KOREA AND THE AMERICAN GENERALIZED SYSTEM OF PREFERENCES: WAS GRADUATION A PROPER RESPONSE?

JAY S. NEWMAN*

To the Congress of the United States:

I am writing concerning the Generalized System of Preferences (GSP) and Hong Kong, the Republic of Korea, Singapore, and Taiwan. The GSP program is authorized by the Trade Act of 1974, as amended ("the Act").

I am hereby providing notice of my intent to remove Hong Kong, the Republic of Korea, Singapore, and Taiwan from their status as beneficiaries of the GSP program as of January 2, 1989, under Section 504(a)(1) of the Act (19 U.S.C. 2464(a)(1)). All four have achieved an impressive level of economic development and competitiveness, which can be sustained without the preferences provided by the program. Graduating these economies may also enable other less developed countries to benefit more fully from the GSP program.

Ronald Reagan.

THE WHITE HOUSE, January 29, 1988.¹

President Reagan’s declaration to remove South Korea and three other Asian nations, often called NIC’s (Newly Industrialized Countries), from the Generalized System of Preferences (GSP) is an important step for their entrance into the world’s economic system. South Korea’s “graduation” from this program is a milestone in its economic development. Its recent growth has catapulted the nation out of the ranks of the “developing” countries. This article will examine the historical significance of the GSP concept, its development, its purpose, and its implementation as illustrated by the American program. It will focus upon the events leading up to the graduation of South Korea from the American GSP and analyze the impact that this event will have

* J.D. Candidate 1990, University of Pennsylvania Law School; B.A. 1987, Brandeis University.
upon Korea, various actors in the United States and other affected parties. The costs and benefits of "graduation" will be addressed with these considerations in mind. This comment will also discuss whether the graduation of countries such as South Korea are in the best interests of the graduating country, the benefit-providing nation and the international economy. There are no easy answers. This comment hopes to stimulate further critical analysis of the GSP as well as the general issues of international trade and international relations.

1. THE CONCEPT OF A GENERALIZED SYSTEM OF PREFERENCES

The concept of unilateral trade preferences given to developing nations can be traced to Principle Eight of the United Nations Conference on Trade and Development of 1964 (UNCTAD I). This principle declares that "[d]eveloped countries should grant concessions to all developing countries and extend to developing countries all concessions they grant to one another and should not, in granting these or other concessions, require any concessions from developing countries." The developed countries, including the United States, were not prepared to accept such a sweeping doctrine: "Almost all the developing countries and the socialist countries voted in favor [of the Principle], but the developed market-economy countries either abstained or voted against it." Opposition to this concept dissolved at UNCTAD II, as developed and developing nations agreed that the idea of a preference system based on Principle Eight should be considered and subsequently implemented by each developed country. "Thus, the aim of the preferential treatment of developing countries should be, according to the Resolution:

a) to increase their export earnings;

2 The unilateral trade preferences utilized in the various GSP systems are the reduction or elimination of tariffs. Tariffs create an artificially higher price for the imported good. This effect, theoretically, decreases consumer demand for the good. Thus, the tariff weakens the exporting nations' comparative advantages in producing that good. See generally J. Barton & B. Fisher, International Trade and Investment: Regulating International Business 14 (1986).


5 Id. at 80.

6 See UNCTAD, supra note 3, at 1.
b) to promote their industrialization;
c) to accelerate their rates of economic growth."
The developed nations' change in position regarding Principle Eight can perhaps be explained by the fact that the GSP was no longer seen as a threat to the General Agreement on Tariffs and Trade (GATT) and the Most-Favored Nation (MFN) principle.8

The developed nations did not want the GATT principles adversely affected. "The cornerstone of the GATT is the requirement that tariff concessions should be granted on a MFN basis. The purpose of the MFN clause is to confine arbitrary distortions in the flow of international trade by discriminatory unilateral or bilateral measures."9 Preferential trade benefits given to recipients without a subsequent benefit given to the donor threatened the concept of MFN and multilateral trade concessions. It was realized, however, that a limited granting of preferential treatment would not be detrimental to the broader agreement.

[T]he GSP should not be considered a major blow against the spirit of GATT; a particular group of countries was awarded preferential status according to the consensus of the contracting parties in order to give the former easier access to export markets, i.e., following trade liberalising motives with a developmental policy orientation.10

Furthermore, the GSP was strengthened in 197911 when "agreement was reached in the MTN Framework Group on an enabling clause which provides the legal basis for special and differential treatment for developing nations."12 Acceptance of the enabling clause by the developed countries was obtained when developing nations, in turn, agreed

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7 YUSUF, supra note 4, at 82.
8 The concept of most-favored nation treatment states that any customs duties, including tariffs in which any advantage is "granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." General Agreement on Tariffs and Trade, Oct. 30, 1947, art.1, G1 Stat. (5),(6),T.I.A.S. No. 1700 at 8, 55 U.N.T.S. 194, 198.
11 Nicolaides, supra note 9, at 374-75.
to a "graduation" principle which required an increase in their GATT responsibilities as their economies grew and diversified. These concepts and agreements are the foundation upon which the United States has based its GSP program.

2. The American GSP and the Trade Act of 1984

The concept of a Generalized System of Preferences received widespread support following UNCTAD II. It was agreed that such programs would be implemented by individual governments, each with its own requirements and limitations. The United States was the last developed nation to implement a Generalized System of Preferences because unlike other countries which implemented their schemes by "administrative measures or by community regulations, . . . the United States' scheme required implementing legislation." On January 3, 1975, the 1974 Trade Act was adopted which included Title V-Generalized System of Preferences. In 1984, the Act was amended to its current form by Pub. L. 98-573. This section will examine some of the important changes which resulted from the recent amendment and their impact upon the process of "graduation."

