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EXECUTIVE SUMMARY

HONG KONG SHOULD NOT BE DENIED GSP ELIGIBILITY ON THE BASIS OF A LOWER GNP PER CAPITA TEST

When the GSP program was extended for ten years by the Trade and Tariff Act of 1984, the concept of GNP per capita was added to the list of criteria for determining country eligibility. In recognition of the problems inherent in using GNP as a measure of development, care was taken to set the cut off at a level ($8,500) which was realistic in relation to the current position of existing beneficiaries; but which, incidentally, represents only about 55 percent of the comparable U.S. figure. The objective was to establish an upward cap that might come into play in the future, rather than excluding existing beneficiaries upon enactment. Having thoroughly reviewed the entire GSP scheme, including the issue of eligibility, Congress chose to reaffirm the use of competitive need on a product-by-product basis as the primary vehicle for graduation.

Reducing the GNP threshold level so soon after this comprehensive review by Congress would be objectionable for several reasons.

1. GNP alone is an unreliable yardstick for determining a beneficiary's level of economic development and continuing need for GSP benefits. This was recognized by Congress when enacting the original legislation. A GNP standard was specifically considered and rejected at that time. Congress did not reverse its position on this matter when establishing the $8,500 per capita GNP test in the 1984 Trade Act. It established a level that was well above the current position of even the most advanced developing country beneficiaries. Separately, Congress rejected an amendment that would have excluded Hong Kong and other advanced beneficiaries from the GSP program.

2. The arbitrary use of GNP to exclude Hong Kong and others is unnecessary given the effectiveness of the current system of graduation which is fair, predictable and properly focused on an individual country's competitiveness in specific products. In 1984, Hong Kong was denied duty-free treatment on over $2.7 billion worth of trade in GSP products. Hong Kong has had a majority of its GSP trade excluded from the duty-free treatment since the program's inception: 67 percent of its trade in 1984.

3. A lower GNP standard, in all likelihood, would result only in the exclusion of Hong Kong and Singapore from further participation in the program. In light of their unwavering commitment to free and fair trade, the use of such an arbitrary standard would send a confusing signal to both countries (as well as others being asked to adopt the same free trade policies). Hong Kong has no duties or other restrictions on imports of U.S. products and has a high reputation in respect of protection of intellectual property.

4. It is well documented in studies by both USTR and the USITC that the arbitrary graduation of Hong Kong on the basis of a reduced GNP standard would produce few if any benefits for the lesser developed beneficiary countries. Studies have shown that in the past the main beneficiaries of product graduations have been Japan and other developed countries. This would again be the case if Hong Kong were totally excluded from the GSP program in the future.

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HONG KONG SHOULD NOT BE DENIED GSP ELIGIBILITY ON THE BASIS OF A LOWER GNP PER CAPITA TEST

Although the concept of GNP per capita as a determinant for GSP eligibility was added to the Trade and Tariff Act of 1984, care was taken to set the cut-off point at a level ($8,500) which was realistic in relation to the position of existing beneficiaries. The objective was to establish an upward cap that might come into play in the future, rather than exclude any existing beneficiaries upon enactment. This was a logical step in view of the decision to extend the program for ten years.

Congress, in 1984, thoroughly reviewed the entire GSP scheme including the issue of graduation and chose to reaffirm the use of competitive need on a product-by-country basis as the primary vehicle for graduation. Congress did tighten the graduation rules further by lowering the competitive need criteria for the economically more advanced beneficiaries under certain conditions.

Reducing the current GNP threshold level would be objectionable for several reasons. First, GNP alone is an unreliable yardstick for determining a beneficiary's level of economic development and continuing need for GSP benefits. This was specifically recognized by the Congress in enacting the original legislation. Second, it is unnecessary given the effectiveness of the current system of graduation, which is fair, predictable, and properly focused on an individual country's competitiveness on a product

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specific basis. Third, a lower GNP standard in all likelihood would result only in the exclusion of Hong Kong and Singapore from further participation in the program. In light of their unwavering commitment to free and fair trade, this would send a confusing signal to both of them (as well as to others being asked to adopt the same free trade policies). Finally, developed countries, especially Japan, would reap most of the benefits were Hong Kong and Singapore denied further eligibility.

1. Per Capita GNP Is Not a Reliable Measure of Development. During the course of drafting the original GSP legislation in 1973, Congress considered and rejected the establishment of a GNP standard that would exclude countries otherwise recognized as developing from the GSP program.

> Your committee understands that there are several definitions of developing countries in use by various U.S. Government agencies and international organizations. Statistical criteria such as per capita GNP are not very satisfactory measures by themselves for distinguishing between various levels of development, since these statistics must be evaluated in the light of other economic factors.

H.R. Rep. No. 93-571, 93rd Congress, 1st Session (1973).

Congress did not reverse its position on this matter when establishing a per capita GNP test as an additional determinant of eligibility in the 1984 Trade Act. Rather it chose to establish a level ($8,500) that was well above the position of even the most advanced beneficiaries, such as Hong Kong and Singapore; but represented only about 55 percent of the comparable U.S. figure. Separately, the Congress rejected an amendment to the 1984 Act that would have removed Hong Kong and others from the GSP program.

