S. HRG. 110–1053

# OVERSIGHT OF U.S. TRADE PREFERENCE PROGRAMS

## HEARING

BEFORE THE

## COMMITTEE ON FINANCE
## UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

JUNE 12, 2008

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

57–557—PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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# OVERSIGHT OF U.S. TRADE PREFERENCE PROGRAMS

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**THURSDAY, JUNE 12, 2008**

U.S. SENATE,
COMMITTEE ON FINANCE,
*Washington, DC.*

The hearing was convened, pursuant to notice, at 10:07 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Bingaman, Lincoln, Cantwell, Grassley, Smith, and Bunning.

Also present: Democratic staff: Bill Dauster, Deputy Staff Director and General Counsel; Demetrios Marantis, Chief International Trade Counsel; Chelsea Thomas, International Trade Analyst; and Claudia Martinez Garcia, Fellow. Republican staff: Claudia Poteet, International Trade Policy Advisor; David Johanson, International Trade Counsel; and Stephen Schaefer, Chief International Trade Counsel.

## OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

On the plains of Moab, Moses told the Israelites, "If you see your fellow's ox fallen on the road, do not ignore it. Help him to get it to its feet." In Montana's Gallatin Valley, farmers apply the same good neighbor policy. Once Montana families have harvested their crops, they help their neighbors to finish their work. They help because it is the right thing to do; it is just who we are as Montanans.

In the global economy, just as in the plains of Moab and the valleys of Montana, good neighbors do what they can. They do what they can to help those in need. That is why America has trade preference programs, and that is why we have the Generalized System of Preferences and the Andean Trade Preference Act.

Today we will review this important piece of our trade agenda, our trade preference programs. Many Senators on this committee care deeply about these programs: Senator Bingaman has advocated enhanced trade preferences for Haiti, the poorest country in the Americas; Senators Cantwell and Hatch have worked hard to bring economic opportunity to war-torn Afghanistan and Pakistan; and Senator Smith has advocated providing preferences for the world's least-developed countries.

Preference programs are the tools that we have, but as we continue to use them to help our neighbors we need to ask, are these the tools that our neighbors need? Are our preference programs the best way to help our neighbors?

With two preference programs expiring this year and the rest in coming years, we need to ask these questions of ourselves and of those whom we wish to help. For us and for our neighbors, we cannot let these programs expire. But for us and our neighbors, we must make our preference programs the best that they can be.

First, we must look at how we are helping. Can beneficiary countries utilize our programs, or are they too complicated to be useful? Do staggered and short-term extensions create too much uncertainty? Would longer-term programs be more effective, or would longer-term programs reduce the incentive for countries to be better trade partners?

Second, we must look at which countries we are helping. Are we helping those in greatest need? Do countries like Bangladesh and Cambodia suffer because America does not give them preferences as favorable as those that we provide to our African partners?

Should we continue to provide preferential market access to more economically advanced countries like Brazil and Russia? Are we helping countries that could be doing more to help themselves, frankly?

Finally, we must look at why we are helping. Let us ask how these programs help our economy. Do these programs work for U.S. businesses? Do they create jobs here at home? Are American investments and beneficiary countries secure? We do not want to help countries that refuse to help themselves, and we do not want to undermine America's goals in multilateral trade negotiations. We help because it is the right thing to do. We do it because our programs help others to help themselves. We do it to help build sustainable economies in a developing world. We help because these programs often work: Singapore, Chile, and Korea are moving from beneficiary countries to dynamic global economies.

Farmers in the Gallatin Valley of Montana have a few months until harvest. We here have a few months until two of these programs expire. Montana's farmers will use that time well, and we must do the same. Let us extend these programs the right way. Let us help to get our neighbor's oxen back on their feet. Let us help our neighbors to reap a plentiful harvest that we all can enjoy.

Senator Grassley?

**OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. Mr. Chairman, 30 seconds for a point of personal privilege. Because we are dealing with things like how the United States can help the rest of the world, I would like to point out that I would be remiss if I did not say a few words about my home State of Iowa, and there are a lot of other States in the Midwest affected, being very hard hit either by tornadoes, which was the case of my home town of New Hartford or neighboring Parkersburg. Now much of the eastern part of Iowa and parts of central Iowa are under rains and floods that are as bad as they were in 1993.

Just last night, four boys were killed at a Boy Scout camp in western Iowa when a tornado went through. So I would like to make sure that the people back home, and here, know that we are concerned about what happens back home as well as around the world.

The CHAIRMAN. I might say, Senator Grassley, I am just so impressed how people are pitching in, throwing sandbags, and helping as good neighbors in Iowa, helping everybody out in this tragedy.

Senator GRASSLEY. Yes. Very characteristic of our kind of people.

This is a very important hearing, Mr. Chairman, so thank you very much. It is something you and I have had a great deal of discussion on, and we always get together on these issues. We may be coming from a little different point of view, but we believe that these programs do serve a very valuable purpose.

Our trade preferences merit fundamental reconsideration on three levels: first, what is their purpose; second, how effective are they in achieving it or can their operation be improved; and third, do U.S. trade preferences undermine our broader trade policy objectives to any extent? If so, how can they be reconciled? This reconsideration of our preference programs is needed because the answers to at least some of these questions may have changed since these programs were started decades ago.

Those changes may have consequences for how we utilize our trade agenda to advance our national economic and foreign policy interests. If we accept that our preference programs are primarily intended to help facilitate economic development in beneficiary countries, it is natural then to ask how well they are achieving that objective.

According to GAO, the distribution of benefits appears limited. Our broadest preference program, GSP, has been in place since 1975. Of the 131 beneficiary countries, the top 10 account for over three-quarters of our imports under GSP. Similarly, if you consider all preference programs together, the top 4 beneficiary countries account for over half of our imports under those programs, while the top 25 account for over 95 percent of such imports. A threshold concern then is how to spread those benefits more broadly.

The composition of imports raises another concern. Fuel accounts for about 60 percent of our imports under preference programs. How can we utilize our preferences to better facilitate vertically integrated business development in beneficiary countries outside the energy sector? That is an issue that we have been grappling with under the African Growth and Opportunity Act (AGOA).

On the other hand, we also need to consider the point at which it becomes appropriate to limit or withdraw benefits under preference programs. The GSP does contain limitations on the amount of preferential treatment to beneficiary countries, but those limitations can be waived.

Congress took a first step in reforming the waiver framework in 2006 by providing for the review and revocation of such waivers if they have been in place for 5 consecutive years and the volume of imports reflects that such imports have become super-competitive. We need to further review the conditionality that attaches to our various preference programs and assess whether the operation and administration of those conditionalities can be improved.

We must also guard against complacency. Trade preferences should not be taken for granted. That goes for U.S. importers as well as foreign governments. I am concerned that we are seeing evidence of complacency from some of the advanced developing countries in ongoing WTO Doha Round negotiations. If trade preferences become an obstacle to achieving broad multilateral market liberalization, then we need to rethink the construct of our preference programs.

And, finally, we need to consider, what are the limitations of these programs, and other factors such as civil strife, conflict, inadequate infrastructure, and an inefficient transportation network. Poorly developed capital markets, and even political corruption may play a large role in impeding sustainable economic development.

So I put it to our witnesses: how should we utilize our preference programs to better facilitate this sort of sustained economic development? As developing countries prosper, how do we transition them to more mature reciprocal trading relationships?

Thank you.

The CHAIRMAN. Thank you very much, Senator.

I would like, now, to introduce our witnesses. Today's panel begins with Loren Yager, Director of International Affairs and Trade, U.S. Government Accountability Office. Following Dr. Yager is Mr. Grant Aldonas, principal managing director for Split Rock International. Grant, welcome back to the committee.

Mr. ALDONAS. Thank you.

The CHAIRMAN. Our third witness is Ed Gresser, director of the Project on Trade and Global Markets at the Progressive Policy Institute, and the author of "Freedom From Want." Ed, it is very good to see you back again.

And finally, we welcome Father Andrew Small, Foreign Policy Advisor for the United States Conference of Catholic Bishops. Thank you, Father, for attending.

As is our usual practice, I would ask each of you to give about 5-minute statements, and your prepared statements will automatically be included in the record.

Dr. Yager?

**STATEMENT OF DR. LOREN YAGER, DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC**

Dr. YAGER. Thank you. Thank you, Mr. Chairman. I am pleased to be here today to report on our work on U.S. trade preference programs. Since the committee's hearing last year on this subject, GAO has completed two in-depth studies of U.S. preference programs for the Finance Committee and the Committee on Ways and Means.

This hearing is particularly timely, as it provides an opportunity for the Congress to review the progress and performance of these programs as a group and begin to address some of the difficult questions that you posed in your last hearing and that you both posed in your opening statements.

In order to contribute to that discussion, I will address two topics today. First, I will outline key policy trade-offs involving various domestic and foreign interests that are inevitable in the design of preference programs. Second, I will summarize our recent recommendations regarding the importance of considering the preference programs as a group.

Let me first talk about the policy trade-offs. I know that the committee discussed some of these trade-offs at the last hearing. I know two of my fellow panelists are also very familiar with the difficult policy trade-offs from their time working for the Finance Committee and in the administration on these very issues.

First, the programs are designed to offer duty-free access to the U.S. market, but only to the extent that they do not harm U.S. industries. Because of this, they exclude certain products from duty-free status, including some that the developing countries are capable of producing and exporting. As a result, there are notable gaps in product coverage, particularly in agricultural and apparel markets.

The second trade-off involves deciding which developing countries can enjoy preferential benefits. Two least-developed countries, Bangladesh and Cambodia, have become exporters of apparel to the United States but do not have duty-free access for their goods because they do not qualify for a regional program. On the other hand, African private sector spokesmen have raised concerns that giving preferential access to Bangladesh and Cambodia might endanger the African apparel export industry that has grown up under AGOA.

This same trade-off involved decisions regarding the graduation of countries or products from the programs. In terms of products, over one-third of the trade from GSP beneficiaries, $13 billion in 2006, is no longer eligible for preferences because countries have exceeded the Competitive Need Limitations for those products. Although the intent of country and product graduation is to provide greater benefits for poor countries, we repeatedly heard concerns that China would be most likely to gain U.S. imports as a result of a beneficiary's loss of preferences.

Policymakers face a third trade-off in setting the duration of preferential benefits. Preference beneficiaries and U.S. businesses that import from them agree that longer and more predictable renewal periods are desirable. Members of Congress have recognized this argument with respect to Africa and renewed AGOA's general provisions until 2015.

However, some U.S. officials believe that periodic program expirations can be useful as leverage to encourage countries to act in accordance with U.S. interests, such as global and bilateral trade liberalization.

Let me now turn to the second issue, that the preference programs have proliferated over time. In response to differing statutory requirements, agencies pursue different approaches to monitoring the various criteria set for programs. The result is a lack of systematic review and little to no reporting on impact.

Let me list just a few examples. One, many countries participate in more than one of these programs. Of the 137 countries eligible for preference programs, more than half were eligible for two or more programs. And while there is overlap in various aspects of trade preference programs, each program is currently considered separately by Congress based on its distinct time table and expiration date.

Only one preference program directly links to capacity building, even though many nations lack the capacity to effectively participate in international trade. Finally, separate reporting for the various preference programs makes it difficult to measure progress towards achieving the fundamental and shared goal of promoting economic development.

To address the concerns I have summarized today, GAO recommended that USTR more consistently review beneficiary countries and hold more joint evaluations and discussions. USTR just wrote a letter to the Congress detailing their plans to address the GAO recommendations.

We also suggested that Congress should consider whether trade preference programs' review and reporting requirements could be better integrated. We believe that the hearings held by the committee last year, and again today, are consistent with the need to consider these programs in an integrated fashion.

Mr. Chairman, this concludes my prepared statement, and I would be happy to answer any questions that you or other members have.

The CHAIRMAN. Thank you, Dr. Yager.

[The prepared statement of Dr. Yager appears in the appendix.]

The CHAIRMAN. Mr. Aldonas?

**STATEMENT OF GRANT ALDONAS, PRINCIPAL MANAGING DIRECTOR, SPLIT ROCK INTERNATIONAL, ARLINGTON, VA**

Mr. ALDONAS. Thank you, Mr. Chairman.

Mr. Chairman, Senator Grassley, members of the committee, I want to thank you for the opportunity to come back to the Finance Committee. Before I start, I would just like to add, Mr. Chairman and Senator Grassley, thanks for the hard work that you have done, and the committee has done, on Trade Adjustment Assistance over a sustained period. I have to say that personally I think the reform and expansion of those programs is absolutely critical to help American workers meet the challenges of competing in a global economy. So, thank you very much.

The CHAIRMAN. Could you say that one more time, please? [Laughter.] Thank you.

Mr. ALDONAS. With respect to today's topic, I want to thank you as well. I know that it is a busy time for the committee and a busy time for the Senate, so taking the time to do the oversight necessary on our preference programs is important. As reflected in my written statement, our preference programs can play a critical role in our trade and development policies, but in my view, as currently structured, they work at cross purposes with our goals in both those areas.

I would summarize my critique of our preference programs like this: economic development is a microeconomic rather than a macroeconomic phenomenon and involves the process of economic change. That requires changes in economic incentive structures that shape individual behavior.

In a global economy, economic development depends heavily on connecting people to world markets, both as producers and significantly as consumers. To be effective in that context, our preference programs, along with the other elements of our development policy, should focus on eliminating the disincentives that prevent the poor, both as consumers and producers, from realizing the benefits of markets. Our goal, as a consequence, should be to offer the broadest possible opportunity for the poor to engage in trade. In return, we should ask that the beneficiary countries create the conditions necessary for local markets to flourish.

The question the committee should ask, therefore, as a part of its oversight, is whether our preference programs meet that challenge. Do they maximize the incentives facing market participants in beneficiary countries in ways that ensure broad economic opportunity, both locally and globally for the poor? In my view they do not, for the reasons I stated in my written statement.

Within that framework, I do want to highlight one problem in particular, and that is the inconsistency between our preference programs and the other aspects of our trade policy that, from my perspective, are just as important to economic development. And here I may differ slightly with some of my colleagues, including my good friend, Fr. Andrew.

Trade agreements are preferable to preferences for a pretty simple reason: the benefits of trade flow from both exports and imports. The real gains from trade come from efficiencies generated by specialization, in other words, shifting your economy toward what it does best.

Focusing solely on exports eliminates the benefits you gain from imports and the freedom they give you to specialize, which is why we should encourage developing countries, particularly the more advanced developing countries, to engage fully in trade liberalization so that they gain from both ends of the trade equation.

As currently structured, our preference programs work against that goal as well as work against America's own trade negotiating objectives. Both my own experience as a trade negotiator and the economic evidence to date reinforce the conclusion that our preference programs have, in practice, eroded the incentive to negotiate further trade liberalization among a number of rapidly rising developing countries. Indeed, the Doha development agenda has, in part, foundered on precisely that problem.

As a remedy, I would suggest a 6-point agenda for achieving our trade and development goals. First, I would recommend the committee expressly limit the availability of our preferences to the least developed countries in the world. I would suggest adopting a single set of conditions that apply to both our preference programs and our development assistance, conditions that focus on eliminating the barriers the poor face in gaining access to markets, both locally and globally, both as consumers and as producers.

Third, we should create a single process for consideration of potential beneficiaries, both for our preference programs and for our development assistance. We should gear our development assistance toward individual entrepreneurs rather than governments, particularly where it would help connect them to global supply chains that form the basis of competition in the global economy.

Fifth, we should gain greater operational consistency by combining the administration of our preference programs with our development assistance programs.

Sixth, I feel we should adopt a broader trade policy approach consistent with delivering on the promise trade holds for the poorest in the world. Toward that end, I would recommend a grant of negotiating authority to the President to, number one, negotiate a free trade area within the WTO among developed countries willing to move rapidly toward that goal in order to offer the broadest possible market opportunities not only for our exporters, but also for firms and workers in the least-developed world.

I would also suggest, number two, that we harmonize our preferences with our developed country trading partners so that entrepreneurs building businesses in Africa, in Asia, and Latin America would know that they could sell as easily in Athens, Greece as they could in Athens, GA.

Thank you.

The CHAIRMAN. Thank you very much. That was very helpful.

[The prepared statement of Mr. Aldonas appears in the appendix.]

The CHAIRMAN. Mr. Gresser?

**STATEMENT OF EDWARD GRESSER, DIRECTOR, PROJECT ON TRADE AND GLOBAL MARKETS, PROGRESSIVE POLICY INSTITUTE, WASHINGTON, DC**

Mr. GRESSER. Thank you very much, Mr. Chairman. Let me echo Grant's comment on Trade Adjustment Assistance. I think the committee really deserves some praise and thanks for its work on that issue.

Let me make three basic points. First, I believe trade preferences over the last 30 years have made a very valuable and important contribution to American trade policy and to some of our national security goals. They cover a modest fraction of trade, roughly 2 percent of non-oil trade, or roughly 4–5 percent if one includes energy.

But, within this small scope, they have done some important things: the Caribbean Basin Initiative in the 1980s and 1990s helped Central America restore its economic stability and recover from the era of wars and guerrillas and death squads at that time. The AGOA program has helped Lesotho and Swaziland, very small and poor countries hit hard by HIV and AIDS, as well as Madagascar, to employ thousands of women in garment industries. Andean program flowers are a major job opportunity for Colombians and for Ecuadorans, especially in rural areas.

And many middle-income and lower-income countries—Paraguay, Thailand, India, Armenia, the Philippines, Indonesia, Turkey—rely very heavily on GSP for competitiveness in light industry vis-à-vis China. They are not substitutes for multilateral liberalization, nor are they guarantees of export success for beneficiaries, but, as these examples show, they are an important part of American trade policy. They have contributed to development, and they have made an important contribution to security as well.

Looking ahead though, I would say they face two significant challenges. One of these is geographical. The preferences offer relatively little benefit to least-developed countries in Asia and the

Pacific and they do not offer much benefit to some of the large majority-Muslim countries that are at the heart of our largest national security concern.

Here we could cite Cambodia as a good example. Cambodia's clothes face some of the highest tariffs we have in our schedule. Last year, Cambodia's $2.4 billion in exports faced a $419 million tariff penalty. This is a larger tariff penalty than the $412 million that British goods faced, and those totaled $57 billion altogether. Pakistan is in a similar state, Bangladesh is similar, and Nepal as well as a number of other small, low-income countries that are important to us for a variety of reasons.

Here, I would like to note and applaud two proposals, one by Senator Smith and Senator Feinstein, the Trade Act, and one by Senator Cantwell and some others to provide a special benefit for Pakistan's border regions and Afghanistan.

The other challenge is in policy. Some countries, I believe, could use their preferences more effectively with better technical support and capacity building. Here I would point in particular to Africa, where a number of countries are struggling with inadequate infrastructure and port management. A number of countries could be selling non-import-sensitive agricultural products to the U.S. if they had better support and advice on sanitary and phytosanitary standards.

On a deeper level, I would say three of the programs—AGOA, CBI, and ATPA—are struggling. If you look at their share of the American clothing markets, their share is going down. It is not only going down by share, but by absolute exports. So, despite the extensive benefits these programs offer, the beneficiaries are not using them as well as one would have hoped.

My hypothesis is that the unusual qualifying procedure for clothes, known as the Rule of Origin, may be at the heart of this problem, because we can see the same thing happening in our FTAs. The GSP system is less extensive and covers fewer products, but the beneficiaries seem to be holding their share of the market. In the regional programs for clothing, they are losing their share of the market.

This, I believe, is because, in order to qualify a T-shirt or pair of pajamas, most of the beneficiaries have to show that the inputs came from particular places, from the United States, from internal sources. I do not think this matches up very well with the multinational supply chains that most manufacturers use and that are most convenient for retailers and buyers to use. If these programs are to contribute in the future as they have in the past, I would suggest that we need to look hard at these rules and maybe reshape them.

My final point is that these programs are not the world of trade. Africa is struggling in its clothing exports. Africa, at the same time, is surging in its other exports to the world. Since 2002, the African continent's exports have grown from about $140 billion to about $420 billion, led by energy and metals and so forth.

I would suggest that it is time for us to work with the African countries to see how this influx of cash can be used to fix some of the infrastructure problems and capacity problems that have made trade difficult for Africa.

Let me close there. Once again, I thank you very much for your invitation and for holding this hearing today.

The CHAIRMAN. Thank you, Mr. Gresser, very much.

[The prepared statement of Mr. Gresser appears in the appendix.]

The CHAIRMAN. Fr. Small?

**STATEMENT OF FR. ANDREW SMALL, FOREIGN POLICY ADVISOR, UNITED STATES CONFERENCE OF CATHOLIC BISHOPS, WASHINGTON, DC**

Fr. SMALL. Good morning, Mr. Chairman, Senator Grassley, honorable members of the committee. I would like to begin by offering my condolence, and those of the Bishop's Conference, to the Senator and the people, particularly those who lost loved ones very abruptly and tragically.

The Bishop's Conference is grateful for this invitation to offer testimony on oversight of trade preference programs. The notion of preference itself, the subject of today's hearing, is one that lies at the heart of the church's vision for economic activity in which rules governing economic life can, and should, be designed so that the dignity of all, especially the poor and vulnerable, is respected.

