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GSP graduation: impact on major Latin American beneficiaries

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TEXTO PARA DISCUSSÃO
Nº 150
GSP GRADUATION: IMPACT
ON MAJOR LATIN AMERICAN BENEFICIARIES*

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e
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*The authors wish to thank Maria Bernadete Gutierrez, who kindly made available her estimates of US import penetration rates used in section 4 and made helpful suggestions, and Antonio Carlos Quintela for research assistance. Study originally prepared for SELA.

GSP Graduation: impact on major Latin American beneficiaries

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This is a preliminary draft. Please do not
quote.

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1. The origins of the GSP

The notion that developing countries should be granted special and preferential treatment in the sets of rights and obligations governing multilateral trade relations within the framework of the GATT took long to materialize. In a formal sense this was a consequence of the need to preserve the basic principle of non-discrimination embodied in Article I of the GATT. Its paramount importance to the GATT, it was argued, ruled out the possibility of granting preferential - and, as such, discriminatory - treatment in favour of developing countries.

The first two post-war decades would, however, witness a steady departure from the rigid application of GATT principles by many of their leading parties as well as a growing disbelief in its efficient operation in the sphere of North-South trade.

Firstly, the action of the major European countries would slowly undermine the sanctity of the non-discrimination principle. As most European countries grouped together in two weighty free-trading blocs - the European Customs Union of the EEC and the European Free Trade Association (EFTA)*. Moreover, old colonial empires reenacted quasi-mercantilist "special"

* Note that the formation of a free-trade zone, by eliminating tariff barriers on intra-bloc trade, places exporters outside the zone at a disadvantage relatively to suppliers within the zone, violating the non-discrimination principle.

trading subsystems - such as the British Commonwealth Preference Area and the French Union - or created closed preferential trading areas as in the Yaoundé Convention*, in a clear breach of the MFN clause. Secondly, in spite of the impressive results achieved in the successive multilateral trade negotiations (MTNs) until the mid-sixties, it became increasingly clear that, given the uneven distribution of trading power and the existing differences in the industrial structures of developed and underdeveloped GATT members, the operation of its liberal and formally equitable rules were provoking great distortions in the distribution of the benefits of trade liberalization, biasing the structure of protection in industrial countries against developing countries' exports.

Although the GATT's failure to positively respond to the trade needs of underdeveloped countries was identified as early as the late 'fifties and such problems formally placed in the GATT agenda in the early 'sixties, no significant practical changes ensued. The only noticeable change was the rather formal recognition of the possibility of special treatment for developing countries under a new Part IV (Trade and Development) of the GATT, inserted in 1965, including a so-called relative reciprocity principle (Article XXXVI, §8) whereby developing countries were allowed to benefit from tariff concessions negotiated by other parties even without making concessions of their own.

* The Convention was an outgrowth of an agreement of the EEC of six under the Treaty of Rome to establish closer economic ties with eighteen African countries with which Belgium, France, Italy and the Netherlands had special neo-colonial ties. The first preferential trade agreement was signed in 1963.

However, the debate on the trade problems of the Third World in the first half of the 'sixties were not confined to the GATT. Indeed, after the U.N. General Assembly's 1961 resolution to call a conference on international trade and development, the growing LDC disillusionment with the GATT's effectiveness slowly undermined its position as a forum for the discussion of North-South trade relations. Not surprisingly, when the first United Nations Conference on Trade and Development (UNCTAD) was held in 1964, the problem of trade preferences, among many others, reemerged in the shape of demands for a Generalized System of Preferences (GSP) to be extended by the industrial countries to all developing countries.

The advantages developing countries could derive from the GSP were twofold. Its immediate impact would be felt on the export earnings of a beneficiary country through the operation of static price advantages - caused by the tariff cut on its export products - increasing their competitiveness in the preference-giving country markets vis à vis domestic production and imports from third countries. By helping to overcome the limitations imposed on industrialization by the size of domestic markets in developing countries, their increased access to developed country markets was also expected to bring important dynamic advantages through the stimulus to faster productivity growth in the beneficiary countries. Although these long-run advantages are difficult to quantify, they provided an important argument for the concession of tariff preferences to developing countries.

Opposition to the GSP idea came at first mainly from the United States. The Americans, which had traditionally been in the forefront of the opposition to the concession of tariff preferences on the grounds that this would not justify a formal breach of GATT's non-discrimination principle, reinforced its traditional argument by adding that with the low OECD tariff levels to be achieved after the Kennedy Round, the gains from preferential treatment would be small. The real motives underlying the U.S. traditional negotiating position was, however, that a formal breach of the MFN clause would open the door for trade regionalization along bilaterally negotiated preferential lines, a trend which had the support of some European countries which envisaged to use the concession of tariff preference to former colonies to promote their own national objectives and was clearly detrimental to U.S. economic and political interests. Thus, when to increasing developing countries' pressure was added the growing threat of proliferation of regional preferential agreements on the lines of the "Mediterranean policy" of the EEC or the recently signed Yaoundé Convention, the Americans rapidly evolved towards accepting the GSP as a defensive stance*.

U.S. adherence to the GSP idea - the removal of the major stumbling block to the progress of the talks on trade preferences - was announced in April, 1967 and following that the pace of negotiations quickened. After unanimous agreement on the establishment of a GSP was reached at UNCTAD's 1968 New Delhi meeting, the OECD countries submitted their preference

* On this see T. Murray, Trade Preferences for Developing Countries. New York, 1977, pp. 14ff.

offers, and the required reform of Article I of the GATT took place in the form of a 10-year waiver of the MFN clause in June, 1971. In the next five years the various GSP schemes were established: by the EEC, Japan and Norway already in 1971; by Austria, Denmark, Finland, New Zealand, Sweden, Switzerland and the United Kingdom in 1972; by Canada in 1974 and, finally, by the United States in 1976. More recently, after the lapse of their first ten years of existence these systems have been renewed for periods ranging from eight and a half years - as in the case of the 1984 renewal of the U.S. scheme - to ten years, as was the case of most of the others.