The United States Constitution, Art. I, § 8, cls. 1 and 3, grant the power to "lay and collect duties" and to "regulate commerce" to Congress and not to the Executive branch. Congress, however, has delegated substantial amounts of power to regulate international commerce to the Executive. The GSP exemplifies this power relationship between Congress, which enacted the program, and the Executive, which executes the program. The 1984 Amendment to the Trade Act added an additional criterion that the President should examine when determining whether a country is eligible for duty-free treatment for a particular article under GSP. The three original criteria included the following: (1) the effect benefits would have on the developing country; (2) the benefits granted by other developed nations through their GSP programs; and (3) the impact on United States producers. The amendment added the following paragraph: "(4) the extent of the beneficiary

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13 Id.

14 Yusuf, supra note 4, at 127.


16 See generally United States v. Yoshida Int'l, Inc., 526 F. 2d 560 (C.C.P.A. 1975) (President has authority to impose a temporary surcharge on imports); Star-Kist Foods, Inc. v. United States, 275 F.2d 472 (C.C.P.A. 1959) (emphasizing that Congress limited the Presidential authority to modify duties strictly in accordance with the purposes for which the Act was promulgated).
developing country's competitiveness with respect to eligible articles."\(^{17}\)

It is claimed that "[it] was added to § 501 of the 1974 Act to emphasize Congressional desire for a more rigorous application of graduation principles."\(^{18}\) This provision authorizes a more thorough investigation of each article receiving preferential treatment. Implicit in the increased scrutiny towards individual goods is the greater likelihood that a particular product will be graduated once it obtains the requisite "competitiveness." Congress has announced a number of more stringent provisions regarding "article graduation" as well as the graduation of countries from the program.

The 1974 Trade Act's discussion of graduation focused upon specific articles which would not be designated as eligible.\(^{19}\) The 1984 Trade Act retained these provisions and also added other provisions which restrict the eligibility of a nation's articles. According to § 505(a),

The President shall, as necessary, advise the Congress and, by no later than January 4, 1988, submit to the Congress a report on the application of sections 501 and 502(c), and the actions the President has taken to withdraw, to suspend, or to limit the application of duty-free treatment with respect to any country which has failed to adequately take the actions described in section 502(c).\(^{20}\)

The implementation of this section is vividly illustrated by the Reagan message of January 29, 1988.\(^{21}\) This provision gave authority for the graduation of Hong Kong, Korea, Singapore and Taiwan. Furthermore, the 1984 Act added a mandatory graduation provision:

If the President determines that the per capita gross national product (calculated on the basis of the best available information, including that of the World Bank) of any beneficiary developing country, for any calendar year . . . after 1984, exceeds the applicable limit for the determination year . . . such country shall not be treated as a beneficiary developing country under this title . . . .\(^{22}\)

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\(^{18}\) Note, Renewal of the GSP: An Explanation of the Program and Changes made by the 1984 Legislation, 18 VAND. J. TRANSNAT'L L. 625, 651 (1985) [hereinafter Renewal of the GSP].

\(^{19}\) See generally 1974 Trade Act, supra note 15, at §§ 503-504.

\(^{20}\) 1984 Trade Act, supra note 17, at § 505(a)(2).

\(^{21}\) MESSAGE FROM THE PRESIDENT, supra note 1.

\(^{22}\) 1984 Trade Act, supra note 17, at § 505(c).
The "applicable limit" according to § 505(c) is approximately $8,500. This limit is well above Korea's GDP of US$2361 as of 1986. Congress' protectionist sentiment is demonstrated by these various provisions: "The 1984 Act expanded the graduation concept [from removal of products] to include the complete removal of countries from continued GSP eligibility for all their products." These changes in the program are argued to be appropriate in light of the purpose and intent of the concept of a Generalized System of Preferences.

The purpose of the American GSP is declared in § 501 of the Generalized System of Preferences Renewal Act of 1984. There are ten enumerated purposes which include:

(1) [to] promote the development of developing countries, which often need temporary preferential advantages . . . ;
(2) [to] promote the notion that trade, rather than aid, is a more effective and cost efficient way of promoting . . . development . . . ;
(5) [to] encourage the providing of increased trade liberalization measures . . . ;
(8) [to] integrate developing countries into the international trading system with its attendant responsibility in a manner commensurate with their development;
(9) [to] encourage developing countries-
(A) to eliminate or reduce significant barriers to trade . . .

This comment will examine the recent graduation of South Korea from the GSP in terms of these particular goals of the program. The economic benefits that Korea has obtained from this system as well as the implications of the loss of these benefits must be analyzed to determine whether the graduation of Korea from the American GSP was a necessary or useful act.

3. THE GRADUATION OF KOREA FROM THE U.S. GSP

South Korea graduated from the American GSP on January 2, 1989. The spectacular economic growth that Korea has achieved in such a relatively short period of time is often considered to have motivated this decision. An understanding of the size and strength of the Korean and American industries affected by the GSP provides greater

23 Id.
24 See infra notes 28 & 29 and accompanying text.
25 Renewal of the GSP, supra note 18, at 646 (emphasis omitted).
26 1984 Trade Act, supra note 17, at § 501.
27 See Message from the President, supra note 1.
insight into the rationale for President Reagan’s announcement of January 1988. Although the Reagan message focuses upon two principal considerations to justify Korea’s graduation, there are also other implicit reasons for the cessation of these trade benefits. Examining each of these factors is necessary to comprehend why Korea has graduated from the GSP.

