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THE GENERALIZED SYSTEM OF PREFERENCES OF THE UNITED STATES AS IT AFFECTS THE CARIBBEAN BASIN

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This will be a summary of the empirical studies carried out by the External Sector Program of the OAS, regarding the Generalized System of Preferences (GSP) of the United States. The conclusion which emerges from the current evidence is that its impact on the Basin is, at best, rather modest, for reasons which will be explained.

GENERAL BACKGROUND

To put the Caribbean Basin in a proper framework, let us first look at the GSP of the United States in its overall context. The gradual inauguration of the tariff preference systems for the LDCs by the developed countries was the result of years of persistence by the LDCs in UNCTAD. The tariff preference idea was based on the notion that, for a variety of reasons, the developing countries needed greater market acess to the wealthy, large markets of the developed countries in semi-industrial products. After a fair amount of resistance on the part of the developed countries, the concept of discriminatory treatment in favor of the LDCs was accepted and preference schemes were gradually introduced.[1] The preferences were not coordinated among the developed countries and a great deal of individuality has thus emerged — eligible products under the schemes are not necessarily identical, and the rules and limitations which were imposed in each scheme are peculiar to the country. The United

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1. Prior to the imposition of the schemes, concern was expressed that the schemes would be more cosmetic than substance in terms of the amount of potential benefits to the LDCs. The degree to which this concern was justified with regard to the United States system for the Caribbean Basin can be seen in empirical studies carried out by the OAS for the Western Hemisphere countries. The results are contained in: Organization of American States, *Evaluation of the First Year's Operation of the United States Generalized System of Preferences, Part I: Quantitative Analysis*, OEA/Ser. H/XIII CIES/CECON/251 (1977) and Organization of American States, *La exclusión de Ecuador y Venezuela como paises beneficiarios del SGP, antecedentes y analisis cuantitativo*. All other data used is official U.S. trade data from the Department of Commerce, various computer tape series.

States was the last major developed country to introduce a GSP scheme in the Trade Act of 1974,[2] and, as might be expected, it had a number of its own peculiarities and limitations.

In 1976, the first year of operation, the U.S. scheme granted complete tariff exemption on the importation of 2,728 semi-industrial products coming from eligible beneficiary countries, out of a total of 6,000 articles in the TSUS. Of these 2,728 articles, the United States imported from both beneficiary and non-beneficiary countries $26 billion of imports in 1976 and $31 billion in 1977, which represented in both years twenty-one percent of total U.S. imports. Of course, the beneficiary countries did not have the major share of their United States trade in eligible GSP articles. With respect to the above dollar totals, beneficiary countries secured only sixteen percent of the market both in 1976 and 1977. Thus, in 1976, imports of GSP articles by the United States from beneficiary countries represented only 3.5% of total U.S. imports and only 3.4% of U.S. imports in 1977 — a rather modest portion for both years.

CARIBBEAN BASIN GSP EXPORTS

Of course, what may be a paltry sum to the United States might be a significant amount to the Caribbean Basin countries. Looking at the exports of these countries to the United States, we find that, excluding Venezuela, which we will consider separately, GSP-subject exports from the Basin to the U.S. represented ten percent of its total exports to that country in both 1976 and 1977. This percentage is not an insignificant portion of the Basin exports to the United States — it represented about $890 million in 1976 and $1 billion in 1977.

This does not, however, answer the question of what effect the GSP has on the trade between the Basin and the U.S. This can be roughly estimated by calculating the trade creation and trade diversion effect of the tariff reductions under the GSP for the Caribbean Basin countries. The trade creation value will be the increase in the value of imports from beneficiary Basin countries replacing United States domestic production of competitive goods.[3] The trade diversion value is the increase of U.S.

2. 19 U.S.C. § 2101 (1974).

3. Trade creation (TC_i) of product "i" will be:

$$TC_i = M_i \eta_i \left[\frac{\Delta t_i}{1 + t_i}\right]$$

where M_i is the initial level of U.S. imports of "i" from the beneficiary country, η_i is the import demand elasticity, and t_i is the ad valorem of "i".

imports from Basin countries which replaces imports from non-beneficiary sources which do not receive the tariff exemption.[4] Combining the two values, it was estimated that the total value of trade expansion which could be attributed to the U.S. GSP for 1976 was approximately $111 million for the Basin countries with the exception of Venezuela. This would represent only 1.4% of the value of U.S. imports from the Basin for 1976. This is hardly a significant part of Basin trade with the United States, and the calculation makes several assumptions which err on the side of mercy, increasing the calculated benefit.

