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1156 15th Street NW, Ste 400
Washington, DC 20005
Tel: 202-525-3926
Fax: 202-525-3941

GENERALIZED SYSTEM OF PREFERENCES: OVERVIEW AND REAUTHORIZATION OPTIONS

Edward Gresser
Vice President, Progressive Policy Institute
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Chairman Smith, Ranking Member Blumenauer, and Members of the Subcommittee:

Thank you for inviting me to testify at this morning's hearing on the Generalized System of Preferences (GSP). I am Vice President of the Progressive Policy Institute (PPI) in Washington, D.C., a 501(c)(3) nonprofit research institution established in 1989, which publishes a wide range of public policy topics. Before joining PPI, I served at the Office of the U.S. Trade Representative from 2015 to 2021, as Assistant U.S. Trade Representative for Policy and Economics. In this position, I had the responsibility of overseeing USTR's economic research and use of trade data, interagency policy coordination including chairing the interagency Trade Policy Staff Committee, and overseeing administration of the GSP.

I applaud the Subcommittee's interest in reauthorizing GSP. By waiving tariffs on about $20 billion in imports from 119 low- and middle-income beneficiary countries, GSP makes a useful contributor to development and poverty alleviation, provides American buyers useful sourcing alternatives, and supports U.S. policy in areas such as labor, intellectual property, and market access. At the same time, GSP is a small program and can be revised and improved in several ways. My testimony discusses the system and some future options in detail, but I would like to begin with three general points:

1. Early Reauthorization: Most important, early reauthorization is important, in the aftermath of the current three-year lapse of benefits. Whether the concern is for development, supply chain security and diversification, or policy goals, the program needs benefits in place to succeed.

2. Clear Priorities: Revisions to GSP will likely achieve most when designed to serve clear larger priorities. If the aim is to encourage businesses to shift sourcing from China, these buyers should see GSP as a valuable, generally stable long-term benefit. This in turn suggests a long authorization term, possibly more significant economic benefits for users, and some confidence that removal of benefits based on eligibility criteria would be a last resort in serious cases of noncompliance. To maximize GSP's value as a policy tool, it would need (a) economic benefits significant enough to be major incentives for beneficiary countries to remain eligible, (b) a limited list of clearly defined criteria, so beneficiary countries clearly understand what they must do to qualify, and (c) criteria flexible enough to ensure governments acting in good faith but with limited capacity for policy implementation remain eligible.

3. Limited Reporting Requirements: Finally, I recommend caution on new reporting requirements. Administrations should keep Congress informed about emerging GSP eligibility issues, addition and removal of products, and so on, and provide a public record of decisions and their rationales. However, I

would recommend caution about new reporting requirements beyond this, especially with respect to matters beyond the agency's institutional expertise. USTR's GSP staff is quite small at 2.5 or fewer full-time employee equivalents, and should spend as much as possible of their time on substantive issues.

The balance of my testimony provides an overview of the system's current rules and trade coverage; the enforcement of existing eligibility criteria, with some observations from my experience in 2015-2020; trends since the lapse of benefits at the end of 2020; and some thoughts on several proposed revisions.

GSP COVERAGE AND ECONOMIC BENEFITS

GSP is a 50-year-old system created as part of the Trade Act of 1974, which uses tariff waivers to help smaller and poorer countries develop by attracting investment, diversifying their economies, and creating better jobs. All developed economies, including Canada, the European Union, Switzerland, Norway, Israel, Japan, Australia, New Zealand, and Korea, run GSP systems, though their programs' product coverage, eligibility rules, and degrees of tariff reduction vary. Some large middle-income countries, including China, have smaller duty-free systems often for least-developed countries.

With benefits authorized, GSP waives tariffs on 3,614 of the U.S.' 11,414 HTS-8 lines for all 119 beneficiary countries (with some exceptions based on Competitive Need Limits), and 5,138 lines for 42 "least-developed" beneficiary countries.[1] Average rates on the lines authorized for waivers are 4.8%. To claim benefits, buyers must show that at least 35% of a given product's value comes from the beneficiary country. The system excludes a number of goods considered import-sensitive at the time of its creation, including clothing, textiles, shoes, and some others. Interested parties have annual opportunities to request removal of goods not on excluded lists, and/or to add new products (subject to review for import sensitivity). Several such cases typically occur each year, but at values small enough not to greatly affect overall levels of GSP trade. Congress' designation of new categories of products, however, can be significant — in fact, travel goods, designated eligible in 2015, are now the largest GSP import category.