2. The rise of the concept of "graduation" within the GSP

The idea of "graduation" of a beneficiary country product from preferential treatment previously granted to it under the GSP is not more than an outgrowth of the general trend towards protectionism in OECD countries since the early seventies prompted, to a large extent, by worries about the increasing competitiveness of manufacturing exports from semi-industrialized developing countries.

Ironically, however, the introduction of the concept of graduation of developing countries in the trade rules of the GATT took place during the Tokyo Round, which had as one of its two prominent objectives to bring "additional benefits for the international trade of the developing countries so as to achieve a substantial increase in their foreign exchange earnings,

the diversification of their exports, the acceleration of the growth of their trade... and a better balance between developing and developed countries in the sharing of the advantages resulting from this expansion..."*.

Developed country willingness to pursue these stated objectives during the MTNs was undoubtedly undermined by the rise of protectionist pressures due to the damaging impact of the first oil shock on their levels of investment and employment. However, their insistence upon the acceptance of the principle of graduation at the Tokyo Round can only be properly understood as a defensive reaction to the unprecedented pressures then put by developing countries to fulfill their long-standing demands for fundamental reforms in GATT rules. From the very outset of the negotiations, the LDCs - which were for the first time massively represented at GATT talks - pressed for the creation of a proper forum for discussions aimed at implementing the "improvements in the international framework for the conduct of world trade which might be desirable in the light of progress in the negotiations...", as proposed in paragraph 9 of the Tokyo Declaration. As a result, by the end of 1976, a special committee known as the Framework Group was created to work out the improvements to be made in the rules governing trade between developed countries - with special reference to differential and more favorable treatment - so as to bring them closer into line with the trade and development needs of the latter.

* Tokyo Ministerial Declaration, September 12-14, 1973, para 2.

The developing countries' major negotiating objective within the Group was to enlarge and make legally binding the rights to special and more favourable treatment achieved since the 'sixties. Of special importance in this connection were the improvements to be made in the GSP. Besides a general desire to increase its effectiveness* there was the specific intention to make perpetual and to place on a permanent legal basis the concessions granted under the GSP which, should be recalled, were accepted at the GATT as a 10-year waiver of the non-discrimination principle.

However, it was clear from the beginning of the negotiations that the industrial countries would not agree with the extension and legal formalization of differential treatment for LDCs within the GATT without a simultaneous commitment to "graduate" the beneficiaries of such treatment as long as improvement in their development and trade situation so permitted. In fact, with the benefit of hindsight it can be said that their main objective was to guarantee that the introduction of a legal framework to perpetuate non-reciprocal concessions would not prevent the possibility of excluding product-country pairs from the benefit of individual GSPs if necessary on protection-ist grounds, as had been the practice in the main GSP schemes.

* The main complaint in this connection was that a host of protectionist measures hindered the extension of preferential treatment to a large number of goods of great interest to LDCs in the actual implementation of the individual GSPs. In fact, in 1980 the GSP covered only 48.8 percent of total dutiable (on duty-free) OECD imports from developing beneficiary countries, whereas only 21.3 percent of these were in fact enjoying preferential tariff treatment.

The results of the Framework Group efforts, as embodied in the final GATT Decision on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" of November 28, 1979 - also known as the "Enabling Clause" - reflected, not unexpectedly, a compromise between those divergent interests.

Developing countries attained many of their objectives as, for instance, (i) the formal possibility of discriminatory concessions to developing countries*, (ii) the explicit revokation of the non-discrimination principle in relation to preferential tariff treatment under the GSP as well as to differential and more favourable treatment with respect to provisions concerning non-tariff measures,**and (iii) to sharpen the wording of the relative reciprocity clause of Part IV***.

* Paragraph 1 of the Decision reads: "Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties". Idem, p.5.

** Idem, p.5. The provisions are part of Paragraph 2 of the Decision.

*** This clause, now Paragraph 5 of the Framework Group Decision, reads: "The developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to trade of developing countries, i.e., the developed countries to not expect the developing countries, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs. Developed contracting parties shall therefore not seek, neither shall less-developed contracting parties be required to make, concessions that are inconsistent with the latter's development, financial and trade needs", Idem, p.6. Emphasis added.

However, industrial countries also achieved their defensive goal with the incorporation of a "graduation clause" in Paragraph 7 of the Decisions, according to which: "Less developed contracting parties expect that their capacity to make contributions or negotiated concessions or to take other mutually agreed action under the provisions and procedures of the General Agreement would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement". Although drafted in very general and non-operational terms, the clause certainly implied that less-developed-country status enjoyed by a contracting party to the GATT - and the ensuing differentiated and more favourable treatment enjoyed under the General Agreement - could be reviewed in the light of "the progressive development of their economies and improvement in their trade situation".

Not surprisingly, developing countries reacted strongly to the graduation clause* and, indeed, it is not difficult to demonstrate the weakness of the arguments put forward by the industrial countries to justify it in principle.

* The Group of 77 considered it as "an unilateral and arbitrary manner of discrimination among developing countries". UNCTAD V, Declaration of the Group of 77 on the Multilateral Trade Negotiations, Part II, n^o 5, Manila.

The clause was justified on two basic grounds: equity in the distribution of developed countries' non-reciprocal concessions among developing countries, and the preservation of basic liberal principles in the rules of the GATT.

It was argued that graduation is equitable because it guarantees that the benefits accruing from the GSP are increasingly concentrated in the more needy, "least-developed" countries among the LDCs. This argument has the strength of shifting the discussion of trade preferences to the framework of industrial country development assistance policy where the concept - as applied in the sphere of financial assistance - could claim at least a longer existence*. However, although even academics have questioned whether the "limited political tolerance to the instrument [of trade preferences] should be exhausted by its further liberalization if the primary beneficiaries of that liberalization will be relatively prosperous LDCs"**, it will be shown in Section 4.2, below, that this is a speculation without a trace of empirical evidence.

