. In response to this kind of problem, the Mexican Government suggested in 1979 that exporters be allowed to calculate costs by family of products if each component of the family has similar costs.

According to some foreign businesses and government officials, the burden required to make value-added calculations is especially difficult for small companies because their accounting systems do not readily permit this calculation to be made. A Mexican Government official told us that the problem of determining value added discourages some firms from seeking the benefit. Government officials in Thailand and Brazil echoed these sentiments.

Lack of precise definition of "substantial transformation"

The U.S. delegate to a 1978 Organization of American States meeting on GSP explained the substantial transformation rule as follows.

> "Imported materials can be counted toward the 35 percent value-added requirement if they are substantially transformed into a new and different article of commerce which is then processed into the eventual GSP eligible product."

> "Substantial transformation, while admittedly somewhat complicated, is not a rule of origin. In fact, it is a liberalization of the rules of origin which enables the exporting country to count the full value of imported components as local materials provided that they have been substantially transformed within the country."

A U.S. Customs Service official told us that substantial transformation occurs when a newly produced product is a new and different article of commerce, has new and different uses, and has a new and different name.

Regulatory language is apparently the source of some confusion about what this means; it says that the phrase "produced in the beneficiary developing country" means either wholly the product of the beneficiary or substantially transformed in the beneficiary country into a new and different article of commerce.

The following Customs Service rulings on specific imports expanded this brief language.

> "Wooden doors. Lumber, in the form of rough boards of random lengths and widths imported from the United States into Mexico, is there made into rails, * * * panels and moldings, which are then assembled into doors for export to the United States. The door components qualify as substantially transformed constituent components. Their value may be included in the computation of the 35% in determining eligibility of the wooden doors."

> "Plastic caps and spouts. Plastic resin pellets, imported from the United States into Mexico, are mixed in a drum with dry colorant and, through [an] injection moulding machine with pressure and heat, made into plastic caps and spouts. There is no intermediate article or materials to qualify as a substantially transformed constituent material. The value of the plastic resin pellets cannot be included as part of the 35% requirement in determining eligibility of the plastic caps and spouts." (Underscoring added.)

These examples expand the regulatory language by saying that imported material must in effect undergo two substantial transformations. In the first example rough boards are first "transformed" into panels and moldings and then transformed again into wooden doors. In the second example, there is only one substantial transformation (resin pellets to plastic caps).

Summarizing the confusion this rule has caused, an UNCTAD official said in 1979 that:

> "What strikes the mind of exporters and officials in beneficiary countries is the interpretation of what is substantial transformation of any imported material. For many of U.S. officials participating in missions of [UNCTAD's GSP Project] * * * substantial transformation occurs when the imported materials have undergone a manufacturing process in

> the beneficiary country important enough to transform them into a new and different article of commerce. Other officials would explain that substantial transformation takes place when the imported materials have undergone two stages of manufacturing processes. * * * This * * * creates uncertainty and, in the opinion of many officials and exporters in beneficiary countries, a more clear-cut definition for substantial transformation * * * should be provided."

Government officials and exporters in several countries we visited also expressed these sentiments. Singapore businessmen told us that the rule is hard to apply to machined parts that do not change significantly in their appearance but have higher tolerances than the imported pre-processed part. And a Thai gem exporter told us that an imported gem stone that is cut or recut may increase substantially in value but not qualify for GSP because it remains a gem stone. The U.S. Customs Service offers advisory opinions to foreign exporters on these types of substantial transformation questions as well as on questions about the value-added calculation.

Some beneficiaries would also like to see the U.S. rules of origin include as a local cost the value of the materials a beneficiary exporter buys from the United States and includes in the final product. Adoption of such a "donor country content rule" in the American rules of origin would, in effect, mean a more liberal value-added requirement because it would increase the value amount eligible as local content.

The GSP programs of Australia, Canada, Japan, and New Zealand presently include a donor country content rule. An UNCTAD official noted in 1979 that:

> "This provision provides mutual benefits to both the donor countries, through increased exports of components and materials, and to developing countries particularly the poorer among them, by allowing an improvement in production techniques by advancing from simple products requiring minimal processing to more sophisticated products where they now have extreme difficulties in meeting the rules of origin requirements."

An Organization of American States staff evaluation of GSP suggested that the United States adopt such a rule but raise from 35 to 50 percent the value added required for products made with U.S. materials.

Beneficiaries believe U.S. direct consignment rules could be fairer

The direct consignment rule is designed to prevent alteration of GSP goods in transit. U.S. GSP law requires that an eligible product must be "imported directly" from the beneficiary country to the United States. U.S. regulations define direct importation to mean

--when goods are shipped without passing through any other country;

--when goods enter the territory of another country but do not enter its commerce and the shiping documents show the United States as the final destination; and

--when goods are shipped through a free trade zone in a beneficiary country but do not enter its commerce.

For goods passing through free trade zones, the regulations restrict the type of processing to such operations as sorting, grading, and repacking.

The most important feature of the U.S. direct consignment rule is that merchandise must be destined for the United States without contingency for diversion before it is exported from the beneficiary country. A U.S. Customs Service official told us that shipments can pass through any number of countries as long as there is no "contingency for diversion." U.S. Customs examines invoices, bills of lading, and other documents as a whole to determine the shipping conditions and route; these papers must show that the (1) merchandise did not appear to have entered a third country's commerce, (2) United States was the intended final destination before export, and (3) purpose of transshipping was not to find a buyer but rather to transport the merchandise.

The European Economic Community, Switzerland, and Austria allow third-country transit if it is justified for geographic or transport reasons when the goods remain under customs control, do not enter trade or consumption, and do not undergo any operations other than unloading, reloading, or processing needed to keep them in good condition.

A 1979 UNCTAD review of GSP said the United States is the only donor that requires the final destination of a GSP product to be known at the time of export. Other countries have dropped

this requirement to facilitate preferential imports, particularly from landlocked countries. Australia, according to UNCTAD, has dropped the direct consignment requirement altogether.

A U.N. rules of origin digest says that the United States has one of the most stringent direct consignment provisions for products from landlocked beneficiaries. The destination of products from these countries is often decided only after they arrive at a port in a neighboring country. The United States and Japan would deny GSP treatment to a product made, for example, in Nepal, stored temporarily in an Indian warehouse under customs control, and shipped directly from India, if there was no declared destination before the product left Nepal. Other donor countries would permit Nepalese articles to receive GSP in this case.

Applicability of rules of origin to development-level indexing

The U.S. Government compiles aggregate figures on the amount of eligible imports denied GSP status for reasons other than competitive need; these reasons may include

--failure to meet the rules of origin;

--an exporter's failure to apply for GSP; and

--a beneficiary government's failure to certify the accuracy of the value-added computation on the "certificate of origin" which virtually all major donors require.

Table 5 shows the amount of these imports compared with duty-free imports by development level. According to a U.S. Customs official, specific reasons are not given for why imports dutiable for rules of origin and other reasons failed to receive duty-free treatment. Thus, it is not possible to test the proposition that indexing the rules of origin would increase GSP benefits for mid-level and LDDCs. We have confined our discussion, therefore, to those aspects of the rules which potentially could be changed in relation to a beneficiary's development level.

GSP-dutiable imports are common to all development levels. Advanced beneficiary countries are affected to a greater extent, in dollar terms, because their GSP-eligible exports are greater than those of the other countries. The less developed beneficiaries are more adversely affected in terms of a percentage of total eligible trade.

Table 5

1978 GSP-Dutiable and Duty-Free Imports to the United States
(value in millions)

Beneficiary development level	Imports dutiable for rules of origin and other reasons		GSP duty-free imports		Total GSP-eligible imports
	Value	Percent of total GSP-eligible imports	Value	Percent of total GSP-eligible imports	
Advanced	$1,100	14	$4,449	56	$7,882
Mid-level	159	10	577	36	1,583
Less developed	59	22	170	64	266
All beneficiaries	1,319	14	5,196	53	9,732

Source: Same as table 1.

Indexing the rules of origin is, to a limited extent, already part of GSP law; it recognizes that distinctions should be made among countries belonging to economic associations pursuing regional integration with other beneficiaries. While other beneficiaries individually must meet the value added rule, a regional association member may combine processing operations with other eligible members in order to satisfy the 35-percent requirement.

Some GSP donor countries, as mentioned previously, have liberalized their rules of origin. Australia, for example, dropped its direct consignment requirements. Steps which the United States could take in indexing the rules of origin to beneficiaries' development levels include the direct consignment and the 35-percent value added rule.

The local-content percentage, for example, could be indexed by development level so that the least competitive would have to add only a small percentage to the value of a product while advanced beneficiaries would have to add more. A donor country content rule could be applied only to the LDDCs or to all beneficiaries in different ways. For the less developed, for example, 100 percent of the value attributable to imports of U.S.-made materials incorporated into the finished

article could be counted toward local costs; for more competitive beneficiaries this percentage could be reduced or made inapplicable. Other aspects of the value-added computation could also be made more liberal for LDDCs. The present prohibition against including management costs, overhead, and profit as allowable local costs could be abolished for selected countries in order to increase the amount of eligible goods which actually receive GSP.

LDDC countries could also be exempted from some of the direct consignment requirements, such as the rule that the country of destination must be declared before a product leaves the country of origin. The prohibition against the sale of goods in a country of transit might also be relaxed for LDDCs (as five donors allow for all beneficiaries) to allow warehousing or other operations required primarily to facilitate the product's sale, so long as it is not substantially altered.

GETTING GSP: THE ROLE OF BENEFICIARY ORGANIZATIONS

Table 5 indicates that mid-level and LDDC products worth $218 million failed to receive duty-free treatment in 1978 for reasons other than those associated with the competitive need exclusion. Although some of this amount may have been due to failure to meet the rules of origin requirements, beneficiary countries also have organizational problems which limit fuller use of the GSP concession and which may account for a substantial proportion of the $218 million. For this reason, indexing the rules of origin probably would not bring substantial added benefits to mid-level and LDDC beneficiaries.

A beneficiary country's success in fully using GSP depends not only on various program elements defined by the donor countries, such as product eligibility, safeguard mechanisms like the competitive need exclusion, and rules of origin, but also on factors unique to the beneficiaries themselves. These factors are basically the effectiveness and efficiency of beneficiary governments and exporters as well as the relationship between them; beneficiary institutions themselves are hindering full use of the concession.

Beneficiary governments are minimally responsible for providing "certificate of origin" forms to their exporters and certifying the accuracy of the required information. An eligible product cannot receive GSP without a properly certified certificate of origin.