Promoting development among the world's poor nations was a priority at the dawn of the world trading system, and this squares well with the Catholic tradition where the economy exists to serve people and not the other way around.

Pope Benedict XVI, a recent visitor to our Capitol city, reiterated this call only last week, speaking about the need for globalized solidarity as the global hunger crisis worsens. Our entire body of bishops offers the following advice, as they do every 4 years. This year during this election season they say, "While the common good embraces all, those who are weak, vulnerable, and most in need deserve preferential concern."

The committee has heard from several experts on the current state of U.S. preference programs. I would like to highlight the impact of these programs on two of the poorest countries in our own hemisphere, Haiti and Bolivia.

Church leaders from both countries visited Washington to speak about the need to both expand and strengthen these programs, and we are grateful to you, Mr. Chairman, Senator Grassley, and the committee for the support that you have given to these programs.

Haiti, as we all know, has known a great deal of hardship. In the early 1980s, employment in the apparel sector began to decline, from 100,000 jobs to around 15,000 by 2004. Since the U.S. began implementing the HOPE Act of 2006, Haiti has recovered approximately 5,000 jobs. This achievement is modest, but it is especially important for people like Carlène, a mother of two who lost her job in October of 2006. With new orders coming in because of HOPE, Carlène started working again in January of this year. The same is true for Samuel, a father of two, who like Carlène now gets his paycheck every 10 days.

Arnelle received computer training after she lost her job in 2006, and her training was paid for by remittances sent by a family living in the United States, so preference programs actually help people remain in their home countries and resist the push to emigrate.

These kinds of jobs, on average, earn about $5 or more a day, and while this might seem incredibly low it is 4 times the country's per capita income and enough for a family to pay for food, shelter, and clothing. So, as well as meaningful preferences, these programs need to be reliable.

On a visit to Washington last February, Cardinal Terrazas from Santa Cruz, Bolivia urged long-term extension of the preferences Bolivia receives under the Andean Trade Promotion Drug Eradication Act (ATPDEA), and he reported how much these U.S. preference programs are known by the Bolivian people and are valued by ordinary Bolivians, many of whom depend upon them to develop viable alternatives to coca production.

Of course, trade policy needs to promote more than economic growth, and that is why USCCB has urged a strong link between trade and human rights, including labor and environmental protections, access to lifesaving medicines, and respect for freedom and democracy.

As the global economy integrates, USCCB, the Bishop's Conference, urges lawmakers to prioritize the rights and dignity of workers at home and abroad, taking meaningful steps to help those in the U.S. who lose their jobs because of globalization.

There is a Haitian proverb: "Beyond the mountains there are more mountains." It refers to the peasant farmer's dream of neverending lands yielding bounty upon bounty. But for many, the path to a better life is blocked by insurmountable obstacles.

U.S. preference programs make straight the path for poor country exports, and they offer a unique way for countries like the United States to build global solidarity using trade laws to privilege the powerless. They bring hope and life to millions of people like Carlène, Samuel, and Arnelle, and for that I would like to say thank you.

The CHAIRMAN. Thank you, Father, very much.

[The prepared statement of Fr. Small appears in the appendix.]

The CHAIRMAN. I would like to ask the four of you, what are the top three changes that you think we should make to the current preference programs? We will go down the table here. I do not have a lot of time here. I have about 4½ minutes left. So could you just, very briefly, like one minute?

Dr. YAGER. All right. Mr. Chairman, I think we made a couple of specific recommendations in our reports to USTR to align the reporting of the results of these programs, as well as to look for different ways to ensure that the review of different countries—for example, in GSP—is more uniform than it has been in the past.

I think there are also opportunities for the Congress to help align the goals of these programs and to simplify them, not necessarily, as Grant said, along with other countries, but even within these programs to ensure that they are not working at cross purposes. Because, for example, some countries now might not choose to be reviewed for AGOA or may not be eligible, they may in fact be still eligible for GSP, which could be at cross purposes with the goals of the programs.

The CHAIRMAN. So more reporting, more alignment, more accountability, basically?

Dr. YAGER. That is correct.

The CHAIRMAN. All right.

Mr. Aldonas?

Mr. ALDONAS. The first thing I would do is limit them to the least-developed in the world, the poorest who need the opportunity. We are now living in a world where the more advanced developing countries have access to investment capital that the least-developed do not. In that world, they do not need the preferences any longer, number one.

The CHAIRMAN. So who would you cut off?

Mr. ALDONAS. Brazil. Zimbabwe. Venezuela. There are a host of countries that either are not doing the things they need to do domestically to allow the preferences to work, or frankly, they work against the broader effort to liberalize trade that would benefit the least-developed countries.

The CHAIRMAN. So you would shift away from the more developed and focus much more on the least-developed.

Mr. ALDONAS. Absolutely. It increases the preferences that they benefit from if you focus on the least-developed countries.

The CHAIRMAN. Go ahead.

Mr. ALDONAS. The second thing is a single set of criteria that focuses on developing markets domestically in the developing countries. The third thing is that we should put the money on the table with our trade preferences. We really should come to the table, both with our development assistance budget and our preferences, when we sit down to talk with countries and we should say, look, let us understand what you need in the way of infrastructure to get your goods to market, let us build those markets with you domestically, and let us find a way to help you link those markets to the global economy, which is what our preferences do.

The CHAIRMAN. All right.

Mr. Gresser?

Mr. GRESSER. I would say, try to fill the gap for the least-developed countries in Asia and the Pacific and the Muslim world. Two, improve development assistance and capacity building for Africa. Three, probably make the programs a bit longer and with more synchronized renewals.

The CHAIRMAN. What would you do about the eligibility criteria? To what degree do we know that the countries who participate are focusing on those, that those conditions are being met?

Mr. GRESSER. I think we could probably do a better job in weeding out genuinely bad actors. Grant mentioned Zimbabwe and Venezuela as kind of odd beneficiaries of these programs. I would say also that we should have a shorter and less complicated list of eligibility criteria than we do now because, the more you create very specific and multiple categories and reasons for eligibility or non-eligibility and the more you create very detailed limits on the type of products that can be imported under these programs, the harder they become to use and the less valuable they become to the beneficiaries.

The CHAIRMAN. All right.

Fr. Small?

Fr. SMALL. Just agreeing with a lot of what my colleagues have said, but it just seems such a difficult thing to try to figure out, which is why we tend to talk about it on a case-by-case basis. Associating worker protections and labor provisions as we did with the recent HOPE II Act, I think, was a great way forward. Maybe increasing that so that it is more capacity building around labor rather than, there is always the carrot and the stick. I think the carrot will probably work if we focus on those countries that, as Grant says, should be focused on, which are the least-developed countries.

The CHAIRMAN. So do you all agree that we should begin to limit some of the more developed countries and focus more on the least-developed? Does anybody disagree with that basic point?

Fr. SMALL. I suppose the conference could not go on record as saying who should not get the preferences.

The CHAIRMAN. Right. Right.

Fr. SMALL. We generally say who goes to heaven, but we do not say who goes to hell. [Laughter.]

The CHAIRMAN. Right. I am not going to touch that one.

Fr. SMALL. Not even Martin Luther got that.

The CHAIRMAN. What about India? Does anybody have a view about India?

Mr. ALDONAS. Yes. India was the principal obstacle, frankly, to the launch of the round in Doha. India is the principal obstacle now in terms of actually concluding the round. Any movement at all in terms of goods and services can make a significant contribution to liberalization, not only for the benefit of American exporters, but for the poor in the world.

The CHAIRMAN. My time is expiring, but just one question. What are the potential unintended adverse consequences of starting to phase out the Indias and the Brazils of the world? What are the consequences of doing that?

Mr. GRESSER. Well, most of the goods, particularly under India's GSP, are non-import-sensitive. If India's privileges are limited, they will drift off to China, Vietnam, or some other country. India is a large, rapidly developing country, but it is also a very poor country, with a $700 or $800 per capita income. Many of the people who work in the GSP industries in India are low-income women whom I think deserve and need some support.

The CHAIRMAN. Thank you very much.

Senator Grassley?

Senator GRASSLEY. Yes. Thank you very much.

Mr. Gresser, I think you wrote about something I want to ask you about, so not a very specific question, but your views. This is where I am coming from, because I have noticed that some of the strongest congressional supporters of preference programs also oppose negotiating new trade agreements. That is puzzling to me. It seems to me that liberalizing trade is a powerful tool for helping the poor in other countries, and GSP is one example of trying to do that. When folks oppose greater trade liberalization, they are hurting the poor, not helping them. Your views?

Mr. GRESSER. Well, among the group of people who are supporting preferences and are unhappy with trade agreements, I think there are probably a range of views. I do not presume to speak for them, particularly for people in Congress, but there is a group of people who feel that the FTA asks too much of low-income countries. There may be people who place kind of very high reliance on conditionalities and the potential of withdrawing benefits as a way to influence the policies of beneficiaries.

In my experience, this is not as easy to do as one might think at first glance, but maybe those are some of the explanations. I do agree with you that liberalizing trade has been a real benefit for the poor in the world. Last year, Muhammad Yunus from the Grameen Bank testified to that. I think his words were very eloquent and well worth recalling.

Senator GRASSLEY. Mr. Yager, last year the administration revoked Competitive Need Limitation waivers for eight super-competitive products under GSP. The purpose of the revocation was to provide additional import opportunity to other beneficiary countries. Your testimony mentioned that beneficiaries of GSP will not necessarily profit from another country's loss of preference. However, I feel we have some trade data suggesting revocations were a success.

To just give an example, imports of gold jewelry are rising from other GSP beneficiary countries, as well as from our free trade agreement partner, the Dominican Republic. I expect that the administration will continue its efforts this year and revoke waivers on super-competitive requirements set out in the law. In any case, then how do you respond to the trade data, assuming I read the trade data right?

Dr. YAGER. Yes. Senator Grassley, I believe you are correct. I am familiar with one particular case where a Competitive Need Limitation on gold jewelry—I think it is the one you mentioned, that was certainly an unusual case because the volume that was being shipped under the waiver—by India, I believe—was over $2 billion, and so more than 10 times the threshold that normally would push a country's product out of the GSP program.

So it certainly is no surprise that, when you have an exporter like India that is pushed out of that kind of a volume of trade, that the benefits would be widely distributed across both preference beneficiaries, free trade partners, as well as other countries around the world.

I think it is a very useful exercise to go through and look to see what the effects of these revocations of the waivers are, and so we can actually do a little bit more and communicate with your office on that, because we think it is useful to see what happens in these cases.

The case that you mentioned, gold jewelry, though, was certainly one where there were a great deal of shipments under that program vastly in excess of the CNL limits, so it is not surprising that those benefits were spread around the world.

Senator GRASSLEY. I presume then that you feel that we do not have enough trade data to justify a very sweeping opinion in that direction?

Dr. YAGER. Well, I think what we wrote in the testimony was that there is no guarantee that the benefits will go to other preference beneficiaries, so I think that, by looking at the data, it is certainly a good way to determine whether, in fact, it occurs in that way. So we think it would be a very useful exercise.

Senator GRASSLEY. All right.

On another point, Grant, you suggested in testimony that we should ask beneficiaries of preference programs to create conditions for markets to flourish. For example, you mentioned private property rights for the poor and the needs to ensure enforceability of contracts. Are you suggesting that we should require countries to implement these types of reforms as a condition for receiving preferences?

Mr. ALDONAS. Thank you, Senator Grassley. That is exactly what I am suggesting. In the absence of those domestic reforms that allow individuals in the developing country to engage in that simple human freedom of exchange, there is not much hope for economic development, number one.

The other thing is, those rules are also consistent with creating contestable markets in which our exporters can compete fairly, so it helps both in terms of development, as well as our own commercial interests.

Senator GRASSLEY. All right.

Senator Baucus asked me to call the next person on the list, and that is Senator Bingaman.

Senator BINGAMAN. Thank you all for being here.

Mr. Yager, let me start with you. I have thought for a long time that one of our problems with trade generally is that we do not properly staff up the U.S. Trade Representative's office to do all the things that we require them to do. Accordingly, their priority has been to get more agreements signed. There is not enough time, not enough people to properly monitor what we already have in place.

Your comments about how these programs are not properly monitored, not properly reported on, all of that. Am I right that this is a symptom of the larger problem, that we are not properly staffing, not adequately resourcing our Trade Representative's office?

Dr. YAGER. It is certainly related to that point. For example, there is an annual review under the AGOA program in which each country is looked at each year. On the other hand, in the GSP, it can be many years between program reviews for individual countries. In fact, many of the countries in the GSP program have never been reviewed.

So when we talked to the Trade Representative's office, one of the things that did concern them was the work and the amount of effort necessary to go through the entire list of GSP countries on an annual basis. They looked at that as quite a daunting task. So, there are issues related to the requirements and the expectations on USTR and the staffing that they have to try to comply with congressional interests.

Senator BINGAMAN. Mr. Gresser, you point out here that in 2007 GSP covered $30.8 billion in goods, or $20.3 billion in goods, excluding oil. Why are we including oil in this? I mean, I have real trouble understanding given the demand for oil today, which we see reflected every time we drive up to the gas pump. Why do we have to give particular countries a preference to import oil into this country?

Mr. GRESSER. Senator, I cannot see any good reason for it. The tariffs on oil are small, specific duties, typically a quarter, a nickel, or fifty cents per barrel. I do not think they have any noticeable effect on trade. I think it is not really meaningful to include them in these programs. They should probably not be included.

Senator BINGAMAN. And is oil the main one or are there others that you would put in that same category? It just does not make any sense. I mean, the people producing oil or companies producing oil in these countries are not giving work to low-income people who otherwise would have no income as a general matter.

Mr. GRESSER. Yes. That is a very good point. We would be importing it no matter what in either case. There may be some other natural resource products in a similar state. I would have to look at the schedule. But I think oil is the big one.

Senator BINGAMAN. All right.

Mr. Aldonas, let me ask you here, the business of coordinating our development assistance and our trade preference policies makes a lot of sense to me. I think Dr. Yager talks about the fact that we do not have this linked to capacity building. How do all those three fit together? I mean, what are we talking about by way of capacity building that is not included in what you are describing by way of development assistance? Or maybe it is all the same thing.

Mr. ALDONAS. That is a great question. The world we are living in is really driven by competition among supply chains, and it would be useful to take that mode of thinking about the world and apply it to what we do from a development perspective, because what you will identify is what kind of domestic reforms you need inside the country to ensure that it has a vibrant market domestically. You will see what the infrastructure problems are to be able to link that to a global market, and you also identify the external barriers that those exports face, which is really what our preference programs address.

So, in one sense, you would be mirroring precisely what the buyers of the goods that Ed was describing look at when they ask, "Am I going to source in a place like Cambodia?" The financial part of it is to ask, "How do we finance the infrastructure, both human infrastructure, institutional infrastructure, and physical infrastructure to allow this to happen?"

So, ultimately, if you want to line up both our development assistance and our preference programs with the way the world works in the global economy, the best thing to do is to take that methodology and apply that analysis and really set a single set of criteria that would apply to both so, when you come to the table with a least-developed country, you have the opportunity to talk both about the money and about the preferences.

Senator BINGAMAN. My time is up. Thank you, Mr. Chairman.

Senator GRASSLEY. Next on the list is Senator Smith.

Senator SMITH. Thank you, Mr. Chairman.

Ed Gresser and Grant Aldonas, a number of members of the committee have introduced different types of models of trade preferences. Senator Feinstein and I have introduced legislation that would extend AGOA-like benefits to developed countries throughout Asia and the Pacific. I know others have models that are more targeted to areas within those areas.

I wonder if you could briefly discuss the pros and cons of both models and how business and investments respond to the two. Is there a better way or preference that you have as between these two types?

Mr. GRESSER. Just so I understand this correctly, a broad benefit for least-developed countries in general or a targeted——

Senator SMITH. Well, Senator Feinstein's and my bill for least-developed countries targets an entire region. For example, I think Senator Cantwell and Senator Hatch have one more targeted within a specific area within a country. My question is not a criticism of either, but really more a question of which is getting a greater response in terms of investment and business activity.

Mr. GRESSER. Well, I have thought, and PPI has advocated, a broad kind of benefit for the Muslim world and for least-developed countries. Senator Cantwell's bill covers Afghanistan as a whole and the border areas of Pakistan. If you could successfully bring jobs and growth to those regions, the northwest frontier, and so on, that would be a major contribution to American security. I guess I do not see the two in conflict. I see them as both good ideas and complementary, especially in that Pakistan is not a least-developed country and does not have a very meaningful benefit right now.

Senator SMITH. The fact is that Pakistan does not qualify under the bill that Senator Feinstein and I introduced, but the truth is, its economics are just slightly above those of Cambodia, which does qualify. I wonder if you can give me an update on, what is the state of Pakistan's apparel industry and what benefits you see. Obviously you have cited national security, but are there other benefits that come from helping them in this regard?

Mr. GRESSER. I think from our perspective the big benefit is national security. Pakistan is at the center of our largest current concern. In a social sense, I visited Karachi, walked around the area where they have the textile industry. You can see many young, 20- or 30-year-old Pakistani women coming to work wearing black, and pink, and red, and yellow clothes—a very colorful sight. This is one of the relatively few opportunities for Pakistani women to become self-sufficient, to build up some savings, and I think, has a social benefit, especially for a large and quite conservative Muslim country, that we should not ignore.

Senator SMITH. And I think one of you mentioned, they are very mindful that they have these opportunities for these jobs because of the United States offering these trade preferences.

Mr. GRESSER. I would hope that they are. I have read and talked to Pakistani people who say, each container full of towels sent to the United States—very simple, cheap goods—puts 500 Pakistanis to work, takes people out of madrassas, takes them out of sitting around in village squares, and I think can help on a large scale to bring down the social temperature and make some of our political goals easier to achieve.

Senator SMITH. I know this is about trade preferences, but Senator Cantwell and I have a bill that is related to affordable footwear, for example. Many parts of the world still have duties of 67 percent that relate back to the days of Smoot-Hawley, and it was designed in Smoot-Hawley to protect an industry that, frankly, no longer exists in our country at much of a level. Our bill is actually supported by the remaining American shoe manufacturers.

I wonder, as you look at kids going back to school in a few months when families are going to have to buy them new shoes, would it not be advisable to pass this Affordable Footwear Act now so that the poor in those countries get the benefit and those who are less-advantaged in our country get the advantage of the footwear that is not produced here?

Mr. GRESSER. A very good idea.

Senator SMITH. I like your answer. [Laughter.]

Mr. GRESSER. One of the interesting things about our tariff system is that its highest rates are on clothes, and luggage, and shoes, those manufactured goods. Particularly in shoes and luggage, there are very few made in the U.S., and very high duties. Those two products account for about a tenth of all tariff money and probably cost families $5 to $8 billion a year.

The highest duties, as you mentioned, are on the cheapest sort of shoes, which are most important to poor families. There are none made in the United States. It is really worth a look. The question is, why do we do this? What is the point? So, I applaud your bill.

The CHAIRMAN. Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman. And thank you so much for having this hearing. I would ask if I could submit a longer statement for the record about the GSP system, and on legislation you mentioned.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Cantwell appears in the appendix.]

Senator CANTWELL. I appreciate that. Some of my colleagues have already talked about creating a Reconstruction Opportunity Zone within Pakistan and Afghanistan.

As my colleague from Oregon said, the Northwest kind of looks at this issue in a broad perspective. Trade has been an important part of our economy. But it was after 9/11 that a group of constituents—Bill Gates, Sr., former U.S. Senator Dan Evans, General John Shalikashvili—formed what was known as the Initiative for Global Development. Their focus was basically at the root of global poverty, if we could address that, that it would be a critical factor in addressing our security as a Nation.

So, Mr. Chairman, I would also like to add to the record letters submitted from Secretary of State Condoleezza Rice, the Afghan and Pakistan Ministers of Commerce, and also letters submitted by former Ambassador Richard Holbrooke and 9/11 Commission Chair Lee Hamilton.

The CHAIRMAN. Without objection.

[The letters appear in the appendix beginning on p 51.]

Senator CANTWELL. Obviously you have already started discussing this notion of what we can do in these communities of the tribal region of Pakistan and Afghanistan. I guess I am curious, Mr. Gresser, to go on further about this, because obviously we have a drug problem in Afghanistan. I am told by businessmen and women in the Pakistan area that they would use the money benefit of this to actually send children to school.

So I do not know what your feelings are about the secondary benefits of this and being able to bring up a higher standard of living, of education, from the business development that is happening. If you could comment on that, and any comments about the drug problem and how this will help with Afghanistan.

Mr. GRESSER. Well, I am afraid the drug problem is a little bit out of my expertise. I will defer to others on that. But when one region or part of a country develops successful businesses and the local government begins to collect taxes, public services can improve, education can improve.

You will have more women working in factories, and that will create, I think, a climate in which education for girls is more widely supported and accepted. So I think these are very good aspirations, and with your bill, I think we have a better chance of success with them.

Senator CANTWELL. Does anybody else want to comment on that?