* The World Bank has since the 1970s come to the fore as the main proponent of the wholesale adoption in the financial sphere of a graduation policy based on a slightly qualified simple criterion of an income per capita threshold. Since 1982, with the world financial crisis, the stance was changed as the Bank had to step up their disbursements to cover the gap left by private finance. The Bank's Statement on Graduation, R 84-252, September 6, 1984 involves a much less significant shift of policy than is usually suggested. In spite of its inflation of qualifications one should expect that in the event of an improvement in international conditions, the emphasis on graduation will recur.

**W. Cline, N. Kawanabe, T.O.M. Krousjö and T. Williams; Trade Negotiations in the Tokyo Round: a quantitative assessment, The Brookings Institution, Washington, 1978, p.222. The authors go on to say that, instead, "the ideal policy probably would be to grant unrestricted preferential access only to a list of 'poorest' LDCs, such as those eligible for IDA lending". Idem.

In fact, as would be expected a priori given the concentration of GSP preferences on manufactured products, the lion's share of the gains from the contraction of exports of the larger, semi-industrialized, GSP beneficiaries caused by the withdrawal of tariff preferences would accrue to the GSP-donor country domestic producers and its other OECD suppliers.

It was argued that graduation is a guarantee of progressive trade liberalization in the GATT system because it prevents the consolidation of a two-tier system of world trade in which developing countries would have little incentive to contribute towards freer trade. In this connection, a standard argument presented by industrial countries was that perpetuation of the GSP consolidated a vested interest in developing countries and that multilaterally negotiated tariff reductions, since the latter evaded the preferential margins enjoyed under the GSP - which, of course, are directly related to the height of the MFN tariff then in force on GSP eligible products. Although these arguments are, in principle, undeniably correct, they are also an admirable instance of the use of liberal rethoric when it suits the interests of parties involved in trade negotiations. In practice one can hardly say that trade preferences for developing countries constitute an effective barrier to further liberalization of the multilateral trading system while other and infinitely greater distortions - such as the widespread barriers to trade in agricultural products and manufactures such as textiles and steel - designed to keep developing countries' exports off OECD markets are in force.

3. Graduation as applied in the major GSP schemes.

Although no instance of graduation of a less-developed party to the GATT is on record and, indeed, a concrete case has never been presented to the organization, the concept is not unheard of in the context of GSP programs. This section briefly reviews the basic characteristics of the US and EEC GSP schemes and their policy of graduation, officially defined by the Americans as "the discretionary removal from the GSP list of beneficiary countries on a product by product basis"* which has been systematically applied by these major donors since the early eighties.

Graduation in the US scheme.

Among the leading OECD countries it was the US which took longer to respond to the GATT waiver of a strict application of the MFN clause establishing the conditions for the creation of a Generalized System of Preferences, as mentioned in Section 1. It was only in 1976 that the American GSP scheme was implemented, following authority given to the President of the United States to do so under Title V of the Trade Act of 1974. The initial scheme, granting duty-free treatment for a list of eligible products and countries for a period of ten years, has been extended with small changes until mid-1993 in the recent US Trade Act, passed at the end of 1984.

* Office of the U.S. Trade Representative, A Guide to the U.S. Generalized Systems of Preferences (GSP), Washington, September 1984, p.5.

From the very beginning protectionist fears, limited the eligibility of a wide range of products as well as the extent that eligible products coming from particular countries might benefit from duty-free treatment in the American scheme. Besides a general GSP limitation of product coverage to industrial products and semi-manufactures, the US scheme explicitly exclude textile and apparel articles subject to textile trade arrangements, footwear, watches, and many items considered to be import-sensitive among electronic, steel and glass products.

Moreover, authority was granted to the President to enlarge the list of import-sensitive items in the context of the GSP and, since 1980, presidential power has been used to "graduate" product-country pairs from GSP eligibility*.

Limits to the extent that specific product-country pairs should benefit from the US GSP were defined in Section 504 of the 1974 Trade Act. The Act set "competitive need limits" to imports of each product from each beneficiary country, which, if reached, would make imports of that product from that source no longer eligible for duty-free treatment in the following year. In the original US scheme these limits stood at either 50% of total US imports of the product, or a dollar value yearly adjusted according to US GSP growth and which in 1984 stood at 63.8 million dollars.

* The policy of discretionary graduation was announced in USTC (1980).

Fears that substantial restrictive changes concerning country and product eligibility would be introduced by the US legislative in the course of the 1984 revision of GSP rules were falsified. Although the law did suffer several modifications*, the significant change introduced in the recent renewal of the American scheme under Title V of the 1984 Trade Act was that aimed at transforming it from an unilateral and non-reciprocal offer into an instrument apt to be used to extract reciprocal concessions in trade negotiations with the larger beneficiaries - the so-called "new negotiability" introduced in the US GSP. This reflects the broader trend towards "reciprocity" as a new approach in US trade policy-making that basically seeks to achieve bilateral reciprocity in levels of protection and over a certain range of products.

The main recent changes in this direction were two-fold. Firstly, power was given to the President of the US to waive competitive need limits on specific products altogether. Secondly, Section 504 of the Trade Act establishes as Executive responsibility the undertaking of periodical general reviews of GSP exports from each beneficiary country - the first to be completed not later than January 4, 1987 - aimed at identifying those products in which the beneficiary has demonstrated a "sufficient degree of competitiveness" so that, in relation to those products competitive need limits should be halved.

* As, for instance, the introduction of an upper limit of US\$8,500 for country eligibility, a limit not likely, however, to be reached by any Latin American or Caribbean country in the near future.

Criteria for gauging the beneficiaries "degree of competitiveness" were not elaborated in the 1984 Trade Act, but have since then been put forward by the Office of the US Trade Representative*. In addition to reaffirming the loose rules which allegedly guided GSP discretionary graduation to date, emphasis will be given to the extent to which the beneficiary has assured Americans of equitable treatment in matters relating to intellectual property right, eliminated distortions in the treatment of foreign direct investment and has taken steps to liberalize trade in areas of specific export interest to the US such as services.

