United States and European Union Preference Programs Are Extensive

The nonreciprocal preferential trade programs operated by the United States and European Union differ in structure and detail, but have many features in common and have tended to evolve over time in similar ways. Both countries have increased the number of products covered by their programs, particularly products exported by the poorest countries. While U.S. programs offer duty-free access to all eligible products, EU programs offer duty-free access to some products while simply reducing tariffs on others. Both countries tend to exclude import-sensitive products from these programs or include some of the products but effectively limit the quantity imported, through a variety of policies and regulations. They both have revised their rules of origin—program restrictions that specify where and how goods can be produced in order to qualify for preferences—by giving recipient countries more leeway to use inputs from multiple countries to produce their exports.

U.S. Preferential Trading Programs

Nonreciprocal preference programs are tools designed to promote economic growth in the developing world by providing enhanced trading relationships with the United States. The U.S. GSP program, established under the Trade Act of 1974, became operational on January 1, 1976. Additional nonreciprocal trade preference programs were implemented in 1983, through the Caribbean Basin Economic Recovery Act (CBERA) and in 1991, through the Andean Trade Preference Act (ATPA). In 2000, the United States extended nonreciprocal preferences to the majority of the Sub-Saharan African countries through the African Growth and Opportunity Act (AGOA). Through these various programs, the United States offered selected nonreciprocal trade preferences to 151 countries and territories in 2002. All products eligible to be imported at preferential rates under these programs enter duty-free.

Generalized System of Preferences

The GSP program is the largest in terms of country eligibility. In 2002, 147 countries were eligible for tariff preferences under the GSP. Even though the preferences under the GSP represent a unilateral, nonreciprocal granting of benefits, potential recipients have to comply with certain requirements to remain eligible to participate in the program. In general, participating countries agree to offer reasonable access to U.S. goods and services, protect intellectual property rights, reduce trade-distorting investment policies, eliminate trade-distorting export practices, and ensure internationally recognized worker rights (USTR, 1999).

Country eligibility is constantly under review and, as a result, the number of participating countries has fluctuated over time. Country participation is affected primarily by "graduation" out of the program, but countries have also been removed for not meeting program qualifications. When a country's per capita GNP exceeds the threshold level of income set for high-income countries by the World Bank, it automatically loses its eligibility under the program. Since the program's inception, numerous countries, including South Korea, Taiwan, Singapore, Hong Kong, Malaysia, Bahrain, Bermuda, and Brunei, have been graduated out of the program under this standard.

Countries also can lose their eligibility, at the discretion of the U.S. President, for reasons such as disrupting the world economy or negatively impacting U.S. commerce (U.S. Government, 2004). Iran, Burma, and Cuba are not extended preferences under U.S. programs for political reasons.

Another type of "graduation" occurs when one or more products of a beneficiary country lose GSP eligibility as a result of exceeding "competitive need limits" (CNL). As the main restriction in the GSP other than the noneligibility of certain products, CNLs provide a safeguard mechanism designed to prevent the extension of preferential treatment to countries that are considered competitive in the production of an item. Ceilings are set for each product and country, and with certain qualifications, a country automatically loses its eligibility for a given product the year following that in which the ceiling is surpassed.

In the 1984 re-authorization of the GSP program, the CNL was modified and the ceilings split into an upper and lower level. At the upper level, a beneficiary country loses GSP eligibility for a product if its exports exceed 50 percent of total U.S. imports of that product, or if the imports exceed a flat amount ($105 million in 2002, scheduled to increase by $5 million each year after that). At the lower level, if it is determined that a particular product from a given country is "sufficiently competitive," then the product is limited to 25 percent of U.S. imports, or a flat amount (40 percent of the upper CNL dollar value, $42 million in 2002). There are four ways countries may receive a waiver from these rules:

- Submit a petition.
- Fall in the least developed income group.
- Show the product is not produced in the U.S.
- Show that import values are relatively small (defined as less than $17 million in 2002).