Dr. YAGER. If I could just make a comment about this. I mean, one option would be to look at Colombia for the lessons that we might learn there, because obviously a big part of the ATPA was to encourage agriculture, alternative forms of agriculture to give people opportunities out of the illegal sector.

We certainly have observed that, in the area of cut flowers, there is significant employment growth among people within Colombia, so there are examples in which the preference programs have sent a signal, both to the country as well as investors, to invest. Of course, the investment then would create the opportunity for jobs and, of course, exports back to the United States.

So, perhaps a look at the Colombian experience would provide some insights into the ROZ options that you are putting forward.

Senator CANTWELL. That is a good point. I traveled to Colombia, at the chairman's suggestion to do so, and I did tour that flower-growing region and the facilities and some of the additional benefits of job training and education that are accruing to that workforce. So, we will look at that.

Mr. ALDONAS. Senator, if I could just add in response, business and employment contribute to stability, and there is a tremendous spill-over effect in terms of societal benefits, and that ought to be the goal of everything we do, both in terms of preferences and in terms of development assistance. I did not get a chance to respond to Senator Smith's question, but I do not see your proposal and the proposal for the least-developed as inconsistent. In fact, I think they reinforce one another.

But, you have to get out of the mind-set that development is something that takes place only within the confines of a geographical border designated as a country. You have to sort of grapple with the fact that you have regions that are under-developed, and we might want to focus on that. This is a proposal that would allow us to do that for the first time, in many respects.

Senator CANTWELL. Thank you.

And thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Cantwell.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Mr. Aldonas, I am interested in your testimony that the availability of trade preferences is eroding the support of certain developing nations toward more comprehensive bilateral and multilateral trade agreements. You mentioned India, in particular. Why should we continue to extend these programs if they are barriers to promoting bilateral trade agreements?

Mr. ALDONAS. I think, particularly for the rising export powers, you have the equation exactly right, Senator Bunning. The truth is, for those countries, you actually want an incentive for them to engage in full liberalization. It is actually in their economic interest and it is also in our economic interest. So, ultimately that is why I would like to see these things focused on the least-developed.

The other point I would make is, in today's world, the preferences were originally a way of trying to attract investment capital to very poor countries. There is no doubt in India, China, Brazil, as you go down that list, they have plenty of access to global capital flows at this point. There is lots of private investment in each one of those economies. You do not need the additional incentive of the preference.

Senator BUNNING. All right.

This is a question for the entire panel. Last summer, the IMF issued a set of objective criteria to evaluate whether a country is manipulating its currency to gain a trade advantage. The example of China, which now has close to $2 trillion in foreign reserves, is encouraging other developing countries to use the same techniques. The Port of Los Angeles is busy all day emptying thousands of cargo containers from China and shipping empty containers—empty containers—back from Los Angeles.

When we reauthorize GSP, should we consider currency manipulation as a disqualifying factor? Any of you.

Mr. ALDONAS. I would say what you would want to do is ensure that the operation of their capital markets reflected the market, and that is broader than just the foreign exchange rate. But, ultimately you want to have conditions in the domestic market that give you some assurance that people there have the opportunity to invest fairly and engage in exchange, and that we have the opportunity to link them to global markets. Part of that is making sure you have the rules right in the capital market, as far as I am concerned.

Senator BUNNING. Well, there is no question in my mind that China passed the right laws and rules to engage in the WTO, but they are not enforcing them. Therefore, if a country is not enforcing the laws that make the playing field level, why should we give them preferences?

Mr. ALDONAS. I appreciate what you are saying. I think the problem is more fundamental, that the demands that we made in the context of the WTO accession agreement on financial services, in large part, are because the financial services community was not very demanding and were inadequate to ensure that you have a functioning capital market in China. Until you have a functioning capital market in China, you will see all sorts of distortions in their economy that spill over our way as trade problems. They metastasize because of the lack of a functioning capital market.

That is one of the essentials, whether you are talking with the Chinese under our anti-dumping laws about whether they are a market economy or whether it is in the context of preference programs. I think you always want to insist that one of the things that we are trying to create, for their own benefit, is a functioning capital market.

Senator BUNNING. Would anybody else like to comment on that?

Dr. YAGER. If I could make a brief comment on that, Senator Bunning.

Senator BUNNING. All right.

Dr. YAGER. I think one of the things that we are suggesting that USTR do is make a more conscious decision about eligibility of countries, whether it is on an annual basis or on a number-of-years basis. We think it is important that they make an actual explicit decision about certain countries, whether it is for movement towards a market economy or whether it is to comply with other U.S. priorities such as IPR rights, human trafficking, or things of that nature.

I think the point that we would like to make to USTR is that there should be a decision, if not every year, at least on some period of years, so that considerations can be discussed. There may be different considerations for different countries and different regions, but at least there is a discussion about it and there has been a decision made.

The example of Zimbabwe came up earlier, that those are the kinds of things that would provide an opportunity to ask questions about their performance on different aspects, not necessarily currency in that case, but on other things that are important to the United States.

Senator BUNNING. This is a follow-up, because I only have about 10 seconds left. When we reauthorize GSP, should we reevaluate the criteria for graduating countries from the GSP program?

Mr. ALDONAS. In my view, absolutely. I think one of the things you want to be looking at is the extent that they still need the preference to attract capital, which was the original goal, to attract investment capital. That is part of why I think you ought to have that single criteria that applies both to what we do on the preferences side and what we do with respect to our development assistance.

Senator BUNNING. Yes, sir?

Mr. GRESSER. I think, on the whole, I am pretty satisfied with the graduation criteria. Malaysia, Korea, and Hong Kong have moved on as time passes. I think I am not quite so alarmed about this as Grant would be.

Senator BUNNING. All right. Thank you very much.

Senator LINCOLN. I think it is my turn.

Well, I want to thank Chairman Baucus and Senator Grassley for holding this hearing, and thanks to all of you all. Welcome back, to many of you.

I have said it time and time again in this committee room: I am certainly a supporter of free trade. It is not hard to point to the benefit that trade has brought to my home State of Arkansas. We certainly, on behalf of agricultural products and others, want to make sure it is fair trade.

But Arkansas is also home to Wal-Mart, a business with one of the most sophisticated sourcing operations in the world. It has created countless new jobs and opportunities around the globe, as well as, focusing now domestically, sustainability and a host of other things that they have done a tremendous job on. Row crops, livestock, and poultry producers help feed the world, when they can get into those markets. Our steel producers have built some of the most efficient and effective environmentally friendly steel mills in existence today in Arkansas.

So just as trade has benefitted our State, granting less-developed countries greater access to our markets can, I think, be one of our more powerful tools in order to help alleviate poverty by creating those opportunities for entrepreneurism and investment. Our trade preference programs are great examples of how we can provide countries a hand up, and I think many of you all have really contributed to that in today's hearing. We appreciate your being here and your testimony and bringing forth those, or certainly examples of those, ideas.

It has also added foreign policy benefits of fostering political and economic stability, and as you all have mentioned, creating goodwill for the United States, shoring up relationships with important allies.

I know, just mentioning some of what Senator Cantwell talked about, I, too, visited Colombia. Being able to not only visit and experience what the military there, along with our military and the assistance of our aerial applicators, have been able to go in and do with the military in Colombia, dealing with how they go into the drug areas, and the use of canines, has been phenomenal. But we have used a lot of that now as well in Iraq where we have been looking to locate IEDs and a whole host of other things. So it has been something that, when we engage, it provides us mutual information.

You mentioned the flower industry. I, too, toured one of the farms, without a doubt providing jobs and additional agricultural industry, but it also was a relocation program for victims of violence, to be able to move out of a violent area and move into a sustainability situation. There is tremendous support for that in those countries, and I really attribute a lot of the progress that we have made in that to those types of programs that have been fostered through the trade that we have really tried to encourage.

I would like to just quickly ask a couple of questions. Mr. Aldonas, I have been very interested. You have talked about expanding our preferences to the least-developed countries and really focusing on that. Do you have a thought, or maybe an experience or something in terms of explanation, that really led you to that conclusion? I mean, you have talked about what it means, I know that. But I am just wondering if there is one specific that really kind of comes out in your mind.

Mr. ALDONAS. A couple of things. One is looking at Bangladesh, which is one of the poorest countries in the world, and recognizing that it suffers in competition with China and a variety of others in turning a long staple cotton crop into goods that would benefit us, benefit the rest of the world, and recognizing that they would benefit from these preferences but are excluded. So, that is one example.

The other one I would pick is this odd sort of anomaly whereby limiting what we do on textiles under the African Growth and Opportunity Act, where, as Ed was pointing out, there are some significant constraints on the rules of origin. It actually ended up in some respects not building a strong enough industry, and as a consequence Chinese exports are now out-competing local production in Africa.

So, in one sense, what we did—and I was a part of it, I admit it—in drafting those rules of origin was create something that did not give them the edge that would allow them to sustain their competitiveness in their own market, much less in markets abroad.

If I could just add, Senator Lincoln, I used to kid Lee Scott and Mike Eskew that in today's world, that Wal-Mart represents the Agora, the old Greek market, where everybody had to bring their goods on a donkey, and UPS represents the donkey. [Laughter.] In this world, it would be very useful to take what Lee and the folks at Wal-Mart have done, take a look at their sourcing model and think about our preference programs from that angle, because it is actually a wonderful way of saying, how would I set the incentives so people can participate and bring their goods to the Agora?

Senator LINCOLN. Yes. The last question I have, because my time is about up and we will probably finish up the hearing, but how might USTR better coordinate with other agencies to improve trade capacity in some of those less-developed nations? We talked a little bit about USDA. My husband's godfather, in the 1950s, worked for USDA and was in countries like Afghanistan, Lebanon, and other places, trying to have a coordinated effort of knowledge in terms of agricultural practices and a host of other things.

Is there some way that USTR could better coordinate with other agencies in terms of using benefits that would help escalate the development of industries in certain ways?

Dr. YAGER. Senator Lincoln, I think the answer is yes. In fact, they have done so with regard to the AGOA program, because the AGOA program does specifically link the preferences to capacity building, but it is the only preference program that does that. Of course, there are a number of other countries around the world outside of Africa that could use the type of trade capacity building assistance that is built in and is linked with the actual preference program.

So there is probably both an argument for it, as well as some experience that might be gained from what the United States has done through the AGOA program to learn a little bit more about how that capacity building can be provided along with the preference programs to gain greater benefits.

Senator LINCOLN. I know there are a lot of different nonprofits. We are the home in Arkansas to Heifer International, as well as Winrock International, both of which teach an awful lot about microeconomics and entrepreneurship and building those kind of industries from the very small entity up. I am assuming that USTR in some way connects with some of those; I do not know.

Mr. ALDONAS. Senator Lincoln, they do not. I actually chair one of those institutions. Based on what I know about the preference programs, we certainly take them into account deeply in terms of the sorts of investment projects we would look at. It is without reference to any discussion with USTR or the sort of formulation and administration of the preference programs, because there is not a point of access that allows you to do that.

Equally important, there is no place where you can go in the U.S. Government for a single conversation about an entity which is designed to finance cooperatives among small producers of asparagus and figure out how to link them to General Mills. There is no way to go and have the conversation. When you go talk to the Department of Agriculture and APHIS, which sets the standards, the folks at AID and the Millenium Challenge Corporation (MCC), which both have different operating rules, and USTR, what you are going to end up with is dealing with four conflicting standards. That is why I think one of the things you have to do is draw all the threads together.

I understand it raises jurisdictional issues, but I know that this committee has squared those jurisdictional issues in the past, particularly with respect to AGOA. But that is where I think the heart of the problem lies, because it is a very difficult position to be that provider as an NGO, to find one source, one consistent set of advice and support for trying to draw the threads of finance and trade together.

Senator LINCOLN. Thank you.

The CHAIRMAN. Thank you very much, Senator.

Fr. Small, could you tell us a little bit more about your experiences in Bolivia, and also in Haiti? I would like you to focus on the degree to which GSP and the Andean Trade Preferences Act is really helping, say, in Bolivia and what effect it is having on people.

Fr. SMALL. Sure. Thank you, Senator. I was just going to tag on the end—Senator Lincoln talked about Wal-Mart. I am just always stunned why this is sort of the best-kept secret of our development policy through our preferences at a time when trade is not really seen as friendly to the U.S. economy, et cetera.

In a popular way it seems something that is inimical to economic development, and yet our preference programs should be the flagship of how genuinely it is about development. If you take the case of Bolivia, for example, even though there are some tensions, from the reports that we get and from church leaders who have been there, they are very literate in what this preference program means to their people, certainly in La Paz and the western regions, those areas that President Morales has spoken about as people who need liberation, who need equality.

They actually provide some estimates up to 25,000 jobs; others claim that it is much larger. In a very tense and difficult situation in that country, U.S. trade preference programs are something that stand as a beacon, at least, for the people, that they have assistance that is beyond traditional development assistance.

If you take that away or if that lapses—and I understand the largest employer, a private employer in Bolivia, 45,000 jobs, has started to move some of that production to Peru, given the uncertainty around the extension of those preferences. They have been extended relatively short periods, which is deeply troubling and sort of gives something of a propaganda victory to those who say that this model of trade and openness and integration is not something that we should be pursuing, it is more about looking internally.

But if you think of the rest of the hemisphere, now that Haiti has what it has, you think of the DR-CAFTA, you think of the CBI, Bolivia would be left as pretty much the poorest country of the hemisphere with nothing outside of GSP, which, as you said, when you think of your neighbors who need a lift up, is that the signal and the message we want to be sending at this time? So, it is deeply important. I just regret that we do not do a better job of showing how valuable and important these trade preferences are domestically.

The CHAIRMAN. Go ahead.

Mr. ALDONAS. I just wanted to make mention, I think it is the same individual, Marcos Iberkleid and Ametex, which does a lot of the textile and apparel exporting out of Bolivia. They are going to be forced to shut down in the absence of the preference program. The reason I raised that is because that firm implements one of the most forward-looking policies with respect to workers and worker rights of anyone in the hemisphere.

The CHAIRMAN. What is the firm?

Mr. ALDONAS. It is Ametex. It is a remarkable story about how the incentives—and certainly how Marcos thinks about our market—are responding and are making available rights to his workers well beyond those that are guaranteed under local law. And so that is exactly the sort of thing I think we would want to highlight and reinforce.

The CHAIRMAN. Are there others on the panel who might want to comment on the degree to which preference programs help the United States' business, United States' consumers? Anybody want to comment on that?

Mr. GRESSER. Well, all right. One particular product, roses and flowers. Most of the flowers sold for Valentine's Day are flown in from Colombia and Ecuador. If the ATPA lapses or is cut off, their prices will go up, people buying flowers for their wives and girlfriends next year are going to be paying more money and probably buying fewer roses. There is a real benefit in there for ordinary people and for a bunch of florists whose businesses improve. I think that is a very nice thing to do.

If I can make two brief comments about your last question. Haiti. I was just there a few weeks ago. There are 8.6 million people. They have 200,000 or so paying jobs. People in Haiti live very close to the margin. About 20,000 of those jobs are garment exports to the United States, and each of the workers there are supposed to feed about 10 people in extended families in rural areas, and so on.

The other one is the Cambodian case. A big garment factory in Cambodia can employ 4,000 or 5,000 young women. They wear little silver earrings and bracelets, which is how they save money, because they cannot get bank accounts most of the time. A factory like that takes about 4 weeks to set up and 2 weeks to bring down if they want to move to Vietnam or if they want to move to some other country which is larger, which has a better port, those sorts of things.

I think people in Cambodian government and business feel if they had a good trade preference benefit they would be secure for a while. They would allow the development of the last 10 years—which has taken Cambodia from basically a failed-state, desperate condition into a fairly rapidly growing least-developed country—to move the country beyond the least-developed stage and become a self-supporting place for the first time, really, since the 1950s or 1960s. That would be a big accomplishment.

The CHAIRMAN. Yes, Mr. Aldonas?

Mr. ALDONAS. Thank you, Senator Baucus. I just wanted to chime in because your question invites something about the broader benefit of our openness and the ability of American companies to source. We are living in a global economy where the nature of competition has changed fundamentally to a global competition over capital, talent, and ideas. Our goal, as you know, working on tax policy, health care, and a variety of other things, is to make ourselves as inviting a place for people to invest as possible by the mix of those policies.

Well, trade policy plays a role in that. The more broadly open we are, particularly to new sources of supply, we are benefitting people, including small businesses on the low end that have to be a part of the global supply chain to be able to compete. So, in a weird sort of way, in the world we are in now, this very openness is what makes us most attractive.

The CHAIRMAN. How does the European Union preference program compare with the U.S., generally?

Dr. YAGER. We have a couple of different programs which are related to our preference programs. They have one program which is called the "Everything but Arms" program which is available to the least-developed countries, and while some of the products—some agricultural products in particular—were phased in over a long period of time, it provides duty-free access to LDCs for virtually all products shipped into the EU.

So you have some rules of origin, and some of those are fairly restrictive and complex, as are the rules of origin in some of the U.S. programs, but they have the "Everything but Arms" program for the least-developed countries.

They also have other agreements that they have set up, the African, Caribbean, and Pacific (ACP) program, which is designed also to help a particular group of countries. In those cases they have a multi-step program which aligns not just the trade aspects, but also the development aspects with other considerations. So they have a package of programs, as does the United States, with different targets and different kinds of——

The CHAIRMAN. But generally about as generous, a little less generous, more generous? If you could generalize.

Mr. ALDONAS. Well, I used to crack jokes about it, Senator Baucus, saying "Everything but Arms" was the Venus de Milo approach—it was only half a sculpture, and the program was half a program. [Laughter.] The problem is, as Loren was pointing out, the rules of origin are horribly complex. So, in a weird sort of way, if you took the best of our stuff and limited it to the developing world, and you took the best of their stuff and limited it to the developing world, you might have one good program.

But that is the sort of thing that you would want to think about, and that is why I was suggesting harmonizing the rules with our developed country trading partners so that they are consistent. It would offer a much more powerful incentive for folks in the least-developed countries, where they need the incentive most.

The CHAIRMAN. All right. We are going to have to conclude here. Does anybody want to say anything, commenting on something that somebody else might have said that was so outrageous it deserves a response? [Laughter.]

[No response.]

The CHAIRMAN. Seeing not, thank you very much. We deeply appreciate your time. It was very helpful.

The hearing is adjourned.

[Whereupon, at 11:28 a.m., the hearing was concluded.]

# APPENDIX

## Additional Material Submitted for the Record

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**Testimony of Grant D. Aldonas[1]**
**Before the Senate Committee on Finance**
**Oversight Hearing on U.S. Trade Preference Programs**
**June 12, 2008**

**Introduction**

Mr. Chairman, Senator Grassley and Members of the Committee, I want to thank you for the opportunity to appear before the Committee today to discuss the operation of our trade preference programs. As reflected in my testimony, I think our preference programs can play a critical role in our trade and development policies, but that, as currently structured, they work at cross purposes with our goals in both areas.

By way of introduction, I am currently the founder of a global trade and investment consulting firm that is, in part, dedicated to mobilizing investment for entrepreneurs at the bottom of the economic pyramid in the developing world. I also chair a non-profit microfinance fund – Synapse, Inc. – that is developing innovative approaches to financing farming operations in the developing world, principally Africa, and linking those operations to the global supply chains operated by Fortune 1000 companies. In both capacities, our trade preferences play a role in our decisions regarding the projects in which we choose to invest.

My experience with respect to our trade preference programs is one of longstanding. While at the State Department in the early 1980s, I played a role in the creation of the original Caribbean Basin Initiative ("CBI"), which, at a later stage at USTR, I was responsible for implementing. For over a decade after leaving USTR for private practice, helping U.S. investors invest in emerging markets formed an important part of my law practice and our preference programs played an important role in the advice I provided.

More recently, I was fortunate enough to serve as the Finance Committee's Chief International Trade Counsel, when, in the late 1990s, the Committee succeeded in securing the passage of the Trade and Development Act of 2000, which significantly expanded the original CBI and created the African Growth and Opportunity Act. During my tenure, the Committee also worked on renewal of the Generalized System of Preferences and the Andean Trade Preferences Act.

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[1] Principal Managing Director, Split Rock International, and Senior Adviser, Center for Strategic and International Studies; Under Secretary of Commerce for International Trade (2001-2005); Chief International Trade Counsel, Senate Finance Committee (1997-2001); Partner, Miller & Chevalier (1986-1997); Director for South American and Caribbean Affairs, Office of the United States Trade Representative (1984-1985); Special Assistant to the Under Secretary of State for Economic Affairs, U.S. Department of State (1983-1984).

While serving as Under Secretary of Commerce, I played a significant part in the development of our trade policy, the launch of the Doha Development Agenda in the World Trade Organization ("WTO"), and the negotiation of a series of bilateral free trade agreements with trading partners that otherwise benefitted from our preference programs. I was also involved in the creation of the Millennium Challenge Corporation and served on the board of directors of the Overseas Private Investment Corporation, which insures and finances U.S. investment in developing countries where such investment makes a demonstrable contribution to the recipient country's economic development.