Graduation in the EEC scheme

EEC's GSP scheme was in operation by 1971. In 1980 it was renewed until 1990. Fundamental principles are full tariff exemption for most beneficiaries' exports of semi-manufactures and manufactures under various pre-conditions and within certain product-specific and country-specific annually fixed limits; full or partial duty exemption for processed agricultural products under similar restrictions.

Although for cotton and textiles coverage is limited to signatories to the Multifibre Arrangement (MFA) almost all manufactures and semi-manufactures are included in the scheme, whereas the number of processed agricultural products included has increased significantly in the past,

* See Federal Register, vol. 50, n° 31, 14 February 1985, pp. 629ff.

especially in order to compensate certain Asian countries for their loss of Commonwealth preferences in 1978. ACP and Mediterranean countries can opt out for the most favourable preferential agreement (either Lomé or GSP; either their specific agreement or GSP, respectively).

Besides, a general escape clause for processed agricultural products a ceiling is annually established for each GSP item on the basis of past trade flows. Imports exceeding ceilings may face MFN treatment depending on how a product is classified as non-sensitive, semi-sensitive (now only valid for textiles) or sensitive.

For non-sensitive products ceilings are irrelevant as imports do not threaten domestic production and employment. Previously to 1981, the semi-sensitive category included borderline items expected to disrupt the domestic market and so kept under permanent surveillance. Now it is restricted to textiles, as most formerly semi-sensitive products became sensitive. There is an effective tariff quota on imports which exceed ceilings in the case of sensitive products and these imports automatically face MFN duty.

There are further limitations to sensitive products. The tariff quota for each item is divided into fixed EEC member state quotas a system which imposes additional costs on triangular GSP imports. Moreover, a maximum amount rule applies to avoid the crowding out of smaller countries by the larger beneficiaries: the so-called butoirs limiting the share of any specific country, range from 15% to 50% (for non-sensitive products).

Since the 1981 revision tariff quotas and butoirs have been combined in a new sub-category of "very sensitive" items where some competitive developing countries have been granted individual identical tariff quotas not as a share of imports but in absolute amounts. These are in turn also divided into member quotas. Other GSP suppliers of very sensitive products face facultative ceilings, so do all GSP beneficiaries in another sub-category of less sensitive items. In both cases tariffs can be reimposed at the request of member states as in fact, has been done on several occasions.

Graduation in the EEC, or in what is called in EEC's jargon différenciation, is likely to be stepped up considerably in the near future as the revision of the working of its GSP scheme produced by the Commission makes clear*. There is indeed clear dissatisfaction with what is considered the limited range of protection afforded by the present criteria to establish butoirs. The Commission, while making the usual and rather formal provisos concerning the graduation criteria requirements (objectivity, coherence and equity) has been suggesting as thresholds disqualifying a given beneficiary exports either 20% of EEC's imports or ten times the GSP butoir, always taking into account the general level of development of the country as measured by GNP per capita.

* Commission des Communautés Européennes, Revision du Schéma de Préférences Tarifaires Généralisées de la Communauté Européenne, COM (85), 203 final, Brussels, 1985, pp. 3 and 4.

4. A critical view of GSP graduation

Criticism of graduation in general and as applied by the major GSP donor countries can be made both on a priori and on empirical grounds.

4.1. A priori criticisms of the graduation concept

The main a priori criticisms levelled against graduation relate either to its unilateral imposition by developed countries reflecting a dangerous tendency to substitute a narrow bilateralist approach for the multilateral framework in which special treatment to developing countries was traditionally considered, or to the arbitrary division affecting specific developing countries resulting from the limitations of applying a single criterion such as GNP per head as a graduation threshold.

Graduation as an unilateral concept

Although no formal procedure exists in the rules of the GATT for the outright graduation of less-developed contracting party, such a decision should, of course, involve collective deliberation. Even the withdrawal of the differentiated and more favourable treatment granted by a contracting party under the Enabling Clause can only be done after consultations involving - if so requested by an interested party - all contracting parties.

Nevertheless, as described in the preceding section, since 1981 the U.S. and other major GSP-donor countries have established directive for the "graduation" of product-country pairs from the list of GSP - eligible products. This is done on an entirely unilateral basis on the grounds that the GSP is an unilateral concession, involving no contractual obligation on the part of the preference-giving country. It can be argued, however, that "graduation", thus understood, is just a different label for neo-protectionist "safeguards" against "market disruption" by "excessively competitive" imports, and one more instance of the erosion of the multilateral trading system by narrow bilateral defensive actions taken by the industrial countries.

While developed countries have stressed that their support of graduating policies is related to broader, global, considerations such as the need to reserve resources for those countries which need them most, it is becoming increasingly clear that such stances can be much better explained by self-interest than by equity arguments.

Graduation as an arbitrary concept

Criticisms of the lack of flexibility of the graduation concept or of its lack of symmetry have never been adequately met. Why is there a single threshold? Why an all or nothing procedure and not a gradual one? The crux of the matter is the resistance by countries recently graduated or on the brink of graduation to consider fair that they should be

treated as part of a homogeneous group together with the super-rich in the name of a policy based on stressing their heterogeneity in relation to other developing countries.

Criticisms are not restricted to the "theoretical" concept of graduation but apply also to the difficulties of defining an adequate trigger point variable so as to make the concept operational. The GNP per capita criterion has several limitations. Given the same level of GNP per head different countries can show considerable heterogeneity; some countries in the graduation fringe present economic and social indicators which are akin to those of other developing countries not menaced with the prospect of graduation, especially income distribution.

In the case of trade preferences, the application of a single GDP per head threshold is even more objectionable. In this case most pro-graduation arguments relate to the degree of competitiveness in certain product lines. This, however, can provide little consolation for those willing to produce an objective criteria of graduation since there is as yet no objective definition of "competitive need" or "market disruption" which does not resort to some kind of protectionist argument.