Duty-free treatment under the GSP is more extensive for manufactured products than for agricultural products. Product coverage has varied over time, but relative to other U.S. preferential programs, the GSP has the least extensive coverage. The products that are prohibited by law from receiving GSP treatment include most textiles, watches, footwear, handbags, luggage, work gloves, and other apparel made partially or wholly from leather (U.S. Government, 2004). Any other products determined to be import-sensitive are not eligible for the GSP, e.g., steel, glass, and electronic components. Agricultural products subject to tariff-rate quotas (beef, peanuts, tobacco, and sugar and dairy products) are ineligible for any amounts in excess of the in-quota country/quantity.

In 1997, the GSP underwent a reform that included improved market access for the Least Developed Countries (LDCs). Since GSP treatment in the United States was already duty-free, special treatment for LDCs involved providing additional product coverage. Under a special GSP/LDC program, selected LDCs were granted duty-free treatment on an additional 1,783 tariff lines. In 2003, 41 countries were eligible for expanded benefits under the U.S. GSP/LDC program. In agriculture, many horticultural products (certain fruits and vegetables, cut flowers, and citrus juices) and fibers (cotton, flax, wool, and cashmere) are still excluded from duty-free treatment under this program.

Caribbean Basin Economic Recovery Act

The Caribbean Basin Economic Recovery Act of 1983 is the trade-related component of the Caribbean Basin Initiative (CBI). CBERA is intended to facilitate the economic development and export diversification of the Caribbean Basin economies. As with the GSP, CBERA benefits are conditioned on compliance with a set of eligibility criteria (USTR, 2001). In addition to meeting these criteria, countries must express a desire to be designated as a beneficiary under the program. Twenty-eight countries are potentially eligible to receive benefits under the CBERA, but only 24 are currently eligible participants. The other four (Anguilla, Cayman Islands, Suriname, and Turks and Caicos) have not requested program participation.

Product coverage under CBERA is greater than under the GSP program (e.g., luggage, handbags, and leather goods). Congress amended the CBERA in 1990, expanding the list of products eligible for duty-free treatment, and relaxed the constraints on imports of footwear, some apparel and textiles, and some agricultural goods, but other goods are still exempted (e.g., plastic, rubber gloves, tuna, and petroleum products). For agriculture, excluded goods are olives, mandarin oranges, wool, and cashmere, in addition to those subject to tariff-rate quotas (TRQs). For textiles and apparel, the program charges duties only for the value-added portion of the products, provided that the raw materials come from the United States.

The U.S. Congress made CBERA's trade benefits permanent by repealing the previous termination date, leaving CBERA as the only one of the four programs that has no statutory expiration date. And, unlike GSP, CBERA is not subject to country "graduation" or competitive-need limitations. Currently there are three high-income countries (Aruba, Bahamas, and Netherlands Antilles) that are eligible for preferences under CBERA.

Andean Trade Preference Act

Also known as the Andean Pact, ATPA extends preferential market access to four countries: Bolivia, Colombia, Ecuador, and Peru. The purpose is to promote broad-based economic development and viable economic alternatives to coca cultivation and cocaine production. The program offers trade benefits to help these countries develop and strengthen legitimate industries. To be eligible, each country must certify that it is cooperating in efforts to control illegal drugs. ATPA was expanded under the Trade Act of 2002, and is now called the Andean Trade Promotion and Drug Eradication Act (ATPDEA).

In 2001, the ATPA program reached its 10-year life limit and was terminated. But, in 2002, the ATPDEA was signed, which renewed ATPA preferences for an additional 6 years and amended it to cover additional products. It currently provides duty-free access to U.S. markets for approximately 5,600 products. The product coverage for agricultural goods is almost identical to the CBERA program and, like the CBERA countries, the ATPA countries are not subject to graduation or CNL-type product limitations under the program.

African Growth and Opportunity Act

The passage of AGOA in 2000 offered tariff preferences to 48 Sub-Saharan African countries to encourage higher levels of trade and direct investment. In a slight departure from other U.S. nonreciprocal trade programs, AGOA contains provisions for providing technical assistance to help build Sub-Saharan countries' capacity to take advantage of program preferences (GAO, 2001). The U.S. President is responsible for determining annually which countries are eligible for the program based upon their degree of market orientation, free trade, rule of law, poverty reduction policies, and protection of worker rights. As of early 2004, 38 Sub-Saharan African countries were eligible for tariff preferences under the AGOA, 15 qualified for the general GSP while 23 qualified for expanded GSP/LDC treatment (see AGOA box).