By value, GSP covers about $20 billion worth of imports annually, which was about 0.72% of all U.S. imports when the program lapsed in 2020 and about 0.6% now. It makes up about 11% of imports from beneficiary countries. The top imports in 2020 (at HTS-4 level in tariff jargon) were travel goods at $1.9 billion, jewelry at $1.05 billion, auto parts at $0.56 billion, and mattress supports and similar goods at $0.53 billion. Table 1 lists the ten leading beneficiary countries in 2020, as measured by total import value and by share of U.S. trade covered by GSP tariff waivers.

TABLE 1: LEADING USERS OF GSP BENEFITS BY VALUE AND IMPORT SHARE

	Top Sources of GSP Imports, 2020	Top GSP Users by Share of Imports, 2020
Total Imports	**$2,346 billion**	**0.7% of total U.S. goods imports**
GSP Total	**$17 billion – all beneficiaries**	**11.2% – Average across all beneficiaries**
1.	$3.85 billion – Thailand	72% – Lebanon
2.	$3.22 billion – Indonesia	67% – Georgia
3.	$2.21 billion – Brazil	59% – Zimbabwe
4.	$2.04 billion – Cambodia	41% – Armenia
5.	$1.56 billion – Philippines	38% – Paraguay
6.	$0.71 billion – South Africa	35% – Burma (pre-coup)
7.	$0.59 billion – Ecuador	34% – Kosovo
8.	$0.37 billion – Pakistan	34% – Serbia
9	$0.36 billion – Burma (pre-coup)	31% – Cambodia
10.	$0.36 billion – Argentina	29% – Tunisia

Source: USITC Dataweb

GSP's core benefit is the creation of opportunity for beneficiary countries to use the tariff advantage the program offers to draw higher-value investment, diversify their economies, and create employment in value-added industries. Real-life examples appear in U.S. purchasing of Cambodian-produced backpacks and suitcases, Kenyan horticulture, Armenian and Lebanese jewelry, Tunisian dates and olive oil, Thai industrial inputs for American HVAC and automotive industry, Pakistani sports equipment, Ecuadoran roses, South African boats and auto parts, Paraguayan leather, Ukrainian paint and carpentry supplies, Moldovan wine and jam, and the Solomon Islands' exports of about 500 tons of canned tuna (a product for which tariff waivers are reserved to least-developed countries) per year in the 2010s. Macro-level effects, however, are limited given the small scale of the program, though more useful when taken together with those of other countries' GSP systems.

A second benefit is the creation of alternatives for U.S. buyers to heavy reliance on larger suppliers — particularly China, as the current leading supplier of the mid-level manufactured goods that account for most GSP trade. Congress' approval of "travel goods" (a tariff category including luggage, wallets and purses, handbags, backpacks, and some other products) as eligible for GSP at Chairman Smith's initiative in 2015 suggests that in some cases this can be very successful. As Table 2 shows, a year before Congress' action, China was the dominant supplier of travel goods and GSP countries were only very minor suppliers. By 2018 the GSP beneficiary share had tripled, largely at the expense of Chinese imports. By 2020, after the imposition of "301" tariffs on many Chinese products, GSP countries were a larger source than China.

TABLE 2: TRAVEL GOODS IMPORT SHARES BEFORE & AFTER GSP DESIGNATION

Travel Goods Imports	**2014**	**2017**	**2018**	**2020**	**2022**
World Total	$5.529 billion	$9.958 billion	$10.757 billion	$7.504 billion	$12.84 billion
China Share	61%	57%	54%	26%	23%
GSP Beneficiary Share	4%	9%	12%	27%	39%
All Others	35%	34%	34%	47%	48%

Source: USITC Dataweb

Third, to the extent GSP benefits help smaller and poorer countries integrate into international trade and global supply chains, they also likely improve life for workers in these countries who are coming into cities from rural areas or are looking for alternatives to informal-sector work in domestic service, construction, and day labor. The ILO's *World Employment and Social Outlook 2023* reports that in middle-income countries, supply-chain jobs linked to developed economies are generally better than purely domestic-economy jobs. Such jobs, ILO finds, provide generally higher wages and have lower levels of "informality," meaning workers in these jobs are more likely to have health and safety protection, social security, limited hours and required holidays, and other legal protections and benefits:

> "[S]ectors with higher GSC ["global supply-chain"] integration tend to have a larger share of wage and salaries employment, a lower incidence of informality and a lower proportion of low-paid employment – and hence in principle a higher quality of employment."[2]

ELIGIBILITY RULES AND THEIR ENFORCEMENT

Fourth, GSP also supports some important U.S. policy goals through its eligibility criteria.