4.2. Loss of trade implied by US GSP graduation to its major Latin American beneficiaries

Many of the arguments frequently put forward by donor countries as a justification for GSP graduation are, however, of an empirical nature. The most popular are:

- (i) that losses entailed by graduation are small, and
- (ii) that graduation of the larger, relatively more developed, beneficiaries would produce a more equitable distribution of GSP benefits by increasing the participation of imports from the least developed countries under the scheme.

To discuss these empirical points, the losses entailed by graduation from the US GSP of the 50 most important eligible products from Brazil and Mexico (the two leading beneficiaries) were calculated together with an estimate of the distribution of these losses among beneficiary and non-beneficiary countries.

These losses were estimated by applying traditional ex-ante methodology to 1984 trade flows to calculate the sum of the "trade contraction" and "trade diversion" effects caused by the abolition of preferential treatment. The trade contraction effect - i.e., the losses incurred by substitution of domestic US production for imports of the graduated product-country pair - can be calculated for the products of a beneficiary country as:

$$TC_i = M_i^O \cdot E_i \cdot t_i$$

where:

M_i^O - level of effective product i imports under the GSP in 1984.

E_i - US price elasticity of imports of product i

t - US ad-valorem MFN tariff on product i.

The trade diversion effect - i.e., the substitution of imports from third sources for imports of the graduated product-country pair in the US market - can be estimated as*:

$$TD_i = TC_i \cdot k_i$$

where:

TC_i - trade contraction effect of product i graduation

k_i - ratio between US product i imports not originated in the beneficiary country and US domestic output of product i.

The distribution of the losses of a beneficiary's graduation among other GSP beneficiaries and non-beneficiaries was estimated assuming that losses from the graduation of a particular product would be shared by other beneficiaries and non-beneficiaries according to their current shares in the US import market of this product.

* This is a way of calculating trade diversion effects without resorting to cross (substitution) elasticities of demand for imports from different sources. It can be done under the assumption that substitutability between donor domestic production and beneficiary country imports is the same as that between the former and imports from third sources. On this see Baldwin, R. and T. Murray, MFN Tariff Reduction and Developing Countries: trade benefits under the GSP, in The Economic Journal, March 1977.

Disaggregated results of the calculations of trade losses and its geographical distribution - the latter only for the case of Brazil - are presented in Appendix A. Estimates of the trade losses are summarized in Table 1, below:

Table 1
Losses of US GSP graduation to Brazil and Mexico

	Trade Contraction	Trade Diversion	Total Trade Loss
<u>Brazil</u>			
Total dollar loss (in US\$ millions)	77.0	5.5	82.5
Loss as proportion of exports of graduated product to US (%)	9.15	0,65	9.80
Loss as proportion of total exports to the US (%)	1.00	0.07	1.07
<u>Mexico</u>			
Total dollar loss (in US\$ millions)	141.3	10.7	152.0
Loss as proportion of exports of graduated product to US (%)	22.13	1.80	23.93
Loss as proportion of total exports to the US (%)	0.98	0.08	1.06

Source: Appendix A tables.

Inspection of the results presented in Table 1 shows that, although - reflecting the limited product coverage of the GSP - trade losses would be relatively small as a proportion of total beneficiary country exports to the US, they would represent a significant contraction of the exports of the graduated products themselves. In some cases, as can be seen in Tables A.1 to A.4 in Appendix A, the losses could be very substantial: products which would have their exports curtailed

by over 10% would number 16 in the case of Brazil and 27 in the case of Mexico. In the light of these results the argument that trade losses are not substantial seem to be ill-founded.

Finally, the figures presented in Table A.5 help to gauge the regional distribution of these trade losses. It can be seen that although in a very few cases most of the losses to be inflicted upon Brazil from US GSP graduation would accrue as gains to other beneficiaries, for the average of the 50 products included in the sample not less than 89.6% will revert to non-GSP beneficiaries. If one considers that of the residual 10.4% accruing to other beneficiaries the lion's share will most probably go for the more advanced among them, the argument that large beneficiaries' graduation will produce a diversion of GSP benefits to the least developed countries also seem to be ill-founded.

APPENDIX A

The estimates presented in Tables A.1 to A.5, below, were based on the following sources:

- . GSP trade data and MFN tariffs from the OAS and USTR data banks. Where ad-valorem duties did not apply, ad-valorem equivalents were calculated from US Department of Commerce, FT246-US Imports for Consumption and General Imports TSUSA Commodity and Country, USGPO, 1984.
- . Price elasticities at the ISIC 3-digit level were taken from Stern, R. et alii, Price Elasticities in International Trade, OUP, 1975.
- . Import penetration ratios were calculated using US trade and output data presented in the UN Yearbook of International Trade Statistics and the UN Yearbook of Industrial Statistics, respectively.

A list of the descriptions of the corresponding TSUS items is presented after Table A.5.

Table A.1
Brazil
Trade Contraction Effect Stemming from Loss of the US GSP
(50 leading eligible products in 1984)

