COALITION FOR GSP
1001 Connecticut Avenue, NW, Suite 1110
Washington, DC 20036
(202) 347-1085

Written Statement of the

Coalition for GSP

To the United States Senate Committee on Finance

Regarding

"U.S. Preference Programs: Options for Reform"

Submitted by

Laura M. Baughman
Executive Director
Coalition for GSP

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Introduction

The Coalition for GSP is pleased to have the opportunity to provide the following views to the Committee on Finance on the operation of U.S. preference programs. In particular, we intend to focus our comments on the importance of preference programs to American competitiveness, and on ways in which U.S. preference programs can be improved so that their contribution to American competitiveness is maximized.

The Coalition for GSP is an ad hoc group of U.S. companies and trade associations that use the Generalized System of Preferences (GSP) program to improve their competitiveness, as farmers, manufacturers, and suppliers of consumer goods to American families. Over the years, GSP has become an integral part of our businesses. Our members import a wide range of goods under GSP, from auto parts to jewelry to plywood to batteries to spices. We therefore have first-hand knowledge about how preference programs works – and don't work – in U.S. company raw material and finished good sourcing plans.

Preference Programs Matter – to Americans

When thinking about whether or not U.S. preference programs "work," one's focus tends to be on whether they work for the beneficiary countries. This of course is appropriate as preference programs are designed to promote poverty-eradicating development in poor countries.

Less common is a related consideration: how do they work for the American farmers, manufacturers, retailers and other importers who also use them? Preference programs succeed in their primary goal – promoting growth in developing countries through trade – only if U.S. companies find them attractive to incorporate into their sourcing and investment/production plans. U.S. companies will do so only if the benefits of the preference programs contribute positively to their "bottom lines," if the programs can be relied upon, and if the rules and regulations associated with claiming program benefits are not so complicated as to be more trouble than the benefits are worth.

Preference Programs Reduce Costs

U.S. preference programs extend duty-free treatment to imports of selected products from selected beneficiary countries. Although on average U.S. most-favored-nation duty rates are among the lowest in the world, for many individual products they can be quite high (see Table 1[1]). The U.S. market is very competitive, so any program that saves U.S. farmers, manufacturers, retailers and other importers money – even pennies – can be highly attractive. GSP alone saved U.S. importers more than $580

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[1] The list of products in Table 1 is by no means exhaustive, nor does it always show the highest tariff rate in a given product grouping.

million in duties in 2009.[2] The motivation to source from a preference-eligible country can therefore be strong.

Table 1
U.S. Tariff Rates for Selected GSP-Eligible Products

Certain household porcelain/china tableware/kitchenware	26.0%
Porcelain/china napkin rings	20.8
Certain nuts and seeds	17.9
Certain artificial flowers	17.0
Certain grated cheeses	15.0
Cotton hammocks	14.0
Railway cars	14.0
Certain silver jewelry	13.5
Ceramic roofing tiles	13.5
Flashlights	12.5
Screws made of iron/steel, for wood	12.5
Wood blinds, shutters	10.7
Wrenches	9.0
Metal drilling tools	8.4
Umbrellas	8.2
Machine tool parts	8.0
Christmas tree lights	8.0
Glass paving blocks	8.0
Certain transmission belts	8.0
Certain plywood	8.0
Paint rollers	7.5
Steam turbines and parts	6.7
Optical fibers	6.7
Aluminum alloy sheets/plates	6.5
Various chemicals and mixtures	6.5
Polyvinyl chloride	6.5
Average U.S. tariff	4.6

Source: Harmonized Tariff System of the United States, 2010; U.S. Census Bureau.

[2] See http://tradepartnership.com/pdf_files/2010_GSP_Update.pdf. p. 12.

Preference Programs Improve U.S. Competitiveness and Support U.S. Jobs

A study conducted by The Trade Partnership for the U.S. Chamber of Commerce found that the impact of GSP on a variety of sectors of the U.S. economy is significant.[3] It concluded:

- GSP keeps American manufacturers and their suppliers competitive. In 2005, three quarters of U.S. imports using GSP were raw materials, parts and components, or machinery and equipment used by U.S. companies to manufacture goods in the United States for domestic consumption or for export. Electrical equipment and parts, and transportation vehicle parts are significant imports under GSP.