The core eligibility rule is one of income levels — that is, a country must be at "middle-income" or "low-income" range, as defined by the World Bank, to qualify for GSP benefits. The Bank's threshold for "high-income" status is now $13,845 in Gross National Income per capita, meaning that all countries above this level are in principle ineligible and that countries whose GNI per capita rises above the level must "graduate." Countries also graduate from the program if they join the European Union, and in most cases lose eligibility should they become U.S. Free Trade Agreement partners.

Beyond this income threshold, GSP has a list of 15 policy-based eligibility criteria created at different times in the 1970s, 1980s, and 1990s. Eight of these criteria are "mandatory" and seven are "discretionary." A country's failure to meet any one of them can result in loss of its tariff benefits, after a USTR-led "review" of benefits and engagement with the relevant government. The criteria most frequently invoked for reviews of benefits include "taking steps, or having taken steps, toward respect for internationally recognized labor rights," affording "adequate and effective protection of intellectual property", providing "prompt and adequate compensation for expropriation and respect for arbitral awards," and providing "reasonable assurance of access to markets." Administrations enforce these criteria in two ways:

(1) Annual solicitation of public comment through *Federal Register* notices. These notices at times elicit petitions for reviews of benefits by individuals, businesses, trade associations, NGOs, and other interested parties who believe a particular beneficiary country may not be compliant with one or more criteria. During my tenure, such petitions led to the opening of reviews of benefits regarding South Africa on intellectual property rights and Thailand on market access for pork. The review of South Africa remains open, while the review of Thailand did not succeed and led to the partial withdrawal of GSP benefits.

(2) Triennial "assessment" of all 119 beneficiary countries, in which USTR leads an interagency process examining each country's compliance with all 15 criteria. This system was designed in 2017, principally by the late Erland Herfindahl, then Deputy Assistant USTR responsible for GSP administration, and resulted in the first baseline assessment of all current beneficiaries since the 1970s. Its core goal was to ensure that all beneficiary countries met the program criteria, and that these criteria were enforced in a systematic and equitable way across the entire system, with similar problems in similar countries bringing similar treatment regardless of whether USTR had received a petition. The program assessed roughly 40 countries per year, proceeding by region with Asia and the Pacific Islands first; then Europe, Latin America/Caribbean, and the Middle East; then sub-Saharan Africa. These assessments led to self-

initiation of reviews of benefits for India and Indonesia on market access, and of Azerbaijan, Eritrea, and Zimbabwe on labor standards. The Indonesia market access case closed successfully, with the resolution of U.S. concerns related to dairy exports, import licensing in horticultural products, and digital trade issues. The India case, by contrast, did not resolve successfully, and the administration terminated India's GSP benefits. The labor cases related to Azerbaijan, Eritrea, and Zimbabwe remain open, and with the lapse of GSP benefits at the end of 2020 no action has been taken since.

Experience with these "enforcement" efforts offers some useful lessons. Several cases in my view yielded important and valuable results. In addition to the Indonesia case noted above, examples during my tenure included reform of child labor law in Bolivia in 2019, reduction of barriers to pork imports in Argentina in 2017, revision of copyright law in Ukraine in 2017, abolition of forced labor and abusive child labor in Uzbekistan's cotton industry, and revision of a national workplace safety and health law in Georgia in 2019 and 2020.

On the other hand, enforcement efforts sometimes fail, as in the India and Thailand cases and several earlier examples. Removal of benefits in these cases can come with a cost, and this cost often falls most heavily on workers and businesses rather than on governments or politicians. In 2013, academic economists Emily Blanchard and Shushan Habikyan noted that "when a developing country loses GSP access, its exports in affected industries fall by an average of 19% in the year of exclusion, an additional 20% in the first year, and are still 60% below pre-exclusion levels three years later."[3] A vivid illustration, drawn from the African Growth and Opportunity Act rather than GSP, of the inherent risk is that of the Obama administration's removal of Eswatini (then known as Swaziland) from AGOA benefits in 2014.[4] Here, an attempt to improve labor standards through the withdrawal of AGOA tariff waivers brought the collapse of the garment industry the administration was hoping to reform, with attendant job loss and harm to the workers the administration and the petitioners had meant to help.

COMPETITIVE NEED LIMITS

Finally, GSP also limits benefits through "Competitive Need Limits." These, known as "CNLs" for short, cap the level of exports of any particular product a country can provide under GSP by market share and by total value. A beneficiary country whose exports of a particular GSP good rise above an annually adjusted dollar ceiling (currently $210 million and rising by $5 million annually), or has more than half of all total U.S. imports of the relevant product, loses all duty-free benefits for this product. The dollar-value ceiling is not adjusted for inflation, and therefore has fallen in real dollars over time. Moreover, once a country loses eligibility for a product due to CNL imposition, it has great difficulty recovering it even if the country's market share drops below 50% or its export value declines.