TSUS Class.	Imports under the GSP (US\$)	Elasticity	Ad-valorem tariff	Trade Contraction	
				US\$	% of imports
12161	29353935	1.58	5	-2318960.9	7.90
15540	4803265	1.13	0.28	-15197.5	0.32
15630	8256898	1.13	5	-466514.7	5.65
15640	32344793	1.13	0.63	-230262.6	0.71
15710	8454134	1.13	7	-668722.0	7.91
17614	28038826	2.53	2.79	-1979176.6	7.06
24530	5403230	0.69	10.5	-391464.0	7.25
25275	27179424	0.55	3.8	-568050.0	2.09
25630	8428528	0.55	4.7	-217877.4	2.59
40716	19505614	2.53	23.76	-11725370.7	60.11
40822	6943842	2.53	16.28	-2860057.4	41.19
40823	4775083	2.53	13.5	-1630929.6	34.15
40872	8629503	2.53	10.55	-2303343.8	26.69
42300	6759012	2.53	4.2	-718212.6	10.63
42834	8953635	2.53	12.6	-2854239.8	31.88
42896	12315860	2.53	7	-2181138.8	17.71
44530	8682109	2.53	13.1	-2877511.4	33.14
44546	12373004	2.53	10.1	-3161673.7	25.55
52039	26142374	2.06	2.3	-1238625.7	4.74
61231	6114323	1.38	1.2	-101253.2	1.66
61239	14908892	1.38	1.3	-267465.5	1.79
61262	16937202	3.59	2.4	-1459309.3	8.62
61802	48851928	1.38	0.42	-283145.8	0.58
61806	19519918	1.38	0.12	-32325.0	0.17
61815	11110504	1.38	2.7	-413977.4	3.73
61825	12210795	3.59	3	-1315102.6	10.77
64030	13352988	3.59	1.9	-910807.3	6.82
64409	5619106	1.38	7.4	-573823.1	10.21
64943	5477199	1.02	10.1	-564261.0	10.30
66067	56669575	1.02	3.4	-1965300.9	3.47
66071	59692547	1.02	4.2	-2557228.7	4.28
66092	6185441	1.02	2.7	-170347.0	2.75
66097	6634942	1.02	3.8	-257170.4	3.88
66109	19136756	1.00	3.8	-727196.7	3.80
66110	9297617	1.00	3.8	-353309.4	3.80
66210	5722284	1.02	4	-233469.2	4.08
66408	28624661	1.02	3.4	-992703.2	3.47
66410	6065311	1.02	3.1	-191785.1	3.16
67216	7023317	1.00	4.2	-294979.3	4.20
67850	21173585	1.02	4.2	-907076.4	4.28
68360	8054469	1.00	3.4	-273851.9	3.40
68415	18407692	1.00	10.6	-1951215.4	10.60
68590	21408562	1.00	6.5	-1391556.5	6.50
68804	8018992	1.00	5.3	-425006.6	5.30
72330	19427550	1.08	4.2	-881233.7	4.54
72735	7961936	3.00	3.4	-812117.5	10.20
77143	7160338	2.53	4.9	-887667.1	12.40
77251	72672643	5.26	4	-15290324.1	21.04
77455	10078480	1.02	6.5	-668203.2	6.63
79127	21095494	1.58	4.4	-1466558.7	6.95
Total trade contraction				-77027100.6	9.15

Table A.2

Brazil
Trade Diversion Effect Stemming from Loss of the US GSP
(50 leading eligible products in 1984)

TSUS Class	Import Penetration Ratio (%)	Trade Diversion (US\$)
77251	0.09	1376129.2
66071	0.08	204578.3
66067	0.08	157224.1
61802	0.04	11325.8
15640	0.07	16118.4
12161	0.25	579740.2
66408	0.08	79416.3
17614	0.04	79167.1
25275	0.05	28402.5
52039	0.25	309656.4
68590	0.13	180902.3
67850	0.08	72566.1
79127	0.25	366639.7
61806	0.04	1293.0
40716	0.04	227795.9
72330	0.11	96935.7
66109	0.13	94535.6
68415	0.13	253658.0
61262	0.04	58372.4
61239	0.04	10698.6
64030	0.04	36432.3
44546	0.04	126466.9
42896	0.04	87245.6
61825	0.04	52604.1
61815	0.04	16559.1
77455	0.08	53456.3
66110	0.13	45930.2
42834	0.04	114169.6
44530	0.04	115100.5
40872	0.04	11003.7
15710	0.07	46810.5
25630	0.05	10893.9
15630	0.07	32656.0
68360	0.13	35600.7
68804	0.13	55250.9
73735	0.04	32484.7
77143	0.03	26630.0
67216	0.13	38347.3
40822	0.04	114402.3
42300	0.04	28728.5
66097	0.08	20573.6
66092	0.08	13627.8
61231	0.04	4050.1
66410	0.08	15342.8
66210	0.08	18677.5
64409	0.04	22952.9
64743	0.08	45140.9
24530	0.07	27402.5
15540	0.07	0.0
40823	0.04	65237.2
TOTAL		5518933.9

Mexico
Trade Contraction Effect Stemming from Loss of the US GSP
(50 leading eligible products in 1984)

TSUS Class.	Imports under the GSP (US\$)	Elasticity	Ad-valorem tariff	Trade Contraction	
				US\$	% of imports
13530	5412	1.13	10.20	-623,7871	11.53
15540	6592	1.13	0.27	-20,11219	0.31
16898	9981	1.64	15.75	-2578,092	25.83
16932	28900	1.64	33.31	-15787,60	54.63
17070	5719	1.13	na	na	na
18220	5544	1.13	1.10	-68,91192	1.24
18305	6409	1.13	10.00	-724,217	11.30
20700	5596	1.69	6.20	-586,3488	10.48
24550	9553	1.69	6.30	-1017,107	10.65
25275	20856	1.55	3.80	-1228,418	5.89
40716	100348	2.53	27.57	-69994,83	69.75
40884	5519	2.53	10.91	-1523,370	27.60
40930	5440	2.53	11.30	-1555,241	28.59
41718	8477	1.38	1.50	-175,4739	2.07
42094	22487	1.38	1.10	-341,3526	1.52
43757	7361	2.53	3.90	-726,3098	9.87
44546	22402	2.53	10.10	-5724,383	25.55
47085	6953	2.53	3.40	-598,0970	8.60
47376	13119	2.53	0.60	-199,1464	1.52
54431	20517	1.6	8.00	-2626,176	12.80
54441	24754	1.6	6.80	-2693,235	10.88
54525	10573	1.6	1.12	-189,4681	1.79
60628	7540	1.42	1.40	-149,8952	1.99
61203	8469	1.38	1.20	-140,2466	1.66
61302	5960	1.38	2.00	-164,496	2.76
64943	7287	1.02	10.10	-750,7067	10.30
65725	5775	1.42	7.10	-582,2355	10.08
66042	8175	3.28	4.20	-1126,188	13.78
66086	28239	3.28	1.50	-1389,358	4.92
66067	13716	3.28	3.40	-1529,608	11.15
66120	11506	1	3.40	-391,204	3.40
66408	7154	1.02	3.10	-226,2094	3.16
68017	6210	3.28	9.50	-1935,036	31.16
68205	5681	1	8.80	-499,928	8.80
68207	5380	1	3.80	-204,44	3.80
68307	7846	1	6.50	-509,99	6.50
68415	10953	1	10.60	-1161,018	10.60
68529	10248	1	6.00	-614,88	6.00
68804	11049	2.6	5.30	-1522,552	13.78
72315	10338	1.08	4.20	-468,9316	4.54
72445	5478	2.06	4.90	-552,9493	10.09
72735	19415	3	3.40	-1980,33	10.20
72770	16501	3	6.30	-3118,689	18.90
73486	5636	2.06	4.50	-522,4572	9.27
73780	10369	2.06	13.80	-2947,699	28.43
73795	12053	2.06	10.90	-2706,380	22.45
77220	5719	2.53	4.70	-680,0462	11.89
77251	23234	5.26	4.00	-4888,433	21.04
77325	10438	2.53	4.10	-1082,733	10.37
77455	5852	1.38	6.50	-524,9244	8.97
Total trade contraction				-141353.2	22.13