I will divide my testimony into two parts. The bulk of my testimony will focus on the premises on which our preference programs are based and what changes are needed to ensure that they contribute to, rather than conflict with, our broader trade and development policy goals. I will, however, also offer my thoughts on how our preference programs and our trade policy might be reformed to produce a better result from the perspective of both development and trade policy interests of the United States.

**Rethinking the Bases of Our Preference Programs**

When I first started studying economic development in the international relations program at the University of Minnesota in 1972, there was a wonderful professor there at the time by the name of Ed Coen. Ed was British and by nature a skeptic. He believed in examining the facts and trying to draw conclusions from them, rather than grand theories – which is why I have always wanted to go back to ask Ed why everything he taught us about economic development has proved wrong.

We now have roughly 60 years of experience with development finance through institutions like the World Bank, almost 50 years of experience with bilateral assistance via the Agency for International Development ("AID"), and going on 40 years of experience with our trade preference programs. In each instance, our approach has failed to deliver the promised spur to economic development among beneficiary countries.

Today, the most successful developing countries, which have lifted hundreds of millions of people out of poverty, tend to be those that were least dependent on World Bank lending, AID programs, or trade preferences for attracting investment capital and stimulating development. From Korea to China to Taiwan and much of Southeast Asia, none of the champions in the development race relied on either source as the main driver of its economic development.

By contrast, those countries that did rely heavily on the World Bank, our bilateral assistance, and trade preferences remain significantly behind the leaders in terms of development. That remains true today even after nearly a decade of experience under Europe's "everything but arms" trade preference program and the implementation of our own African Growth and Opportunity Act.

The Committee's oversight of our preference programs should, as a consequence, start with a simple question – why have they failed? Why haven't they done a better job of fostering both trade and economic development?

The answer lies in three inter-related flaws inherent in our approach to trade and development – they start from the wrong premise; they do not reflect the changing nature of trade in a global economy; and they conflict with the goals of our trade and development policy goals.

**Starting from the Right Premise**

Our preference programs, like World Bank lending and AID assistance, largely ignore what we have learned over the past half-century of misguided development policies. They think of "development" as the sum of various government policies, rather than the result of individuals engaged in the simple human act of exchange – trading goods and services freely in the marketplace for mutually beneficial gain.

That problem is endemic among theorists of development economics, from Rostow to Singer and Prebisch to more modern advocates like Jeffrey Sachs. It leads to simplistic solutions like Sach's recent call for significant wealth transfers to governments in the developing world, as if cash were the missing yeast in the recipe for development. Accepting that conclusion would, of course, ignore 60 years of development cakes that failed to rise.

In the 1990s, Nobel Laureate Amartya Sen debunked the enduring myths of development theory by pointing out that all development flows from (1) expanding an individual's freedom to create their own economic future and (2) providing the tools or capabilities to effect that outcome. Implicit in Sen's critique of longstanding development theories was the notion that the most effective measure of development policies lay in the extent of their contribution to those two goals.

Seen in the light of Sen's insight, economic development is best understood as a process of economic change – one involving the transition from a state in which an individual's ability to trade the value of his or her labor or output fairly is constrained to a state in which the individual is free to exchange his or her labor or output in return for the goods and services of others.

The work of another Nobel Laureate, Douglas North, explains that the process of economic change depends heavily on changing the incentives for various market participants in ways that yield the outcome you seek. What that means, in the case of economic development, is changing the incentives facing market participants in developing countries in ways that ensure broader economic opportunity via access to markets, both locally and globally.

The question the Committee should ask, therefore, is whether our preference programs significantly change the incentives facing market participants in the beneficiary countries in ways that ensure broad economic opportunity, both locally and globally, for the poor.

Putting it that way would, I believe, inform the Committee's exercise of its oversight responsibilities in that the paradigm Sen and North suggest offers both a measure of the distance many potential beneficiary countries have to travel and a measure of the extent to which our preferences contribute to their progress in their journey.

Our goal should be to offer the broadest possible opportunity for the poor to engage in trade. In return, we should ask that beneficiary countries create the conditions necessary for local markets to flourish – private property rights for the poor; ensuring both freedom of contract and the enforceability of such agreements; and the ability to protect those rights against the predations of government power, to name but a few.

The implications of that approach are significant because they help illuminate the flaws in our current system of preferences that prevent it from making a more significant contribution to development. Consider, for example, what that means for the competitive need limits and product exclusions of our current Generalized System of Preferences ("GSP"). It is hard to escape the conclusion that those conditions on our preferences discourage, rather than enhance, the opportunities for trade.

The same holds true for the process by which we ask foreign governments to apply to add specific products to the list of goods eligible for duty-free treatment. That condition puts the power over the use the preferences in the hands of the politically powerful who can exercise their economic demands through the political process, rather than enhancing the opportunities for the poor to engage in exchange, both locally and globally.

Those specific examples suggest a broader lesson the Committee can use as a part of its work. We should ensure that our preference programs maximize the market opportunities for the poor in their own countries, both as producers and consumers, and, ultimately, link those markets to the global economy. Our preferences would, in the process, create incentives that enlarge individual economic freedom and encourage its exercise.

**Reflecting the Changing Nature of Trade in a Global Economy**

The second flaw in our current system of preferences is one that is endemic in our trade policy as a whole. Our trade policy, preference programs included, simply does not conform to the reality of how trade operates in today's global economy,

The construct on which our trade policy and our preference programs are built is dated. It thinks of trade as an arm's length sale between independent buyers and sellers in different countries. In reality, that sort of transaction represents a smaller and smaller portion of world trade.

The technological revolution in computing, communications and transport that is driving global integration has fundamentally reshaped the way we trade. In essence, those technological changes have conquered economic geography. Distance is no longer a barrier preventing the organization of production on a global basis.

The changes in technology that have made global supply chains possible have also made them a competitive necessity. Even small firms in the United States, for example, find it necessary to source globally in order to remain competitive and to sell globally in order to gain the scale they need to survive.

That effect was best captured for me a couple of years ago when the head of a Grand Rapids, Michigan, auto parts manufacturer explained that he no longer thought of exporting to Japan or Korea or China. Instead, he was intent upon "exporting" to General Motors and Toyota. What he meant by that was he wanted to ensure that his products were integrated in the supply chains of both General Motors and Toyota so that those two firms would take his product global through their sales in Japan, Korea and China.

What that means in practice is that trade is increasingly dominated by competition between supply chains. Barriers to market access as traditionally defined (e.g., tariffs; quotas, subsidies and other non-tariff measures) no longer represent the most significant barriers to global markets.

Today, the principal barriers to trade are the commercial standards that exporters must satisfy in order to become a supplier integrated into a global supply chain that serves customers all over the world.

Now, consider what that means for a system of trade preferences that are based largely on the elimination of tariffs on imports into the United States. Helpful, certainly, but those preferences do not come close to helping the individual asparagus producer in Malawi find his or her way to our market. To do that, our preferences would have to help that entrepreneur and exporter satisfy the product quality and safety standards demanded by U.S. grocery manufacturers.

Preferences alone will not meet that challenge. What we must do is ensure that we are coordinating our preference programs with our development assistance, whether that takes the form of bilateral assistance via the Millennium Challenge Corporation ("MCC") or AID or takes the form of lending and other forms of assistance through multilateral institutions like the World Bank.

Adopting that approach would, of course, signal big changes in our approach to development assistance as well as our preference programs. Just like our preference programs, our development assistance should focus on connecting people to markets, both locally and globally, because that is the surest route to expand the economic freedom of the poor in the developing world.

We would not, however, be alone in adopting that approach. Japan, during Prime Minister Koizumi's tenure, shifted the focus of much of its development assistance filling in the institutional and educational gaps that prevent producers in developing countries from participating in Japanese companies' supply chains. Those reforms are worth looking at as the Committee rethinks how our current preference programs operate and what they will need in the way of reinforcement from our development assistance programs in order to succeed.

I recognize that the approach I suggest would raise potential jurisdictional conflicts, both in terms of authorization and oversight. But, those problems are not insuperable. This Committee already has significant experience in doing just that in the context of our preference programs.

The current Chairman and Ranking Member and their staffs were both instrumental in engaging the Foreign Relations Committee in the effort to shape the Senate's version of the African Growth and Opportunity Act. The Senate bill that ultimately passed bore the mark of both Committees, even though the Finance Committee held sole jurisdiction over its subject matter because it was a revenue measure related to trade.

The jurisdictional conflicts in Congress, moreover, often have a way of becoming disabling conflicts among separate agencies in the Executive. The surest way to avoid that problem and ensure that our trade preferences and development assistance work together, rather than in potential conflict, would be to ensure that they operate under a single set of criteria for bestowing the benefits of either our trade preferences or our cash. It makes sense, as well, to create a single coordinator for development policy capable of ensuring the two strands of our development policy worked together in practice, as well as on paper.

Neither the Finance Committee nor the Foreign Relations and Foreign Operations Subcommittee of Appropriations need lose oversight responsibility in the process. I know from experience that joint oversight can not only work, but can improve the way an agency operates. As Under Secretary of Commerce for International Trade, I administered an agency that was subject to the jurisdiction of both the Finance and Banking Committees and frankly I benefitted from the involvement of both Committees in our work.

**Ensuring Consistency with Our Trade Policy Goals**

There is one other challenge the Committee must confront in its oversight of our preference programs. That is the conflict between our preference programs as currently structured and the broad goals of our trade policy.

Properly understood, the goals of our preference programs and our trade policy should be entirely consistent. For the poorest countries, our preference programs offer a means to encourage investment in new enterprises by virtue of the export opportunities our preferences create. Our efforts to negotiate further trade liberalization serve the same purpose, albeit by a different route. They create similar sorts of investment opportunities as a result of mutually agreed commitments to a reciprocal lowering of trade barriers.

What's more, both strands of our trade policy can contribute significantly to economic development. Both expand the freedom of the poor in the developing world to participate in the global economy. In the case of our trade agreements, our trade policy allows the poor to benefit as consumers as well as producers.

There is, however, no doubt in my mind that our preference programs have, in practice, eroded the incentive to negotiate further trade liberalization among a number of rapidly rising developing countries. In Doha, at the outset of what became the Doha Development Agenda or "development round," I was responsible for negotiating the text of the declaration on "rules" (i.e., subsidies, other forms of unfair competition, and the domestic remedies the WTO allows to combat them).

Early in the week, we held consultations with a wide variety of countries to assess their interest and stake in the talks over rules. The discussions with our Indian counterparts were the most instructive. I was told that our Indian counterparts had no interest in negotiating because they were entirely content with their access to our market and their success in bringing the United States before the WTO Dispute Settlement Body when India felt its access to our market threatened.

Despite the fact that India was, at the time, and still is the world's most prolific user of trade remedies, they felt they had no stake in the talks because of the market access they already enjoyed in the U.S. market and the special and differential treatment they received under provisions of the Subsidies and Antidumping Agreements. The Indians never did participate in the rules negotiations and were, in fact, the last obstacle to the launch of a round that was expressly intended to benefit the developing world.

Now, economists have a phrase for the error we make when we try to reason from our own individual experience to a general rule. It's called the fallacy of composition. Not wanting to fall prey to that error, I thought I would check to see whether the economic literature contradicted or confirmed my anecdotal experience.

Recent research by World Bank economists strongly suggests that my experience in Doha was symptomatic of a broader problem. Our preference programs have, in fact eroded the incentive to engage in further liberalization.[2] Indeed, the evidence further suggests that "graduation" results in a shift of the graduating country's trade policy in favor of further trade liberalization.[3]

What that suggests is a relatively easy fix that would ensure that our preferences focused on those countries where they were most needed. That would involve making our trade preference programs available solely to the least developed countries in the world.

Focusing our preferences in that manner would also be broadly consistent with the original intent of our preference programs, Part IV of the GATT and the Enabling Clause which makes such preferences possible in a world trading system based on the most-favored-nation principle. The original intent behind the preferences was to encourage investment in developing countries, together with the employment and wealth creating effects such investment brings, in an era when most developing countries were largely excluded from access to global capital markets.

Significantly, while the least developed countries remain largely excluded from global capital markets, except to the extent they are significant exporters of commodities, the rapidly rising developing countries like China, India, and Brazil now have access to such markets and are significant recipients of foreign direct investment.

The point is that the rapidly rising developing countries like China, India and Brazil no longer need the incentive provided by trade preferences to attract investment capital. Indeed, to the extent that we offer preferences to India and Brazil at this stage of their development, we are allowing them to crowd the least developed countries out of potential export markets.

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[2] See, e.g., C. Ozden and E. Reinhardt, The *Perversity of Preferences: GSP and Developing Country Trade*, Journal of Development Economics 78 (2005) 1–21 (arguing that preferential tariff treatment may retard trade liberalization in beneficiary countries preferences reduce the incentive that export industries in developing countries have to lobby for trade liberalization at home as a step toward gaining greater market access abroad).

[3] Id.

Having said that, I also think that we can and should use the other strands of our trade policy to do a better job of encouraging the more advanced developing countries to liberalize and to meet them half way in that process. We should, for example, consider how to create an incentive for their export industries to take on the entrenched interests that seek continuing protection in their home market.

One way to do that is to pivot from our current approach to the Doha negotiations towards a deal that would encourage significant liberalization on the part of the rapidly rising developing countries. The current Doha declaration calls for a single undertaking by all WTO members, which gives every member a unit veto over any progress as a result. We need to free ourselves from that particular shackle and take the lead in pressing for serious liberalization that would benefit both U.S. commercial interests and the developing world far more than anything currently on the table in Geneva.

**A 6-Point Agenda for Achieving Our Trade and Development Goals**

Toward that end, and in the interest of achieving our broader trade and development policy objectives, I would suggest the following integrated approach.

First, I would recommend that the Committee expressly limit the availability of our preferences to the least developed countries in the world. That would enhance the benefit of the preferences as a tool for attracting investment to the poorest countries in the world (i.e., those that lack access to global flows of private investment capital). Limiting our preferences would also limit the "free rider" problem we face where developed countries lack any incentive to negotiate further liberalization, whether within the framework of WTO, regionally or bilaterally.

Second, I would recommend that the Committee work with its colleagues on the Foreign Relations Committee to create a single set of criteria for gaining access to both our preference programs and our development assistance. Adopting a single set of criteria would ensure that our trade preference programs and our development assistance, whether offered bilaterally or through multilateral development banks, reinforced each other, rather than operating on separate and, at times, inconsistent tracks

Third, in the same vein, I would encourage the Committee to work with their colleagues on Foreign Relations to adopt a single process for consideration of potential beneficiary countries under both our preference programs and our development assistance in order to encourage a more consistent development strategy from the potential recipient country. I would also adopt an integrated approach to the grant of our preferences and assistance so that both strands of our development policy could be drawn together for the benefit of the recipient countries.

Fourth, while access to our preferences and development assistance ought to be assessed in terms of the needs of a particular country, which of necessity will require discussions with governments, our development assistance should not flow through the recipient governments hands. Our development assistance should be geared toward expanding the economic freedom that individuals in the recipient country enjoy and enhancing their ability to exercise that freedom to build their own economic future.

What that means in practical terms is that we should concentrate on financing private investment and, where needed, building the physical and institutional infrastructure needed to connect people to markets. We should, as the Japanese have increasingly done, focus on connecting firms and workers in the developing world to the global supply chains that will allow them to benefit from the growth in the global economy.

Fifth, to gain greater operational consistency, I would combine the administration of our preference programs, our development assistance programs (i.e., AID, MCC, etc.), and the responsibility for oversight of our participation in multilateral development banks in the hands of a single administrator. The current incoherent mess that is our trade and development policy will remain the underperforming failure it is until we confront the need for a single point person responsible for developing our approach, implementing it, and being held accountable for it.

Finally, we need to recognize that our preference programs do not exist in a trade policy vacuum. We must match the reform of our preference programs with reform of our trade policy objectives in order to deliver on the promise trade holds for the poorest in the world.

Toward that end, I would recommend a grant of negotiating authority to the President to pursue the following objectives –

- Harmonizing our preferences for the least developed countries with our developed country trading partners and making them permanent so that entrepreneurs building businesses in Africa, for example, would know that they could sell as easily in Athens, Georgia, as they could in Athens, Greece;

- Negotiation of a free trade area within the WTO among developed countries willing to move rapidly toward that goal, which would include an accelerated removal of tariff barriers on industrial and agricultural goods, the immediate elimination of agricultural export subsidies, and an immediate delinking of existing agricultural subsidies from production.

The net effect of this last step would be to create a significantly broader market into which the least developed countries could sell, while providing a significant incentive for the more advanced developing countries to join the United States and other developed countries in moving toward free trade.

Thank you, Mr. Chairman and Members of the Committee. That concludes my testimony.

# QUESTIONS FOR THE RECORD FOR MR. GRANT ALDONAS

## United States Senate Committee on Finance

## Hearing on Oversight of U.S. Trade Preference Programs

## June 12, 2008

### Questions From Senator Baucus:

#### Question 1

Much of the debate around preference programs has been focused on the overall benefits or drawbacks to beneficiary countries. Less attention has been paid to these programs' effects on the U.S. economy. What effect do you think preference programs have on the U.S. economy? How can we encourage increased U.S. investment in beneficiary countries? If we allow preference programs like ATPA and GSP expire, will U.S. workers and consumers be adversely affected?

#### Answer

The macroeconomic impact on the U.S. economy is negligible. In 2006, for example, U.S. imports under GSP in 2006 from all beneficiaries totaled $32.6 billion according to the U.S. International Trade Commission. That reflected an increase of 22 percent over 2005. During that same period, U.S. gross domestic product was nearly $14 trillion and imports from all sources represented roughly 13% of that total or close to $2 trillion. Any macroeconomic effect is swamped by other currents at work in the economy as a whole.

That said, GSP and other preference programs do provide important tariff relief for American consumers and American firms that need access to the lowest cost/highest quality goods in order to remain competitive on a global basis. That is particularly true for consumers when one examines the impact of expanding the benefits of the Caribbean Basin Economic Recovery Act and the African Growth and Opportunity Act to textiles and apparel, which were previously excluded from all U.S. preference programs.

It is not widely appreciated that textiles on consumer goods like apparel and foot-ware make up the vast majority of the tariff revenues collected by Customs each year. Nor is it widely understood that tariffs are a painfully regressive form of tax on the income of the poor in America. Putting those two concepts together highlights why the preference programs, particularly the effort over the last decade to extend them to products of interest to America's poorest consumers, have had a beneficial effect on families trying to squeeze more out of each dollar they earn.

At the same time, it is important to recognize that the savings to consumers do not come cost free in terms of the adjustments they require elsewhere in the economy. In the case of textiles and apparel, the savings to consumers come out of the pockets of U.S. textile and apparel firms that derived significant economic rents from the trade barriers maintained for their protection over many decades. In other words, the savings the preference programs generate for the poor in the United States come out of the pockets of owners of U.S. textile and apparel firms.

There is, finally, one other way in which our preference programs have an effect on our economy – one that is profoundly beneficial at a deeper level. Globalization had fundamentally changed the way trade flows and the nature of economic competition. What was once an international battle among firms for markets has become a global context for capital, talent and ideas. In that context, the goal of all U.S. economic policy – including trade policy – must be to make the United States the most attractive place to invest and create value in the world.

There are many facets of economic policy, most of which flow through the Finance Committee's jurisdiction, that affect the economic environment that investors look at when considering capital investment decisions. But, the key element in attracting investment capital is, ultimately, the openness of the U.S. economy to the rest of the world. In that context, Congress' renewal of our preference programs is an extraordinarily useful signal to those making investment decisions in firms, both domestic and foreign, that the United States is open for business and will remain engaged globally because that is where our economic interests lie.

**Question 2**

In your written testimony, you mention that you think that competitive need limits and product exclusions within GSP "discourage, rather than enhance, the opportunities for trade". In the 2006 extension of GSP, Congress included a provision that allowed the president to revoke competitive need limit waivers for supercompetitive products.

What do you think of that change? Does it further discourage trade opportunities for beneficiary countries? Do you think Congress should attempt to remove those restrictions in any upcoming GSP extension bill?

**Answer**

The effect of Congress' action, which capped competitive need waivers at 5-years where the specific product from an eligible beneficiary country has an annual trade level in the previous calendar year that exceeds 150 percent of the annual trade cap or 75 percent of all U.S. imports of that product, is to immediately reimpose whatever the prevailing rate of tariffs would otherwise apply to all of the beneficiary country's imports. Not only would that have a predictably sharp impact on trade, despite the obvious competitiveness of the product in question.

But, the more profound effect falls on investment. One of the ironies about both trade agreements and our trade preference programs is that, while the ostensible subject matter of the agreements and preference programs is trade, the goal, ultimately, is to affect the pattern of investment. In the case of our trade agreements, one of the main goals of eliminating tariffs and other trade barriers is to eliminate the artificial incentives that such border measures or trade-distorting subsidies create for investment in one country, rather than another. In the case of our preference programs, we offer the tariff relief as a way of encouraging investment in the developing world.

Investors' choice of location when making investments is inherently about the risk and rewards of investing in one place rather than another. The goal of the preference programs is, at least on the margin, to effect that equation and tip the balance in favor of investing in one of the beneficiary countries. Given the other challenges of operating in many parts of the developing world, particularly in the least developed countries, any significant increase in the risk associated with investment there tends to drive investment dollars away.