DEVELOPMENTS SINCE LAPSE

The last reauthorization of GSP came in 2017, and program benefits lapsed on January 1, 2021. Since then, GSP users have continued to register products as GSP-eligible, but have not received benefits. To my knowledge, this is the longest lapse in program history. As renewal prospects have faded, the share of imports arriving under GSP has fallen from close to 0.8% to about 0.6%, and there are some cases of imports shifting away from GSP countries altogether.

An example is that of the Solomon Islands, a Pacific Island country of about 800,000 people with "least-developed" beneficiary country status. As of 2020, the Solomons exported about 500 tons of canned tuna per year to the U.S. under GSP. This is normally a high-tariff product, with tariff rates ranging from 12.5% to 35%, but through 2020 GSP waived these tariffs for eligible least-developed countries. China buys most of the Solomons' roughly $200 million in annual exports, principally raw lumber. U.S. purchases of canned tuna was less in value, but likely more useful as a job creator: though small-country economic statistics are often blurry, Australian estimates suggest that the tuna cannery in question provides about one-thirtieth of the Solomons' formal-sector, wage-paying jobs.

The U.S. has imported no canned tuna from the Solomons since the end of 2020. This does not mean U.S. production has risen to replace imports — in fact, import levels have risen from about 210,000 tons to 240,000 tons per year — but rather that a low-income, strategically sensitive country has lost trade to larger competitors. Buyers of the Solomons' modest shipments of tuna appear to have shifted to larger Southeast Asian and Latin American sources not eligible for LDC tariff benefits. Similar problematic cases show up in products removed from GSP by CNLs as well.

REAUTHORIZATION OPTIONS AND TRADE-OFFS

Looking ahead, I applaud the Subcommittee's interest in reauthorizing and improving GSP.

Overall, the system provides some tangible U.S. support for smaller and poorer countries through trade opportunities. It gives the U.S. government a useful tool for several policy goals, and helps U.S. firms reduce production costs by saving tariff expenses on industrial inputs. From a different perspective, GSP is not a significant source of competition for domestic businesses, as it covers only a very small share of U.S. imports, applies to goods not considered "import-sensitive," and allows interested parties regular opportunities to remove goods that have become sensitive for some reason.

The option of renewing GSP without significant change is in my opinion not a bad choice, given that it is a relatively small program whose benefits have lapsed for a long time. On the other hand, I believe some changes could enable GSP to accomplish more than it now can. A few thoughts, therefore, on potential goals in reauthorization, and the types of changes to GSP that might make more able to help the U.S. reach them:

1. <u>Supply Chain Security and Sourcing Diversification</u>: If a primary goal of the reauthorization is to diversity U.S. sourcing and encourage less reliance on Chinese products, the program should probably have a relatively long reauthorization period, and within its limits should provide significant incentives for companies to use it. In policy terms, this could involve:

(a) <u>Renewal term</u>: A renewal of at least five years, taking the program at minimum to the end of the next Presidential term.

(b) <u>Level of economic benefit</u>: Some additional real-world benefits for users that provide more incentive to shift supply chains. My understanding is that some of the products excluded from the program as "import-sensitive" are now not made in the United States, and despite the opportunities presented by Free Trade Agreements and the AGOA and CBI programs, are often remain overwhelmingly sourced from China. These might be examined for inclusion in GSP.

Short of this, the CNL system limits the ability of beneficiary countries to export products in which they are particularly competitive, and based on analysis I've seen likely reduces the value of GSP imports by about a third. Legislation offered in the last Congress by the late Representative Jackie Walorski and former Representative Stephanie Murphy represents a thoughtful approach to revising and improving it. Their bill would have replaced the current dollar-value threshold with a more economically sensible percentage-based annual increase, and given administrations more flexibility to restore benefits to countries in cases when a given product, having risen above a CNL threshold, then falls back below it.

(c) Stability of benefits: GSP's success as an incentive for supply chain shifts and diversification, especially in higher-value products requiring relatively greater capital investment, depends on buyers' confidence that benefits are relatively stable and that countries will undergo benefit reviews and removals only for very serious and clear evidence on failure to comply with the eligibility criteria. While I do believe some updates and additions to the list of criteria are appropriate, a very large number of new criteria (particularly if they include very general or vaguely written criteria), may require administrations to conduct many new reviews of benefits and so erode buyer confidence in the system as a whole.