LEGISLATIVE LIMITATION ON THE UNITED STATES GSP SYSTEM

There are several reasons why the potential benefits are surprisingly low and several other reasons why their magnitude might even be lower than indicated. While it is not possible to quantify and rank the relative importance of each of these factors, some data are illuminating.

One reason for the low benefits is the limitations imposed by law on the eligible products. Under the 1974 Trade Act, any beneficiary country which exports more than $25 million of an eligible product[5] to the United

4. The calculation of trade diversion is based on the indirect method of Baldwin & T. Murray, *MTN Tariff Reductions and Developing Country Trade Benefits under the GSP* (mimeo) (1976), which assumes that the substitutability between a beneficiary developing country product and similar products of non-beneficiary countries is not greatly different from the substitutability between a beneficiary developing country product and a similar product produced in the U.S. This latter substituability would then be trade creation weighted by the ratio of imports from non-beneficiary sources to domestic production (minus exports):

$$TD_i = \frac{TC_i \, M_i^{non\text{-}bfc}}{O_i - X_i^{US}}$$

where TD_i is the value of trade diversion of product "i", $M_i^{non\text{-}bfc}$ is the U.S. imports of "i" from non-beneficiary countries, O_i is U.S. domestic production of "i", and X_i^{US} is U.S. exports of "i".

5. The $25 million limit is increased each year in proportion to the percentage increase of the United States GNP. The value was about $33.8 million for 1977. Also products for which a beneficiary country accounts for 50% or more of U.S. imports are also denied preferential treatment the subsequent year. This limitation tends to be an insignificant yet irritating feature of the competitive-need formula in the majority of cases.

States in any one year will be excluded from the GSP for the same product during the subsequent period. An estimate was made as to the benefits which Basin countries would have received under a trade creation and diversion effect had the limit not been applied in 1976. The resulting value was $241 million, more than double the estimated benefit actually received from the scheme as designed.

It has been frequently argued that this limitation is justifiable since producers who can export such volume certainly are competitive in the world market without special help. If the GSP is justified on an infant industry argument, this is probably true. To the degree it is seen as an income transfer mechanism, however, the justification is less persuasive, and considering the resentment which the limitation creates, it would seem that the United States pays a high price for such a small savings.

The product coverage is another obvious cause of the modest potential of the GSP as presently structured. The Trade Act of 1974 itself excluded a number of important product categories such as textiles, wearing apparel and footwear. Even without tampering with these so-called "import-sensitive" products, it would be possible to significantly expand GSP benefits through an expansion of the product coverage. The countries of the Caribbean and Latin America expressed through the OAS their interest in the inclusion of a number of products within the scheme which were not then eligible nor on the exclusionary import-sensitive list. It was calculated that their inclusion would have represented a benefit to the Basin countries through trade creation and diversion of $128 million, more than the estimated benefits conferred by the scheme as constituted. Depsite these modest costs, the United States has been extremely reluctant to extend GSP product coverage to any important degree.

An inherent limitation of the GSP is the fact that the tariff rates on most goods granted eligibility are already low. Thus, little advantage is conferred on a beneficiary country relative to a non-beneficiary competitor or U.S. producer of a like product. An analysis of U.S. tariffs of GSP articles and non-GSP goods shows that eighty-three percent of GSP-subject imports have a tariff of 7.4% ad valorem or less while only sixty-nine percent of non-GSP imports fall within this tariff range. As the figures suggest, the low tariff impact is not due just to a practice of selecting low-tariff items for eligibility but because tariffs in general have come down in the developed countries since World War II. Nevertheless, as tariffs have been reduced, non-tariff barriers such as "voluntary" quotas and orderly marketing agreements have been employed with increased frequency by the developed countries to control imports. This is a shift of import control mechanisms which a GSP-type scheme can do little to remedy.