When a pattern of tariff treatment, such as the President's routine grant of waivers of the competitive need limits for certain products, is called into question by actions like the 2006 amendment, investors are forced to take that into account as part of their analysis. To offset that increasing risk, investors demand a higher rate of return than would otherwise have been the case, which cuts against the developing country trying to attract investment as part of its overall development strategy.

That is one of the reasons, in my testimony, I suggested limiting the preferences to the least developed countries in the world, but when the preferences are made available, they should be made available without the current competitive need limits, including the 2006 clawback provision. Otherwise, the investment incentive of our preference programs is undercut precisely where it is needed most.

## Questions From Senator Grassley:

### Question 1

Mr. Gresser states in his testimony that while erosion of preferences may be an obstacle in the Doha Round negotiations of the World Trade Organization, it is a manageable problem that shouldn't present a hurdle to reaching an agreement. How do you respond?

**Answer**

While I have enormous respect for Ed and his work, my own practical experience of participating in the launch of the Doha Development Agenda, as well as the work I have done on development since, suggests that the erosion of preferences is a significant hurdle in the way of reaching an agreement within the WTO. West African countries that already see their textile and apparel exports to the United States under the African Growth and Opportunity Act declining and find Chinese made textiles and apparel imports taking over their local markets using local designs, predictably look at the margin of preference as the only thing that offers an incentive to keep their nascent textile and apparel export industry alive.

The West African beneficiaries of AGOA are not alone. Virtually all of the negotiators for the least developed countries, with Bangladesh in the lead, resist broad tariff reduction consistent with an aggressive Swiss formula that would lower the existing tariffs imposed by the United States and other developed countries on imports of competing products from China and other countries in Asia. That is one of the reasons why, when you apply game theory of any sort to the dynamics of the Doha Development Agenda, the results you get suggest that the status quo is the best outcome for the vast majority of participants.

**Question 2**

Some people argue that longer renewals of our trade preference programs would better promote economic development. Other people insist that more frequent renewals provide opportunities to engage beneficiary countries on important reforms, which ultimately leads to more economic development. What is your view?

**Answer**

Longer is far better precisely because you are trying to affect the investment environment, specifically by offering a guarantee of the tax treatment of certain goods when imported into the United States. The longer the guarantee, the lower the risk from the point of view of the investor and the lower rate of return they will demand for investing in the beneficiary country, making it more likely that the investment will take place.

I would add, from a practical perspective, that I was responsible for the review of benefits provided under the CBI when I was at USTR in the mid-1980s. The review process proved to be worse than useless in terms of encouraging policy reforms. That experience suggests to me that you have maximum bargaining leverage at the point where you grant beneficiary status, but that it declines significantly after that.

In my own view, the way in which USTR decided to approve the eligibility for AGOA benefits bears that out in an ironic way. The Clinton Administration's approach was to complete the process as expeditiously as possible, which implied requiring little in the way of real change on the part of the beneficiary countries.

That, in many respects, undercut the intent of Congress in crafting a new path for U.S. trade relations with the continent – one that recognized that economic development depended heavily on the sorts of institutional changes, including wide-spread democracy and the recognition of human rights, both economic and political, that Congress called for in AGOA. Having lost the leverage available at the outset of the program, USTR has been able to do nothing to improve AGOA's utility as a tool to foster real, sustainable economic development in Africa.

**Question 3**

The reduction of tariff and non-tariff barriers is important to the continued growth of the U.S. economy. It's also vitally important to the poor countries of the world. What can we do to convince beneficiary countries that the economic benefits associated with market liberalization outweigh the impact of any preference erosion?

**Answer**

In my view, there are two ways we could create a bargain that would be profoundly beneficial to the United States and the developing world, particularly the least developed countries that need to see economic expansion and the broadest possible distribution of the benefits of participation in the global trading system.

The first would create a deal that falls squarely within the tradition of WTO bargaining. If we are willing to open our markets in a number of areas that are particularly relevant to the developing country members of the WTO, we can, in my view, find a way to structure a deal with each of the developing country members that would serve their interest and ours.

Take, for example, the demand of various West African cotton-producing states for the elimination of U.S. cotton subsidies. That is no small request in U.S. political terms given widespread benefits on the U.S. side and the heavy dependence of many U.S. cotton farmers on the subsidy programs.

What could we ask for in return that the West African countries would be likely to agree to? The answer lies in the needs of their own cotton farmers. Cotton exports from West Africa are largely controlled by a limited group of middlemen. For them to see any benefit out of a reduction in U.S. cotton programs, they have to break the hold of those middlemen. That requires access to technologies that would bring the cotton farmers both more market information that would help improve their bargaining power and the ability to reach other buyers, which would ensure that they were not forced to give up a greater share of their income to the current middlemen.

Therein lies the possibility of a deal between the United States and the West African cotton-producing states. We trade changes in our cotton program in return for significant liberalizations in their market for telecommunications goods and services. The result is a significant benefit for development on both the import and export side of the equation for the West African countries and new market access for U.S. exports on our side of the equation.

Now, that would necessarily involve adopting a request-offer approach to the talks, rather than the formulaic approach on which the talks have foundered to date. That, to my mind, is no great loss. Negotiators certainly cannot argue that a request-offer approach would take too long in light of the lack of success of the formulaic approach over the past seven years.

But, more importantly, the two approaches are not mutually exclusive. We could certainly settle for a less radical overall reduction in developing country tariffs if we could achieve more in specific sectors or on specific products through a request-offer approach.

The second option would be more radical. It would involve bargaining directly for development. It would require a willingness on our part to trade our border measures (tariffs and the like) for changes in domestic institutions in the developing world, such as their protection of property rights and the freedom to contract, that would set the stage for economic freedom and the real economic development it spurs.

When I raise this possibility, most hardened trade cynics think of it as naïve. But, the reality is that it would contribute more directly to income growth in the developing world than would removing their barriers to trade and it is income growth, as much as the existing barriers to trade, that make these markets potentially viable for U.S. exporters. In other words, it is in our own self-interest and the interest of our exporters to bargain directly for development, rather than leaving it to the more indirect effect of simply removing border measures and relying on market forces to drive change over time.

In my view, simply relying on the indirect effects of removing trade barriers in the developing world is politically naïve – to think that we can maintain broad public support for an outward looking trade strategy that uses our market as a means of encouraging development, without demanding development and the broader benefits that would extend both to the beneficiary country and to the United States in terms of market access over the longer-term.

Now, walking down this road would also require us to come to the negotiating table with a more integrated approach to development than we have been able to muster to date in the U.S. government. That is why I would advocate putting both our trade negotiators and our development assistance officials in the same room with our friends and interlocutors in the developing world, particularly among the least developed. We ought to be able to speak about trade liberalization and development assistance at the same time.

That said, I doubt whether the WTO is ready for the more radical approach to bargaining for development, particularly after watching the slow death of the Doha Development Agenda. In the short run, the request-offer approach is more easily accomplished. But, I do think that our policy should shift increasingly toward bargaining directly for development in the years ahead, particularly as we think of what we would like to see in future bilateral free trade agreements with developing country trade partners.

## Question From Senator Lincoln:

### Question 1

Mr. Aldonas, you urged members of the committee to look at Wal-Mart's sourcing operations when we consider how best to structure our trade preferences program. Could you please further clarify and expand your thoughts on this idea?

### Answer

I was alluding to the fact that the nature of world trade and global economic competition has changed. What was once a world dominated by firms selling "internationally" via arm's length sales between independent exporters and importers has given way to a world in which firms, including Wal-Mart, source globally and sell globally.

Unfortunately, both the trading system and our trade policy is badly out of date in that it is premised on the way trade was conducted in that old world. The single most important trade statistic that I have seen lately is the fact that most U.S. trade takes place within companies (i.e., among the company's various affiliates), rather than between independent buyers and sellers. Plainly, if that is the case, a still larger share of U.S. and world trade takes place among such companies and their supply chains.

The rise of global supply chains is one of the main effects of globalization. The revolution in computing, communications and transport technology has largely conquered geography. That has made global supply chains possible, which, as in all things, has also made them a competitive necessity.

Our ideas of trade and development largely ignore the profound changes that holds, both for our own firms and for our trading partners in the developing world. In a global economy, the ostensible barriers to trade may mean less than the commercial standards a supplier must meet in order to qualify to sell to a firm like Wal-Mart that can take the local supplier in a developing country global.

One way of countering that is to involve Wal-Mart and other firms that regularly best the competition in managing their supply chains in ways that bring value to consumers in the

United States and the rest of the world. In effect, we should employ the same tools that Wal-Mart does in thinking through the problem of trade and development.

In practice, that would take the form of using a map of Wal-Mart's supply chain and its criteria for qualifying suppliers as a more realistic measure of the hurdles that exporters in the developing world face in participating in the global economy. Applying a map of Wal-Mart's to a particular developing trading partner would accomplish four inter-related things that most analyses of development miss.

First, the map would show the weaknesses in the local institutions that raise risks or costs. Those may be institutional, but they will also involve problems with physical infrastructure. In either case, however, the map would show the path that internal reforms should follow in order to allow the developing country's citizens to participate in the global economy, both as producers and as consumers.

Second, the map would show the sorts of regional arrangements the developing country must pursue to ensure that its goods can reach Wal-Mart and other buyers. Mali represents a good example. As a land-locked country, it will not benefit from any of the changes it has demanded in U.S. cotton programs unless it can reach agreement with other countries in the region on transshipment of its goods to an open water port serviced by container shipping.

Third, the map will also illuminate the trade barriers in export markets that most hinder the participation of the developing country's exporters in global markets. In effect, the supply chain map helps define the country's trade negotiating agenda.

Finally, using Wal-Mart's supply chain map would also illuminate where development assistance was most needed in order to allow individuals in the developing world to participate fully as producers and consumers in the world economy. It is an intensely practical approach to how we should be spending our own development assistance, as well as how we should seek to modify or shape the approach of the multilateral development banks to the same markets.

The result of involving Wal-Mart in that sort of discussion is that Wal-Mart, along with FedEx, UPS, EBay, Amazon and a variety of other global firms represent the market and all good things flow from enabling people, no matter how poor, to engage in the simple act of human exchange that is their birthright as much as any political freedom.

Jim Bunning

**STATEMENT FOR SENATOR BUNNING**
SENATE COMMITTEE ON FINANCE
"Oversight of U.S. Trade Preference Programs"
June 12, 2008

Thank you, Mr. Chairman.

In 2006, more than $92 billion of trade entered the United States under a preference program, a significant increase from 1992, when the volume of imports was only $20 billion. The increase has been most rapid in the last ten years, and it has come largely from a small subset of GSP beneficiary countries: India, Brazil, and Thailand.

The oldest and largest of our trade preference programs, the Generalized System of Preferences (GSP) expires at the end of this year, and this gives us an opportunity to review questions that have been raised about the effectiveness and goals of the trade preference concept as a tool of trade policy. We need to consider whether trade preferences are helping the poor as intended and whether they are serving our overall trade policy goals.

If the goal of trade preferences is to help the poor living in less developed countries, there are questions about whether we are spending our resources the right way. When we offer trade preference benefits conditionally and only for short periods of time the foundation we create for entrepreneurship is uncertain at best. It can be taken away by circumstances outside the investor's control, most notably the expiration of preference programs here in the United States.

Another problem is that trade preference programs are based on outdated notions of how to promote economic development in the third world. New research, such as the work of Nobel Laureate Amartya Sen, suggests that the true foundations of economic development are personal freedoms such as private property and freedom of contract, not simply the availability of capital or low tariffs abroad. As currently structured, there is no direct linkage between our preference programs and progress towards securing these rights. We should consider creating one.

A final problem is that our extensive network of trade preference programs has become an obstacle to the critical goal of opening foreign markets for United States goods and services. Content to pursue mercantilist trade policies, foreign governments see no reason to grant concessions on their own import barriers to U.S. goods, when their own goods enter the United States' market unscathed by duties. This is becoming an acute problem with respect to the larger developing countries that have accounted for most of the recent growth in preference program imports.

I look forward to the witnesses' testimony today, and I thank the Chairman for holding this important hearing.

**Senator Maria Cantwell**
**Finance Hearing June 12, 2008**
**ROZ Statement for the Record**

I want to thank the Chairman and Ranking Member for holding this important hearing today. I believe of U.S. trade preference programs such as the Generalized System of Preferences (GSP) play a critical role in promoting economic development and alleviating global poverty. GSP also helps U.S. manufacturers and their suppliers stay competitive. Most of U.S. imports using GSP are raw materials, parts and components, or machinery and equipment used by U.S. companies to manufacture goods in the United States. GSP and the Andean Trade Preference Act (ATPA) must be renewed before the end of this year.

My state has long understood the power of trade to improve people's lives around the world. Following the terrorist attacks on September 11, 2001, a group of my constituents including Bill Gates Sr., former U.S. Senator Daniel Evans, and General John Shalikashvili formed what has become known as the Initiative for Global Development.

Today it is a national organization chaired by former Secretaries of State Madeleine Albright and Colin Powell. The group believes that global poverty is at the root of many of the world's greatest challenges and that addressing the inequities of people living in poverty is a critical factor in ensuring the future security and prosperity of us all.

That 9/11 Commission made a similar finding. It recommended that a "comprehensive U.S. strategy to counter terrorism should include economic policies that encourage development, more open societies, and opportunities for people to improve the lives of their families and to enhance prospects for their children's future." I fully agree with this sentiment.

To help fulfill this goal, I along with Senator Hatch introduced the Afghanistan and Pakistan Reconstruction Opportunity Zone (ROZ) bill (S. 2776) in March of this year.

Congressman Chris Van Hollen will be introducing companion legislation in the U.S. House of Representatives.

This legislation is crucial to bringing peace and stability to troubled parts of both Pakistan and Afghanistan. It will give the U.S. a new tool to promote development as an alternative to terrorism and narcotics trafficking.

The ROZ bill would authorize the President to designate Reconstruction Opportunity Zones throughout Afghanistan and in the border regions of Pakistan. These zones would permit non-trade sensitive exports like textiles, apparel, agricultural products, and hand-crafted goods, from these areas to enter the U.S. duty-free, creating a strong incentive for private sector investment and job-creation.

In order for an area to be designated as a ROZ so that goods may qualify for benefits, the president must determine that Pakistan or Afghanistan are making progress towards establishing a market-based economy, the rule of law, efforts to combat corruption, and the protection of human rights and internationally recognized workers rights.

The bill provides safeguards to make sure bad actors do not benefit from ROZs. It provides the president with the authority to withdraw, suspend or limit duty-free treatment for exports from specific ROZs if he determines that such treatment is inconsistent with U.S. foreign policy or national security interests.

ROZs will give the people of Afghanistan and Pakistan new opportunity and hope.

I spoke with a group of businesswomen and businessmen from Karachi who told me that they will use money earned through trade to send their children to school. It is imperative that we create opportunities for the people of Pakistan and Afghanistan to choose education and business instead of Madrasas and extremism.

These are serious threats to stability in both Afghanistan and Pakistan. ROZs should become part of a long-term international strategy to promote sustainable economic development in the region.

There is strong support for the ROZ bill in the administration and from the governments of Pakistan and Afghanistan. I would like to submit letters for the record from Secretary of State Rice, and the Afghan and Pakistani Ministers of Commerce and the Pakistani Ambassador. I am pleased to also submit a letter of support from Ambassador Richard Holbrooke and 9/11 Commission Chair Lee Hamilton. I appreciate their support and hope my colleagues will heed their advice and pass the ROZ bill this year.

THE SECRETARY OF STATE
WASHINGTON

Dear Senator Baucus:

I am writing to ask you to support an initiative of great importance to U.S. national security – the establishment of Reconstruction Opportunity Zones (ROZs) in Afghanistan and in designated areas of Pakistan. In March, Senator Cantwell introduced a bill (S.2776) that would authorize these zones and spur sustainable economic growth and job creation by providing significant incentives for private investment. I urge your support for swift passage of this important legislation.

A stable Afghanistan and Pakistan are vital to U.S. national security interests. Lack of legitimate economic opportunity in Afghanistan and in Pakistan's border regions has helped to create conditions where violent extremism and other illicit activities can flourish. Creating a secure environment in these areas is a priority for the United States and for our allies, but military action alone will not solve the problem. Long-term stability can be achieved only by supporting robust social and economic development. ROZs will encourage this type of development by helping to generate new business opportunities and much-needed jobs.

Support for democracy in Afghanistan and Pakistan is another critical part of our engagement with the region. Afghanistan is now planning for elections in 2009. Pakistan held historic elections last February that continued its transition to democracy. Creating ROZs is a visible and concrete way we can signal our support for these democratically-elected governments and their citizens.

The Honorable
Max Baucus,
United States Senate.

We are committed to working with Congress to ensure that Afghanistan and Pakistan have the means, both military and economic, to confront the terrorist threat. Passage of S.2776 would make a very important contribution in this regard. I look forward to working with you on enacting this legislation this year and making ROZs a reality.

Sincerely,

Condoleezza Rice

Condoleezza Rice

THE SECRETARY OF STATE
WASHINGTON

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I am writing to ask you to support an initiative of great importance to U.S. national security – the establishment of Reconstruction Opportunity Zones (ROZs) in Afghanistan and in designated areas of Pakistan. In March, Senator Cantwell introduced a bill (S.2776) that would authorize these zones and spur sustainable economic growth and job creation by providing significant incentives for private investment. I urge your support for swift passage of this important legislation.

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Sincerely,

Condoleezza Rice

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جمهوری اسلامی افغانستان
وزارت تجارت و صنایع

د افغانستان اسلامي جمهوريت
د سوداګري او صنايعو وزارت

Islamic Republic of Afghanistan
Ministry of Commerce and Industry

NO:------------
Date: June, 12th, 2008

نمبر:--------
تاریخ : / / 1387

Senator Max Baucus
Chairman of the Senate Finance Committee
511 Hart Senate Office Bldg.
Washington, DC. 20510-1501

**Re: Senate Reconstruction Opportunity Zones Bill (S2776)**

Dear Senator Baucus,

Based on the instruction of President Hamid Karzai, I am writing to endorse the Reconstruction Opportunity Zones (ROZ) initiative for promoting Afghanistan's economic development and prosperity. The Government of Afghanistan is fully committed to enabling a strong market-based economy and creating an appropriate environment for the private sector and entrepreneurs to flourish.

We believe that eventually each ROZ site will be an important medium for creating long-term employment opportunities, building Afghans skills and technology, and promoting local and regional economic development. Notwithstanding the aforementioned, it is important that the ROZ initiative is ultimately managed by the Government of Afghanistan thus ensuring ownership and enhancing the ability of our government to deliver appropriate services to the private sector.

Yours Sincerely,

For; Dr. Mir Mohammad Amin Farhang
Minister of Commerce and Industry
Islamic Republic of Afghanistan

جمهوری اسلامی افغانستان
وزارت تجارت و صنایع

د افغانستان اسلامي جمهوريت
د سوداګرۍ او صنايعو وزارت

Islamic Republic of Afghanistan
Ministry of Commerce and Industry

NO:----------- نمبر:--------

Date: June, 8th, 2008 تاریخ : / / 1387

Senator Chuck Grassley
Ranking Member
Senate Finance Committee
135 Hart Senate Building
Washington, DC. 20510-1501

**Re: Senate Reconstruction Opportunity Zones Bill (S2776)**

Dear Senator Grassley,

During our meeting in Iowa in 2007, we had good discussions which included the topic of Reconstruction Opportunity Zones (ROZ). Based on the instruction of President Hamid Karzai, I am writing to endorse the Reconstruction Opportunity Zones (ROZ) initiative for promoting Afghanistan's economic development and prosperity. The Government of Afghanistan is fully committed to enabling a strong market-based economy and creating an appropriate environment for the private sector and entrepreneurs to flourish.

We believe that eventually each ROZ site will be an important medium for creating long-term employment opportunities, building Afghans skills and technology, and promoting local and regional economic development. Notwithstanding the aforementioned, it is important that the ROZ initiative is ultimately managed by the Government of Afghanistan thus ensuring ownership and enhancing the ability of our government to deliver appropriate services to the private sector.

Yours Sincerely,

Dr. Mir Mohammad Amin Farhang
Minister of Commerce and Industry
Islamic Republic of Afghanistan

Minister

No. 9(3)/2008-America
Government of Pakistan
Ministry of Commerce
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Islamabad June 12, 2008

Senator Max Baucus,
Chairman,
Senate Finance Committee,
U.S. Senate,
Washington DC

Senator Richard Lugar,
Ranking Member,
Senate Finance Committee,
U.S. Senate,
Washington DC.

Dear Senators Baucus and Lugar,

I am addressing this letter to reiterate the resolve of the newly elected Government of Pakistan to continue our collective fight against terrorism by adopting a multi pronged strategy. In this war, economic growth and national development is an important factor of strategic importance. As an ally of the U.S. in this effort, both of our countries need to work together to achieve the global objective of peace and security.