3.1. Facts: United States-South Korea Trade Relation

According to the March 1988 ABECOR country report, Korea’s GDP per capita is US$2,361 (1986). As its economy has experienced rapid rates of economic growth, so too have its exports. In 1986, Korea’s exports totaled US$33.9 billion and its trade surplus was US$4.2 billion. This was the first year that Korea enjoyed a trade surplus after a relative balance in 1985 and deficits of US$1.8 billion and US$1.0 billion in 1983 and 1984, respectively. Manufactured goods are a significant part of the total. It has been reported that “[t]he share of manufactured exports in total exports is about . . . 85-100% in the case of Hong Kong, South Korea and Taiwan.” The apparently sudden economic expansion of the Korean economy can be attributed to its implementation of a policy of export-propelled growth. In particular, beginning in the 1960’s, the Korean government emphasized “export expansion in labor-intensive consumer nondurables. Because [this] strategy offered the most rapid growth prospects consistent with Korea’s comparative advantages in labor skills, the government chose to follow that path.” This growth in labor intensive goods, however, cannot continue indefinitely. In the late 1970’s it was realized that, “[e]ven though the labor force will continue to grow at the fairly high rate of 2.7 percent a year during the 1980’s, Korea’s comparative advantage will start to shift from products intensive in labor to products intensive in capital and skills.” This is the economy of Korea: rapid growth, labor intensive and dependent on exports. The United States is also an important partner in the development of the Korean economy.

26 “ABECOR is an association of European banks seeking to improve the services that each individual member is able to offer to its customers by developing banking and financial objectives on the basis of mutual co-operation.” BARCLAYS, ABECOR COUNTRY REPORT, SOUTH KOREA 1 (March 1988).
27 Id. This is an increase of 11.9% from 1985.
28 Id.
29 KRAUS & LÜTKENHORST, supra note 10, at 23.
The United States has always played an active role in Korea’s economy. It is only recently that Korea has played a significant part in the American economy as it has “emerged as the US’ seventh largest trade partner with a US$10 billion trade surplus in 1987.”\textsuperscript{34} Only two decades ago such a prediction would have been ridiculed. A dynamic export policy and the liberalization of international trade as exemplified by the Generalized System of Preferences, however, have contributed to Korea’s amazing growth.

The American GSP has had only a limited effect on America’s domestic economy.\textsuperscript{35} The specific articles covered by the program include sporting goods equipment, toys and other light manufactured goods.\textsuperscript{36} Senator Robert Dole accurately described the program’s role in a hearing before the Subcommittee on International Trade. He stated that “[s]ince its inception 10 years ago, the GSP has not played a large role in terms of its coverage of total imports. Nevertheless, the program clearly is of importance to our political relations with the third world, and to their economic growth.”\textsuperscript{37} Examples of the economic growth to which Senator Dole referred are the estimates of duties forgone through the GSP. As of 1983, Hong Kong had “saved” $54.5 million, Taiwan, $159.8 million, and Korea, $74.6 million.\textsuperscript{38} These savings provided a powerful incentive for the growth of industries affected by the removal of tariffs. “In Korea [for example], the government noted that GSP has stimulated small and medium-sized industries and has led to a diminished role for textiles and footwear in overall exports.”\textsuperscript{39} The significance of the GSP should not be overemphasized. It is a program of limited size and limited applicability in the United States. Its importance to other countries such as Korea, however, is of a higher magnitude. The reasons for Korea’s graduation must therefore be scrutinized to ensure that the loss of these benefits is justified.

\textsuperscript{34} Chandra, \textit{Burdens of the Giant: Deficit and Defense}, \textit{Far E. Econ. Rev.}, May 12, 1988, at 24.


\textsuperscript{36} \textit{See generally id.} for an evaluation and enumeration of eligible articles under the United States’ Generalized System of Preferences.


\textsuperscript{38} \textit{Id.} at 14 (statement of Ambassador Brock).

\textsuperscript{39} \textit{First Five Years’ Operation}, \textit{supra} note 12, at 35.
3.2. The Reagan Message: Rationale for Graduation

President Reagan's message to the Congress on January 29, 1988 formally removed South Korea from the GSP.\textsuperscript{40} Officially, the factors that led to this act were that Korea had "achieved an impressive level of economic development and competitiveness, which could be sustained without the preferences"\textsuperscript{41} and that other developing countries could receive greater benefits from the program once Korea and others were graduated. Congress was concerned that only seven recipient nations\textsuperscript{42} received a significant majority of the GSP benefits. This disparity is the primary factor which motivated Congress into enacting the 1984 Trade Act.\textsuperscript{43} In order to integrate the developing countries into the international trading system, a more equitable distribution of benefits is required. Congress may have feared that the continuation of the current program with recipients like Korea would jeopardize one of the enumerated purposes of the program.\textsuperscript{44} Therefore, Korea's removal was motivated, in part, by a desire to provide the least developed countries (LDC's) with an opportunity to utilize GSP fully. Another important factor pronounced in the presidential message was the economic achievement of South Korea.