The refusal to use a GNP test to arbitrarily remove current beneficiaries from the program makes sense because per capita GNP by itself is not a reliable measure of development. According to a 1967 OECD study on the definition of a developing country, the simplest quantitative measure of development would be some assessment of the real per capita flow of economic resources available to each country, usually in the form of GNP per capita. But the OECD study noted that there were many questions which might be raised about such a measure, not the least of which include the fact that GNP statistics are very often inaccurate, differ in composition from country to country and are thus frequently not comparable, do not reflect often large disparities in income distribution, and may be distorted by nominal exchange rates.

Even if all these problems could be corrected, the resulting per capita GNPs would still not show a clear division between "developed" and "developing" countries. If a line must be drawn, it is bound to be arbitrary, and there will always be overlapping at the margin: some countries typically classified as developed would rank below others generally considered developing, and the increments between countries are generally very small.

The OECD study concluded that there is no clear a priori description of the phenomenon of underdevelopment from which an acceptable criterion for development can be inferred. Neither does any particular combination of specific and limited criteria seem to carry conviction as being efficient and acceptable.

Evaluating a country's level of development by relying on per capita income -- or any other social or economic indicator -- at a particular point in time says nothing about the country's ability to maintain that level or to develop further. In addition, it gives no indication of the relative "gap" between developing and developed economies; it does not address the question of whether the developing country is growing relative to developed countries. For example, while Hong Kong's per capita market GNP expanded over the 1980-83 period at an average annual rate of 12 percent, compared to 7 percent in the U.S., the absolute difference or gap between Hong Kong and the United States was widening at an average annual rate of 4 percent. To maintain the same gap as existed in 1980, Hong Kong's per capita GNP would have had to have grown by 17 percent.

A crucial problem in using a specified market per capita GNP as a cut-off for GSP graduation is that it does not neutralize the impact of inflation. Inflation in many developing countries is a serious problem, amplifying per capita GNP measures significantly. Differences in market per capita GNP are only an approximate measure of the differences in real per capita GNP. The former cannot substitute for the latter, particularly in marginal cases. Any discussion at all of per capita GNP must use real data. Unfortunately, the World Bank publishes in its World Development Reports only market per capita GNP. When these data are deflated by GDP deflators published by the International Monetary Fund, however, the resulting real per capita income statistics can sharply reduce trends indicated by market data. Hong Kong's real per capita GDP, for example, averaged about $4,500 during the period 1980 to 1983 -- rather than increasing steadily as indicated by the unadjusted market data.

COMPARISON OF MARKET TO REAL GDP PER CAPITA, 1980-83
(U.S. Dollars)

Hong Kong	1980	1981	1982	1983
Market GDP/Capita	$4,240	$5,100	$5,340	$6,000
Real GDP/Capita	$4,240	$4,632	$4,417	$4,688
GDP deflator	100.0	110.1	120.9	128.0
Singapore				
Market GDP/Capita	$4,430	$5,240	$5,910	$6,620
Real GDP/Capita	$4,430	$4,874	$5,253	$5,767
GDP deflator	100.0	107.5	112.5	114.8

Sources: World Bank and IMF; Taiwan data from Far East Economic Review Yearbook and U.S. Department of Commerce; Hong Kong deflator derived from Hong Kong yearbook.

2. <u>Current Graduation Standards Work</u>. The record of the past decade has established that the competitive need and other limitations contained in the existing GSP program work effectively to insure that beneficiaries do not continue to receive GSP duty free treatment on products where they have become internationally competitive.

In this context, it should be noted that the major GSP beneficiaries, including Hong Kong, do not dominate U.S. imports of GSP eligible products. To the contrary, GSP ineligible developed country suppliers have captured the overwhelming share of this trade since the program began. They accounted for 75 percent of GSP eligible imports in 1977 and still accounted for 70 percent of the trade in 1984. Significantly, the developed countries captured over two-thirds of the growth in GSP eligible imports from 1977 to 1984. Hong Kong's share of total GSP eligible trade has not increased from the 4 percent recorded in 1977.

In 1977, only 42 percent of Hong Kong's GSP eligible trade actually received GSP duty free treatment. By 1984, the comparable figure had been reduced to just 33 percent. In reality, Hong Kong had a majority of its trade (67 percent) excluded from the benefits of the GSP program since the program's inception. In 1984, Hong Kong was denied duty free treatment on over $2.7 billion worth of trade in GSP products. Other advanced beneficiaries, including Korea and Taiwan, are in roughly similar positions.

Source	Share of GSP Eligible Trade Subject to Duty		Share of GSP Eligible Trade Entered Duty-Free	
	1977	1984	1977	1984
Non-eligible suppliers	100	100	0	0
GSP eligible suppliers	49	57	51	43
Hong Kong	58	67	42	33

Source: Office of the U.S. Trade Representative.