The recently introduced legislation in the U.S. Congress for the establishment of Reconstruction Opportunities Zones (ROZs) in the border areas of Pakistan contiguous to Afghanistan is an initiative in the right direction. Although there may be certain concerns on the Rules of Origin especially on certain items of textiles, which can be discussed at length at the technical levels, Pakistan supports and welcomes this initiative.

I have been informed that certain amendments relating to criteria on account of labour and social compliances are being included in the Bill, already introduced in the U.S. Congress. In case the criteria for such compliance delays the implementation of the concept for a few years, the initiative may lose its importance.

You will agree that time is of the essence and both countries cannot wait indefinitely to put in place the initiatives to establish real market access in the U.S. markets for goods produced in the proposed Zones.

I, however, appreciate the efforts of Senator Cantwell and other distinguished members of Congress who are sponsoring the ROZs legislation. I hope that the U.S. Congress would expeditiously adopt a realistic legislation on ROZs which would serve as an additional tool in our hands to deal with terrorism and extremism in an effective manner, both in the short and the long term.

Yours sincerely,

(Ch. Ahmed Mukhtar)
Federal Minister for Commerce
Government of Pakistan
Islamabad

AMBASSADOR OF PAKISTAN

EMBASSY OF PAKISTAN
3517 International Court, N.W.
WASHINGTON, D.C. 20008
Tel: (202) 243-6500

10 June 2008

Dear Senator Baucus,

I understand the Senate Finance Committee will soon consider the legislation to establish the Reconstruction Opportunity Zones (ROZs) in Afghanistan and border regions of Pakistan. The ROZs initiative was announced by the US Government in March 2006 as a core component of its broader counter terrorism strategy designed to connect the area to the global economy, and create vital employment opportunities and economic development in territories prone to extremism.

The newly elected democratic Government of Pakistan is strongly committed to fighting terrorism and curbing extremism. The Prime Minister of Pakistan has very clearly stated that the war against terrorism is Pakistan's own war, and that we want to fight it by adopting a comprehensive multi-pronged strategy.

Nurturing sustainable economic development and creating employment opportunities to address the issues of poverty and hopelessness – regrettably endemic in our border regions – is an essential part of this strategy. I would, therefore, like to express the strong support of the Government of Pakistan for this legislation.

I would also like to take this opportunity to thank Senator Cantwell and the co-sponsors for introducing the ROZ legislation in the Senate. I hope you will lend your support to this initiative enabling the legislation to move through Congress quickly and allowing the Government of Pakistan to implement it as one of the essential elements of its counter terrorism strategy.

Please do not hesitate to contact me should you wish to discuss the issue in greater detail.

With warm regards,

Yours sincerely,

( Husain Haqqani )

Senator Max Baucus,
Chairman,
Senate Committee on Finance,
Room No.511,
Senate Hall Building,
Washington, DC 20510

CC: Mr. Kurt Beckett, Chief of Staff to Senator Maria Cantwell (Fax No.202-224-3441)

AMBASSADOR OF PAKISTAN

EMBASSY OF PAKISTAN
3517 International Court, N.W.
WASHINGTON, D.C. 20008
Tel: (202) 243-6500

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Please do not hesitate to contact me should you wish to discuss the issue in greater detail.

With warm regards.

Yours sincerely,

( Husain Haqqani )

Senator Charles E. Grassley,
Ranking Member,
Senate Committee on Finance
Room No.135,
Senate Hall Building,
Washington, DC 20510

CC: Mr. Kurt Beckett, Chief of Staff to Senator Maria Cantwell (Fax No.202-224-3441)

**RICHARD HOLBROOKE**

June 11, 2008

The Honorable Max Baucus
Chairman, Committee on Finance

The Honorable Charles E. Grassley
Ranking Minority Member, Committee on Finance

The Honorable Joseph R. Biden, Jr.
Chairman, Committee on Foreign Relations

The Honorable Richard G. Lugar
Ranking Minority Member, Committee on Foreign Relations
United States Senate
Washington, DC 20510

Dear Chairmen and Ranking Minority Members:

Relations between the United States and Pakistan have cycled up and down for decades yet at no time has it been more important for our country to send clear messages than now. Those messages need to be a continuation of democracy, reconciliation and strong support for the new government's counter insurgency strategy.

The government of Prime Minister Gilani has announced how it wishes to combat the insurgency - by using force against terrorists and through negotiations and economic development for those who, as the prime minister described, "were misled into supporting extremists."

One of the most important and potentially effective cooperative tools that the United States can offer Pakistan and Afghanistan at this fragile moment are Reconstruction Opportunity Zones (ROZs).

ROZs would form a strong third-leg of support via private sector development -- along with military/diplomatic efforts and expanded economic assistance -- in meeting mutually held counterinsurgency policy goals in this volatile and dangerous area. Job-creation in ROZ-eligible areas would counter al-Qaeda and Taliban recruitment efforts by offering alternatives to joining the insurgency. This has been a key goal of U.S. policy since the 9/11 Commission Report and in subsequent legislation. During my recent travels to Pakistan's North West Frontier Province I held many discussions with Pakistanis who point to development as equally important as force in dealing with these challenges.

I commend Senator Cantwell and her co-sponsors, Senators Bond, Hagel, Hatch and Lieberman, in introducing ROZ enabling legislation, S. 2776. I believe that ROZs will have an important impact on stabilizing the border and promoting our public diplomacy goals in both Pakistan and Afghanistan. In essence, this legislation is as much about national security as it is about trade.

I hope that this legislation will move through Congress as quickly as possible.

Sincerely,

Richard Holbrooke

June 11, 2008

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Minority Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Dear Chairman and Ranking Minority Member:

America's crucial role in a complicated world demands that we apply effectively all the tools of U.S. power—public and private, military, political, and economic. And nowhere is this more important than in Pakistan and Afghanistan.

We must demonstrate our commitment not just to the Pakistani government, but to the Pakistani people, by doing what we can to promote economic development and decrease radicalism's appeal. We must be equally committed in Afghanistan.

In Pakistan, radical Islamists have developed a sanctuary on the eastern side of the Afghan border. From this rugged terrain, the Taliban supports its resurgence within Afghanistan, and al Qaeda operatives plot terrorist attacks.

There is an important role for military action to play in the fight against terrorism, but other tools are needed. Recent reports and studies have suggested growing dissatisfaction with al Qaeda and terrorist tactics among Muslims around the world. Reconstruction Opportunity Zones (ROZs) are one way we can wield American soft power and demonstrate a clear alternative to extremism at one its centers.

Senator Cantwell and co-sponsors Senators Bond, Hagel, Hatch and Lieberman have shown great leadership in introducing S. 2776. This legislation would enact some of the recommendations of the 9/11 Commission, which recognized the importance of economic policies as means to develop open societies as a bulwark against extremism and terrorism.

I believe that ROZs will have an important impact on stabilizing the border and promoting our goals in both Pakistan and Afghanistan and would urge quick Congressional action.

Sincerely,

Lee H. Hamilton

Additional addresses:

The Honorable Joseph R. Biden, Jr.
Chairman
The Honorable Richard G. Lugar
Ranking Minority Member
Senate Committee on Foreign Relations
Dirksen Senate Office Building
Washington, DC 20510-6225

The Honorable Maria Cantwell
511 Dirksen Senate Office Building
Washington, DC 20510

**U.S. TRADE PREFERENCE PROGRAMS:
RECORD, CHALLENGES AND FUTURE**

Senate Committee on Finance

Edward Gresser
Director, Project on Trade and Global Markets
Progressive Policy Institute

Washington, D.C.
June 12, 2008

Mr. Chairman, Ranking Member Grassley, Members of the Committee, thank you for inviting me to testify today on America's trade preference programs. By way of introduction, I direct the Trade and Global Markets Project at the Progressive Policy Institute, a non-profit think tank based in Washington, DC, which conducts research in areas ranging from trade and globalization to defense and foreign policy, environment and energy, health, social policy and other issues.

I am honored and pleased to join these distinguished panelists today. The hearing is not only timely, with two of the six preferences scheduled to expire at the end of the year, but offers a chance to assess preferences and their future as a whole. My testimony accordingly makes three main points:

- First, the six trade preferences – the Generalized System of Preferences and five regional programs – have a modest but significant place in U.S. trade policy. Though they cover a relatively small volume of trade, they are valuable ways to help America achieve national security objectives, encourage development and reduce poverty, and offset the tariff system's unintended tilt against poor countries. They are neither substitutes for multilateral liberalization, nor guarantees of export success for beneficiary countries. But since the 1970s they have made an important contribution to American trade policy, and can continue to do so in the next decade.
- Second, they have geographical gaps which diminish their ability to achieve these goals. Specifically, they give little benefit to large majority-Muslim countries, and least-developed countries in Asia and the Pacific.
- Third, they face some serious policy challenges. Some beneficiary countries could use GSP preferences more effectively with better technical training programs. And the five regional preference programs seem to be growing less effective, likely because their reliance on strict 'rules of origin' requiring use of inputs from particular countries clashes with the multinational supply chains used by most businesses. We will need more integrated, simpler programs and better capacity-building efforts if preferences are to fulfill their potential in the future.

I will come to these policy points in a moment, but let me begin with a few figures to put the trade preference programs in context.

## INTRODUCTION: U.S. TRADE AND THE DEVELOPING WORLD

The United States will conduct about $4.6 trillion worth of international goods and services trade this year. At a likely $2.63 trillion in imports and $1.95 trillion in exports, we will be the world's largest importer and exporter of goods and services. The U.S. government uses market-opening negotiations, enforcement actions at the WTO and in FTAs, enforcement of trade remedy laws, export promotion, and unilateral preferences to shape these flows of trade to suit U.S. interests and sound economics. Over many years, these policies have sought to create an open economy at home for efficiency, competitiveness and living standards; to open foreign markets to U.S. goods and services to support growth and quality jobs, especially during domestic downturns like this year's; and to ensure fair treatment for American businesses, farmers and workers.

The U.S. has also, especially since the 1970s, seen trade policy as a way to help us achieve humanitarian and national-security goals. Preferences are one of the main policy tools we have used, and have a significance well beyond their modest place in total U.S. trade flows.

America's 2007 goods and services imports were roughly a fifth of the world's $17-trillion total last year, and will be only slightly lower this year. Our share of the consumer-goods and light manufactures especially important to poor countries is even higher, making trade with the United States crucial to growth, employment, and often political stability in many poor countries. American purchases of clothes alone, for example, account for about a tenth of the GDP's of Haiti and Lesotho. They make up an eight of Honduran GDP and a quarter of Cambodia's GDP.

These figures have important human consequences. Haiti's 22,000 garment workers make clothes for American retail outlets. With wages of roughly $5 per day – about four times the Haiti's $1.20-per-day per capita income – each is believed to earn enough to feed and house an extended family of ten. Pakistan's leading export to the United States is towels; each containerful of towels for export to the U.S. employs 485 Pakistani men and women, enabling them to care for families and see the U.S. not as a looming presence or threat to religion but as a source of employment.

Cambodia's case may be especially striking. When Congress normalized trade with Cambodia in 1996, the country's main urban employers were government agencies, the army, and foreign humanitarian relief groups. Twelve years later, Phnom Penh's 350 garment factories employ about 400,000 production workers, about 360,000 of whom are young women from rural areas. Each earns enough money, often saved in the form of silver jewelry, to give her rural family a year's worth of food security. Roughly 5,000 more are young urban college graduates working as middle managers, who in future will form a business class to replace the one destroyed thirty years ago by the Khmer Rouge.

Roughly 60 percent of this industry's sales are to the United States. Its success has helped hundreds of thousands of young women become self-sufficient family providers, offered security against hunger to roughly 3 million people, and – if sustained – given Cambodia a realistic hope of escaping least-developed country status in the next decade. The progress is not secure, as Cambodian businesses are still mostly foreign-owned, and face intense competition from nearby China and Vietnam, both with larger workforces and superior infrastructure. But so far, the results of Congress' decision to normalize trade in 1996 have far outstripped all hopes.

This kind of development is important in a humanitarian sense, and contributes to larger American interests as well. As poor countries develop, they become better markets for American goods and services. In a more immediate sense, an environment of economic growth, employment and optimism helps the U.S. and friendly governments more effectively combat radicalism and political instability on one hand, and pursue democratization and peacemaking on the other.

## THE TARIFF SYSTEM AND THE PREFERENCE PROGRAMS

Since the 1970s, trade preferences have helped many poor countries create these conditions for their people. In the 1980s and 1990s, the Caribbean Basin Initiative helped foster employment and growth in Central America. This in turn helped the region's governments and people develop stable democratic political systems and end the wars of the 1970s and 1980s, settling one of America's enduring security problems in the process. Since 2000, the African Growth and Opportunity Act has helped Lesotho, Swaziland and Madagascar employ thousands of women in local garment industries, and has begun to foster American florist trade with Kenya. Andean Trade Preference Act flowers are one of the major job opportunities available to Colombians and Ecuadorans, offering particular benefit to rural areas. And several middle- and lower-middle income allies, such as Paraguay, Armenia, Thailand, India, the Philippines, Indonesia, Turkey and others, rely on the Generalized System of Preferences system for urban employment and competitiveness in light manufacturing industries vis-à-vis China.

With this background, let me turn to a more detailed discussion of the tariff system and the preference programs.

### 1. The Tariff System

Fundamentally, though due to historical accident rather than intentional policy, America's permanent trade system tilts against most low-income countries.

The United States has participated in nine tariff-cutting agreements since World War II. Together these eliminated most U.S. tariffs on the sophisticated manufactured goods – airplanes, semiconductors, pharmaceuticals, medical technologies – we import from wealthy countries. Most tariffs on luxury goods like artwork, liqueurs or exotic-fabric clothes are also gone, and natural resources like oil or metal ores rarely had significant tariffs in any case. The overall U.S. tariff rate of 1.3 percent in 2007 (based on dividing the U.S.' $26.2 billion in tariff revenue by the $1.943 trillion in merchandise imports) shows that these agreements have created a generally open market.

But the agreements left high tariffs in place on most light consumer goods and some kinds of food. These include mass-market clothes, shoes, costume jewelry, luggage, cheap tableware and silverware, watches and some types of food. Under the NTR schedule, (MFN in international usage), tariffs on these goods are far higher than on other products. Clothing tariffs average about 14.5 percent – nearly eight times the rate applied to other goods – and rise to 32 percent for polyester pullover shirts and acrylic sweaters. Shoe tariffs are even higher, peaking for cheap sneakers at 48 percent and 60 percent. Table 1 summarizes the system, showing that these high-tariff goods account for about ten percent of total imports outside the Free Trade Agreement network, but raise about half of all U.S. tariff revenue.

**TABLE 1: THE U.S. TARIFF SYSTEM, 2007**

| PRODUCT | IMPORTS | Tariff penalty | Average Rate |
|---|---|---|---|
| **ALL GOODS** | **$1.26 trillion** | **$25.3 billion** | **2.0%** |
| **High-Tariff Manufactures** | **$112.4 billion** | **$13.5 billion** | **12.0%** |
| Clothes | $63.1 billion | $9.1 billion | 14.5% |
| Leather/Luggage | $7.3 billion | $0.95 billion | 13.0% |
| Shoes | $19.0 billion | $1.9 billion | 10.0% |
| Costume Jewelry | $1.3 billion | $0.11 billion | 8.0% |
| Household linen | $9.3 billion | $0.7 billion | 7.5% |
| Silverware/tableware | $1.9 billion | $0.15 billion | 7.9% |
| Watches | $3.3 billion | $0.15 billion | 4.5% |
| Sports & Fishing Equipment | $5.4 billion | $0.19 billion | 3.6% |
| **Three Agricultural Products** | **$1.8 billion** | **$0.3 billion** | **16.7%** |
| Orange juice | $0.4 billion | $0.08 billion | 20.0% |
| Cheese | $1.0 billion | $0.1 billion | 10.0% |
| Ethanol | $0.43 billion | $0.1 billion | 26.5% |
| **All Else** | **$1.14 trillion** | **$11.7 billion** | **1.0%** |
| Energy | $168 billion | $0.25 billion | 0.1% |
| Cars | $87 billion | $2.2 billion | 2.5% |
| Other foods | $32.1 billion | $0.5 billion | 1.6% |
| Steel | $25 billion | $0.01 billion | 0.4% |

*Source: ITC. Excludes goods imported from FTA partners.*

When the tariff system was drafted in the 1920s, the high-tariff goods were typically made in industrialized countries. Today, countries specializing in the high-tariff products are usually low- to middle-income countries without large natural resource endowments. A random list would include places such as Turkey, Indonesia, Pakistan, El Salvador, Haiti, Thailand, the Philippines, Fiji, Cambodia, Pakistan and Egypt. The nature of the NTR ("Normal Trade Relations") system. Thus they typically face much higher U.S. tariff barriers than rich countries or natural resource exporters.

## 2. The Preference Programs

Trade preference programs attempt to ease this tilt by waiving tariffs on many low- and middle-tariff products and in some cases high-tariff manufactures. Their hope is to give importers extra incentive to buy from poor countries, regions threatened by wars and radicalism, and countries important to the United States for other reasons. In exchange they ask that beneficiaries cooperate in efforts to fight terrorism, enforce intellectual property rights, and enforce labor rights.

We have created six such programs since the 1970s. The first, the Generalized System of Preferences, dates to 1974 and excludes most high-tariff products. Since 1985 we have added five regional programs with broader product coverage: the Caribbean Basin Initiative/Caribbean Trade Partnership Act (1985); the Andean Trade Preference and Drug Eradication Act (1991); the Qualifying Industrial Zones program in the Middle East (1996); the African Growth and Opportunity Act (2000); and the Haitian Hemispheric Opportunity Through Partnership Act (2006). A brief summary of each is as follows:

*GSP:* The Generalized System of Preferences waives tariffs on most low- and middle-tariff manufactured goods from 131 countries and territories. It excludes high-tariff products including clothes, shoes, luggage, household linens, watches, and many glass and ceramic goods, which have been considered import-sensitive since GSP's creation, though employment in these industries is usually well below the levels of the 1970s and – as in the case of cheap sneakers – vanished altogether.

In 2007, GSP covered $30.8 billion in goods, or $20.3 billion in goods excluding oil. Setting energy aside, the largest GSP import was jewelry, accounting for about $3.3 billion or 14% of all non-oil GSP imports in 2007. Other leading GSP products include tractor and bus parts, ferroalloys, insulating material, automobile tires, felt-tip pens, musical instruments and so on. Again apart from oil exporters, the largest beneficiaries of GSP preferences are lower-middle to middle-income states, specifically India, Thailand, Brazil, Indonesia, South Africa, the Philippines, Turkey, Argentina and Russia. While these are lower-to-middle-income countries, the beneficiaries within them are often precisely the type of lower-income people the preferences are meant to help.

*Regional Preferences:* The five regional preference systems add clothing and other high-tariff goods to GSP's coverage, though the benefits for clothes are usually limited by rules of origin. In chronological order, they are:

- *Caribbean Basin Initiative (CBI)* – CBI and its Caribbean-island counterpart CBERA exempt eighteen countries and colonial territories in the Caribbean islands and littoral, Jamaica and Haiti largest among them, from tariffs on clothes and other goods. CBI also offers residual benefits for Central America and the Dominican Republic as they phase into the CAFTA. Oldest of the regional preferences, it helped turn Central America into a major center for clothing exports between 1985 and 1993. With the five Central American states and Dominican Republic transitioning into new roles as FTA partners, the program's main users are Haiti, Jamaica and Trinidad, along with the smaller Caribbean islands. These countries have smaller and different economies than the original CBI beneficiaries in Central America, and the program may be ripe for a redesign to meet new purposes.

- *Andean Trade Preference and Drug Eradication Act (ATPDEA)* – The Andean program was created to encourage Andean farmers to find alternatives to narcotics production, and expanded seven years ago to include clothes and some other manufactured goods. With the U.S.-Peru Trade Promotion Agreement now approved, the ATPDEA beneficiaries are Colombia, Ecuador and Bolivia. Colombia's use of the program depends on Congressional decisions on the US-Colombia Trade Promotion Agreement. The main imports under this program are clothes; copper goods (normally covered by tariffs of 2 percent or less); and selected agricultural products, in particular flowers. ATPDEA's waiver of the 6.5 percent NTR tariff on flowers from other sources – the Netherlands in particular – has been credited with helping to create 60,000 jobs in flower-growing operations around Bogota. Most Valentine's and Mother's Day flowers, incidentally, are ATPDEA goods from Colombia and Ecuador.

- *Qualifying Industrial* Zones (QIZ) – This is the main benefit for the Middle East, waiving tariffs on clothes and luggage made by joint Israeli-Arab industrial projects in Jordan, Egypt, and the West. The program is a waning factor in US-Jordan trade, replaced by the US-Jordan Free Trade Agreement, but a growing one in US-Egypt trade. Egypt joined the QIZ program in 2005, and by 2007 was exporting $700 million worth of clothes from about 223 factories employing roughly 179,000 people in Cairo, Alexandria and Port Suez. Egypt is the sole large Muslim state with an extensive preference program, and now seeks approval of a new QIZ in Upper Egypt, a more rural and lower-income area home to about a quarter of its people.