(d) Rule of origin: GSP's 35% value-added rule of origin has some significant benefit. In particular, it makes the program simple and inexpensive for buyers to use. It is not, however, a feature of the program that has received much in-depth analysis, and some types of revisions to it could lead to greater value-added trade for GSP beneficiaries and less for other countries including China. It may be useful to explore in some rigorous way:

> (i) whether allowing GSP beneficiaries to count value added by use of American input, or input from U.S. FTA partners and perhaps non-FTA allies, and/or input from other GSP beneficiaries, would help to diversify their sourcing of inputs; and
>
> (ii) whether a requirement that more than 35% of the value of a GSP product come from GSP beneficiaries themselves (or some combination of beneficiary countries and other eligible contributors) would increase local production, or simply raise costs and deter use of the GSP system.

2. New Policy Goals and Addition of Criteria: Most recent reauthorization bills have included a significantly longer list of eligibility criteria than the current program has. I share the view that some updates are appropriate, for example the addition of an environmental criterion. However, I also have some concern about additions of a large number of new criteria:

(a) A significantly longer list of eligibility may not achieve more: The more new eligibility criteria are added, the less likely users are to see the overall benefits as stable and reliable. This is particularly likely when new criteria are written vaguely or have numerous sub-criteria that can cause the opening of reviews and loss of benefits for many different reasons. I feel that some criteria drawn from the African Growth and Opportunity Act have this sort of weakness. Likewise, a significantly longer list of eligibility criteria risks making it harder for beneficiary countries to understand what is necessary to remain in compliance, and for executive-branch administrators to enforce these criteria in systematic and equitable ways across the system. Alternatively, a list of many criteria may mean administrations feel they need to reduce the priority given to each individual criterion including those in the current list.

(b) Very strictly written criteria may be quite hard for some well-intentioned governments to meet. Developing-country governments – in particular, governments of low-income countries and small island states — often have very talented national leadership, but weak civil services and policy capacity. This can mean they impose policies unevenly, often effectively in national capitals but spottily in provinces.

The current GSP criteria typically (and I believe wisely) offer administrators flexibility to view governments whose records may be imperfect, but who are acting in good faith on relevant issues, as compliant. I hope this will remain the case if Congress chooses to add new criteria or revise existing ones.

3. New Requirements for Administrations: Several renewal bills suggest, in various ways, codifying the triennial "assessment" program that Mr. Herfindahl developed in 2017, and adding new reporting requirements.

(a) I feel the assessment program is a significant improvement on the purely petition-driven approach of earlier years, and that it has been quite valuable to develop a baseline of compliance for each country. I believe it is appropriate for this to continue.

(b) I would recommend caution about new reporting requirements. Administrations should keep Congress informed about emerging GSP eligibility issues, additions and removals of products, and so on, and provide a public record of decisions and their rationales. However, the GSP staff is quite small at 2.5 or fewer full-time employee equivalents. A reporting requirement that is very extensive and/or covers matters well beyond the agency's institutional expertise would place a heavy new work burden on these people, and divert them from working directly on product and eligibility compliance issues to drafting, verifying, and producing reports. So I would hope any new reporting rules would be relatively limited.

CONCLUSION

In conclusion, Mr. Chairman, thank you once again for this opportunity to share ideas and experience on GSP with you. I admire and applaud the work the Subcommittee is doing to affirm America's commitment to support smaller and poorer countries through trade policy; think through ways GSP can most effectively promote supply chain security and diversification; and promote American policy goals. I would be happy to answer any questions you and the Subcommittee Members may have.

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[1] For context, as of 2023 the U.S. Harmonized Tariff System has 11,414 8-digit lines, of which 4,315 are permanently duty-free. This leaves 7,099 lines subject to tariffs above 0%, with 1,961 in excluded categories. The U.S. International Trade Commission's line counts for the system as a whole, GSP, and other categories is at https://www.usitc.gov/sites/default/files/tariff_affairs/documents/2023_hts_item_count.pdf

[2] *Employment and Social Outlook 2023: Trends*, International Labour Organization, pp. 16 and 44-45, at https://www.ilo.org/global/research/global-reports/weso/WCMS_865332/lang--en/index.htm

[3] Emily J. Blanchard and Shushanik Hakobyan, "The U.S. Generalized System of Preferences: In Principle and Practice," *Tuck School of Business* Working Paper No. 2439798, December 19, 2013, http://dx.doi.org/10.2139/ssrn.2439798

[4] "President Obama Removes Swaziland, Reinstates Madagascar for AGOA Benefits," Office of the United States Trade Representative, June 26, 2014, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2014/June/President-Obama-removes-Swaziland-reinstates-Madagascar-for-AGOA-Benefits.