Ideally, beneficiary governments should also be able to follow and adjust to changes in product eligiblility; with the U.S. program, this means changes resulting from the annual product review and potential or actual loss of eligibility due to competitive need. The petitioning process also places special demands on beneficiary governments since they must provide specific supporting information with their petitions (see ch. 4).

Exporters cannot receive GSP unless they apply for it and submit a properly executed certificate of origin form to their government's certifying authority. Businessmen exporting to the United States might also want to monitor and adjust their exports in relation to the competitive need limits. This would be important only if the "cost" of exceeding the limits is greater than the "benefits" of expanding exports above them. Exporters shipping to the United States should, ideally, also be able to support their own or their government's petitions to change product eligibility.

Beneficiary institutions not always effectively organized to get GSP

The inability of beneficiaries to effectively and efficiently fulfill some of these requirements means that some GSP-eligible products are assessed regular duty at the time of entry. As we have noted, eligible products worth $1.3 billion and not limited by competitive need failed for a variety of reasons to receive GSP in 1978; GSP products worth $5.2 billion entered duty-free in the same year.

Lack of sufficient and/or efficient government personnel can be a problem. For an African beneficiary, officials responsible for GSP programs also represent their country in international trade negotiations and are thus frequently out of the country.

Government officials for an Asian beneficiary told us that limited staff means that they cannot review the eligibility list in sufficient detail to exploit whatever competitive advantage they might enjoy.

In some beneficiaries, the certificate of origin form is either not available or not always certified and returned to exporters in a timely manner. In some cases, export information and documents reportedly are distributed to favored exporters. Some beneficiaries require exporters to complete additional GSP-related forms. This may deter exporters from applying for GSP because the benefits of the concession allegedly do not always exceed the cost of the paperwork involved.

The relationship between exporters and their government is sometimes ineffective. For an Asian beneficiary, a law firm attempted to organize a joint seminar on GSP with several government agencies; the firm finally conducted the seminar by itself after waiting a year for the government to respond to its invitation.

A Latin American jewelry manufacturer spent 6 months trying to get an opinion from his government on the eligibility of his products. Asian manufacturers complain that their government did not notify them when their exports approached the competitive need limits.

These examples doubtlessly could be multiplied many times. What they demonstrate, we believe, is the interrelationship between organizational and economic development. GSP places specific demands on beneficiary organizations, demands which sometimes exceed the ability of these organizations to respond effectively.

CHAPTER 4

CHANGING GSP: THE DECISIONMAKING PROCESS

GSP decisionmaking consists of two related processes--petitioning and determinations of product eligibility. Common to both are adversary situations where conflicts are initially defined and subsequently resolved. Petitioning is the process where contending claims about the effects and proper limits of GSP are debated by those who have an economic stake in the outcome. It is the role of Government, however, to authoritatively define these proper limits. The Government must repeatedly rule on the question: Under what circumstances is the goal of GSP inconsistent with and/or damaging to domestic economic interests?

While petitioning is an open process involving public hearings, determination is less so. No minutes are kept of interagency meetings on petitions accepted for annual review. There has been little attempt to publicly explain the basis on which product eligibility decisions are made. The President's Report was virtually silent on this subject; it did not, for example, discuss how phrases in GSP law like "import sensitive in the context of the GSP" have been interpreted in previous petition reviews. We believe the administration can better explain its decisions to petitioners and generally be more forthcoming on how it has interpreted GSP law concerning petition-related decisions.

CONFLICT DEFINED: THE PETITIONING PROCESS

Requests to change product eligibility are generally initiated by beneficiary governments and domestic organizations, although the Trade Policy Staff Committee also can propose changes. The very openness of this process has ironically worked against the interests of some petitioners, including, but not limited to, beneficiary countries. To be a competent adversary, a beneficiary's petitions are supposed to meet minimum information requirements requested by the Government.

Regulations announced in late 1975 describing the petitioning process said that those requesting additions to the list of eligible articles--generally beneficiary countries--needed to say "why such * * * articles should be so designated, together with information relevant to the import-sensitivity of the article in the context of the GSP." In 1977, the requirement to provide import-sensitive information was deleted. Petitioning beneficiary governments are now specifically

asked to provide information on production, capacity, employment, prices, and sales in their country in support of each request and an "analysis of how those factors might change in the future both with and without the GSP treatment of the product." These provisions were added to prevent beneficiaries from submitting so-called shopping lists of products they want designated. Although the regulation states that all petitioners requesting designation of additional items are required, in part, to provide "specific information" on "how the GSP treatment would affect the petitioner's business and the industry producing like or directly competitive articles in the United States, including information on how the requested action would affect competition in that industry * * *", from the context of the regulation, this requirement is mandatory only for an "interested party" having a significant economic interest and not for a foreign government. The regulation provides, however, that foreign government petitioners "should" submit information on the relevant U.S. industry if "available and appropriate."

As stated by USTR's General Counsel in 1978, "Foreign governments are not required per se to submit information on the affected United States industry. The relevant portion of the regulations states that petitions should contain certain information on that country's industry * * *." In the same year, for example, the State Department told the Government of Thailand that "In addition, foreign governments should, if available and appropriate, submit the information on how GSP treatment would affect industry producing like or directly competitive articles in the U.S."

The burden of providing information on the "anticipated impact" that GSP treatment would have on the affected U.S. industry should rest in the first instance with domestic petitioners in their own petitions or in their counterarguments to beneficiaries' petitions. Domestic petitioners, we believe, are presumably most knowledgeable about the domestic marketplace and the anticipated impact of imports. If foreign government beneficiaries wish to address the "anticipated impact" of proposed GSP treatment or respond to domestic petitioners, they are of course free to do so.

Some beneficiaries lack the institutional resources to effectively participate in the adversary process which GSP regulations establish. A process intended to encourage beneficiaries to participate in decisions affecting their international trade has, in some instances, become itself a source of conflict. A number of beneficiaries have cited difficulties with the information requirements; two examples from our fieldwork in Asia illustrate this problem.

Beneficiaries' experiences with petitioning process

The Thai Government does not maintain a statistical data base from which it could easily support requests and must request this information from individual businessmen. Thai Government officials told us that their requests are often ignored because small businesses, in particular, do not compile extensive statistics. Requests are also ignored, we were told, because businessmen do not want to divulge information which also might interest Thai tax officials and/or their business competitors.

In summarizing the Thai Government's view of the petition process, a U.S. Embassy official in Thailand correctly noted that the Thais find it "exasperatingly complicated--so much so that they don't mount the effort unless the odds are heavily in their favor that the petition will be approved."

The Malaysian Government in 1978 narrowly avoided having its first petition rejected for review when the U.S. Government informed it that it had "no rationale or data" in support of "only an indicative list of products that Malaysia would desire to see on GSP." The Malaysian petition was clearly a problem since some of the requested items were already entering the United States duty-free. Other items, such as textiles, were statutorily excluded by GSP law, and still others had been previously rejected in the 1977 review. The Malaysian Government was told that the deadline for a possible resubmission was 7 days.

The U.S. Government had invited Malaysia and other Association of Southeast Asian Nations beneficiaries in 1977 "to request the inclusion of items of interest to them." The Malaysian Government, perhaps unsure of the then new 1977 regulations, asked the U.S. Embassy to review its petition for adequacy. The Embassy instead sent the petition without the desired review to Washington where it was denied for the previously noted reasons.

During the week allowed for resubmission the Embassy worked with the Malaysian Government to prepare a more adequate petition by the deadline date, and some of the requested items were in fact accepted for review.

We do not want to leave the impression that failure to strictly comply with the regulations invariably means that a beneficiary's petition will be denied acceptance for review. The Malaysian Government's resubmission, for example, did not include all of the required data. On the other hand, failure by beneficiaries to provide requested information has caused

petitions to be denied. The State Department noted in a 1978 cable to U.S. Embassies in beneficiary countries that a "number of government petitions were not accepted [for review in 1977] because they did not contain all the required information, and there was no time to seek additional information from governments [because of the late publication of the 1977 regulations]."

Defining proper limits of GSP

The petitioning process is a public forum where contending ideas about the proper limits of GSP are debated. The following 1976 case is an example of this kind of debate.

Arguments for removing ferroalloy products from GSP

The petitioner requested removal of seven ferroalloy products from GSP for which the tariff ranged between 3.2 and 7.8 percent; eight related products were never eligible. The petitioner argued that

--ferroalloy products are import sensitive within the context of GSP,

--the anticipated impact of future imports will adversely affect the ferroalloy industry, and

--other GSP-granting countries do not permit duty-free entry of ferroalloy products.

The petitioner argued that all imports, regardless of origin, are relevant to import-sensitivity determinations. He noted that the six import-sensitive product categories statutorily excluded from GSP are imported primarily from developed countries as distinguished from developing countries. The petitioner claimed that in GSP law "import sensitive" and "import sensitive in the context of GSP" are synonymous. What is important, he argued, is the impact, not the source of all imports. This was an important distinction because the petitioner's own data for one product, ferrosilicon, showed that, while 1975 estimated imports from developed countries were 53 percent of domestic consumption, imports from developing countries were 7 percent. The data also showed that imports of the same product from both developing and developed countries declined absolutely and relative to domestic consumption between 1974 and 1975.

The petitioner, in invoking the anticipated impact clause, argued that duty-free status "will inevitably encourage those countries under GSP to develop production capabilities" for ferroalloy products not currently imported in significant quantities. This argument was supported by the observation that "most ferroalloy furnaces have a degree of flexibility that normally allows several different ferroalloy products to be made in the same facility." Thus the petitioner anticipated that GSP will cause developing countries to shift production and exports from excluded to eligible items, further exacerbating an "already serious condition."

The petitioner alleged that the "[European Community] countries and Japan do not permit GSP duty-free treatment to any effective degree with respect to any ferroalloy products." He further noted that it would be "inequitable for the United States to be the only consuming country that extends duty-free treatment * * *."

Arguments for retaining GSP for ferroalloy products

A counterargument on behalf of Brazilian ferroalloy producers claimed that the phrases "import sensitivity" and "import sensitivity in the context of GSP" have separate meanings in GSP law. In determining the latter, only imports from beneficiaries are relevant. This argument alleged a trade diversion effect, saying that future increases in imports from beneficiaries would be at the expense of developed countries and not domestic producers. The counter-argument asserted that claims of import sensitivity had to show a causal link between imports and aspects of the competing domestic industry, such as profits and employment. One could not claim as a general proposition that imports as such are injurious. Noting that 1975 developing country imports of ferrosilicon were 7 percent of consumption, the rebuttal brief wondered that "If the domestic industry were so wobbly that 7 percent of the market supplied by GSP countries would tip the scales, [employment and profit] data would have been supplied."