MexicoTrade Diversion Effect Stemming from Loss of the US GSP
(50 leading eligible products in 1984)

TSUS Class	Import Penetration Ratio (%)	Trade Diversion (US\$)
13530	0.07	43.7
15540	0.07	1.4
16898	0.08	206.2
16932	0.08	1263.0
17070	0.06	na
18220	0.07	4.8
18305	0.07	43.7
20700	0.07	41.0
24550	0.07	71.2
25275	0.05	61.4
40716	0.04	2799.8
40884	0.04	60.9
40930	0.04	62.2
41718	0.04	7.0
42094	0.04	13.7
43757	0.04	29.1
44546	0.04	229.0
47085	0.04	23.9
47376	0.04	8.0
54431	0.25	656.5
54441	0.25	673.3
54525	0.25	47.4
60628	0.14	21.0
61203	0.04	5.6
61302	0.04	6.6
64943	0.08	60.1
65725	0.14	81.5
66042	0.15	168.9
66056	0.15	208.4
66067	0.15	229.4
66120	0.13	50.9
66408	0.08	18.1
68017	0.15	290.3
68205	0.13	65.0
68207	0.13	26.6
68307	0.13	66.3
68415	0.13	150.9
68529	0.13	79.9
68804	0.25	380.6
72315	0.11	51.6
72445	0.25	138.2
72735	0.04	79.2
72770	0.04	124.7
73486	0.25	130.6
73780	0.25	736.9
73795	0.25	676.6
77220	0.03	20.4
77251	0.09	440.0
77325	0.03	32.5
77435	0.04	21.0
TOTAL		10709.10

Table A.5

Brazil

Distribution of the Trade Diversion Effect of the Loss of
US GSP among other GSP beneficiaries and non-beneficiaries
(50 leading eligible products in 1984)

TSUS Class.	Share (in %) accruing to		Total US imports (thousand US\$)
	Beneficiaries	Non-Beneficiaries	
12161	31.76	68.24	172890628
15540	75.78	24.22	94029551
15630	19.03	80.97	72830094
15640	45.08	54.92	138983504
15710	12.21	87.79	222181659
17614	94.65	5.35	42696681
24530	62.62	37.38	8750210
25275	43.43	56.57	110274725
25630	32.12	67.88	45750708
40716	68.29	31.71	176384000
40822	22.65	77.35	34927000
40823	0.55	99.45	93960000
40872	30.85	69.15	43755324
42300	9.34	90.66	93992076
42834	0.17	99.83	38743680
42896	0.00	100.00	14477038
44530	31.34	68.66	86566830
44546	45.16	54.84	89357533
52039	58.60	41.40	83498711
61231	7.86	92.14	65628663
61239	14.31	85.69	174894577
61262	51.18	48.82	48161706
61802	9.05	90.95	645027086
61806	10.03	89.97	644930441
61815	79.04	20.96	78096404
61825	9.46	90.54	922891591
64030	20.55	79.45	105945804
64409	18.48	81.52	30956188
64943	29.89	70.11	148314510
66067	6.94	93.06	466510294
66071	10.19	89.81	658115258
66092	6.36	93.64	120734348
66097	6.27	93.73	412313040
66109	0.22	99.78	179103482
66110	7.69	92.31	386965473
66210	5.21	94.79	117804672
66408	2.71	97.29	907595447
66410	4.21	95.79	661308699
67216	0.30	99.70	162347044
67850	1.79	98.21	2724825227
68360	6.69	93.31	302694107
68415	39.78	60.22	66116631
68590	0.09	99.91	1832322789
68804	18.73	81.27	154748770
72330	0.97	99.03	254215434
72735	15.47	84.53	784482085
77143	7.20	92.80	443584828
77251	5.22	94.78	1704632744
77455	25.41	74.59	662330820
79127	93.84	6.16	133638202
TOTAL	10.42	89.58	

List of eligible products included in calculations presented
in Tables A.1 to A.5