The trade preferences contained in AGOA have been given to the WTO as a modification to the U.S. GSP scheme. The program extends duty-free status to 1,800 tariff lines, above and beyond the 4,600 duty-free items in the GSP program in 2000. With a few exceptions, almost all of the products accorded duty-free access under the GSP/LDC scheme are also eligible for duty-free treatment under AGOA. Some of the products included under AGOA were previously excluded from both the GSP and GSP/LDC program as "sensitive" products, including footwear, luggage, handbags, watches, and flatware. The program will phase in greater access of fabric, yarn, thread, and apparel items over 2000-08. These products receive duty- and quota-free access subject to a 1.5 percent share of total U.S. apparel imports, which increases up to 3.5 percent over 8 years. AGOA was scheduled to expire in 2008 but to encourage investment the program has been extended to 2015.

European Union Preferential Trading Programs With Developing Countries

Most preferential trading arrangements of the European Union with developing countries have been nonreciprocal. EU programs consist of a mix of policies that include tariff elimination, preferential tariffs that are lower than MFN tariffs, preferential quotas, and quotas. EU programs include the GSP program,

List of AGOA Beneficiary Countries by GSP Eligibility, 2004

GSP and AGOA Beneficiaries (15)
Botswana, Cameroon, Ivory Coast, Gabon, The Gambia, Ghana, Kenya, Mauritius, Namibia, Nigeria, Sao Tome & Principe, Senegal, Seychelles, South Africa, and Swaziland

GSP/LDC and AGOA Beneficiaries (23)[1]
Benin, Cape Verde, Central African Republic, Chad, Republic of Congo, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Guinea, Guinea-Bissau, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sierra Leone, Tanzania, Uganda, and Zambia

[1]In 2002, the year of our analysis, only 37 countries were eligible. The Democratic Republic of the Congo was added in 2003.

which contains a special scheme for LDCs known as the "Everything But Arms" Agreement (EBA); the Cotonou agreement with Africa, Caribbean and Pacific countries (ACP); and the Euro-Mediterranean agreements.

The EU describes its programs as providing stable conditions for investment because they afford trading partners a high level of predictability through a combination of contractual obligations and firm political commitment (EU Business.com). The EBA is of unlimited duration, but the Cotonou Agreement will come to an end in 2020. The EU maintains, however, that the trade preferences granted to the ACP countries will be continued and improved under Economic Partnership Agreements currently being negotiated with ACP countries.

Generalized System of Preferences

The European Union was the first to implement a GSP program in 1971, the provisions of which have been revised on numerous occasions. Originally, there were different regulations for industrial products, textiles, and agricultural goods. Today, regulations are the same for all products. Regulations used to be adopted on an annual basis, after yearly reviews which involved changes in product coverage, quotas, ceilings and their administration, beneficiaries, and depth of tariff cuts for agricultural products. On January 1, 1995, the EU adopted a new GSP for the 1995-2004 period revolving around three key features, "tariff modulation," country-sector graduation, and special incentive arrangements.

The traditional approach of granting reduced duties on limited quantities of GSP imports was replaced with tariff modulation, which provided limited preferences for unlimited quantities. Quotas and ceilings for individual countries and products were replaced by a graduated tariff reduction system based upon the import sensitivity of products. Products deemed nonsensitive were allowed to enter the EU market duty-free. Products listed as import sensitive (determined by the situation of the product sector in EU countries) were accorded a reduction in tariffs below the MFN rate, depending on the level of sensitivity of the imported product. This system of tariff modulation provided for tariff reductions of 15 percent for the most import-sensitive products and reductions of 30 and 65 percent for sensitive and semi-sensitive products, respectively. However, most agricultural products supported by the EU's Common Agricultural Policy (CAP) were totally excluded from the GSP regime, thereby receiving no tariff reductions.