This "debate" raised a number of issues which have proved enduring:

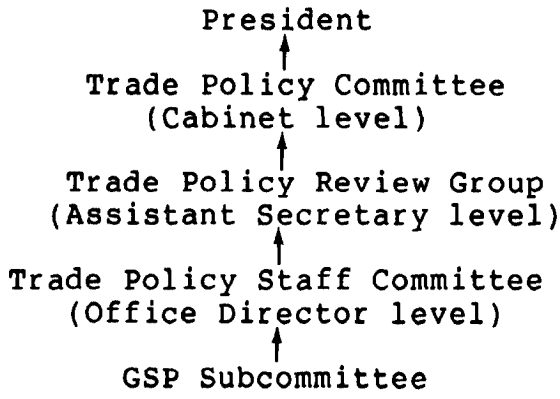
--What is the relevant source of imports in making import-sensitivity determinations?

--Does "anticipated impact" refer to identifiable injury or does it refer to a more hypothetical impact?

--To what extent is the behavior of other GSP donor countries relevant to the U.S. Government's decisions on product eligibility?

CONFLICT RESOLVED: THE DETERMINATION PROCESS

Petitions are resolved on a case-by-case basis in the interagency committee structure depicted below.



USTR chairs all of the interagency committees, with GSP-relevant membership from the Departments of Agriculture, Commerce, Defense, Interior, Labor, State, and the Treasury. In January 1980, the newly formed International Development Cooperation Agency was added to the Trade Policy Committee and more recently to the GSP Subcommittee. Other agencies, such as Justice and Transportation, participate at higher levels when issues require their expertise.

Petitions are initially discussed in the GSP Subcommittee, which recommends a determination to the Trade Policy Staff Committee which, in turn, prepares recommendations for the President if no further review is needed. The Staff Committee made the recommendations for most of the petitions we reviewed. Some were appealed to the Trade Policy Review Group and at least one petition was appealed from this Group directly to the President. Annual product review results are implemented by executive order and changes take effect on March 31. While each petition the Subcommittee reviews is in some respect unique, analysis of the petitions in our sample showed that certain clusters of issues continually reappear. The following discussion centers on a case we constructed from actual petition histories in our sample.

Constructed petition

A domestic firm requests that manufactured product "A" be removed from the GSP list of eligible products. The petitioner

represents an industry in which production, employment, and profits have been in slow, but unmistakable, decline since the mid 1960s. Firms producing "A" are concentrated in small towns of several adjacent States and are the principal employers in these towns.

Developed country imports of product "A" have declined since 1976, while beneficiaries' imports have been moderately increasing since the early 1970s. Most beneficiary imports are from Taiwan, but recently some Central American beneficiaries have exported small but increasing amounts of product "A."

Product "A" is not represented by a single tariff number but is part of a large basket category. There is virtually no current domestic production for some items in the basket. Domestic consumption for these items comes from exports by a large number of beneficiaries. Product "A" is about 7 percent cheaper than the domestic product, with little quality difference between the two. Imports from developed countries are subject to a 10-percent tariff; imports from beneficiaries enter duty-free with GSP. Taiwan accounts for 45 percent of the basket category imports and an unknown but presumably high percentage of product "A".

Discussion of constructed petition

Neither GSP law nor its legislative history defines "import sensitive" or "import sensitive in the context of GSP" or the possible differences between them. In several decisions as well as in internal memorandums, the GSP agencies have attempted to clarify the ambiguity. They generally discuss import sensitivity in the GSP context in terms of three interrelated issues, the

--degree to which imports affect domestic producers of like or directly competitive products,

--source of the imports causing the alleged problem, and

--contribution the source makes to the alleged problem.

Internal agency memorandums note that these agencies have three possible choices in defining the first issue. They can decide whether an item is import sensitive if it is causing (1) only "serious injury," or (2) an identifiable but not serious problem, or (3) a largely hypothetical or future problem.

The second issue asks whether it is permissible to consider as import sensitive (1) imports from both beneficiaries and developed countries, (2) only imports which enter from beneficiaries, regardless of whether they actually receive duty-free treatment, or (3) only imports which actually enter duty free.

The issue concerning the contribution the source makes, regardless of how "source" is defined, is also addressed in terms of three possible choices. An item is import sensitive if imports from the designated source (1) contribute to the alleged problem, or (2) contribute importantly but are not the single most important factor, or (3) are the major cause.

The petitioner in our constructed case is claiming injury from both developed and beneficiary country imports. The Government decided that imports from developed countries are not relevant to the GSP law's import-sensitivity language in several petitions that we reviewed. In the ferroalloy products case the Government denied the petitioner's request and thus implicitly narrowed the issue concerning the source of an alleged injury. In our constructed case, beneficiary exports seem to be increasing at the expense of developed country exports. This trade diversion effect is, according to the administration, a major goal of the GSP program and, as such, tends to undermine the petitioner's argument.

The petitioner in our constructed case claimed a deteriorating market position since the mid 1960s. In a product eligibility decision we reviewed, the Government decided that a deteriorating market position which predates GSP is not, by itself, sufficient evidence of adverse impact. Petitioners must demonstrate that their problems are at least substantially caused and not merely aggravated by GSP.

The degree to which GSP imports do, or may, cause problems "unites" the "import sensitivity" and "anticipated impact" language of GSP law. Decisions to grant GSP must consider "the anticipated impact of such action" on domestic producers of "like or directly competitive products." Anticipated impact is presumably more difficult to assess than actual impact. The Government has decided that petitioners cannot claim anticipated and presumably adverse impact as a purely hypothetical possibility, that is, where there are no or very small imports from beneficiaries. Domestic firms presumably cannot successfully argue that GSP will inevitably cause beneficiaries to begin manufacturing and exporting eligible items which will, by definition, damage domestic producers. This was of course part of the petitioner's argument in the ferroalloys case.

An argument which rests on anticipated impact language must, it appears, refer to actual imports and their future adverse impact on domestic producers. The relevant question in our constructed case is whether GSP is aggravating an already difficult situation to the extent that the anticipated impact language of GSP law becomes important.

The petitioner in our constructed case has a somewhat special problem since the firms he represents are geographically concentrated. The Government has decided that geographical impact is a legitimate factor when determining import sensitivity (for example, in the small wooden sticks case mentioned in ch. 1), but has not hesitated to rule against individual firms which are the sole producers of eligible items and which protest their eligibility. The sole domestic manufacturer of bicycle horns, for example, petitioned to remove his product from eligibility in 1976. He said that GSP "effectively denies both jobs and income to U.S. workers at various levels" and that his company is "doomed by the destructive tariff policy of the U.S. * * *" The petitioner further said that if "emergency relief" is not granted by the government, there is "no alternative to liquidation at the end of the current fiscal year, [and] dismissal of all [48] personnel * * *." The petitioner cited "low pay scales * * * [in Taiwan and Korea], [and] restrictive regulations [which] add significantly to the cost of doing business * * *."

In denying the petition, USTR said that:

> "We found no evidence that a marked increase in imports occurred as a result of the GSP, or that there was a loss of [petitioner's] sales due to GSP imports. [The petitioner's] problem with imports predated the GSP program [the petitioner's business began to suffer from imports in 1958]. Restoration of the [8.5 percent tariff for bicycle horns] would be unlikely to benefit [the petitioner]. The company contends that Taiwanese manufacturers undersell it by 43% * * *. If [the petitioner] still wishes to obtain relief through the removal of bicycle horns from GSP, it should provide information indicating that duty-free imports from * * * beneficiaries are the cause of the problem. For example, if it can be demonstrated that imports of bicycle horns from GSP beneficiaries are displacing domestic goods (as opposed to cutting into imports from nonbeneficiary countries), then * * * [the] case would warrant reinvestigation."

The question of whether or not beneficiaries that are competitive without GSP for a specific product should get GSP for those products was discussed in chapter 2. Here it is sufficient to repeat that, until now, the administration was predisposed not to grant eligibility in the first place if a beneficiary was competitive without it. The petitioner in our constructed case, until now, might have rested his argument on the assumption that Taiwan is competitive without GSP.

As discussed in chapter 2, GSP law allows the President to "withdraw, suspend, or limit the application of the duty-free treatment" previously accorded. In taking this action he must consider, in part, a beneficiary's "level of economic development * * * and any other economic factors which he deems appropriate." The Government in the past was reluctant to withdraw eligibility on the grounds that some advanced beneficiaries were "competitive" exporters, especially when their exports did not exceed the competitive need limits. Denial under such circumstances was thought to be discriminatory and to undermine the competitive need provisions of GSP law. In our constructed case, Taiwan's exports under the basket category are below the competitive need limits.

Before the changes announced in the administration's recent report, there were several "acceptable" ways the Government discriminated against particular beneficiaries on a product-by-product basis. Assuming in our constructed case that Taiwan's exports eventually exceed the competitive need limits but subsequently fall below those limits, the Government might refuse to redesignate Taiwan as a beneficiary for the basket category. This flexible redesignation policy was given added emphasis in the administration's report.

Our constructed case suggests an alternative form of acceptable discrimination. Since product "A" is part of a basket category, it might be possible to "break it out" of the basket and assign it a separate tariff number. Such an action would, in our case, accomplish three things. First, since Taiwan's exports are near the competitive need limits for the basket category, they might very well exceed the limits for product "A," thus losing eligibility. If the entire basket were eliminated for all beneficiaries, products which clearly are not competitive with domestic producers would also lose eligibility. Second, beneficiaries that are new to the market for product "A" (in our example, several Central American countries) would not be inadvertently penalized by the success of large exporters like Taiwan. Indeed, if Taiwan exceeded the competitive need limits, small

exporters would be perhaps even more competitive. Third, the alleged injury claimed by the petitioner might be eased if Taiwan's exports were dutiable at the normal rate. In our constructed case, this is a real possibility since the price difference between the imported and domestically produced product is less than the rate of duty. The existing rate of duty has been a factor in a number of actual decisions. Anticipated adverse impact might be assumed where the difference between GSP and the normal duty rate is large and thus the price of the imported item under GSP is considerably lower than its domestic version.

The risk inherent in a decision to break out product "A" is that Taiwan might not exceed the competitive need limits or that, even if it did, other beneficiaries might increase their exports, thus offsetting whatever benefits the decision might bring to the petitioner. If this decision were made subsequent to the recently announced "improvements", beneficiaries other than Taiwan could apparently be selectively designated for continued eligibility of the tariff category containing product "A." Taiwan's eligibility could thus be eliminated.

Such a decision would not be "fair" to Taiwan because it had not exceeded the competitive need limits. On the other hand, selective designation would be "fair" to the petitioner and other less competitive beneficiaries because their major competitors' products would be assessed the normal duty.