TSUS ITEM	DESCRIPTION
10748	Corned beef in airtight containers
11035	Fish nes, frsh chld or frzn, whole or beheaded etc nt scaled
11240	Anchovies, prep or pres, nt in oil, in airtight containers
12125	Upholstery leather
12130	Calf and kip upper leather
12135	Calf and kip lining leather
12156	Reptilian leather
12165	Fancy leather nspf
12460	Plates, mats, linings, strips, etc, of furskins, died, dressd
13037	Corn or maize nes, except certified seed
13040	Grain sorghum
13630	Garlic, fresh, chilled or frozen
14612	Apples, dried
15520	Sugar, sirup, molasses principal crystalline or dry amorphous form
15710	Candy and other confectionery nspf
18220	Biscuits, cake, wafers, simlr baked products and puddings, nes
18296	Wheat gluten
18305	Other edible preparations nes
24520	Hardboard, n/face-finished ov \$96.66-2/3 STN
30706	Wool noils not advanced
40216	Styrene
40716	Mixtures in whole or part of industrial organic chemicals nspf
40822	Herbicides provided for in the chemical appendix to tsus
40868	Polyester resins, saturated
42806	Propyl alcohol
43732	Antibiotics nspf
43930	Natural drugs, advanced
44530	Polyethylene resins
60637	Ferrosilicon, over 60% not over 80% silicon, nes
61262	Brass rods, wrought
61802	Unwrought aluminum, n.e.s., other than alloys of aluminum
61806	Unwrought alloys of aluminum, except aluminum silicon
61815	Wrought rods of aluminum

TSUS ITEM	DESCRIPTION
61825	Bars, plates, sheets and strip of aluminum, not clad
63242	Silicon containing not over 99.7 percent of silicon
64030	Drums flasks etc nes
64943	Cutting tools with cutting part containing dutiable alloys
66092	Fuel injection pumps for comp-ignition engines and parts
66408	Earth-moving and mining machinery, nes
66625	Industrial machinery fr prepar a manufacturing food/drink a part
67435	Metal-working machine tool, nes
68017	Taps, cocks, valves, etc, hand operated and check, a pts, of iron or steel
68241	Electric motors of 1 or more but not over 20 horsepower
69232	Motor vehicle body pts-other than cast iron, nes
72315	Film other than motion-picture film, sensitized
77005	Laminated plastics, plates or sheets
77220	Containers for packing etc merchandise, rubber or plastics
79119	Fur articles nspf, of fur skins nes
79160	Belts and buckles, leather, to be worn on the person
79190	Leather articles nspf except of reptile leather
13530	Cabbage, fresh, chilled or frozen
15540	Sugar, sirup, molasses, etc. Derived from sugar cane/beet inedible
16898	Cordials, liqueurs, kirschwasser, and ratafia, contr ov 1 gal
16932	Tequila, in containers each holding over 1 gallon
17070	Cigars, each valued 23 ¢ or more
20700	Articles nspf, of wood
25257	Cover paper not impregnated coated or embossed, etc
40884	Polystyrene resins, nspf
40930	Benzenoid detergents, wetting agents, emulsifiers, etc
41718	Aluminum compounds, nspf
42094	Sodium chloride or salt in bulk
43757	Hormones, synthetic nspf
44546	Polyvinyl chloride resins
47085	Vegetable color and tanning products nspf, not crude etc
47376	Zinc oxide dry, no lead
54431	Toughened glass made of any glass described in items 541.11
54441	Laminated glass, whether or not shaped or framed or both

TSUS ITEM	DESCRIPTION
54525	Glass containers, nes, over 1/4 pint not over 1 pint
60628	Ferromanganese containing over 1% but not over 4% carbon
61203	Unwrought black copper, blister copper, and anode copper
61302	Copper tubes a tubing, seamless not alloyed
65725	Iron or steel articles nes not precious metal plated
66042	Piston-type compression-ignition engines
66056	Piston-type int combustion eng other than compression-ignition eng, nes
66120	Air-conditioning machines and parts
68205	Transformers of less than 1 kva
68207	Transformers rated 1 kva or more
68307	Lead-acid types storage batteries, nspf; parts
68415	Electric flatirons, nes
68529	Other radio-telegraphic etc equip parts nes exc cb transceivers
68804	Insulated elect conductors, w/o fittings, over 10% copper
71315	Parts of meters
72445	Magnetic recording media, no material recorded thereon
72735	Furniture, wood nspf
72770	Other furniture nes
73486	Lawn tennis rackets not strung
73780	Toys nspf, having a spring mechanism
73795	Toys & parts of toys nspf exc kites or toys with a spring mechanism
77325	Gaskets, of rubber or plastics
77455	Articles of rubber or plastics nspf
77251	Pneumatic tires, nes
66071	Parts of internal combustion engines, nes
66067	Parts of piston-type engines except compression-ignition eng
15640	Cocoa unsweeten and cocoa cake suitable for reduction to cocoa powder
12161	Bovine leather
17614	Castor oil valued ov 20 cts/lb having lovibon color values greater than 6 yellow and 0.6 red
25275	Writing paper n/impregnated etc over 18 lb per ream
52039	Precious and semiprecious stones, cut, not set, for jewelry nes

TSUS ITEM	DESCRIPTION
68590	Switchboards panels, etc for makg connectg o brkg circuit
67850	Machines, not specially provided for, and parts
79127	Leather uppers for footwear
72330	Photographic silver halide papers, sensitized not exposed
66109	Refrigeration and air-conditoning compressors, 1/4 hp and under
61239	Brass sheets, plates and strips not shaped, nes
42896	Ethers of monohydric alcohols nspf
66110	Compressors nspf: parts of compressors
42834	Ethylene glycol
40872	Abs Resins
25630	Paper and paperboard cut to size or shape, nspf
15630	Chocolate, sweetened, except bars and blocks 10 lbs or more
68360	Ign magnetos, coils a othr elec start a ign equipment a pts
77143	Film, strip, a sheet, flexible a unsupportd, n cellulose c
67216	Sewing machines, nes, over \$10
42300	Other inorganic compounds, nes
66097	Other submersible pumps a pumps and liquid elevators nes
61231	Bars, sheets a strip in coils of copper not cut, pressed, etc
66210	Machines for packaging pipe tobacco, wrapping candy etc and parts
64409	Alum foil not backed or cut nov.00035 in tk ov 55c lb
24530	Hardboard, face finished exc oil treatd but not furthr fnshd
40823	Herbicides not artificially mixed, nspf, derived from benzenoid chemicals
66410	Elevator, hoist, winches, etc and conveyors and parts nspf

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