- *African Growth and Opportunity Act (AGOA)* – AGOA is especially liberal, allowing African countries to use 'third-country' fabrics – that is, cloth and yarn bought from India, Pakistan, China and other producers – for clothes, rather than solely locally-made textiles or American products. It also offers beneficiaries more technical assistance than is available under other preferences. Enrolling 40 of the 48 sub-Saharan African states, AGOA covered $2.1 billion out of the U.S.' $12.4 billion in non-energy imports from Africa last year. Leading examples include clothes sewn in Lesotho, Swaziland and Madagascar; a growing Kenyan florist industry; and plus cars, steel and agricultural goods imported from South Africa. AGOA also covered $40 billion in energy imports, though the tariffs here are minimal in any case and likely have little effect on trade.

- *Haitian Hemispheric Opportunity Through Partnership (HOPE)* – The newest preference is the HOPE act for Haiti, created in 2006 and revised last month. HOPE I was a provisional three-year program passed in December of 2006; the country's export employment rose from about 15,000 to 22,000 last year, though this probably owes more to the political stability created by the UN's peacekeeping mission in Port-au-Prince and other cities than to trade policy per se. HOPE II's effects are yet to be determined.

### 3. Scale of Preference Imports

The preferences sometimes cover large fractions of imports from beneficiaries, especially African countries. But they have a relatively small place in total U.S. imports.

Taken together, they covered $92 billion in 2007. This is slightly below 5 percent of the U.S.' $1.94 trillion in merchandise imports; alternatively, excluding the $890 billion in imports of goods that are duty-free under the NTR tariff system, the preferences covered 9 percent of dutiable imports. But this overstates their role. Two-thirds of preference imports are oil and fuels from Africa and Latin America, where the 'tariffs' are really small specific duties of a nickel, dime or half-dollar per barrel. These duties are roughly the equivalent of tariffs of 0.05 to 0.5 percent, and unlikely to have meaningful effects on import patterns. Excluding energy, preferences cover about $31 billion in manufactured goods and farm imports, which is two percent of all U.S. imports excluding energy, or four percent of non-energy imports subject to tariffs.

By program, about two-thirds of non-energy preference imports come from the GSP program, and the rest from the five regional preference programs. Table 2 provides a simple breakdown.

**TABLE 2: PREFERENCES AND IMPORTS, 2007**

| **PROGRAM** | **ALL MERCHANDISE** | **ENERGY EXCLUDED** |
|---|---|---|
| **TOTAL** | **$1.917 trillion** | **$1.595 trillion** |
| **NTR (MFN)** | **$1.335 trillion** | **$1.097 trillion** |
| **FTAs** | **$582 billion** | **$467 billion** |
| NAFTA | $522 billion | $409 billion |
| Other FTA partners | $60 billion | $58 billion |
| **Preferences** | **$92 billion** | **$31 billion** |
| GSP | $31 | $20.3 billion |
| CBI/CBTPA | $5.5 | $3.7 billion |
| ATPDEA | $12 | $3.3 billion |
| AGOA | $42 | $2.1 billion |
| QIZ | $1.7 | $1.7 billion |
| Haitian HOPE | n/a | n/a |

By product, if oil is excluded the top preference import is clothing. Here, $5.6 billion in preference clothing accounted for five percent of America's clothing imports and a sixth of all preference imports. Jewelry, in which $3.3 billion worth of goods were imported under GSP last year, was the second-ranking preference product; and these imports made up a third of all the US' jewelry imports. (Though jewelry imports under GSP are declining, with the removal of some products from the system last year.) The $700 million worth of flowers, mainly imported through the Andean program, was about 70 percent of the total and represented half the flowers sold in the United States.

Finally, the elimination of tariffs on $92 billion in goods imports does not mean preference beneficiaries simply export all their goods duty-free to the United States. The proportion of duty-free goods in their exports, in fact, is roughly equivalent to the proportions for Europe and China. As Table 3 shows, the normal tariff system allows about 40 percent of all goods to come in duty-free, including about half of European goods and more than half of Chinese goods. About a third of imports from preference beneficiaries come in duty-free; and even with the preferences in place, total imports from preference countries face a modestly higher tariff penalty than the EU's products.

**TABLE 3: PREFERENCES COMPARED WITH NTR AND FTAs**

| COUNTRY | Total Imports | MFN Zero | FTAs | Preferences | Tariffed | Penalty |
|---|---|---|---|---|---|---|
| World | $1.942 trillion | $857 billion | $314 | $92 | $679 | $26.1 |
| OECD | $1.100 trillion | $453 | $293 | -- | $354 | $8.3 |
| European Union | $352 billion | $171 | -- | -- | $181 | $4.4 |
| Preference | $342 billion | $115 | $14 | $92 | $121 | $5.4 |
| China | $323 billion | $182 | -- | -- | $141 | $9.9 |
| OPEC | $176 billion | $49 | -- | $49 | $78 | $1.0 |
| LDCs | $24.6 billion | $1.5 | -- | $16 | $7.5 | $1.0 |
| Muslim states* | $181 billion | $72 billion | $0.7 | $40 | $68 | $2.3 |

* I.e. the 57 members of the Organization of the Islamic Conference.

### 4. Potential Drawbacks

It is important to note that preferences have some drawbacks. Creating a preference means setting different tariff rates for different countries, which can encourage trade diversion. I.e., special tariff benefits for one country can mean unintentional harm to another. If the effect is to draw some exports away from large and wealthy economies – for example, a television set imported from Thailand under GSP rather than from Japan or China, or a bottle of olive oil from Tunisia rather than Italy or Spain – this is not economically "efficient" but also not necessarily bad. But if exports are drawn away from countries that cannot easily absorb the loss, they can cause unwitting damage.

Furthermore, beneficiaries can overstate the benefits they draw from preferences. Therefore they can become reluctant to engage in broader liberalizing negotiations to avoid 'erosion' of preferences. This has become an issue in negotiations over the Doha Round, but I believe it is a manageable problem. Countries alarmed over preference erosion are principally smaller and poorer states, and their concerns are not the basic blocking point in the WTO's Doha talks. Doha's deadlock appears to arise from larger divisions between big economies – market access in big developing countries, subsidies and tariff protection for agriculture in wealthy states, and so on. Were the WTO members to bridge gaps on these issues, it is unlikely that fears of preference erosion would block an agreement. And if a final agreement results in broad liberalization, especially with meaningful commitments by big developing countries, the advantages to beneficiaries should outweigh any concerns.

## TWO CHALLENGES

In summary, though the preferences are limited and cover a relatively small amount of imports, they have made an important contribution to development and some major American foreign policy goals over the last three decades. But looking ahead, without some significant changes their future may be less successful than their past. The preferences face two big challenges: a geographical gap, and evidence of declining effectiveness, especially for the regional programs. Both need attention if preferences are to be as successful a policy tool in the 2010s as they were in the 1980s and 1990s.

### 1. Geographical Gaps: Muslim World and Least-Developed Asia

One gap is geographical. As Table 4 shows, a small group of countries – least-developed Asian-Pacific states and large majority Muslim countries without oil wealth – face much higher U.S. tariff rates than countries elsewhere in the world.

**TABLE 4: U.S. TARIFFS FOR WORLD AND FOURTEEN SELECTED PARTNERS, 2007**

| COUNTRY | 2007 IMPORTS | Tariff Collection | Average Rate |
|---|---|---|---|
| Cambodia | $2.5 billion | $419 million | 17.0% |
| Bangladesh | $3.4 | $523 | 15.2% |
| Pakistan | $3.6 | $365 | 10.6% |
| India | $24 | $748 | 3.1% |
| China | $323 | $9,874 | 3.0% |
| **WORLD without FTAs** | **$1,260 trillion** | **$25.3 billion** | **2.0%** |
| Brazil | $25 | $452 | 1.8% |
| Japan | $145 | $2,440 | 1.7% |
| **WORLD including FTAs** | **$1.942 trillion** | **$26.1 billion** | **1.3%** |
| France | $41 | $378 | 0.9% |
| UK | $57 | $412 | 0.7% |
| Malaysia | $33 | $225 | 0.7% |
| Russia | $19 | $61 | 0.3% |
| South Africa | $9 | $7 | 0.1% |
| Saudi Arabia | $35 | $45 | 0.1% |

The table shows that Cambodia, Bangladesh and Pakistan together contribute a nickel in each dollar of tariff revenue, though they account for less than half a percent of imports. Their regrettable treatment is a sign that the preferences are not contributing effectively to America's greatest current national security challenge, and can do more to help promote growth and ease poverty in some of the world's poorest countries.

#### a. Muslim World

In the Muslim world, the basic point is that the 'greater Middle East' – the 30 majority-Muslim states from the Maghreb to South Asia – was the unrecognized loser of the era from 1980 to 2000. This region's share of trade, investment and global GDP shrank by about 75 percent between 1980 and 2000, while its population grew by 250 million. Economic contraction mixed with demographic surge and high unemployment would be a breeding ground for radicalism anywhere in the world, and are all the more dangerous when placed in the backdrop to the unresolved political conflicts of the Middle East. And though the area's political troubles have their own causes that need attention, successful policies to ease the region's economic distress could provide space for democratization and peacemaking.

A broad U.S. strategy to help revitalize Muslim-world economies must address education, domestic economy policy, rule of law and business regulation, regional trade integration and other issues. But preferences can play an important part as well, helping to promote investment and employment that lowers the social temperature, reduces the appeal of radicalism, and eases the tasks of political reform. To some extent this is already happening. Indonesia and Turkey, both examples of religious tolerance and democratization in the Muslim world, are major users of GSP. Egypt's QIZ program and the FTAs with Jordan and Morocco are recent Arab-world success stories. But the preference systems offer little to three countries facing major radical threats – Pakistan, Afghanistan and Yemen – and also little to moderate Arab countries outside Morocco and Jordan such as Tunisia and Lebanon. These are important security partners facing internal threats, and preferences could offer them far more help.

For example, Pakistani businesses face much higher tariff penalties than do businesses in wealthy countries. They must also compete with sixteen FTA partners and nearly sixty preference beneficiaries elsewhere in the world exempted from tariffs. Pakistan's top export last year were towels, which have a 9.1 percent tariff under the NTR system. These tariffs are waived for towels made in FTA partners such as Mexico or El Salvador, or preference beneficiaries in Africa and Latin America, but applied in full to Pakistani towels. Pakistan is eligible for GSP, but the program covers only eight of our top 100 Pakistani imports. (Specifically, toenail clippers, flags, gold jewelry, baseball gloves, jewelry, two types of cut stone, brooms and three small food categories.) It excludes the clothing and household linens that make up nearly ninety percent of Pakistan's exports to the United States, and thus is only of marginal benefit.

b. Asian and Pacific Least-Developed Countries

A similar gap is even wider for some of the world's poorest countries. These are the least-developed countries of Asia, the Muslim world and the Pacific: Bangladesh, Cambodia, East Timor, Laos, Nepal, the Pacific island states and again Afghanistan and Yemen. These countries are usually enrolled in GSP, assuming they meet the conditions of the GSP statute. But they lack the sophisticated mid-range manufacturing industries that are most important in the GSP, and therefore draw little benefit from the program. With no regional preference program comparable to AGOA, ATPDEA, CBI, QIZ or HOPE, they find themselves at a rather drastic disadvantage.

Cambodia is a striking case. Virtually all of the country's exports to the United States last year – \$2.43 billion out of \$2.46 billion – were mass-market clothes. The GSP statute excludes these products, so Cambodian goods faced the full NTR tariff penalty. Cambodia received a \$419 million tariff penalty on its \$2.46 billion in exports, a sum larger than the \$412 million penalty on our \$57 billion in imports of airplane parts, liqueurs, pharmaceuticals, artwork, enriched uranium and other sophisticated goods from Britain. GSP exempted only one of Cambodia's top 100 exports from tariffs (\$7.1 million worth of plastic packaging material) and reduced the tariff penalty on Cambodian products by less than \$1 million.

Bangladesh is in a similar bind. Like Cambodia, though on a larger scale, it has used garment exports (to Europe as well as the US) to begin developing a modern industrial base. Bangladeshi products are also mostly mass-market clothes, along with a smaller amount of shrimp. Therefore Bangladesh also faces some of the highest barriers the US system can produce. GSP covers only two of the top 100 Bangladeshi products, reducing tariff penalties by about $2 million out of $520 million. Shrimp is duty-free for all countries. Bangladesh, our 52nd-largest source of imports, faces the 10th-highest tariff penalty in the US system, larger than the fees assessed to imports from the UK and France and ten times the penalties imposed on Russian and Saudi Arabian goods. Even Afghanistan receives no special tariff benefit, despite the country's central place in American national security concerns.

### 2. Policy Questions: Regional Programs, Need for Technical Assistance

Finally, the existing programs need some reform and improvement if they are to meet their goals.

GSP remains reasonably effective despite its product limits, with beneficiaries on the whole maintaining their share of covered imports. But in some areas the system could offer more benefit with more timely technical help for beneficiaries. For example, potential exporters of farm products which are not import-sensitive and are eligible for GSP often do not use the benefit, as low-income farmers are often unfamiliar with the U.S.' sanitary and phytosanitary requirements. More regular and timely training programs from American experts might help them take greater advantage of this opportunity. This point also applies to regional preferences with agricultural benefits.

By contrast, the regional preference programs are struggling. As Table 5 shows, participants in AGOA, CBI and ATPA are not only losing market share but seeing exports drop in absolute terms.

**TABLE 5: FALLING PREFERENCE/FTA SHARE OF US CLOTHING IMPORTS, 2001-2007**

| WORLD | 2001<br>$63.8 billion | 2004<br>$72.2 billion | 2005<br>$76.3 billion | 2006<br>$79.1 billion | 2007<br>$81.1 billion |
|---|---|---|---|---|---|
| AGOA | $0.9 | $1.8 | $1.5 | $1.3 | $1.3 |
| ATPA | $0.8 | $1.3 | $1.4 | $1.4 | $1.2 |
| CBERA | $1.2 | $1.0 | $1.0 | $1.0 | $0.9 |
| 3 programs | $2.9 | $4.1 | $3.9 | $3.7 | $3.4 |
| *Share* | *4.5%* | *5.8%* | *5.1%* | *4.7%* | *4.2%* |
| Mexico | $8.1 | $6.9 | $6.3 | $5.5 | $4.7 |
| *Share* | *12.7%* | *9.6%* | *8.3%* | *7.0%* | *5.8%* |
| Jordan | $0.2 | $1.0 | $1.1 | $1.25 | $1.1 |
| *Share* | *0.3%* | *1.4%* | *1.4%* | *1.6%* | *1.4%* |
| C. America/DR | $9.1 | $9.6 | $9.2 | $8.5 | $8.0 |
| *Share* | *14.3%* | *13.3%* | *12.1%* | *10.7%* | *9.9%* |

Excluding the five Central American countries and the Dominican Republic, now partners in the CAFTA, preferences covered about $4.1 billion in clothes and 5.8 percent of America's clothing imports in 2004. By 2007 the figures were down to $3.4 billion and 4.2%. The same trends are appearing in free trade agreements, with equally sharp drops for CAFTA members and Mexico, and a recent decline for Jordan. Egypt's QIZ program is the only preference in which share is rising.

It is of course important to remember that preferences cover only a modest fraction of trade, and stress on preference exports is not equivalent to systemic failure in trade. For example, Africa's non-oil AGOA exports to the US have declined since the early years of the program, but Africa's exports to the world have tripled from $140 to $420 billion since 2002. The preference programs' focus in manufacturing and to a lesser degree agriculture, though, can offer employment benefits that natural-resource exports do not always provide. Together with beneficiary governments, we should examine the reasons for this decline and develop options for reforms that might help.

Both the preferences and the FTAs seem to have become less effective after 2004, when the textile quota system was eliminated. This is often ascribed to more intense Chinese competition, but in fact China has been subject to clothing quotas since November 2005, and the preference beneficiaries have not regained market share. Nor has their loss of markets in the US been made up by production in the United States, where clothing employment has fallen at a relatively steady pace.

Instead the explanation may be that the programs have become less attractive to buyers, likely because of their rules. Any tariff differential, whether in preference programs or FTAs, will need a "rule of origin" to define the source of a product and therefore its ability to qualify for duty-free treatment. The rules for the FTAs and preferences often require beneficiaries to use fabric or yarn from the U.S. or local sources to qualify clothes, rather than choosing their own sources of inputs. This adds red tape and cost to the programs at the best of times. As multinational supply chains become more elaborate, the difficulties managing rules of origin seem to be growing more damaging to the programs. Forced to choose between multinational supply chains and even waivers of very high tariffs, buyers seem to be opting to pay the tariff.

It is especially interesting to note that beneficiaries are holding market share through the GSP and QIZ. Both have relatively simple rules of origin. GSP allows manufacturers of jewelry, tires, ferrochromium, pianos and other covered goods to use inputs from any convenient source so long as the manufacturer can demonstrate contributing 35 percent of the value of the good in question. The QIZ requires a similar showing for its beneficiaries. Both remain reasonably successful.

## POLICY

In summary, therefore, the preference programs have made a valuable contribution to American policy goals over the past thirty years. I believe their basic goals – using tariff waivers to reduce poverty, to offset unintended regressive aspects of the US trade regime, and to help the US achieve national-security goals – are still valid, and well-designed preferences can continue to help us achieve these objectives. But they have gaps and the value of the newer programs is eroding. So let me close with four suggestions on policy.

1. **Renew ATPDEA and GSP:** First, two preference programs, GSP and ATPA, are scheduled to expire at the end of 2008. ATPDEA's long-term future of course depends on resolving the uncertainty over the free trade agreement with Colombia. But this agreement's future is unclear, and even the signed agreement with Peru will not be fully implemented for years. In the interim, loss of preference would likely damage the exporters in the beneficiary countries and the buyers of their goods here, particularly in florist industries which cannot easily replace ATPDEA flowers. GSP likewise has suffered over the years because of frequent lapses, generally followed by repayment of duties but still creating uncertainty for buyers. And of course the families shopping for ATPDEA flowers and GSP jewelry do not get any money back. As Congress considers broader reform of preferences in general, it is important to renew those that now exist and to give their users some security against new short-term lapses.

2. **Extend Preferences for Least-Developed Countries and Muslim World:** Second, the minimal preferences available to least-developed Asian and Pacific least-developed states and large Muslim countries mean the programs do much less than they should to support national security objectives and reduce poverty. In this regard, let me note three current proposals that will help.

One is the bill introduced by Senator Maria Cantwell and others to create a preference program for Afghanistan and the frontier areas of Pakistan. Known as "Reconstruction Opportunity Zones," these would parallel the QIZ initiative for the Middle East (and complement the FTA's with Bahrain, Jordan, Morocco and Oman) by creating incentives for investment and job creation in Afghanistan and in Pakistan's border territories. These are of course regions at the very center of America's current national security problems. Since 2003, PPI has advocated a broad preference program for Muslim-world nations, including Pakistan and moderate Arab states. The ROZ is of course a much smaller initiative, but a good start and focused on the single area of greatest security concern for the United States.

The second is the TRADE Act introduced by Senator Gordon Smith and Senator Feinstein. This would waive tariffs on a broad range of goods including clothing to the least-developed countries not now covered by AGOA and Haitian HOPE, such as Bangladesh, Nepal and Cambodia, as well as Sri Lanka. This will ensure that U.S. trade policy does as much as it can to help all least-developed countries reduce deep poverty and in the case of Bangladesh and Cambodia help accelerate their drive to escape least-developed country status.

Finally, Egypt has requested an additional QIZ in Upper Egypt. This is a modest and worthwhile step, which will add value to a program that already is demonstrating success.

3. **Liberalize Clothing Rules:** Third, the regional preference programs focused on clothing for Africa and Latin America are struggling and need reform. The decline in market-share for clothing preference beneficiaries during this decade is broad and sustained, showing that AGOA and CBI at least, and probably ATPDEA as well, need

simpler rules and more flexibility. This will make the programs easier to use and more attractive to importers, helping to preserve their effectiveness in the next decade.

**4. Improve Technical Support:** Fourth, improve, technical support and capacity-building. This is especially important for African countries, which have made a start through AGOA but can make more use of the program. Assistance in infrastructure efficiency that allows easier and cheaper movement through ports and roads will help them use AGOA's extensive market-access benefits in light manufacturing more effectively, and some guidance on SPS guidance that helps farmers meet American health and safety requirements will help Africa's largely rural societies take better advantage of the agricultural features of the preference programs.

## CONCLUSION

Finally, let me conclude by observing that preferences will always have limits. They are often valuable for beneficiaries – but even the best-designed trade policy is not a substitute for peace and political stability, universal education, an effective rule of law and functioning internal markets at home. And in trade policy per se, neither the products in which the U.S. has tariffs, nor the American market generally, are the sole options available to poorer countries.

Even when preferences are not successful in the United States, sales to other parts of the world often easily compensate. Europe, Japan, Canada, Australia, and other wealthy states are also important markets for Latin America, Africa, the Middle East, Asia and the Pacific islands, and also have their own preference programs. And many low-income and middle-income countries are now – appropriately – relying more heavily on China (and to a lesser extent India) as markets for their farm products, natural resources and (also to a lesser extent) manufactured goods. A successful Doha Round, with significant contributions from large developing countries, should remain the strategic goal of trade policy.