3. Market Access Is Ignored. Hong Kong is one of two beneficiaries (the other being Singapore) which offer free market access to U.S. exporters. The use of the GNP criterion would have the ironic effect of graduating both countries at a time when the trade barriers issue is viewed by many as being a key consideration in determining future eligibility for benefits. The record of Hong Kong in the protection of intellectual property, which the Trade and Tariff Act of 1984 specifically linked to GSP benefits, is generally regarded as outstanding.

4. Developed Countries, Especially Japan, Would Be The Prime Beneficiaries. Finally, it is well documented in studies by USTR and the USITC that graduation of the more advanced beneficiaries in specific products has not benefited the lesser developed beneficiary countries. In the past, the main beneficiaries have been Japan and other developed countries, or the other more advanced GSP exporters such as Taiwan and Korea. This would undoubtedly prove to be the case if Hong Kong were totally excluded from the GSP program in the future.

SUMMARY OF POSITION ON US GSP FROM HONG KONG'S POINT OF VIEW

* Reducing the number of GSP beneficiaries will not assist in resolving US trade deficit problems - duty free imports only amount to about 4% of total US imports.

* Moreover the existing scheme already effectively provides for cancelling duty-free status for particular products when the need arises - eg HK only gets duty-free treatment on 33% of the goods theoretically eligible for such treatment.

* Even if objective criteria are used in deciding any cut-off (while certainly that is preferable to arbitrary selection) it will send the wrong message if among the first to suffer exclusion are HK and Singapore, the two most open market, pro free trade places in the world. Rather, others must be encouraged to move in the free trade direction by giving better treatment to open market GSP recipients.

* In practice, experience shows that when HK loses duty free treatment for a product

  - in two cases out of three, HK's import market share declined

  - in a majority of such cases, the developed countries (and in particular Japan) have benefitted.

  [A detailed analysis to demonstrate this point will be available shortly.]

* If HK is excluded from the US GSP, there is a clear danger that others will follow suit and exclude HK also.

* HK will be put at a disadvantage if it loses tariff preference whilst competitors continue to benefit.

* On equity and fair trade grounds, if anyone deserves tariff free treatment it is HK, which accords tariff free treatment to all imports regardless of origin.

SUMMARY OF HONG KONG'S CONCERNS OVER THE UNITED STATES GENERALISED SYSTEM OF PREFERENCES USGSP

Hong Kong is pleased to remain a beneficiary under the US GSP renewed in 1984 for 8½ years and is actively participating in the Presidential Review. However, Hong Kong is concerned at proposals such as those in the "Trade Enhancement Act of 1985" which might result in the exclusion of HK from the US GSP. Points to be considered are:

1. <u>US imports of GSP products are dominated by developed countries</u>
   In 1984, developed countries provided 70% of US imports of GSP products, while only 30% were taken up by developing beneficiaries. Hong Kong's share of the US imports of GSP products was 4%.

2. <u>After exclusions, only about 4% of total US imports enter duty-free; and HK suffers most from exclusions</u>
   In 1984, about 67% of US imports of GSP products from Hong Kong were <u>denied</u> duty-free entry. Hong Kong had a far larger percentage of its trade denied duty-free treatment than either the other major beneficiaries as a group (45%) or all eligible beneficiaries in total (40%).

3. <u>Hong Kong needs GSP</u>

   (a) <u>To assist in diversifying its industrial base</u>
   * The USGSP has helped Hong Kong to diversify away from textiles and garments, which are considered import sensitive by the US, and which already have their scope for growth severely limited by a bilateral restraint agreement which covered over 90% of relevant textiles exports (equal to one-third of Hong Kong's domestic exports to the US in 1984).
   * The extent to which Hong Kong is able to diversify its industry is constrained by the

shortage of land and raw materials. Hong Kong has not been able to diversify into basic industries such as steel, chemicals and automobiles. The scope for diversification would have been further restricted if not for the benefits granted by the US GSP.

* Despite exclusions, 16% of the US's total imports from HK enter duty-free, and this is valuble to HK. Moreoever, if Hong Kong was excluded from the US GSP scheme, there is a danger that others would do likewise.

(b) <u>To overcome many developing country problems</u>

Despite the considerable social and economic progress which Hong Kong has made in recent years, it still has a long way to go in many areas, for example:

	HK	OECD Average	USA
No. of people served by one physician (1980)	1,210	576	520
No. of people served by one nursing person (1980)	790	241	140
No. enrolled in higher education as % of population aged 20-24	11%	27%	58%

(c) <u>To remain competitive with other suppliers to the US market</u>

* A review of the trade pattern in products where Hong Kong has been excluded from duty-free treatment has shown that Hong Kong has

/lost .....

lost market share in a majority of instances; three quarters of the products denied eligibility in 1983/84 recorded a decline in market shares.

* Interestingly, the normal pattern is that those who increase their market share when HK loses GSP are the developed countries, and especially Japan, rather than other developing countries.

4. <u>Equity</u>

If anyone deserves tariff free treatment it is Hong Kong, which almost alone accords tariff free treatment to all imports regardless of country of origin.