Aside from the issues raised by our constructed petition, equitable and reasonable access to beneficiary markets and the role of transnational corporations in GSP trade were also present as issues in petitions we reviewed.

Equitable and reasonable access

GSP law says that "In determining whether to designate any country a beneficiary developing country * * * the President shall take into account * * * the extent to which such country has assured the United States it will provide equitable and reasonable access to the markets and basic commodity resources of such country."

Some petitioners have cited this language as a reason for removing products from GSP. The "equitable and reasonable access" language, interpreted literally, appears relevant only to the designation of developing countries as GSP beneficiaries and less relevant, if at all, to product eligibility

decisions. If a product was denied eligibility because a particular beneficiary failed to provide equitable and reasonable access to its markets then other "innocent" beneficiaries under the equal application principle would lose GSP benefits for that product. The following case from our sample illustrates the use of the equitable and reasonable access language.

Petition to remove edible gelatin from GSP

The Gelatin Manufacturers Institute of America requested in 1976 that various edible gelatin products be removed from GSP eligibility, stating in partial support of this request that:

> "Effective January 1, 1976, the Mexican Government increased the rate of import duty on pharmaceutical grade gelatin. In addition, the Mexican Government continued in effect the embargo on the importation of edible gelatin * * *. In other words, the Mexican Government has responded to its designation as a GSP beneficiary country by taking a highly restrictive action * * *."

The Government denied the petitioner's request, but equitable and reasonable access was not the basis of the decision. The Trade Policy Staff Committee noted that while beneficiaries increased their share of the U.S. market from 2 percent in 1972 to 8 percent in 1975, this share was still a "moderate proportion" and not sufficient to warrant removal of edible gelatin from GSP.

If edible gelatin had been removed from GSP eligibility for equitable and reasonable access reasons, then several beneficiaries as well as Mexico would have also "suffered" loss of eligibility because the administration was adhering at that time to the equal application principle. A GSP official told us that this principle was a factor in denying petitions to remove products from eligibility despite the existence of a reciprocity issue. The official could not recall any instance where a product was removed solely for reciprocity reasons.

Since GSP is considered a unilateral concession to beneficiaries, resolving reciprocity issues was also thought to belong more properly to the Multilateral Trade Negotiations forum.

Cases of this sort raise a number of questions in view of the administration's recent report. Is the equitable and reasonable access language relevant to product eligibility decisions, and, if so, will the use of selective designation be applied to petitions like the one cited?

The equal application principle has seemingly limited the use of this language in making product eligibility decisions. Selective designation, at least theoretically, removes that bar. Mexico's loss of eligibility for gelatin would not adversely affect other beneficiary exporters. Equitable and reasonable access, if selectively applied to advanced beneficiaries, would become an additional graduation device. A GSP official told us that, while this issue is considered relevant to product eligibility decisions, there is no general policy to deny eligibility to a beneficiary that does not provide it. Reciprocity issues will be considered on a case-by-case basis.

In June 1980 testimony before the Subcommittee on Trade, House Committee on Ways and Means, a former USTR official acting on behalf of "The Labor-Industry Coalition for International Trade" noted that the:

> "GSP program should take into account the trade policies of the beneficiary countries. In general, our decisions about GSP benefits should reflect the openness of those countries' policies, not only with respect to access for American goods, but also goods from other developing countries. It is ironic that some countries which may complain about restrictions of industrialized countries, place much tighter restrictions on access to their own market."

Role of transnational corporations

The role of transnational corporations has been controversial from the very start of the GSP program; related issues present in the petitions we reviewed were those in which (1) transnational corporations' subsidiaries manufacture eligible products in beneficiaries for export to the United States, and (2) transnational corporations complete a manufacturing process in a beneficiary, thus qualifying for GSP.

The National Association of Photographic Manufacturers petitioned in 1976 to have a number of photographic products removed from GSP, citing "anticipated impact" as the reason. It supported this argument with a logical inference, arguing that photographic manufacturing facilities are not generally indigenous to beneficiaries; they are owned and controlled by firms headquartered in developed countries, notably Japan and West Germany. The petitioner argued that foreign transnational corporations' photographic manufacturing technology is fully competitive with domestic technology and "is currently being applied together with low labor rates to

produce products which * * * enter the United States duty-free and against which United States manufacturers cannot hope to compete." The petitioner concluded: "We do not believe that it was the intent of Congress in providing GSP * * * to create a windfall situation for the benefit of other developed nations to the detriment of the United States, even though an incidental benefit might accrue to the GSP country." In other words, all things being technologically equal, lower labor rates plus GSP will inevitably have an adverse impact on domestic manufacturers.

Domestic importers of photographic equipment from several Asian beneficiaries argued in counter briefs that:

> "a substantial financial investment was made by the * * * parent company in training local Singaporeans in the skills necessary to produce * * * quality photographic equipment * * *. [T]he large scale transfer of technological skill will remain a benefit to the beneficiary * * * country indefinitely, and will import to that country a resource that can be employed for its ultimate development."

Another importer, echoing this theme, said: "[T]hese manufacturers are doing exactly what GSP intended, i.e., encourage a disbursal of capital from the developed countries to the underdeveloped countries * * *."

The Government denied the petitioner's request without specifically commenting on the role of transnational corporations; rather the Trade Policy Staff Committee rejected the inferential nature of the petitioner's argument. The petitioner did not claim actual injury from imports; its concept of "anticipated impact" was presented in largely hypothetical terms with no empirical evidence relating imports to domestic employment, production, and profits.

The International Association of Bridge, Structural, and Ornamental Iron Workers petitioned in late 1978 to have offshore drilling and production platforms removed from GSP; it had not been aware that platforms were eligible for GSP. Upon discovering their eligibility, the Association expressed the concern that GSP would "have the effect of enormously increasing the tendency of the Japanese manufacturers of such rigs to move finishing stages [to beneficiaries] for duty-free treatment * * * on the expectation that they could evade payment of duty by means of the last step manufacture * * *." The petitioner was aware that a platform was being assembled in Malaysia for use in the coastal waters of the United States. The petitioner wrote the administration in January 1979, noting that:

"It was only after we filed our petition that we discovered that the * * * fabricators were indeed a totally-owned U.S. company. It had never actually occurred to us before that a U.S. company would try to use the GSP status of a country like Malaysia to obtain the equivalent of a U.S. Government subsidy * * * in the form of duty-free privileges. Surely the GSP list was not established to promote this kind of activity * * * [T]he Malaysia stopover is a subterfuge to gain windfall tax benefits."

The Government reached what it considered a compromise decision; it removed drilling platforms from GSP but delayed implementation of the decision for one year. The compromise was justified on the grounds that it "will not penalize the beneficiary developing country which has let contracts this year with the understanding that they would receive GSP duty-free treatment. At the same time, the compromise is responsive to the petitioner's request." The decision did not specifically rule on the question of whether or not a beneficiary "stopover" is a legitimate use of GSP by transnational corporations. The petition was more narrowly decided on the continued eligibility of a particular item. The petitioner claimed that drilling platforms are examples of statutorily excluded import-sensitive steel items. The basis of the Government's decision is not clear. In a letter to the Malaysian Government, apparently explaining its decision, the State Department merely noted that the petitioner had cited the import sensitivity of steel; it did not say whether the U.S. Government agreed with the petitioner's assertion. The letter did, however, refer to the "tremendous congressional interest in this case * * * ." In other justifications of its decision, the Government said that the petitioner "fears a loss of contracts and jobs" if the item continued to receive GSP, but it did not say whether it believed those fears to be justified. The same justification noted that the petitioner "is widely supported by organized labor as well as by a large number of Congressmen."

MAKING GSP DECISIONS: HOW THE AGENCIES VOTE

The President makes petition-related decisions after receiving the advice of the several interagency committees of the Trade Policy Committee structure and the U.S. International Trade Commission; the GSP Subcommittee makes the initial recommendation. Aside from the relationship between GSP law and the specific facts in a petition, two additional factors which apparently determine voting on

petitions are the (1) constraining effect of the existing product eligibility list and (2) interaction of several agencies with differing role perceptions.

The product eligibility list is itself a probable constraint which limits the possibility of amendments. Since the Government spent considerable time in 1975 creating an initial list of about 2,700 items, one would not expect it to, in effect, reverse itself with numerous additions or deletions. That expectation perhaps pertains more to initial product reviews than later ones, since relevant economic facts should change over time. The decision figures in table 6 generally support this inference.

Table 6

Petitions Decided During 1976-79

Petitions	1976	1977	1978	1979
	(percent)			
To add products:				
Granted	0	33	41	22
Denied	100	67	59	78
To remove products:				
Granted	16	0	0	10
Denied	84	100	100	90

Source: Federal Register Notices: Year refers to date decision announced, not date petition submitted.

Between 1976-79 254 petitions requesting additions or deletions were decided; 81 percent of these requests were denied and 19 percent were granted. These figures do not include petitions submitted by the Trade Policy Staff Committee or petitions requesting other action, such as a subdivision of an existing tariff category.

Agency role perceptions differ

The tension inherent in GSP law between the economic development goal and its actual and potential impact on domestic industry is reflected in agency voting on petitions. The GSP agencies have differing perceptions of their roles in the Trade Policy Staff Committee and its GSP Subcommittee. We do not wish, however, to overstress this point; the agencies are not implacably divided on every petition. In the 1977 and 1978 votes on the 62 petitions we analyzed, consensus voting (that is, unanimity or only one agency dissenting) occurred about 57 percent of the time for product additions and about 50 percent for removals.

When consensus is not possible, the agencies tend to divide into those that generally (1) support additions to the product list and oppose removals (State, Treasury, and Defense), (2) support removals and oppose additions (Labor), and (3) oppose additions and removals (Commerce, Agriculture, and Interior). Defense rarely votes at the GSP Subcommittee level and Treasury's support for additions is considerably less than State's. State and Treasury, however, appear about equally opposed to removing products from GSP. USTR votes in tie-breaking situations. Table 7 shows the vote distribution by the patterns we identified.

Table 7

1977 and 1978 Vote on 62 GSP Petitions

Agencies	Vote	Petitions to Add (Percent)	Petitions to Remove (Percent)
State	Grant	90	0
	Deny	10	100
Treasury	Grant	57	5
	Deny	43	95
Defense	Grant	90	0
	Deny	10	100
Labor	Grant	32	61
	Deny	68	39
Commerce	Grant	20	32
	Deny	80	68
Agriculture	Grant	33	21
	Deny	67	79
Interior	Grant	29	37
	Deny	71	63

This data is only suggestive of voting trends; votes for every GSP petition were not available. Several GSP officials, however, confirmed the general patterns depicted here. We believe it is also supported by the commonsense view that State's position on a petition, for example, probably will better reflect beneficiaries' interests than Labor's and that Labor's position will be more reflective of domestic interests.