- American families also benefit from GSP. Finished consumer goods typically sold by retailers accounted for 25 percent of GSP imports in 2005. Jewelry sold at lower price points was the most significant item.

- GSP is particularly important to U.S. small businesses, many of which rely on the program's duty savings to compete with much larger companies.

- Annual sectoral benefits to consumers of GSP products range up to $273 million.

- GSP imports support U.S. jobs. Direct and indirect jobs associated with moving aggregate GSP imports from the docks to farmers, manufacturers and ultimately to retail shelves totaled nearly 82,000 in 2005.

RECOMMENDATION: In addition to thinking hard about ways in which U.S. preference programs might be changed to achieve certain policy goals, U.S. policy makers need to consider closely the impacts of changes on American companies and their workers. While some thought in 2006 that it would be beneficial to narrow the focus of preference programs to the least developed countries or to eliminate benefits extended to imports of certain products (like auto parts from Brazil or jewelry from India or Thailand), these changes have had an adverse effect on U.S. manufacturers and retailers, who now face higher tariffs at the same time as increasing raw material costs and sagging domestic demand.

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[3] The Trade Partnership, "Estimated Impacts of the U.S. Generalized System of Preferences on U.S. Industry and Consumers," prepared for the U.S. Chamber of Commerce, November 1, 2006, http://www.tradepartnership.com/pdf_files/2006NOV_GSP_Impacts.pdf.

Preference Programs Can Be Improved

As key as duty savings can be, however, our preference programs suffer from some important flaws that can lessen the enthusiasm for their use, and consequently limit their effectiveness in contributing to U.S. competitiveness and in promoting development that ultimately opens new markets for U.S. exports and investment. These include their stop-and-start nature, their inapplicability to many of the products made by developing countries, and their complicated nature.

The Frequent Expirations of Preference Programs Discourage Importers and Investors from Using Them

American companies' ability to use the duty-free benefits available under U.S. preference programs is most effective when they know those benefits will be available by the time they need to import the products of interest to them. While the time from design to order to importation varies for each company, for some it can be quite long. For example, some products take as long as one year from design to importation. For others, the products are advertised in catalogues with a shelf life of at least six months. In all cases, U.S. importers need to know what the duty-status will be for the imported product at the very beginning of that process.

If American companies can count on receiving duty savings under a preference program, they can incorporate those important cost savings into their pricing. But if the program expires mid-stream in the order-to-delivery process, importers can be caught with a serious financial burden. They cannot always adjust prices to customers to pass on the unexpected duties. So American companies have to evaluate the risk of losing the preferences mid-stream against the benefits of the duty savings. If the program is likely to expire, they often cannot incorporate the duty savings into their sourcing plans, and prices to customers will need to be higher to offset the risk.

The damage frequent program expiration causes to investment decisions can be just as great, if not greater. Needless to say, the pay-back from a foreign investment – e.g., opening a new factory, ensuring that there is adequate infrastructure to support it, training workers – can take several years to happen. U.S. companies would thus be reluctant to begin new sourcing relationships that require such investment if they are predicated on the need for duty-free benefits under a preference program that may expire.

With those planning constraints in mind, it is not surprising that the short-term renewals of GSP in the 1990s, compared to the long-term period from 2001-2006, affected usage of that program. From July 1993 through September 2001, Congress renewed GSP in fits and starts (largely due to the need to meet "pay-go" constraints). Planning sourcing using GSP was difficult if not impossible. Over this period, from 1994 to 2001, U.S. imports under GSP actually declined an average 2.2 percent annually. But in 2001 Congress renewed GSP for six years, and as a result, imports from GSP beneficiary countries to the United States increased by an average of 13.2 percent annually. Since 2006, Congress has renewed GSP on three occasions, each time for just one or two years (although thankfully before the program expired). Short renewal periods, talks about eliminating or scaling back benefits for major BDCs, and the 2008/2009 recession have all contributed to growing uncertainty for users of the GSP program, so it is no surprise that imports under GSP have fallen dramatically from their 2006 peak of approximately $32 billion.

A long term for any preference program (the ideal of course would be permanence) is therefore important in encouraging sourcing from countries that do not yet have the infrastructure or production capability to be competitive suppliers of preference-eligible products. The Chart below shows how the long-term renewal of GSP increased interest in sourcing from beneficiary countries. To the extent that some of Coalition members are interested in investing in new overseas production relationships, they need time to grow these suppliers. Short-term renewals of the program do not encourage this, and keep them focused on existing sources, whether they are GSP beneficiaries or not.