South Korea has undeniably demonstrated stupendous economic growth.\textsuperscript{45} Whether it is sufficient to "graduate" it from the ranks of developing nations to that of a developed nation is a subjective question that is difficult to measure in terms of statistics. The use of "economic achievement" as a criterion for graduation seems to signal a broader congressional concern. Prior to the 1984 Trade Act there was an "underlying congressional . . . desire to force the NIC's to accept increased independence, economic responsibility and political maturity within the world trading system as an accompaniment to their increasing economic and trade successes."\textsuperscript{46} "Economic achievement" means that a nation is deemed ready to enter the international trading system as a full member and to receive the resulting advantages and disadvantages. Korea has been categorized as such. The presidential message removing South

\textsuperscript{40} Message from the President, supra note 1.
\textsuperscript{41} Id.
\textsuperscript{42} See supra note 37, at 14-15 (statement of Ambassador Brock). The seven nations are Taiwan, Korea, Hong Kong, Mexico, Brazil, Singapore and Israel.
\textsuperscript{43} Renewal of the GSP, supra note 18, at 628.
\textsuperscript{44} See 1984 Trade Act, supra note 17, at § 501 (to integrate developing countries into the international trading system).
\textsuperscript{45} See generally Barclays, supra note 28 (real GDP growth from 1983 to 1987 increased 5.4-12.5% each year). See also Chandra, supra note 34 (emergence of South Korea as a major trading partner, in terms of volume, with the United States).
\textsuperscript{46} Renewal of the GSP, supra note 18, at 629.
Korea from GSP was relatively brief and only referred to the two factors previously discussed. There are other factors which were considered in removing the trade benefits.

3.3. Other Arguments in Favor of Graduation

The GSP was intended to be a temporary program based upon a limited legal obligation. It was also designed to encourage developing nations to reduce and then to eliminate their trade barriers. Invocation of these two principles provides additional evidence of the motive for the graduation of Korea from the American GSP.

The temporary nature of the GSP is explicitly expressed in the Generalized System of Preferences Renewal Act of 1984. Even prior to enactment of this legislation the GSP was viewed similarly. In a Senate hearing during August 1983, William Brock stated that "[a]s initially conceived, GSP systems were to be . . . temporary, unilateral grants of preferences by developed countries to developing countries." In addition, "during the . . . Tokyo Round of Multilateral Trade Negotiations (MTN) the United States maintained that the GSP was a temporary, non-reciprocal program." The 1984 Act merely codified a widely accepted principle. Finally, the principle of graduation itself suggests the limited scope and duration of GSP. "Graduation . . . emphasizes that GSP benefits are temporary and reminds LDC's that they must someday become mature members of the international trading system." As a result of the temporary nature of the preferences, developed nations consider their legal obligations to recipients as limited.

The legal obligations associated with international treaties, agreements, and resolutions vary considerably. Treaties often include more defined legal obligations. "It is generally recognized that recommendations and resolutions are not legally binding on states in the sense of an international treaty or convention." The legal obligations associated with the GSP were apparently pronounced at UNCTAD I.

[T]he developed countries are not legally obligated to grant such preferences to the developing countries. They have clearly indicated in the "Agreed Conclusions" that they

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47 1984 Trade Act, supra note 17, at § 501.
48 Senate Subcomm. Hearing on GSP, supra note 37, at 6 (statement of Ambassador Brock).
49 First Five Years' Operation, supra note 12, at 3.
50 Renewal of the GSP, supra note 18, at 646.
51 Yusuf, supra note 4, at 77. See also Sei Fujii v. State, 38 Cal. 2d 718, 242 P.2d 617 (1952) (The general purposes and objectives of the United Nations Organization do not purport to impose legal obligations on the individual member nations).
did not accept such a legal obligation. Their attitude in subsequent negotiations, and in particular in the recently concluded Tokyo Round MTNs, confirms their reluctance to provide a contractual basis for their preferential relationship with the developing countries”.

Considering the lack of a definitive legal obligation and the explicitly expressed temporary nature of the preferences, the graduation of Korea does not appear to infringe upon or violate any specific legal principles. The graduation, however, may adversely affect the trade relationship between the United States and Korea.

The current United States-South Korea trade relationship has been affected by the perception that Korea is maintaining unacceptable barriers to its markets and is not fulfilling the responsibilities of a more developed nation. For example, this frustration with Korean policies is illustrated by “the initiation of investigations under section 301 of the 1974 Trade Act, which allows retaliatory measures to be taken if unfair trade practices are found, such as those said to be affecting beef and tobacco.” An example of Korean policy that restricts access for American producers, among others, is the concept of a “Free Export Zone.”

A Free Export Zone is a specifically designated industrial area where foreign-invested enterprises can freely import raw materials or semi-finished goods free of duty, and manufacture, process, or assemble export products. Qualification for admission into the zone is based upon the applicant's ability to show that all of the products will be exported and that they will contribute to technological improvement and increased employment.

American frustration with policies of this sort has made it politically difficult for the United States to continue to offer trade benefits to a nation that imposes restrictions on American exports. The pervading opinion is that a more advanced country such as Korea should show

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52 Yusuf, supra note 4, at 96. (See Agreed Conclusions of the Special Committee on Preferences 6, UNCTAD, Doc. TD/B/330.)

53 See generally Jordan & Taylor, Cut U.S. Troops in Korea Now, N.Y. Times, Dec. 2, 1988, at A31 (op-ed) (disagreement in the trade dialogue needs to be contained and addressed); Jameson, May Call for Troop Reductions, L.A. Times, Nov. 6, 1988, at 1 (referring to South Korea's ascendency to the upper ranks of industrializing countries).