These patterns suggest an additional reason why amendments to the eligibility list are difficult to make. Commerce, Agriculture, and Interior are pivotally important; they can block Labor's tendency to support removals and State's tendency to support additions. The result is not necessarily deadlock due to tie votes but rather a reinforcing tendency not to substantially change what has been previously declared eligible.

GSP decisionmaking not fully accountable

It is not possible to clearly determine the basis of product eligibility decisions. In contrast to an open petitioning process, the determination process, as we are calling it here, is not as open because no minutes of GSP Subcommittee meetings are made. This is not always a practice in Government. For example, in another area of trade regulation--export control--interagency deliberations are recorded for certain types of export license applications.

The lack of a similarly documented record of GSP Subcommittee deliberations is part of USTR's generally inadequate GSP-related recordkeeping. USTR's GSP files were compiled over time by different people using their own individualistic systems. The result today, in the words of a GSP official, is rather "unsophisticated." In fact, the absence of any sort of "system" frustrates even those who administer the program.

USTR needs to create an orderly recordkeeping system which preserves in a readily accessible way the complete documentary record of each petition. Above all, USTR needs to establish the obvious and elementary procedure of recording the minutes of GSP Subcommittee meetings as well as the deliberations of any other relevant committees.

USTR needs to more fully explain its decisions to petitioners

We believe the Government has an implied responsibility to more fully explain to petitioners the reason(s) why their petitions are denied. Denials are usually explained in general language, and approvals announced without explanation in the "Federal Register", although one petitioner's approval may be, and often is, a counter petitioner's denial; USTR does not explain that sort of "denial." Petitioners do not always know what specific quantitative economic information was used. In 1979 public hearings on the first 5 years of GSP, a witness noted that:

"one important step that may be lacking in [the] open procedure followed by the Trade Policy Staff Committee is the absence of a published evaluation or report on a case. The result of the Committee's consideration of a petition is no more than the conclusion which appears in the "Federal Register" * * * . In some cases, a petitioner is sent a letter advising him briefly of the rationale for a negative conclusion reached by the Trade Policy Staff Committee. However, such a report is very sketchy and only provides the bare bones of what the Committee has found. Therefore, the Committee may wish to give consideration to a fuller report on its findings."

Government officials in Brazil, Korea, and Malaysia told us that they generally do not know why their petition requests are denied duty-free treatment other than that they are considered "import sensitive in the context of the GSP." They said they are not told what this phrase means.

In denying a request to remove an item from GSP, for example, USTR wrote a petitioner:

"In reviewing your petitions, the GSP Subcommittee and the [Trade Policy Staff Committee] did not find the products to be import sensitive in the context of GSP. In addition, the GSP Subcommittee and [staff Committee] took into account the relatively low duties on these [products] plus the important development benefits which were demonstrated by several beneficiary developing countries. Finally the Committee determined that GSP duty-free imports of [these products] do not affect U.S. domestic production and employment in the industry to the extent which warrants their removal from the GSP eligible list. The decline in demand for these products by the depressed * * * industry was felt to have a significant bearing on the state of domestic production and employment."

While each explanation is to some extent unique, we believe this one is a reasonable example of the level of specificity which USTR uses. Petitioners are asked to provide considerable supporting evidence with their petitions; in a spirit of reciprocity, USTR should be more forthcoming when explaining its decisions. This denial letter does not, for example, discuss how USTR interprets the phrase "import sensitive in the context of GSP" or the relevance of "relatively low duties". USTR apparently does not feel it has a responsibility to share with the petitioner the basis on which it reached its decision.

CONCLUSIONS

GSP decisionmaking needs to be more transparent, especially for those most affected by it. The President's Report announcing a modest step in this direction said:

> "A GSP information center will be established to assist [all interested parties and individuals] in obtaining data necessary for filing product petitions and related briefs and to assist such parties or individuals in the preparations of petitions and briefs."

The following recommendations support this effort; they address not only the availability of information but, more importantly, its quality.

GSP regulations concerning information required to support petitions should more clearly define those requirements by type of petitioner and action requested. Current regulations attempt to do this, but some ambiguity remains.

GSP recordkeeping at USTR is too informal; detailed minutes of all GSP Subcommittee meetings should be kept so the reasons for product eligibility decisions can be preserved. Petitioners should be told in greater detail why their petitions are denied.

The President's Report did not discuss petition-related decisionmaking. The Government has conducted three annual and four semiannual product reviews since 1976. We believe this cumulative experience is sufficient to warrant a detailed discussion by USTR on how the administration interprets various parts of GSP law when making product eligibility decisions. The administration should now be able to say, for example, what "equitable and reasonable access," "anticipated impact," and "import sensitivity in the context of the GSP" has meant in past decisions; this could serve as a guide for future petitioners by making the decisionmaking process more open.

RECOMMENDATIONS TO USTR

We recommend that the United States Trade Representative:

--Clarify the GSP regulations by explicitly stating that only domestic petitioners need to evaluate the impact that proposed additions would have on the domestic industry producing like or directly competitive articles in the United States.

--Establish a records management system which preserves the complete documentary history of each GSP-related petition.

--Direct the Chairperson of the GSP Subcommittee to ensure that minutes of all Subcommittee meetings are kept.

--Give a fuller explanation to petitioners why their requests are denied. Petitioners should be informed not only of which factors influenced the President's decision but also how each factor was weighed in relation to the information received. The explanation should also address the rationale for findings reached; for example, relating each significant factor to the determination that an article is import sensitive or nonsensitive.

--Prepare for public use a collection of his interpretations of GSP law and the law's relationship to past product eligibility decisions.

--Include in the Federal Register notice announcing product eligibility decisions a brief explanation of the rationale used for making all such decisions.

APPENDIX I

ECONOMIC INDICATORS FOR BENEFICIARY DEVELOPING COUNTRIES

The following table is reproduced from the President's recent Report on the first 5 years of the Generalized System of Preferences. The relative positions of the five largest exporters of duty-free goods to the United States--Taiwan, Korea, Hong Kong, Brazil, and Mexico--are marked by •. The column listing 1978 per capita gross national product is divided by underscoring denoting the three development levels used in the President's Report:

--Advanced (over $1,100)

--mid-level ($300 to $1,100) and

--less developed (below $300).

APPENDIX I

Economic Indicators for Beneficiary Developing Countries

1978 Per Capita GNP ($)

1.	Brunei	10,645
2.	Bermuda	9,260
3.	French Polynesia	5,271
4.	New Caledonia	4,647
5.	Bahrain	4,104
5.	Israel	4,104
7.	Gibraltar	3,664
8.	Singapore	3,264
9.	Neth. Antilles	3,154
●10.	Hong Kong	3,041
11.	Venezuela	2,915
12.	Trinidad & Tobago	2,908
13.	Bahamas	2,620
14.	Oman	2,570
15.	Yugoslavia	2,387
16.	Malta	2,164
17.	Cyprus	2,114
18.	Surinam	2,109
19.	Portugal	2,024
20.	Barbados	1,942
21.	Argentina	1,906
22.	Romania	1,747
23.	Uruguay	1,610
●24.	Brazil	1,567
25.	Costa Rica	1,539
26.	Macao	1,458
27.	Fiji	1,442
28.	Chile	1,414
●29.	Taiwan	1,396
●30.	Mexico	1,285
31.	Panama	1,285
32.	T.T. Pacific Isl.	1,229
33.	Turkey	1,206
●34.	Rep. of Korea	1,160
35.	Jamaica	1,110
36.	Malaysia	1,094
37.	Lebanon	*1,070
38.	Seychelles	1,064
39.	Western Sahara	* 967
40.	Antigua	954
41.	Tunisia	953
42.	Syria	926
43.	Dominican Rep.	913
43.	Ecuador	913
45.	Guatemala	912
46.	Colombia	867
47.	Paraguay	846
48.	Nicaragua	844
49.	Belize	843
50.	Ivory Coast	839
51.	Mauritius	827
52.	Jordan	760
53.	Peru	739
54.	Kiribati	690
55.	Morocco	667
56.	St. Christopher-Nevis-Anguilla	657
57.	El Salvador	641
58.	Saint Lucia	632
59.	Botswana	615
60.	Swaziland	591
61.	Yemen Arab. Rep.	581
62.	Papua New Guinea	550

* 1977 per capita GNP

Share of Manufactures in Total Exports

		(pct.)	(year)
1.	Macao	94.8	76
●2.	Hong Kong	92.6	77
3.	Malta	89.4	77
●4.	Korea	84.8	77
●5.	Taiwan	81.0	75
6.	Israel	77.3	76
7.	Yugoslavia	69.1	76
8.	Lebanon	69.1	73
9.	Portugal	68.8	77
10.	Bangladesh	60.9	76
11.	Romania	59.9	73
12.	Sierra Leone	59.6	75
13.	Jamaica	55.8	76
14.	Pakistan	54.4	75
15.	India	52.5	76
16.	Bermuda	48.0	76
17.	Surinam	47.5	76
18.	Br. Virgin Isl.	45.6	74
19.	Singapore	44.0	77
20.	Barbados	43.1	76
21.	Cyprus	42.6	77
22.	Jordan	40.7	77
23.	Uruguay	33.9	76
24.	Haiti	32.4	75
●25.	Mexico	30.1	76
26.	Tunisia	25.7	76
●27.	Brazil	25.1	77
27.	Egypt	25.1	77
29.	Argentina	24.9	76
29.	El Salvador	24.9	76
31.	Guatemala	24.8	75
32.	Costa Rica	24.0	75
33.	Turkey	23.8	76
34.	Senegal	22.2	75
35.	Colombia	22.0	76
36.	Saint Lucia	20.6	74
37.	Benin	17.9	74
38.	Cent. Af. Empire	17.5	76
39.	Thailand	17.1	76
40.	Nicaragua	16.2	76
41.	Morocco	16.0	76
42.	Philippines	15.6	76
43.	Dominican Rep.	15.5	74
44.	Malaysia	15.1	76
44.	Bahrain	15.1	76
46.	Guyana	13.2	76
47.	Congo	12.9	76
48.	Mauritius	11.9	75
49.	Paraguay	10.4	75
50.	Syria	10.1	76
51.	Kenya	10.0	77
52.	Honduras	10.0	76
53.	Afghanistan	9.6	75
54.	Yemen Arab Rep.	9.3	76
55.	Tanzania	8.8	76
56.	Niger	8.4	75
57.	Fiji	8.3	76
58.	Belize	7.9	75
59.	Ivory Coast	7.1	77
60.	Upper Volta	6.3	75
60.	Zaire	6.3	75
62.	Togo	5.8	75
63.	Sri Lanka	5.4	76