At the same time, new rules were introduced to target preferences to countries that need them most. This targeting takes place in two ways. Countries can lose eligibility to export a particular product—referred to as "graduation"—when they become a dominant supplier of total EU imports of the product. As of 2003, 17 countries, including Argentina, Brazil, China, India, Mexico, Malaysia, and Thailand, had lost preferences on specific agricultural commodities. Countries also can be completely removed from the program—referred to as "exclusion"—if they surpass the income threshold set by the World Bank for high-income countries. South Korea and Taiwan have lost all preferences under the GSP (GAO, 2001). In 2002, 171 countries were eligible for tariff preferences under the EU's GSP.

Finally, a special incentive arrangement, which became operational on January 1, 1998, was also introduced. Under this arrangement additional tariff preferences were provided through the GSP under three special incentive schemes for:

- The protection of labor rights.
- The protection of the environment (applied on products originating in tropical forests).
- Combating drug production and trafficking.

The first two arrangements were available to all GSP recipients on request and offered an additional margin of preference to qualified beneficiaries complying with certain requirements related to labor standards and environmental norms. Thus, if a country qualified under both the arrangements for the protection of labor and the protection of the environment, the total reduction on specific duties in 2002 would be 90 percent (30 percent under the general arrangement and 30 percent under each special arrangement). In the case of *ad valorem* duties the total tariff reduction would be 13.5 percentage points (3.5 percentage points under the general arrangement and 5 percentage points under each special arrangement). Again, where duties include both specific and *ad valorem* duties, only the *ad valorem* portion was reduced. If the MFN duty is lower than the combined tariff reduction, the product entered duty-free. The benefits of the special incentive arrangements are also available for products from which the country concerned has been graduated out of the GSP.

The special incentives to combat drugs are only granted to Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru, and Venezuela. The number of products covered by this scheme is higher than the general scheme and they have access to the EU market duty-free except when the duty is composed of an *ad valorem* and a specific component, in which case the specific component is still applied. On March 5, 2001 a fourth special arrangement was added granting unrestricted duty-free access to all products originating in least developed beneficiary countries, excluding arms (see Everything But Arms Agreement section, which follows).

In January 2002, a new GSP scheme entered into force for the period 2002-04. (It was later extended into 2005.) The tariff modulation mechanism was simplified, maintaining duty-free access for all nonsensitive products while classifying all other products in one single category of sensitive products, replacing the previous three categories. A flat-rate reduction of 3.5 percentage points was applied to all sensitive products in the event of *ad valorem* duties. When only specific duties were applied, a 30-percent reduction was granted. When the customs duties included both *ad valorem* and specific duties, only the *ad valorem* part was reduced. However, in order to avoid any increase in preferential duties over those offered under the previous GSP scheme, the current GSP provides for a stand-still clause, under which preferential tariffs applicable at the end of 2001 would continue to apply if they were more favorable than the those resulting from the current scheme (UNCTAD, 2002).

The current GSP regime was not scheduled to enter into force until July 2005, but, in response to the Asian tsunami disaster in December 2004, the

European Commission changed the date to April 1, 2005. The new regime, which is to last through 2008, provides for further tariff concessions, particularly in the clothing and the fishery sectors. In addition, the EU will simplify the mechanism for graduation. The current criteria (share of preferential imports, development index and export-specialization index) have been replaced with a single straightforward criterion: share of the EU market expressed as a share of preferential imports. This share is 15 percent for most goods and 12.5 percent for textiles.

In addition to the general GSP scheme, there will be two special incentive schemes, rather than four. One is called "GSP Plus" and is available to especially vulnerable countries with special development needs (small, low-income economies, land-locked countries, and small island nations). It extends coverage on products which can enter the EU duty-free. The beneficiaries must meet a number of criteria including ratification and effective application of 27 key international conventions on sustainable development and good governance. To benefit from GSP Plus, countries need to demonstrate that their economies are poorly diversified, and therefore dependent and vulnerable. Poor diversification and dependence is defined as meaning that the five largest sections of a country's GSP-covered imports to the EU must represent more than 75 percent of its total GSP-covered imports. GSP-covered imports from that country must also represent less than 1 percent of total EU imports under GSP. The second special incentive scheme will be the unchanged Everything But Arms.