54 Making a Beef about Smokes, FAR E. ECON. REV., May 12, 1988, at 25.

55 Free Export Zone Establishment Law, Law No. 2180 of 1970, as last amended by Law No. 3338 of 1980, art. 2.

56 Kim, Legal Aspects of Doing Business in Korea, BUSINESS TRANSACTIONS with Korea, a Legal & Business Guide to Korea 8, 1018 (3) (1983).
“some willingness to open up and allow trade to flow in both ways.”\textsuperscript{87} Unfortunately, Korea did not heed this warning.

The American outrage was fueled by a presidential campaign commercial questioning why “a US $10,000 Chrysler K [model] car costs US $48,000 in [South] Korea.”\textsuperscript{88} People questioned how we could give a nation such favorable treatment when it had a US$10 billion trade surplus with the United States.\textsuperscript{89}

The average American was unconcerned with the purposes enumerated in the 1984 Renewal Act. The images presented by the media of foreigners taking advantage of Americans led to an outraged public. The Congress and the President have been affected by this emotionally charged issue.\textsuperscript{60} Korea’s graduation from the American GSP is a vivid illustration. There is substantial justification for Korea’s graduation as demonstrated by the above analysis. The harmful effects of graduation, however, are rarely discussed. The significance of these effects leads to the question of whether graduation is an appropriate response to the situation.

4. Was Graduation the Appropriate Response?

Korea’s graduation from GSP will affect American producers, importers, and consumers. Korea’s economy will not be immune from the impact of this event. The only nations, unfortunately, which will not be affected by this event are the LDC’s which the President hoped would now be able “to benefit more fully from the GSP program.”\textsuperscript{81} The unfavorable effects on America, Korea, and other nations suggest that “graduation” was an inappropriate action.

\textsuperscript{87} Senate Subcomm. Hearing on GSP, supra note 37, at 5.

\textsuperscript{88} Chandra, supra note 34, at 24 (statement of Richard Gephardt). See also Rasky, Gephardt’s Iowa Campaign Resurges, N.Y. Times, Jan. 19, 1988, at B7. But see Scherer, Case of the $48,000 K-car; Critics say Gephardt’s Figures Don’t Add Up, Christian Science Monitor, Feb. 22, 1988, at 32 (arguing that the price of the K-car in South Korea would be US $30,451 and not US $48,000). The significance of the discrepancy in the price of the K-car is that the media and public were quickly enraged by the disclosure of the original “statistic.” Even if the validity of this figure were subsequently disproved, many of the detrimental effects could not be easily altered.

\textsuperscript{89} Chandra, supra note 34, at 24.

\textsuperscript{60} See generally id. See also The Trade Bill Fluffs its Feathers, THE ECONOMIST, March 19, 1988, at 21; Remove the Trade-Bill Shackles, N.Y. Times, March 17, 1988, at A30 (Richard Gephardt’s amendment to the Trade Bill generating much public passion).

\textsuperscript{81} Message from the President, supra note 1.
4.1. Effects upon the United States: Importers, Consumers and Producers

A House hearing on August 4, 1983 emphasized that American trade relations with the leading “GSP graduation candidates” were not one-sided. “In 1982 the GSP’s top seven beneficiaries purchased over $30 billion of United States exports, representing 45 percent of United States exports to all beneficiary countries and 15 percent of global United States exports.” It was also stated that “[t]he GSP treatment accorded to leading beneficiaries is strongly supported by U.S. consumers, importers and many U.S. producers.” Each group has benefitted from the GSP. The economic advantages that each group received will be analyzed in the following subsections.

4.1.1. Importers

Importers in the United States, as in other countries, must apprise themselves of newly enacted legislation that may affect the entry into the United States of the goods they buy and sell. The GSP has eliminated or reduced tariffs which the importer would have otherwise had to pay directly or indirectly. It is a rudimentary economic concept that individuals seek minimal costs to generate the maximum economic profits possible. “Manufacturers in Taiwan, Korea and Hong Kong sell products [eligible for GSP benefits] at significantly lower costs than their American counterparts.” Therefore, common business sense justifies the importer’s rationale for purchasing these articles at a lower cost. The utilization of tariffs, however, distorts the cost of the imported good and eliminates the comparative advantage that the exporting nation has with respect to that particular good. The GSP has eliminated this distortion of trade and permitted importers to obtain a larger profit than they would have realized without the program. The removal of the trade benefits on these goods will afford American importers a lower profit margin as their costs increase. It is likely that these

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63 Senate Subcomm. Hearing on GSP, supra note 37, at 19.
64 See generally DIRECTORY OF UNITED STATES IMPORTERS, 1988 J. COMM. (lists and describes various laws and regulations, including GSP, which may affect an importer).
66 See supra note 2 and accompanying text.
67 See generally id. This analysis assumes that either of two scenarios occurs. One, the importer will seek to obtain the same profit for each good sold whether or not there is a tariff. If a tariff is levied, then a higher price will be charged to the consumer. Consumer demand will decrease in response to the higher price and the importer’s net profits will decrease. Two, the importer charges the consumer the same
higher costs will be passed on to the American consumer. This conclusion is based upon the assumption that American importers will continue to buy from Korean suppliers. There is the possibility, however, that these importers will look to other markets for these goods. This issue will be discussed later in this article.\(^{67}\)

4.1.2. Consumers

The individual consumer is often the ultimate destination of goods. The price paid by the consumer consists of all costs that were expended for the good to reach the store, including tariffs. Thus, the consumer benefits under the GSP. “Lower overall manufacturing costs achieved by business utilizing GSP parts and components benefitted consumers by lowering prices.”\(^{68}\) Although the number of products affected by GSP are relatively limited, United States consumers pay for any protectionist measures. For example, “[a] recent study by . . . the Institute for International Economics estimated that car quotas raised prices for Americans by more than $5 billion a year. Orange-juice tariffs cost consumers more than $500 million a year.”\(^{69}\) In summary, the removal of trade barriers such as tariffs is often beneficial to consumers as the artificial price is lowered to a level more representative of its actual cost of production.