1978 GSP Duty-Free Imports ($ millions)

1.	Taiwan	1,433.0
2.	Korea	648.0
3.	Hong Kong	537.0
4.	Brazil	468.0
5.	Mexico	458.0
6.	Israel	192.0
7.	Singapore	153.0
8.	Yugoslavia	152.0
9.	Argentina	148.0
10.	India	120.0
11.	Chile	87.0
12.	Peru	79.0
13.	Portugal	73.0
14.	Philippines	71.0
15.	Uruguay	54.0
16.	Romania	50.0
17.	Malaysia	42.4
18.	Ivory Coast	41.9
19.	Thailand	38.0
20.	Colombia	34.0
21.	Honduras	31.0
22.	Costa Rica	24.4
23.	Dominican Republic	24.2
24.	Haiti	23.0
25.	Trinidad & Tobabo	19.0
26.	Bolivia	14.9
27.	Belize	14.8
28.	Ghana	14.0
29.	Mauritius	13.0
30.	Pakistan	12.0
31.	Guatemala	11.0
32.	El Salvador	9.0
33.	Barbados	8.0
34.	Swaziland	7.7
35.	Jamaica	7.5
36.	Paraguay	7.3
37.	Turkey	7.0
38.	Morocco	6.1
39.	Panama	6.0
40.	Bahamas	5.9
41.	St. Christopher-Nevis-Anguilla	5.5
42.	Nicaragua	5.3
43.	Egypt	4.0
44.	Neth. Antilles	3.6
45.	Sri Lanka	3.5
46.	Macao	3.4
47.	Malta	3.0
48.	Cameroon	2.7
48.	Malagasy Rep.	2.7
50.	Tunisia	2.6
51.	Kenya	2.4
52.	Cayman Islands	2.1
53.	Ethiopia	1.9
54.	Bangladesh	1.8
54.	Guyana	1.8
54.	Malawi	1.8
57.	Mozambique	1.6
58.	French Polynesia	1.5
59.	Fiji	1.4
60.	Zaire	0.6
60.	Mauritania	0.6
62.	Liberia	0.4

APPENDIX I

1978 Per Capita GNP ($)	
62. Guyana	550
64. New Hebrides	542
65. Congo	537
66. Bolivia	509
66. Philippines	509
68. Sao Tome & Principe	494
69. Thailand	491
70. So. Rhodesia (Zimbabwe)	480
71. Honduras	479
72. Zambia	477
73. Liberia	460
74. Cameroon	459
75. Djibouti	450
76. Dominica	442
77. Tonga	435
78. Solomon Islands	431
79. Egypt	401
80. Ghana	387
81. St. Vincent and the Grenadines	377
82. Indonesia	359
82. Western Samoa	*359
84. Senegal	340
85. Togo	321
86. Sudan	319
87. Kenya	318
88. Angola	297
89. Lesotho	281
90. Mauritania	273
91. Haiti	257
92. Central Af. Empire	254
93. Malagasy Rep.	247
94. Afghanistan	241
95. Benin	231
96. Tanzania	230
97. Gambia	229
98. Pakistan	227
99. Niger	222
100. Sierra Leone	210
101. Guinea	209
101. Zaire	209
103. Guinea Bissau	204
104. Sri Lanka	189
105. Comoros	184
106. Rwanda	183
107. Malawi	175
107. India	175
109. Cape Verde	159
110. Upper Volta	157
111. Burma	152
112. Burundi	143
112. Chad	143
114. Mozambique	138
115. Somalia	125
116. Mali	121
117. Ethiopia	118
118. Nepal	116
119. Bhutan	97
120. Bangladesh	91
**121. Maldives	81

Share of Manufactures in total Exports	(pct.)	(year)
64. Mauritania	5.2	72
65. Trinidad & Tobago	4.8	77
66. Panama	4.7	75
67. Chile	4.4	74
68. Malagasy Rep.	4.2	75
69. Ghana	3.9	75
70. Chad	3.8	74
71. Peru	3.4	74
71. Bahamas	3.4	76
71. Malawi	3.4	76
74. Papua New Guinea	3.0	75
74. St. Vincent and the Grenadines	3.0	74
76. Burma	2.9	75
76. Somalia	2.9	75
78. Neth. Antilles	2.6	76
79. Mozambique	2.4	75
80. Tonga	2.1	77
81. Ethiopia	1.8	76
82. Liberia	1.5	73
83. Sudan	.9	75
84. French Polynesia	.8	76
85. Mali	.7	76
85. Guinea Bissau	.7	76
87. Solomon Islands	.4	75
88. Rwanda	neg.	75
89. Oman	neg.	75
89. New Caledonia	neg.	
89. New Hebrides	neg.	
89. Gambia	neg.	
93. Bolivia	N.A.	
94. Swaziland	N.A.	
95. St. Christopher-Nevis-Anguilla	N.A.	
96. Cameroon	N.A.	
97. Cayman Islands	N.A.	
98. Dominica	N.A.	
99. Nepal	N.A.	
100. Western Samoa	N.A.	
101. Botswana	N.A.	
102. Montserrat	N.A.	
103. Antigua	N.A.	
104. T.T. Pacific Isl.	N.A.	
105. Turks & Caicos Isl.	N.A.	
106. Saint Helena	N.A.	
107. Grenada	N.A.	
108. Sao Tome & Principe	N.A.	
109. Lesotho	N.A.	
110. Comoros	N.A.	
111. Maldives	N.A.	
**112. Kiribati	N.A.	

1978 GSP Duty-Free Imports ($ millions)	
62. Cyprus	0.4
62. Bermuda	0.4
62. Lebanon	0.4
62. Congo	0.4
67. Syria	0.3
67. Afghanistan	0.3
69. Tanzania	0.2
69. Dominica	0.2
69. Nepal	0.2
72. Burma	0.1
72. Western Samoa	0.1
72. Sierra Leone	0.1
72. Botswana	0.1
72. Papua New Guinea	0.1
72. Montserrat	0.1
72. Antigua	0.1
72. Senegal	0.1
72. Mali	0.1
81. Surinam	neg.
82. Somalia	neg.
83. Sudan	neg.
84. T.T. Pacific Isl.	neg.
85. Togo	neg.
86. Oman	neg.
87. Saint Lucia	neg.
88. Upper Volta	neg.
89. Bahrain	neg.
90. Turks & Caicos Isl.	neg.
91. Guinea Bissau	neg.
92. Saint Helena	neg.
93. Tonga	neg.
94. Br. Virgin Isl.	neg.
95. St. Vincent and and the Grenadines	neg.
96. Grenada	neg.
97. Niger	neg.
98. Sao Tome & Principe	neg.
99. Benin	neg.
100. Lesotho	neg.
101. Rwanda	neg.
102. Solomon Islands	neg.
103. Djibouti	0
104. Angola	0
105. Br. Indian Ocean Terr.	0
106. Brunei	0
107. Burundi	0
108. Cape Verde	0
109. Central Af. Empire	0
110. Christmas Island	0
111. Cocos Island	0
112. Cook Island	0
113. Equitorial Guinea	0
114. Falkland Islands	0
115. Gambia	0
116. Gibraltar	0
117. Kiribati	0
118. Guinea	0
119. Jordan	0
120. Maldives	0
121. Nauru	
122. New Caledonia	0
123. New Hebrides	0
124. Niue	0
125. Norfolk Island	0
126. Western Sahara	0
127. Pitcairn Islands	0
128. Tokelau	0
129. Tuvalu	0
130. Wallis Island	0
131. Yemen	0
**132. Zambia	0

** Statistics are not available for all beneficiary developing countries.

Source: International Development Cooperation Agency.

APPENDIX II

EROSION OF GSP MARGIN DUE TO MULTILATERAL TRADE NEGOTIATIONS

Beneficiary developing ocuntries have expressed concern over the "erosion" of the GSP resulting from the Multilateral Trade Negotiations. International agreements to lower the most favored nation (MFN) rate of duty which countries generally apply to nonbeneficiary countries allegedly have an adverse effect on developing countries. While U.S. tariffs on GSP-eligible exports from beneficiaries of course cannot be reduced from the zero rate they now enjoy, the MFN rates on these same goods when exported by countries gradually decrease due to the Multilateral Trade Negotiations. This results in the erosion of the preference margin. 1/

The President's Report on GSP notes that, prior to the Tokyo Round of the Multilateral Trade Negotiations, the average tariff level on GSP items was 9 percent. This rate is being reduced to 4.5 percent from 1980 to 1987. As the MFN rate approaches zero, U.S. importers and consumers have a smaller incentive to purchase goods from beneficiary countries, especially if similar developed country products are less expensive, better made, or have other advantages, such as superior servicing or credit arrangements. Beneficiaries therefore allege that the Multilateral Trade Negotiations' erosion of the tariff preference subverts the GSP goals--namely, the encouragement of benficiaries' exports, export earnings, and development.

The view that MFN tariff reductions have only a negative effect on LDDC exports was disputed in 1977 by Professors R.E. Baldwin and T. Murray. 2/ They pointed out that the following positive factors offset erosion's negative effect for developing countries.

--Eligible beneficiary exports subject to MFN because of the competitive need exclusion (and the safeguards of the other GSP donors) benefit from MFN tariff reductions.

1/The preference margin does not erode for goods whose MFN rates are not subject to Multilateral Trade Negotiations' tariff cuts. For agricultural and other goods that already have a low MFN rate, any further reduction is small in absolute terms and may require a less difficult adjustment for beneficiaries.

2/"MFN Tariff Reductions and Developing Country Trade Benefits Under the GSP," The Economic Journal, Mar. 1977, pp. 30 to 46.

APPENDIX II

--MFN duties on goods which are statutorily prohibited from receiving the preference (such as watches and most electronic, steel and textile products) decline when they are subject to Multilateral Trade Negotiations agreement. (The beneficial effect of these tariff cuts, however, is reduced if these goods are subject to import restrictions, such as those pursuant to the Multifiber Arrangement.

--LDDCs that are not GSP beneficiaries benefit from MFN cuts.

Using the assumption that the Multilateral Trade Negotiations would result in a 50-percent MFN reduction, Baldwin and Murray calculated that the export growth which LDDCs would enjoy due to these three factors would more than offset the decline attributable to erosion. They calculated the size of the "cost" of erosion and the "benefits" from the GSP programs of the United States, European Community, and Japan in terms of 1971 trade flows.