IMPACT ON THE CARIBBEAN BASIN

An area in which the potential benefits of the GSP have not been fully realized, and which have not been taken into account in the calculation, is that degree to which the beneficiary countries actually utilize the GSP of the United States. Our calculations were based on the assumption that all of the exports of eligible articles of the Basin countries entered the United States under the GSP so as to avoid understanding the potential benefits of the scheme. We do have, however, data as to the underutilization of the system by a number of the Basin countries. In 1977, only fifty-five percent of the GSP-subject exports of the Basin entered the United States duty-free under the GSP. This figure is extremely low because Mexico, which represents seventy-three percent of GSP-subject exports from the Basin, had a utilization rate of the GSP of only forty-nine percent. Excluding Mexico, the rate for the other Basin countries rises to seventy percent.

This low rate of utilization in the case of Mexico and several other countries of the Basin has several explanations. One important cause is the country-of-origin requirements of the GSP. Under the United States system, an eligible article is considered the product of a beneficiary country only if at least thirty-five percent of the appraised value of the good consists of the cost or value of materials produced in the beneficary country and/or the direct costs of processing the good in that country. Several Basin countries face the problem that they assemble a number of U.S. components of GSP-subject articles under TSUS 807.00 and cannot reach the thirty-five percent value requirement because the U.S. components do not generally qualify as materials produced in the beneficiary country. If we exclude from our utilization rate calculation those GSP articles with significant use of TSUS 807.00, we find that the overall rate for the Basin increases from fifty-five to eighty-one percent, a dramatic improvement.[6] It is not known to what degree the remainder is

6. Utilization rates for selected Basin countries in 1977 include:

Country	*Utilization Rate*	*Utilization Rate without TSUS 807.00 sensitive articles*
El Salvador	41%	67%
Honduras	55%	56%
Nicaragua	60%	65%
Haiti	39%	82%
Dominican Republic	59%	83%
Mexico	49%	81%

due to country-of-origin problems of a different source, ignorance of the GSP on the part of exporters, indifference to the GSP and statistical errors.

Venezuela has been absent from this discussion because, as a member of OPEC, it is excluded by law from the GSP of the United States. This is an exclusion which causes considerable political discord in the hemisphere but one which has little current economic significance. In 1976, Venezuela exported to the United States GSP-subject goods worth $14 million. The calculated benefit from trade creation and diversion through this exclusion amounted to only $1.2 million. Likewise, the incorporation of petroleum within the GSP would be of no practical benefit were Venezuela a beneficiary country since the product would immediately fall into the $25 million competitive-need category and the thirty-five percent value requirement could not be met since profits do not qualify as part of this value. Thus, it would appear that the exclusion of Venezuela is more a political rather than an economic issue, although that is not meant to demean its importance.

POSSIBLE MODIFICATION OF THE UNITED STATES SYSTEM

Based on this analysis, it would appear that the current impact of the GSP of the United States on the Caribbean Basin countries is not really significant, and considerable modification would be necessary to alter that. This could be accomplished through several major changes. First, the product coverage of the GSP would have to be expanded greatly so as to include the import-sensitive products which are presently excluded. If this were done, it would also be necessary to eliminate or greatly expand quota levels of beneficiary countries to have a positive impact. Secondly, the $25 million competitive-need limitation would have to be removed from the law and the scheme. Thirdly, the thirty-five percent country-of-origin rule could be modified to allow U.S. materials to be counted as materials of the beneficiary country and increasing in such cases the local value requirement to fifty percent. It should be noted, however, that this might benefit primarily multinational corporations which control most assembly activity in the Basin. Finally, the lifespan of the GSP might be increased. As the scheme is presently designed, the entire program is scheduled to terminate at the end of ten years. It has been suggested that given the time it takes the developing countries to become familiar with the different schemes, the time in which is left to realize investments is not sufficient to have the GSP influence an investment decision.

OTHER POSSIBLE IMPROVEMENTS

Apart from the U.S. scheme only, another improvement could be made which would require the cooperation of all the developed countries which participate in GSP schemes. If they would harmonize their rules and product coverage, the LDCs would be able to respond more adequately and the total system would increase the potential advantage to the developing countries.

Many of the beneficiary developing countries themselves, including some of the Caribbean Basin countries, need to more aggressively take advantage of the system. A comparative analysis of the hemisphere with other regions of the world suggest that Latin and Caribbean countries have utilized the GSP of the United States far less than some of the beneficiary nations of the Far East. In fact, between 1975 and 1976, beneficiary countries of the hemisphere increased their GSP-subject exports to the United States at only one-half the rate of all other beneficiary countries combined.