4.1.3. Producers/Manufacturers

This section will examine the effects of the GSP upon two distinct groups of producers/manufacturers in the United States. First are those producers that integrate GSP eligible goods into a new “product” which is subsequently sold by the producer. These producers, not surprisingly, have been staunch supporters of the program. Second, are those producers that manufacture goods domestically that are also listed as GSP-eligible. These producers compete against the “cheap imports” and vehemently oppose the GSP as it affects their particular industry. The costs and benefits of the GSP to each of these producers should be weighed in determining the overall impact upon American manufacturers.

Major beneficiaries of GSP have been producers utilizing a particular article as a part of its “product.” “[M]ost domestic producers, in-

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\(^{67}\) See infra notes 86-101 and accompanying text.

\(^{68}\) Webster & Bussert, supra note 64, at 1048.

\(^{69}\) Protectionists in Glass Houses, THE ECONOMIST, April 30, 1988, at 20.

https://scholarship.law.upenn.edu/jil/vol11/iss3/6
cluding all the major firms, import to some extent, . . . [including] the importation of certain lines or parts . . . ." The domestic producer is able to take advantage of lower costs and improve his profit margin. A representative of the American Association of Exports and Imports described the effect of the GSP on domestic producers: "The GSP has helped American industry meet intense foreign competition, both at home in the U.S. and on world markets, by producing less expensive parts and materials from the beneficiary countries for incorporating into U.S. manufactured products." Although a significant number of domestic producers have benefitted from GSP, many others, facing cheaper imports, have not fared as well.

Domestic manufacturers that produce GSP-eligible goods have been injured by the removal of tariffs. The degree of injury, however, has varied by industry. An analysis of a number of industries illustrates the misconceptions concerning GSP and its effect on United States' businesses. The jewelry industry, for example, illustrates the steady decline of domestic manufacturers. Imports' share of the precious metal jewelry market has increased from 4.2% in 1972 to an estimated 33.5% in 1986 and their share of the costume jewelry market has risen from 10.4% to 31.3% during the same period. "The key reason for these increased imports has been lowering of tariff barriers." The lowering of these barriers can be attributed to the GSP as well as other agreements including the implementation of the Caribbean Basin Economic Recovery Act and the United States-Israel Free Trade Area Implementation Act. Thus the actual harm that GSP has inflicted upon this area is not as extensive as a cursory examination of the statistics would reveal. Domestic jewelry manufacturers have lost a substantial portion of the domestic market. The graduation of Korea, Taiwan and Hong Kong from the GSP, however, will not significantly alter this decline. As a result of Korea's graduation, other nations which have a comparative advantage in producing jewelry that are not subject to tariffs will capture an even larger share of the U.S. market. Limiting the scope and the reach of the GSP will not significantly protect domestic

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70 U.S. INT'L TRADE COMM'n, PUB. No. 841, TOYS, GAMES AND WHEEL GOODS, 87 (1983).
71 Hearings on S. 1718, reprinted in Webster & Bussert, supra note 64, at 1048 n.73.
73 Id.
producers from other foreign producers that can manufacture a good more efficiently and inexpensively. It is probable that other developed nations will capture parts of the United States market that are relinquished by higher priced Korean goods. The sporting goods industry illustrates this proposition.

Korea, as well as Taiwan, has received duty-free treatment under the GSP on various types of recreation equipment, another United States industry encountering an increasing number of imported items. "For the last fifteen years the United States has had a trade deficit in sporting goods. The trade deficit grew from $47 million in 1972 to an estimated $1 billion in 1986, and a deficit of more than $1.1 billion is forecast for 1987." The cessation of GSP benefits to Korea and Taiwan could arguably halt this decline. An examination of the comparative shares of world trade, however, illustrates that the rise in imports into the U.S. corresponds to shifts in global trade patterns. From 1975 to 1985, the percent shares of world trade in sporting goods have changed as follows: U.S., 17.4% to 8.6%; Taiwan, 6.5% to 25.8%; South Korea, 2.7% to 9.0%; Japan, 10.9% to 10.6% West Germany, 5.1% to 4.9%. If the NIC's portion of the market declines, Japan and West Germany would appear to be in the best position to capture a larger share of the United States market since they currently possess the necessary industrial infrastructure. It is unlikely that a nation without the appropriate infrastructure would be able to reap the benefits of such a potentially profitable market. The domestic manufacturers may be able to recapture a portion of the domestic market, though the evidence is inconclusive. The developing countries, however, will not benefit from the graduation because they lack the facilities to begin production of these desired goods.