A 1979 UNCTAD evaluation of GSP, on the other hand, argues that erosion due to the Multilateral Trade Negotiations will adversely affect LDDC exports of industrial and, to a lesser degree, agricultural products. To compensate for this, UNCTAD advocated liberalizing the GSP programs, stating that:

"It is therefore important that the other elements of the GSP, such as product coverage, depth of tariff cut [for schemes that, unlike the U.S., merely offer a reduced duty between zero and the MFN rate] and the rules of origin, be substantially improved, and should include relaxation and elimination of limitations on preferential imports, in order to offset the probable erosion of tariff margins."

The following table shows the leading 1978 GSP duty-free exports from beneficiaries. For each export, it compares the tariff in effect before the Tokyo Round of the Multilateral Trade Negotiations (MTN) with the tariff that will be in effect when the reduction is fully phased in (1987). As mentioned in chapter 3, the full tariff reductions recently were implemented in one step for the LDDCs, not phased in over 7 years.

APPENDIX II

Tariff Rate Changes for the Leading 1978 GSP Duty-free Imports

Description	Total value (millions)	Leading supplier	Pre-MTN tariff rate (note a)	Post-MTN (full concession) rate (note a)
Agricultural:				
Sugars, syrups, molasses	$83.3	Belize	(b)	(b)
Unsweetened cocoa	79.4	Ivory Coast	37¢ lb.	same
Sugars, syrups, molasses derived from sugar cane/ beet	56.9	Mexico	(b)	(b)
Corned beef in airtight containers	56.1	Argentina	7.5%	same
*Cocoa butter	54.5	Brazil	3.0%	free
Castor oil over 20¢ a pound	34.4	Brazil	1.5¢ lb.	same
Ale, porter, stout, and beer	14.7	Mexico	6¢ gal.	same
Tequila in containers over 1 gallon	13.7	Mexico	$1.25 gal. [c]	$1.25 proof gal.
Cordials, liqueurs, etc.	12.5	Mexico	50¢ gal. [c]	50¢ proof gal.
Candy and other confectionery	11.9	Argentina	7.0%	same
Industrial:				
Leather wearing apparel except reptile (d)	121.5	Argentina	6.0%	same
*Microphones, loudspeakers, headphones, amplifiers, and parts	90.2	Taiwan	7.5%	4.9%
*Other toys without spring mechanisms	86.9	Taiwan	17.5%	7.0%
*Wooden furniture, except chairs	81.3	Taiwan	5.0%	2.5%
*Unwrought black copper and blister and anode copper	79.7	Chile	(e)	(e)
*Tape recorders, etc.	74.8	S. Korea	5.5%	3.9%
*Calculating machines for multiplying and dividing	66.8	Taiwan	5.0%	3.7%
*Other rubber or plastic articles not specially provided for	62.9	Taiwan	8.5%	(f)
*Wooden chairs, folding	58.8	Yugoslavia	8.5%	(g)
*Motor vehicle body parts other than cast iron	57.4	Brazil	4.0%	(h)

GAO note: *Imports subject to erosion; all others not subject to negotiation in the MTN.

a/All tariff rates expressed in percent are collected as a percent of the item's value.
b/The duty on this tariff item has changed at least once each year over the past several years. These changes result from domestic policy to control sugar prices, not from the MTN; sugar tariffs were not negotiated in the MTN.
c/The unit on which the duty for alcoholic beverages is based was changed effective Jan. 1, 1980, by sec. 851 of the Trade Agreements Act of 1979 (Public Law 96-39, July 26, 1979); a proof gallon is the equivalent of 1 gallon of alcoholic beverage at 100 proof.
d/Removed from GSP eligibility effective Mar. 1, 1979.
e/These coppers are dutiable accoring to the market price as follows.

	pre-MTN	post-MTN
24¢ or more per pound	0.8¢ per pound n 99.6% of the copper content	1% of import's value
under 24¢ per pound	1¢ per pound on 99.6% of the copper content	0.7¢ per pound on 99.6% of the copper content

f/This tariff category was superceded by the three new ones below, all subject to a duty lower than the pre-MTN 8.5-percent rate:

—artificial flowers, trees, foliage (dutiable at 3.4 percent),
—parts of footwear (5.3 percent), and
—other (5.3 percent).

g/This tariff category was superceded by the two new ones below, both subject to a duty lower than the pre-MTN 8.5 percent rate:

—teak (dutiable at 3.4 percent) and

—other (5.3 percent).

h/This tariff category was superceded by the two new ones below, the second dutiable at a lower rate than the pre-MTN 4.0 percent rate, and the first one not subject to the MTN concession:

—parts of bodies for truck tractors (dutiable at 4.0 percent) and
—other (3.1 percent).

APPENDIX III

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

September 9, 1980

Mr. J. K. Fasick
Director
International Division
U.S. General Accounting Office
441 G Street, NW, Room 4804
Washington, D.C. 20548

Dear Mr. Fasick:

The Office of the United States Trade Representative (USTR), on behalf of the Executive agencies (Agriculture, Commerce, International Development Cooperation Agency, Interior, Labor, State, and Treasury) which participate in the interagency process on trade policy matters, appreciates the opportunity to respond to the report issued by the U.S. General Accounting Office (GAO) on the U.S. Generalized System of Preferences (GSP). The Administration finds that the report contains several constructive suggestions on the overall operation of the U.S. GSP program. However, the following comments are submitted to explain the reasoning for the "new flexibility" in the program, to elaborate on those points of the report which require additional examination, and to respond to the specific recommendations made to USTR by the GAO.

The U.S. GSP was authorized by Title V of the Trade Act of 1974 and implemented in January 1976. It is authorized to extend to January 1985. The U.S. scheme is a system of unilateral tariff preferences for the benefit of developing countries. The program currently offers duty-free access to 2,800 products from 140 beneficiary developing countries and territories. It is one element in a coordinated effort by the industrial trading nations to bring developing countries more fully into the international trading system. By offering the developing countries preferential access to the markets of the developed countries, over the long run it is anticipated that the GSP programs of the United States and other donor countries should decrease the need of developing countries for external economic assistance by encouraging a diversification of their production and exports. Nevertheless, in the short run economic assistance will continue to play an important role in the development process, especially for the less advanced developing countries which will require a longer time to develop the capability to produce those goods eligible for GSP treatment. Greater access by developing countries to markets in the developed countries will help to make products from beneficiary countries more competitive in the world marketplace and will promote the expansion of trade opportunities for all nations. The U.S. GSP is administered by the Office of the USTR.

APPENDIX III

In April 1980 the President submitted a report to Congress on the first five years' operation of the U.S. GSP. That report, required by statute, reviewed the major provisions and regulations governing the U.S. GSP. As requested by the U.S. Congress, the report also addressed the operation of the program's "competitive need" limitations and considered measures to increase graduation of countries from GSP duty-free treatment on a product-by-product basis in order to provide a greater distribution of duty-free benefits to the less advanced developing countries.

In addition, the President's report analyzed the impact of the GSP on the United States economy. The overall impact of the program on domestic production and employment has been small, as most import-sensitive products are statutorily excluded from the program. For those products eligible to receive GSP duty-free treatment, the program's competitive need limitations (provided for in Section 504 (c)(1) of the Trade Act of 1974) provide a measure of protection for domestic producers in import-competing industries. In assessing the operation of these limitations, the President's report concluded that the competitive need mechanism is operating as intended by Title V to exclude the more competitive beneficiaries from GSP duty-free treatment in particular products and to help increase trading opportunities for the less developed, less competitive beneficiaries. For example, one-third of all GSP-eligible imports in 1979 did not receive duty-free treatment due to the competitive need limitations.

Although the Administration believes that the competitive need mechanism is working well, it is also true that the distribution of duty-free benefits among developing countries has been uneven. In 1979 approximately 70 percent of total GSP benefits accrued to the program's top five major beneficiary countries. 1/ To aid in bringing about a greater transfer of GSP benefits from the more advanced to the less advanced developing countries, the April 1980 report announced that the President's authority to "withdraw, suspend or limit duty-free treatment" will be used to limit benefits for the more developed beneficiaries in products where they have demonstrated competitiveness in order to provide increased opportunities for less developed, less competitive countries. This approach should help ensure that the more advanced beneficiaries' use of the program does not damage the trading interests of the less advanced developing countries.

In applying this authority, in addition to the points specified in Section 501 of the Trade Act of 1974, the President will take into account three additional criteria: the development level of beneficiaries, the competitive position of the country or countries

1/ These countries are Taiwan, Republic of Korea, Hong Kong, Mexico, and Brazil.

in question with respect to the particular product, and the overall economic interests of the United States. This authority will be exercised in the context of product reviews both in adding and removing products with respect to individual countries. Discretion will continue to be applied in redesignating countries for GSP duty-free treatment for items which were previously ineligible under the competitive need limitations.

It should be acknowledged that much of the uneven distribution of GSP benefits among beneficiaries results from the disparity in productive capacities and export capabilities existing among countries at various levels of development. In recognition of the limited capacities of the less advanced developing countries to take advantage of the U.S. GSP over the short term, the President's report also announced a companion effort to include on the GSP list items of particular export interest to lesser developed developing countries, including handicraft articles. It is anticipated that the "new flexibility" which these two modifications allow will enable the less advanced developing countries, over time, to increase their share of GSP benefits relative to that of the more advanced developing countries.

The GSP Subcommittee has historically applied great flexibility in the decision-making process to determine the eligibility of products under the U.S. GSP (within the context of the Trade Policy Staff Committee (TPSC) regulations codified at Title 15, Chapter XX, Part 2007, Code of Federal Regulations). Congress granted the President this flexibility in administering the GSP program in recognition of the need to facilitate the overall administration of the program. The GSP Subcommittee and the TPSC have used this flexibility in considering petitions filed both by beneficiary developing countries and domestic interests during annual GSP product reviews.

Decision-making in the GSP product eligibility review process necessarily relies on a case-by-case approach. Such a procedure is both warranted and desirable because the economic circumstances pertaining to any one product are often unique and the overall economic conditions in the United States are constantly changing. Thus, a strict "case law" approach to GSP product recommendations would introduce an undesirable and impractical rigidity into the interagency process. Moreover, the unilateral nature of the U.S. program confers no right of entitlement on GSP beneficiaries, thereby making a "case law" approach to GSP product eligibility recommendations inappropriate.

Product recommendations in every case are based on agency considerations of the impact of GSP treatment on domestic producers of like or directly competitive articles, on the one hand, and on the other, of the anticipated economic development impact which the designation of a particular product for GSP would likely have for developing countries. Each agency on the GSP Subcommittee and the TPSC bases

APPENDIX III

its determination of product eligibility on its analysis of the economic considerations relating to the product in question. As the GAO report points out, agencies' considerations of their constituencies' interests are obviously factored into the equation, but these "role perception" considerations are by no means the sole basis for a decision to vote for or against a particular petition. Each case is reviewed on its own merits, with the GSP Subcommittee formulating recommendations for the TPSC by a consensus vote in the majority of cases. The GAO analysis focused on 62 out of a possible 254 petitions. There is much less automatic position-taking in the voting process than is implied by the GAO report.