*Vertical lines mark GSP expirations and renewals

RECOMMMENDATION: Make U.S. preference programs permanent.

The Inapplicability of Preference Programs to Important Products Made by Poor Countries Encourages Sourcing from More-Competitive Suppliers in Asia

One of the greatest frustrations for both developing country producers and U.S. purchasers is that the longest-lived and biggest U.S. preference program – GSP – does not cover imports of products best produced by labor-intensive developing countries. Most notably, these products include apparel and footwear.

Bangladesh and Cambodia – "least-developed countries" by any measure -- offer the best examples. U.S. GSP benefits applied to just 0.6 percent of Bangladesh's total exports to the United States in 2009, while 90 percent of Bangladesh's total exports to the United States are dutiable apparel products. Similarly, only 0.4 percent of Cambodia's total exports received GSP duty-free treatment, with 97 percent of the total exports to the United States being dutiable apparel products. Despite their classification as least-developed beneficiary countries, Bangladesh and Cambodia face trade-weighted tariffs averaging 15 and 17 percent, respectively, compared to an average of 0.6 percent on imports from the United Kingdom. As a result of these high tariff rates, the United States collected more duties on imports from Bangladesh ($563 million) and Cambodia ($318 million) in 2009 than it did on imports from the United Kingdom ($285 million) or France ($281 million).

The benefits of extending preferences to products developing countries are best positioned to make are demonstrated by the impact of the African Growth and Opportunity Act (AGOA). AGOA provides U.S. duty-free treatment (under stringent conditions, see below) to apparel imported from beneficiary countries. AGOA is widely viewed as responsible for the development of tens of thousands of jobs in apparel production in Lesotho, for example. The 2007 U.S. Trade Representative report on the operation of AGOA listed five new textile or apparel-related investments motivated by AGOA benefits, in Lesotho, Malawi, Mali, Swaziland, and Uganda.[4]

From the U.S. perspective, Members of the Committee should consider that an importer considering whether to source apparel with duties applied will evaluate the costs and benefits offered by Bangladesh, for example, compared to China or Vietnam, for example. For many apparel products, China or Vietnam offer cost, quality and/or delivery advantages Bangladesh cannot replicate. A savings of the 15 percent average duty on imports from Bangladesh therefore would be meaningful, increasing the incentive to source from Bangladesh rather than China or Vietnam.

RECOMMENDATION: Extend permanent preference benefits to all products made by developing countries.

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[4] Office of the U.S. Trade Representative, "2007 Comprehensive Report on U.S. Trade and Investment Policy Toward Sub-Saharan Africa and Implementation of the African Growth and Opportunity Act," May 2007, p. 27.

Complicated Rules of Origin Frustrate the Use of Preferences

Another problem with U.S. preference programs is the variety of rules of origin, some of which can be quite complicated, particularly for new-to-export foreign producers. The simplest of all rules of origin is GSP's 35 percent value added rule. To qualify for benefits, a product must be the growth, product or manufacture of a beneficiary country and the sum of the cost or value of materials produced in the beneficiary country plus the direct costs of processing must equal at least 35 percent of the appraised value of the good.

But the rules get much more complicated for apparel imported under AGOA or the Caribbean Basin Trade Partnership Act (CBTPA) preference program. (Remember that apparel generally is not eligible for GSP benefits.) Under AGOA, for example, U.S. importers must ensure that apparel meets *11 separate detailed requirements*.[5] Because these rules of origin are so restrictive, a special – but limited -- more liberal rule of origin had to be established (the so-called "third country fabric" rule). It is that rule that has promoted the development of apparel sourcing in sub-Saharan Africa.

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

RECOMMENDATION: Simplify the rules of origin used to qualify for preferences.

Conclusion

GSP is a preference program that generally works. It works for very poor countries and it works for American farmers, manufacturers and consumers. There are changes the Committee could enact to make preference programs work better, for beneficiary countries *and* for their U.S. customers. In evaluating those changes, Members should consider their impacts not only on beneficiary countries but also on U.S. companies and workers.

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[5] For the excruciating details, see http://www.customs.gov/linkhandler/cgov/trade/trade_programs/international_agreements/special_trade_programs/agoa_african_growth/2002agoa.ctt/2002agoa.pdf.