4.1.4. Summary

The International Trade Commission Reports provide useful information concerning the economic impact of the GSP on the American and recipient nations' economies. "ITC data indicate that GSP imports constitute a significant amount of trade incentive without being overly burdensome to domestic producers . . . . [T]he ITC study concluded that during the last several years the scope of GSP trade has [also] been substantial enough to act as a development incentive." The conclusion

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76 See An Evaluation of U.S. Imports, supra note 35.
78 Id. at 46-12.
79 See infra notes 86-101 and accompanying text.
80 Memoirs of the GSP, supra note 18, at 635.
reached by the ITC comports with the previous analysis. The benefits to importers, consumers and producers in the United States as a result of GSP outweigh its potential costs. Korea should not have been graduated from the American GSP.

4.2. Effects upon Korea

The impact upon Korea of Korea’s graduation from the American GSP must be examined on two distinct levels. First, there is the effect of graduation upon a potential shift of Korea from a labor-intensive to a high-technology based economy. The second level of impact is the effect of graduation upon Korea’s bilateral relationship with the United States. The domestic and international effects of Korea’s graduation from the American GSP clarify the implications of pursuing such a policy.

The precise loss of sales from formerly eligible GSP articles is difficult to calculate. Generally, the production of such goods will decrease and be less desirable than when GSP was in effect. Korea’s comparative advantage will be reduced. As a result, there will be a further shifting away from such less profitable labor-intensive industries. The Korean government has played a pivotal role in this shift. “To further promote the rapid economic development of Korea and enhance international competitiveness of Korean industry, the government . . . is actively promoting increased inducement of foreign technology” through long license terms and higher royalty rates. This policy may explain the Korean government’s failure to protest forcefully its graduation from the GSP. The January announcement will merely quicken the process that pushes Korea into higher technology industries, thereby permitting other developing nations to establish significant labor-inten-

81 See supra note 64 and accompanying text.
82 See P. Hasan & D.C. Rao, supra note 33.
83 Jones, Licensing in Korea, BUSINESS TRANSACTIONS WITH CHINA, JAPAN & SOUTH KOREA § 11.06 (1983). See International Trade Act, Law No. 3895 (Korean Legal Center) (Dec. 31, 1986) (Article 3. (Measure for Promoting Trade) The Minister of Commerce and Industry may take measures to increase continuously exportation or importation of goods pursuant to a Presidential Decree as he deems necessary to promote trade); Industrial Development Act, Law No. 3806 (Korean Legal Center) (Jan. 8, 1986). The Industrial Development Act authorizes the government to devise the following policies- 1. Elevation of industrial technology and productivity; 2. Effective development and utilization of resources; 3. Training and effective management of human resources; and 4. Expansion of the base for industrial development. Furthermore, Article 17 provides that the government shall establish an Industrial Development Fund in order to secure the financial resources necessary for promoting balanced development and nationalization of industry. These are only two examples of the integral role the government has played and continues to play in the development of the Korean economic structure.
sive industries. The likelihood of this occurring will be analyzed in the next subsection.

The removal of GSP benefits will affect the United States-South Korea relationship in two ways. First, it will be more strained and fragile. "Not since . . . Carter threatened to pull out American troops more than a decade ago have U.S.-South Korean relations in trade, security and culture been so uncertain or so emotionally charged." The removal of GSP benefits represents the symbolic disunity of the nations. Second, the removal of GSP benefits eliminates an American bargaining chip to convince Korea to lower trade barriers and impose stricter copyright laws. In the past, Korea was encouraged to consider American concerns through such economic persuasion. The removal of the benefits eliminates this incentive.

As this discussion suggests, it is difficult to measure the objective and subjective costs of GSP removal. The United States-South Korea relationship will experience changes. Whether these changes will be for the better is unclear.

4.3. Impact Upon LDC's and other Developing Nations

A rationale for the graduation of the four NICs was that it might "enable other less developed countries to benefit more fully from the GSP program." Unfortunately, this aspiration contradicts conclusions made by Senate Hearings in 1983 and the message transmitted by the President to the United States Congress in 1980. This subsection will first focus on the feasibility of other developing nations benefitting from the graduation of the NIC's. Second, international concerns and reactions to the graduation will be examined. Finally, the potential effects of these reactions upon United States trade relations will also be analyzed.

Although a major recipient of GSP has never previously graduated from the American GSP, the effects of "selective graduation" present an accurate measure of what is to be expected upon the complete graduation of a country. In the Presidential message of 1980, it was stated that "[w]hile the competitive need limits have graduated major beneficiaries from receiving duty-free treatment for a large share of their eligible trade, these limits to date have not resulted in a wider distribution

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85 These topics are beyond the scope of this article. See generally Chang, Guide to Protecting Trademarks in Korea, 82 Pat. & Trademark Rev. 412-29 (1984).
86 Message from the President, supra note 1.
87 Senate Subcomm. Hearing on GSP, supra note 37 (statement of William Brock).
88 See First Five Years' Operation, supra note 12.
of GSP benefits among developing countries." It was admitted that for a country to utilize the United States GSP program, "it must be far enough along the development path to have a fairly well-developed infrastructure and productive capacity in the manufactures that predominate the U.S. scheme." The International Trade Commission supported this argument when it declared that "many LDC's lack the essential infrastructure, capital and skilled labor necessary to utilize effectively manufacturing opportunities offered by the GSP." Thus the LDC's, especially in the short-run, would be unable to significantly increase their portion of the program's benefits due to the graduation of the NIC's. The LDC's lack the appropriate infrastructure and economies of scale necessary for these industries to be sufficiently profitable at the present time. Graduation will not lead to redistribution.