In reaching final recommendations on products, the GSP Subcommittee reviews briefs and statements submitted by petitioners and interested parties, testimony presented at public hearings, advice furnished by the U.S. International Trade Commission (USITC) on the probable economic effect of GSP duty-free treatment on domestic producers of like or directly competitive articles, background analyses prepared by TPSC member agencies and import trends in the products concerned. The review process begins with the public hearings on accepted petitions in September, followed by thorough interagency consideration from October through February. In most cases an attempt is made to reach decisions by March. Sometimes decisions cannot be made by that date and cases remain pending until further information can be obtained from the USITC.

The annual review process is an open one which encourages input from all interested parties at many points during each review. Each agency's GSP representative is available to answer inquiries concerning aspects of a particular petition or the GSP program either by telephone or by personal appointment. The Office of the USTR, through notices published in the Federal Register, advises the public of all stages of the review process, including the schedule for each annual review and deadlines for submitting petitions or briefs and statements on those petitions, the product petitions accepted for interagency review, and the final disposition of all cases. In addition USTR publishes annual updates of changes in GSP product and country eligibility in booklet form at no charge to the general public in order to disseminate as much information on the program as possible to any interested party. The State Department, through its Embassies in beneficiary countries, likewise disseminates the foregoing information to the beneficiaries.

The Administration announced two additional changes to the GSP in the President's report to assist the public further in obtaining information on the U.S. GSP program and in participating in future annual product reviews. First, an Information Center, headquartered at USTR, is presently being established to assist both domestic and foreign parties in obtaining data and other information on the

GSP program. The TPSC member agencies also will have specific responsibilities to assist interested parties by furnishing them with information for use in preparing statements and briefs submitted during GSP product reviews. Second, the schedule for annual product reviews will be adjusted beginning in 1981 to allow interested parties additional time to prepare support and rebuttal briefs on products for interagency consideration. These changes in the program were introduced in response to testimony and recommendations presented to the GSP Subcommittee by domestic agricultural, industrial and labor union interests and by foreign parties during public hearings on the overall operation of the U.S. GSP held in September 1979 in connection with the preparation of the President's report.

Following are brief responses to each of the conclusions and recommendations in the GAO report.

> "It is not clear, however, that the administration's action will, in the words of the President's report, 'help shift the overall share of benefits from the more to the less advanced and less competitive developing countries.'"

As mentioned above, the uneven distribution of GSP benefits among developing countries is due in large part to the differing infrastructures and productive capacities of developing countries at various levels of development. The Administration's graduation policy is intended, over the longer term, to increase trading opportunities for the less advanced countries. Coupled with special efforts to add products of particular export interest to the less advanced developing countries (including handicraft articles), it is anticipated that graduation of competitive developing countries from duty-free treatment on a product-by-product basis will make it possible for less competitive developing countries to progressively expand their overall share of GSP benefits. It may be premature to conclude that the less advanced developing countries will not improve their performance under the GSP, since the U.S. program has been in effect only since 1976 (whereas some other donor countries' programs date back to 1971) and since many developing countries, particularly those in Africa, have been unfamiliar with the U.S. GSP.

The combined efforts of the U.S. Government and the United Nations Conference on Trade and Development/United Nations Development Programme (UNCTAD/UNDP) GSP Special Project Office in Geneva to disseminate information on the U.S. GSP to the developing countries will hopefully, over time, increase beneficiaries' knowledge of the program. In addition, while it is true that less advanced developing countries are unlikely to have a highly

APPENDIX III

diversified export capacity, it is possible that a relatively modest increase in GSP-eligible exports may prove to be of considerable importance to a "small" economy with a low level of exports. However, the fact that the present program continues only through 1984 limits the time frame for significant shifts in the distribution of benefits.

> "We recommend that the United States Trade Representative, as part of the Annual Report of the President of the United States on the Trade Agreements Program, include an analysis of how the changes announced in the President's April 1980 GSP report are on a product-by-product basis (1) graduating advanced beneficiaries from the GSP program and (2) redistributing benefits to mid-level and less-developed developing countries."

The Administration concurs that some reporting to Congress in this area would be desirable. However, because aggregate shifts due to graduation are likely to occur only gradually, it is doubtful that annual reporting on an item-by-item basis would convey much useful information. Reporting on a more general basis over a longer time period possibly could highlight more meaningful trends.

> Response to GAO analysis in Chapter 3 supporting indexation of the competitive need exclusions and the rules of origin to beneficiaries' level of development.

The Administration notes that the GAO report presents several proposals which are interesting in theory but which even the GAO concludes would likely result in little practical benefit to beneficiary developing countries. Indexing the competitive need limitations and the rules of origin to development levels would complicate further an already complex and technical area of the U.S. program. Beneficiaries would likely have difficulty in understanding the changes and might conclude that the GSP program is being administered arbitrarily. Introduction of new complexity in the U.S. program would undermine its clarity and ease of operation, aspects which developing countries have praised in the past. Further, as GAO notes, it appears that these changes would have a very small trade impact. In addition, the provisions for substantial transformation and direct consignment are fundamental principles of U.S. Customs law, and the changes suggested by the GAO in these areas would likely have an impact far beyond the GSP program.

> "GSP decision making needs to be more transparent, especially for those most affected by it."

The GSP Subcommittee believes that the U.S. GSP program has been administered in a very open and flexible manner. As mentioned

APPENDIX III

above, interested parties have access to the review process at a number of points. Through the Information Center, the GSP Subcommittee will now be able to provide domestic and foreign parties with comprehensive information on the history of past cases, data necessary for preparing product petitions and general information on the operation of the program. Foreign governments also are informed of all changes in the GSP program through the State Department's embassies abroad. The GSP Subcommittee meets periodically with beneficiary government officials to review the program's procedures and respond to questions posed by them. The United States also sends GSP experts to participate in seminars abroad sponsored by foreign governments or by the UNCTAD/UNDP GSP Special Project Office.

> "We recommend that the United States Trade Representative clarify the regulations by explicitly stating that only domestic petitioners need evaluate the impact that proposed additions would have on the domestic industry producing like or directly competitive articles in the United States."

In light of practical experience and the changes announced in the President's report on the GSP, the GSP Subcommittee has already considered the need to revise the existing regulations pertaining to annual product reviews (published in the September 9, 1977 Federal Register, 42 FR 45532). The GSP Subcommittee feels there is merit in the recommendation by the GAO to liberalize the requirements for information required of beneficiaries, and plans to take it into account when considering a revision of the regulations in early 1981. However, it should be noted that the GSP Subcommittee has never rejected a beneficiary's petition solely on these grounds. While it is useful and desirable that a beneficiary country provide such information where available, the GSP Subcommittee has demonstrated flexibility in accepting petitions which may not contain all of the requested information.

Response to recommendations by GAO to the Office of the USTR:

That USTR:

1) more fully explain to petitioners why their requests are denied.

The Office of the USTR and the State Department formally notify in writing each petitioner whose request was denied of the principal reasons for denial of the case. These responses focus on the main considerations of the GSP Subcommittee and the TPSC in

APPENDIX III

reaching a negative determination on that case. This "denial letter" becomes a part of the official public record of the case. If a petitioner desires further details regarding the denial, he is welcome to meet with the Executive Director of the GSP Subcommittee at the Office of the USTR or with other members of the GSP Subcommittee.

In response to the GAO recommendation, however, the Office of the USTR agrees with the importance of furnishing petitioners with the most complete information possible. Accordingly, efforts will be made in the future to include to the extent possible more detailed descriptions in official denial letters and to furnish these letters to petitioners and other interested parties in a timely fashion.

2) establish a records management system which preserves the complete documentary history of each petition.

Due largely to resource and staff limitations, the Office of the USTR often has in the past been unable to maintain complete files and records on each GSP petition. In conjunction with establishment of the GSP Information Center, the Executive Director of the GSP Subcommittee is currently reorganizing all GSP records in order to facilitate public access to these files. As part of this effort, upon the conclusion of the current and future product reviews, the GSP Subcommittee will insert a brief rationale sheet in each file which summarizes the major factors considered by the GSP Subcommittee and TPSC for that item. Inclusion of this information in future case files will preserve a more complete record of each proceeding for public reference.

3) more fully explain the basis of all product eligiblity decisions in Federal Register notices of such decisions.

The GSP Subcommittee considered this recommendation but felt that the public would not be well served by publication of lengthy denial notices in the Federal Register. Aside from the considerable staff time needed to prepare notices and the cost of publishing in the Federal Register, such notices would convey little useful information to the public apart from the petitioner involved in a particular case. As the petitioners are notified individually in any event, separate publication of notices would appear to duplicate that effort at considerable expense to the taxpayer. In any event, the rationale for refusals is available for public inspection at USTR.

4) prepare for public use a collection of their interpretations of GSP law and its relationship to past eligibility decisions.

APPENDIX III

The GSP Subcommittee also rejected this recommendation because the agencies considered that such a "case law" approach does not lend itself well to what is essentially a case-by-case examination of product requests. Interpretations of precedents would reduce the flexibility which has always been a fundamental element of the administration of the GSP program. The GSP Subcommittee concluded that such "case law" also would discourage domestic and foreign interested parties from submitting product petitions, since they might decide to abandon an effort on the basis of prior determinations which may in reality have little bearing on their particular request.

5) begin keeping minutes of interagency meetings which discuss petitions.

The GSP Subcommittee rejected this recommendation after considering the negative impact which public disclosure of the minutes could have on the interagency process. Considerations discussed in GSP Subcommittee and TPSC meetings are not subject to public disclosure because they are included in advice submitted directly by the U.S. Trade Representative on behalf of the Cabinet-level Trade Policy Committee to the President. Even if such minutes were maintained for interagency reference only, USTR does not have the available personnel or resources necessary to record GSP-related discussions. Other agencies have access to USTR GSP files, which in the future will contain publicly available summaries of the major factors considered in granting or denying product requests. These summaries should provide other agencies as well as the general public with adequate information concerning the basis for GSP product eligibility recommendations.

While the GSP Subcommittee did not find it possible to accept all of the recommendations made by the GAO in its report, this Office appreciates the GAO analysis of the operation of the U.S. GSP program. Such independent analysis can bring to light specific areas where both domestic interests and beneficiary developing countries might be better served.

Sincerely,

Stephen L. Lande
Assistant United States Trade Representative

(483110)

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