Everything But Arms Agreement (EBA)

Under the provisions of the Enabling Clause, the EU has provided the LDCs with deeper tariff reductions on a larger set of products than that provided to other developing countries. Like the United States, the European Union increased its GSP product coverage and further reduced tariff rates for LDCs in 1998. In 2001, the EU went one step further by adopting the EBA Agreement. The special arrangements provided under the EBA were available to 48 of the 49 countries officially recognized by the United Nations as belonging to the LDC group in 2002. The only noneligible LDC under this program was Burma, on account of its use of forced labor. The EBA, unlike other EU preferential programs, has no expiration date and is not subject to periodic review.

The EBA provides LDCs duty-free access to EU markets without quotas or other restrictions for most agricultural products (both primary and processed). The EBA coverage now extends to such sensitive products as beef and other meat, dairy products, fresh and processed fruits and vegetables, starches, oils, processed sugar and cocoa products, pasta, and alcoholic beverages. On most of these products, the pre-EBA GSP provided a percentage reduction of MFN rates, which would apply only to *ad valorem* duties, leaving specific duties still entirely applicable. For now, duty- and quota-free access under EBA are not granted on EU imports of sugar, bananas, and rice, which are instead subject to transition arrangements. Duty-free access will be provided for bananas in January 2006, for sugar in January 2009, and for rice in September 2009. In the meantime, there are duty-free TRQs for rice and sugar, which will increase annually.

The GSP program, including the EBA scheme, contains two general safeguard clauses which permit MFN duties to be reintroduced at any time if preferential imports: (1) cause or threaten to cause serious difficulties to EU producers of like or directly competing products; or (2) threaten to cause serious disturbance to EU regulatory mechanisms (UNCTAD, 2002). The second clause has its origins in the EBA initiative, whereby a more stringent safeguard measure was specifically introduced to closely monitor the new preferential market access granted to LDCs for such high-sensitivity products as bananas, rice and sugar. This clause was subsequently extended to the entire GSP program.

Lomé/Cotonou Agreement for Africa, Caribbean, and Pacific (ACP) Countries

The EU actually began offering nonreciprocal tariff preferences in the 1950s, providing preferential market access to former EU colonies for a larger set of products than the GSP program.[3] These preferences were subsumed in the first Lomé Convention, signed in 1975 with 46 countries. Lomé arrangements were continued and expanded every 5 years, and the number of countries grew to 73 by 2000. The 1984 agreement provided for virtually all imports from low-income countries (most of them ACP) to enter free of *ad valorem* duties (although where duties include both an *ad valorem* and a specific component, specific duties were still levied) with the major exception of the CAP agricultural commodities. Under this agreement the 39 Least Developed ACP Countries had duty- and quota-free access to EU markets for most of their products. The market access for the higher income ACP countries (34 ACP countries are non-LDC) did not change much and their provisions remained at a level close to the GSP program.

[3]These preferences have their roots in the Treaty of Rome, which established the European Economic Community (which later became the EU) in 1957 and provided for trading and other arrangements with former colonial territories. The European Development Fund was established to aid in the economic development of those former colonies.

Unhappy with the mixed results of the successive Lomé Conventions, the EU began negotiating a new arrangement in 1998, which culminated in 2000 with the signing of the Cotonou Agreement.[4] The Cotonou Agreement seeks to switch trade cooperation from being essentially based on nonreciprocal preferential tariffs to one where the EU and the ACP States pursue mutual trade liberalization between the parties. Cotonou is meant to be a more complete arrangement than Lomé, with economic partnership agreements to cover numerous trade-related matters such as competition policy, intellectual property rights, sanitary and phytosanitary measures, etc. It also provides some financial aid to improve ACP countries' competitiveness, support their fiscal reform, upgrade their infrastructures, and promote investment. The present regime of tariff preferences is being maintained through 2007 to allow the EU time to negotiate economic partnership agreements with the ACP countries.

[4]The EU considered the impact of nonreciprocal preferences under Lomé to have been disappointing. ACP countries' share of the EU market declined from 6.7 percent in 1976 to 2.8 percent in 1999, with about 60 percent of total exports concentrated in only 10 products (Moreau, 2000).