Other GSP recipients must consider the implications of Korea's graduation. Although Korea's trade barriers were not officially cited as the reason for its graduation, other nations may interpret this as retaliatory act. For example:

The implications of the U.S. GSP action worry both Thailand and Indonesia. While continuing Thai status hinges on it enacting copyright legislation, Indonesia's benefit depends upon a U.S. decision on a petition against lack of labour rights brought by the American Federation of Labour and Congress of Industrial Organizations.

In addition to these specific concerns, there is a general feeling that a breach of good faith has occurred. "The withdrawal of the advantages enjoyed by the developing States under the GSP by a preference-giving country would constitute a breach of the principle of good faith, which is a cornerstone of international law." Developing nations are concerned that the graduation of the NIC's is only the beginning of a trend of restricting imports into developed nations' markets. They seek freer trade and not protectionist threats.

The United Nations Conference on Trade and Development Report of 1984 illustrates the concerns that various developing nations possess:

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89 Id.
90 Id. at X.
91 Renewal of the GSP, supra note 18, at 636.
93 YUSUF, supra note 4, at 115.
The representative of India recalled that the developed countries had committed themselves in 1983 to halting and reversing protectionism; yet there had been increased protectionism . . . Exports of developing countries in a number of sectors in which they gained competitive advantage had come under one or the other form of protectionist regulation . . . [and this] contributed to the erosion of confidence in the international trading system.95

The representative from Malaysia reiterated his country's support of free trade, but questioned the intensification of protectionist measures, especially in North America.96 He explained how his nation "had a comparative advantage in a variety of products. Unfortunately, those products could not be exported or even produced, as markets were closed to them even before they had a chance to enter."97 Finally, he warned that "protectionism had serious repercussions, not only on trade, but also on economic, social and political systems as a whole."98 Government officials as well as manufacturers in the United States must consider the implications of United States trade measures upon these other spheres of international relations.

The concerns voiced by the Malaysian representative at the Trade and Development Conference should not be dismissed. "The ASEAN99 countries are of great political and strategic importance in themselves because they straddle crucial sea-lanes and are neighbors of troubled Indochina . . . Thus U.S. economic policy for ASEAN has an important political and strategic dimension."100 Developing nations are concerned with the protectionist measures implemented by the United States. Their displeasure will affect their willingness to eliminate their own trade barriers. This action will harm exporters from the United States who will be unable to penetrate those markets. Furthermore, the deterioration in trade relations will affect other facets of international relations.

95 Id. at 48.
96 Id. at 52.
97 Id. at 53.
98 Id.
99 The Association of South-East Asian Nations (ASEAN) was formed in August 1967 by Indonesia, Malaysia, Thailand, the Phillippines and Singapore. The association was established to promote cooperation, economic growth, social progress and stability in the region. The principal instruments of ASEAN are the ASEAN Declaration of 1967 and the Agreement, Declaration and Treaty signed in 1976. See Singapore and International Law, 19 Malaya L. Rev. 401, 407-31 for the texts of the ASEAN Declaration of August 8, 1967, and various ASEAN treaties and instruments.
The general implication is that other nations will be less interested in discussing with the United States issues such as free international trade and other concerns of the United States. Cooperation would be replaced by confrontation and the goal of integrating the developing countries into the international economy would fail miserably. This is not the path that we should follow.

5. Conclusions

An examination of the purposes of the Generalized System of Preferences and the reasons enumerated in the Presidential message which formally removed South Korea from the GSP show that the graduation was not an appropriate response to the situation. It is not denied that South Korea is within a classification distinct from the “developing nations.” South Korea, however, is not a completely developed nation. Rather, it is currently in a transitional stage. The removal of GSP benefits may only affect a small part of Korea’s trade, in an area of the economy that has been predicted to decline. What is wrong with simply accelerating the process?

The problem with such a rationale is that it is too narrow and only focuses on the short-term. It eliminates benefits for particular goods and particular countries with the vague hope that the nations that truly need the assistance will be able to develop the appropriate industries in a short period of time. Simultaneously, the NIC’s are congratulated for their stupendous economic growth and are welcomed into the international economic community as “equal members.” Unfortunately, the NIC’s are still inferior economically relative to the developed nations of the world. There is a better policy.

Korea and the other NIC’s could assist the LDC’s to build infrastructures that would be conducive to receiving benefits under GSP. Perhaps Korea could utilize the labor-intensive resources of other countries at a time when its own population and economy can be classified as less labor-intensive. Just as the United States was able to take advantage of lower labor costs in Korea in the late 1970’s and early 1980’s, so too could Korea. Korean investment in such projects would supply the necessary capital. If Korea agrees to provide such assistance, the United States should reinstate certain GSP benefits to South Korea. As Korea continues its growth, it will eventually be phased out of the GSP.

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1 See 1984 Trade Act, supra note 17.
2 Id.
3 See MESSAGE FROM THE PRESIDENT, supra note 1.
Korea's graduation from the GSP should have been delayed until Korea was better developed and the LDC's learned to utilize better the GSP programs of the United States and other industrialized nations. A transitory stage between "beneficiary" and "graduate" of GSP is necessary. This transitory stage should include characteristics of both categories. It should fulfill the goal of integrating all developing nations into the international economic system. It should strengthen the ideals of free trade. This would allow more economically secure nations to help other nations less fortunate to the degree that they are able. The global economic order that will be most beneficial to the United States is one free from barriers and obstacles. We must, therefore, be its most vocal supporter. "Implementing protectionist legislation or free trade legislation in a protectionist fashion will not provide developed countries with a solution to limited growth. Rather, the solution lies in open, fair, and free trade."104