That said, U.S. trade policy can continue to make good use of trade preferences during the next decade. They have been an important part of our policies since the 1970s, and have made significant contributions to development and poverty reduction, to the creation of a fairer U.S. trade regime, and to some of our major foreign policy goals. With attention and careful reform, they can do the same in the decade to come.

Thank you very much.

# QUESTIONS FOR THE RECORD FOR MR. EDWARD GRESSER

## United States Senate Committee on Finance

## Hearing on Oversight of U.S. Trade Preference Programs

## June 12, 2008

## Question From Senator Baucus:

### *Question 1*

*Some of the debate surrounding trade preference programs has focused on the capacity of beneficiary countries to take advantage of our programs. Do you think developing countries have the infrastructure to fully utilize existing preference programs? What changes can we make to existing programs to ensure that beneficiary countries can sustain the economic growth brought about by preference programs?*

Developing countries have a very large range of income levels and varying degrees of industrial sophistication. Some have the capacity to use preference programs well, but others need more help. We might usefully break them down into three categories:

1. Lower-middle income states, even if they are relatively far below the GSP income caps, are often sophisticated enough to use preferences quite well. Mid-tier ASEAN countries such as the Philippines, Thailand and Indonesia find GSP very helpful, as do places like Jamaica and Trinidad in the Caribbean. South Africa's use of AGOA and GSP is also a good example. Their success also probably reflects the fairly simple and straightforward rules of the GSP system.

2. Least-developed countries seem to have more trouble using preferences. Africa in particular is struggling to compete in clothing, despite its extensive benefits through AGOA. This probably in part reflects relatively undeveloped roads and ports, which in turn means long and sometimes unpredictable delivery times. An interesting approach, as Grant Aldonas suggested, might be to synchronize US aid more effectively with aid programs. In addition, as I noted in my prepared testimony, programs with intricate and complicated rules of origin are difficult for any country to manage.

3. Agricultural products eligible for preference programs seem to pose particular technical problems. Countries hoping to export non-sensitive farm products need to meet SPS standards. This is challenging for many poor-country farmers, and training them in the field has been a relatively low priority for the US government. The result is that few low-income countries export eligible farm products under the preferences. For example, $123 million of the $128 million worth of farm products brought in under AGOA last year – citrus fruits, wine, ethanol, fruit juice, grapes, ice cream and other goods – imported under AGOA came from South Africa last year, and another $3.7 million from Mauritius. Other African countries sent only $1.3 million from other African countries. are particularly difficult.

More generally, in order to make the existing programs more able to sustain economic growth in the beneficiary countries, I would recommend three steps: (1) making them simpler, especially in terms of rules of origin for the regional programs; (2) making them longer-lasting, especially the GSP; and (3) more able to exclude genuinely bad governments which are not trying in good faith to improve their people's lives.

## Questions From Senator Grassley:

### *Question 1*

*In your testimony you mention that concerns about "preference erosion" are not likely to block a Doha Agreement. However, we've seen such concerns serve as an impediment for countries to negotiate with us. This was a problem when we tried to negotiate a trade agreement with the Southern African Customs Union. How do you respond?*

This is a fair point. Some countries will likely feel that preferences are enough to serve their goals and will not be interested in FTAs or broader liberalization. But I think this reaction is relatively unusual. Preference erosion was not a major issue for Latin American countries which concluded free trade agreements with the US, beginning with Mexico in 1992 (then the largest user of GSP) and more recently Chile, Central America and the Dominican Republic and Peru. The same has been the case for Morocco, Jordan and Oman. Likewise, in the early 1990s the 'tariff erosion' involved in conclusion of the Uruguay Round talks does not seem to have been a major concern. In some particular cases concern over the issue may arise, but its effect seems to me limited.

It is important for both the U.S. and beneficiaries to remember that preferences and FTAs alike (with the exception of NAFTA) cover a limited amount of trade, and that their value would be outweighed by multilateral agreements that involve the world's major economies.

***Question 2***

*Some people argue that longer renewals of our trade preference programs would better promote economic development. Other people insist that more frequent renewals provide opportunities to engage beneficiary countries on important reforms, which ultimately leads to more economic development. What is your view?*

Both could be right in a sense. It seems to me that very frequent lapses and renewals, as we have seen in GSP and with AGOA's third-country fabric provisions, can degrade the effectiveness of a program by reducing its predictability for buyers and exporters. On the other hand, making programs fully permanent might mean giving up occasional opportunities to improve them and adapt them to changing conditions. I think Congress find a reasonable balance.

***Question 3***

*The reduction of tariff and non-tariff barriers is important to the continued growth of the U.S. economy. It's also vitally important to the poor countries of the world. What can we do to convince beneficiary countries that the economic benefits associated with market liberalization outweigh the impact of any preference erosion?*

I think there are two major points to make.

One is that poor countries rely more heavily than rich countries on agricultural trade. They need agricultural export markets, and also often suffer from market distortions emerging from subsidy programs, especially export subsidies. Preferences offer relatively few export opportunities in farm products, and do not address subsidies at all. Only larger-scale farm-trade agreement, above all through the Doha Round, will help them in this sector.

Two, low-income countries have larger potential benefits in opening the markets of big developing countries than in preferences for the U.S., Europe, Japan and a few other rich economies. If a WTO agreement helps (for example) Bangladesh and Nepal export more effectively to India, or Lebanon export more easily to India and Turkey, this will more than compensate for any tariff erosion.

***Question 4***

*You suggested that a failure to extend the Andean preference program would damage florist industries that cannot easily replace Andean flowers. If florists can't easily replace Andean flowers, one would expect they would keep buying them even without the preferences. They would simply have to pay higher prices. Obviously, that would be bad for consumers. But would it be bad for the producers too?*

About 20,000 retail florists would suffer to some extent as well, though as you point out this would be a lesser issue than the consumer effect. For middle-class and lower-income families, flowers are a luxury product. During a period like the present, which is combining inflation in necessities like energy and food with macro-economic contraction and rising unemployment, shoppers are likely to cut back on this type of product. Adding an additional cost in the form of a revived 6.4 percent rose or chrysanthemum tariff is likely to deter some shoppers from buying flowers at all, as well as raising prices for those who do buy. Thus the retail florists are likely to suffer to some extent, though as you point out the more significant effect will be on consumers.

## Questions From Senator Cantwell:

***Question 1***

*RECONSTRUCTION OPPORTUNITY ZONES (ROZS)*

*Thank you for testifying today Mr. Gresser. I understand that you are Director of the Project on Trade and Global Markets, Progressive Policy Institute and you previously served at the Office of the U.S. Trade Representative and had also been one of Chairman Baucus's trade advisors. As Director at the Progressive Policy Institute, one of your major research focuses has included economic relations between the west and the Muslim world.*

*We hear so much concern today about the negative impact of trade. Do you share my belief that trade can play a positive, transformative role and lift people up out of poverty? Do you think the ROZ bill is the right approach to help stabilize Afghanistan and Pakistan?*

Yes, I fully agree with you. Trade has played a very important and sometimes central role in reducing poverty in many parts of the world. Central America, which used CBI clothing tariff privileges to break dependence on coffee and other primary-product industries during the 1980s and 1990s, is a good example. So are places like Cambodia, Bangladesh and Lesotho today, sometimes with help from preference and sometimes without.

Trade has not yet been given the role it should in helping to reduce poverty and restore a sense of optimism in the Muslim world. After the September 11th attacks, Pakistan's then-Commerce Minister Abdul Razak Dawood suggested a trade-liberalization like the ROZ as a way to reduce unemployment and counter the appeal of radicals, telling the *Financial Times* that "if you want Pakistan to be a liberal and modern state, you are not going to get that unless you've got people employed."

The ROZ bill is an effort in this spirit, and in Afghanistan and Pakistan's northern border provinces has chosen some of the most important places in the world. By creating incentives for legal business creation and growth in areas targeted by al-Qaeda and Taliban, it can help to provide employment – especially as a new avenue for women in conservative societies to find salaried jobs and support families – and help people in the region see the United States as a customer and partner. Trade of course is not a solution in itself, but in tandem with support for education, democratization, anti-corruption measures, it can be a major part of our effort to reduce poverty and erode the appeal of radicals and fundamentalists.

***Question 2***

*AFFORDABLE FOOTWEAR ACT*

*I am also cosponsoring the Affordable Footwear Act (S. 2372) to remove regressive import duties on a range of shoes, which are no longer made in the United States. If enacted, the bill should lower the cost of footwear, especially low priced and children's shoes helping working families.*

*Why are U.S. import duties on footwear so high? Aren't low- and middle-income American households disproportionately impacted by these import duties?*

Shoe tariffs are the highest tariffs imposed on any manufactured good, yielding a $1.9 billion tariff penalty last year on about $15 billion in shoes. This is nearly equal to the $2.1 billion tariff on $138 billion worth of imported cars. They remain very high – the main range is from an 8.5 percent tariff on expensive leather shoes to 48 and 60 percent on cheap sneakers like those covered by AFI – simply because they were high when the modern tariff system was drafted during the Hoover administration, and have remained largely unchanged for the last half-century.

They are now one of the most regressive policies the U.S. has. Given the magnifying effect of retail markups and sales taxes, they likely cost American families about $5.5 billion last year. This would be regressive if it were a 'flat' tax equally imposed on all shoes, since poorer families spend more of their income on shoes. But as the tariffs on cheap shoes bought by poor people are much higher than tariffs on luxury shoes, the actual shoe tariffs are far more regressive than a simple tariff-total suggests.

This is particularly striking since very few shoe tariffs now have any relation to production at all. There are now very few shoes made in the United States, and most shoe jobs are in design, marketing and retailing rather than assembly. The tariffs the Affordable Footwear Initiative would cover are imposed on shoes not made in the United States at all. Passing the bill would be a very good way to eliminate an antiquated policy and provide lower- and middle-income families some help during a difficult time.

Department of Justice, Peace, and Human Development

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**Oversight of U.S. Trade Preference Programs**

**Testimony of the United States Conference of Catholic Bishops to the U.S. Senate Committee on Finance**

**Delivered by Rev. Andrew Small, OMI, Foreign Policy Advisor**

**June 12, 2008**

Good morning Chairman Baucus, Ranking Member Grassley and honorable members of the Senate Finance Committee. The United States Conference of Catholic Bishops (USCCB) is grateful for the invitation to offer testimony on oversight of U.S. trade preference programs. My name is Fr. Andrew Small, OMI and I serve as a foreign policy advisor in the Office of Justice and Peace of the USCCB. This office staffs the Committee on International Justice and Peace of the USCCB, which is chaired by the Most Reverend Thomas Wenski, the Bishop of Orlando. This Committee of bishops shares and applies Catholic social teaching to international issues of concern to the Church.

The mission of the USCCB is to support the ministry of the bishops of the United States in their task of evangelization. Two key aspects of that mission involve collaborative action on vital issues confronting the Church and society as well as fostering communion with the Church and people in other nations. On this basis, the Committee on International Justice and Peace and the Conference as a whole have taken a particular interest in the impact of U.S. trade policies on poor and vulnerable communities around the world. Unlike the distinguished trade experts on this panel, USCCB does not offer technical expertise on questions of trade and economic integration. Rather following the Gospel mandate to care for the "least among us" (Matthew 25:31-34), the USCCB seeks to lift up the experience of those who struggle to provide a decent life for themselves and their families in an increasingly globalized economy.

**The Importance of *Preference* in Global Trade**

In the Church's vision, economic life should be guided by a moral framework that respects the life and dignity of every person. The *Catechism of the Catholic Church* teaches: "The human being is the author, center and goal of all economic and social life. The decisive point of the social question is that goods created by God for everyone should in fact reach everyone in accordance with justice and with the help of charity."[1] The very notion of "preference" that is the subject of today's hearing is one that lies at the heart of this vision, acknowledging that rules governing economic life can and should be designed so that the dignity of all, especially the poor and the vulnerable, is respected.

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[1] *Catechism of the Catholic Church*, United States Catholic Conference Inc.- Libreria Editrice Vaticana, 1997, no. 2459.

As the bishops of the United States recently reaffirmed in their statement on *Forming Consciences for Faithful Citizenship*, a statement prepared in anticipation of this year's national elections:

> While the common good embraces all, those who are weak, vulnerable, and most in need deserve preferential concern. A basic moral test for our society is how we treat the most vulnerable in our midst. In a society marred by deepening disparities between rich and poor, Scripture gives us the story of the Last Judgment (see Mt 25:31-46) and reminds us that we will be judged by our response to the "least among us." The Catechism of the Catholic Church explains: "Those who are oppressed by poverty are the object of a preferential love on the part of the Church which, since her origin and in spite of the failings of many of her members, has not ceased to work for their relief, defense, and liberation through numerous works of charity which remain indispensable always and everywhere. (no. 2448)[2]

The moral measure of any society is how it cares for and gives *preference* to its most vulnerable members. Ever since the nations of the world established a global trading system, the importance of fostering development among less developed countries has emerged as a moral, economic and policy priority for trade policy makers. This can be seen in the *Preamble* to the *General Agreement on Tariffs and Trade* (GATT) of 1947, the Marrakech Agreement establishing the World Trade Organization (WTO) in 1994 and most recently in the agenda for development laid out by WTO members at Doha in November 2001. In a special way, our trade preference programs specify and express this link between trade and development, a link that can benefit from closer scrutiny by this Committee.

Only last week, in a message to world leaders gathered in Rome to address the mounting food crisis, Pope Benedict XVI, a recent visitor to this capital city, said: "The great challenge of today is to 'globalise,' not just economic and commercial interests, but also the call for solidarity, while respecting and taking advantage of the contribution of all components of society."[3] It was this spirit of solidarity that prompted some of the world's richer countries to recognize at the first meeting of the United Nations Committee on Trade and Development (UNCTAD) in 1964 that the state of economic development between them and some of the world's poorest countries was so unequal, that only by giving developing countries preferential access to developed-country markets could newly independent countries in Africa and elsewhere begin to take advantage of the opportunities of a global marketplace. At the heart of the global trading system is the idea that certain countries would need special treatment for their exports because of their current state of

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[2] United States Conference of Catholic Bishops, *Forming Consciences for Faithful Citizenship*, (Washington, DC: United States Conference of Catholic Bishops, 2007), no. 50.

[3] Pope Benedict XVI, *Message to participants in the "High-Level Conference on World Food Security: the Challenges of Climate Change and Bioenergy,"* organized by the *Food and Agriculture Organization*, June 2, 2008, available at http://www.vatican.va/holy_father/benedict_xvi/messages/pont-messages/2008/documents/hf_ben-xvi_mes_20080602_fao_it.html

development, notwithstanding the rules of reciprocal commitments enshrined in the most-favoured nation and national treatment provisions of the GATT.

U.S. trade preference programs can be an expression of the globalization of solidarity that Pope Benedict has championed. Trade preferences for poorer nations should remain a pillar of U.S. trade policy for moral and economic reasons.

This testimony offers some reflections on the importance of U.S. trade preference for some of the poorest communities around the world. In addition, it argues for the need to integrate these programs with complementary norms and strategies that promote what the Church calls "integral human development." Integral human development considers the human person in a holistic way, taking into account the need to attend to the intellectual, cultural and spiritual needs of the human person and not reduce his or her well-being to a purely economic consideration. In the Catholic tradition, the economy exists to serve people, not the other way around.

In order to make this testimony concrete, it will explore some impacts of the Andean Trade Promotion Drug Eradication Act (ATPDEA) and the recently created Haitian Hemispheric Opportunity through Partnership Encouragement (HOPE) Act. As the Committee knows well, a revised version of the HOPE Act was recently enacted into law, thanks your leadership and support, Mr. Chairman, and that of your colleagues. Trade preferences for Haiti were also made possible through the support of Ranking Member Grassley, who as the past Chairman of this Committee, urged passage of the original HOPE legislation in the closing hours of the 109th Congress.

**Sustainable Development - *HOPE* and *ATPDEA***

This Committee has already heard from several experts on the current state of U.S. preference programs, including assessments of their difficulties and the ways in which they are falling short of their original mandate. The U.S. Conference of Bishops would like to offer some reflections on the impact of U.S. trade preference programs on two of the poorest countries in our hemisphere, Haiti and Bolivia. Church leaders from both of these two countries have visited Washington to advocate on behalf of these trade preference programs and the need to expand and strengthen them. USCCB is grateful to this Committee for its support of trade preferences for these and other poor developing countries.

*Pro-poor development -HOPE*

The HOPE Act of 2006, a modification of the larger Caribbean preference programs first offered in 1983 and amended several times since, came at a time of crisis in Haiti, a country that has known so much hardship. Haiti's dire economic and political situation is well-known. In terms of employment, Haiti once enjoyed a thriving apparel assembly sector. At the start of the 1980s, such employment began to decline, plummeting from 100,000 at that time to around 15,000 by

2004 when legislation targeting U.S. preferences to Haiti was first brought before the U.S Congress.[4]

As a result of intense collaboration between Congress, the Administration and the Haitian government, HOPE's preferences became operational after President Bush certified Haiti's eligibility for preferential access to the U.S. market in March 2007. Since then, Haiti has recovered approximately 5,000 lost apparel jobs. This modest achievement is nevertheless significant. It reverses a long decline in Haiti's apparel sector. HOPE is bringing new life to thousands of people whose lives had become desperate. It has given hope to hardworking Haitians who chose to remain in their homeland during these difficult times and needed a lift up to take advantage of new opportunities presented by greater political stability and a more attractive investment climate. Allow me to offer some examples.

Carlène is 44 years old and is a mother of two children ages 17 and 12. She lost her job in October 2006, just before HOPE became law. With renewed clothing orders from the United States, Carlène got her old job back in January of this year. The same is true for Samuel who is 30 years old and is the father of two children. Like Carlene, he was a sewing machine operator who is working again and receives a paycheck every 10 days. There are 5,000 other stories like these. Those in Haiti's apparel export sector earn, on average, $5 or more a day. While this may seem incredibly low, this is four times the country's per capita income and is enough for a family to pay for food, shelter, and clothing.

Arnelle is a single woman who received computer training after she lost her job in an apparel factory in 2006. She stayed in Haiti and the computer training classes were paid for by remittances sent by her family in the United States. Like so many others, Arnelle didn't want to leave her homeland. She remained in Haiti and is now back working at her sewing job and earning her own living, but she is anxious to put her new computer skills to good use. Her story illustrates the connection between trade policy and migration. By creating economic opportunities in sending countries, U.S. trade preference programs help people like Arnelle to remain in their native countries and support themselves and their families.

Since HOPE-II became Public Law last month, some investors have already started traveling to Haiti to discuss orders as well as longer-term investment opportunities. The belief that Haiti could become a success story – the way a number of Asian economies such as South Korea, Taiwan, Singapore and Hong Kong used growing apparel and assembly sectors as a foundation to build powerful and diversified economies - strains credibility for those who know Haiti's tragic history. However, we can all hope – not against hope, but with hope – that things will continue to improve. The support of this Committee has been vital to the small but essential signs of hope that have appeared in the lives of people like Carlène, Samuel and Arnelle.

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[4] Committee on International Justice and Peace, *Letter on Haiti Economic Recovery Opportunity Act* September 20, 2004 available at http://usccb.org/sdwp/international/hero.shtml

Without getting into great detail, the changes made to the original HOPE Act will open up additional opportunities for hard working Haitians. These changes will help them advance as their country advances. For this to happen, all governmental, private and non-governmental actors need to be on the same development page. Ensuring necessary assistance and genuine development to poor countries requires the efforts of many, most especially the participation of local people who are central participants in their own development.

In the case of Haiti, apparel factory owners gathered with church and NGO leaders and government representatives in April of this year in an attempt to advance economic development in a more focused way. As you know, HOPE-II strengthens sound labor standards for Haitian workers, and also offers a better mechanism to help Haiti achieve and enforce those standards for its workers. When complemented by U.S. Department of Labor and the International Labor Organization capacity-building for labor enforcement improvements, these preferences may lead to the creation of thousands of decent jobs. We hope that such collaboration will be on-going.

To translate economic development into human development requires greater collaboration among the public and private sectors as well as civil society and Church organizations. Catholic Relief Services, the U.S. Bishops' relief and development agency, has on-the-ground experience of how people are seeking to provide for themselves and their families. Civil society needs to have a real voice and a regular place at the table to help assure that HOPE is part of an overall development environment. It is vital that on-going U.S. involvement in Haiti's economic development seek to link increased exports to the U.S. with effective labor protections and efforts to build infrastructure and stability in Haiti.

Trade preferences alone cannot hope to solve all the problems of least-developed countries. However, trade preference programs need to be coordinated with U.S. assistance efforts so that trade preferences, development aid, private investment or even remittances from hard-working Haitians contribute in a coherent fashion toward the goal of integral human development. In this regard, it may be appropriate for the Office of the United States Trade Representative to have a more focused mechanism for coordinating with the U.S. Agency for International Development and the U.S. State Department.

*Reliability and Dependability -ATPDEA*

The U.S. Bishops' Conference has supported long-term extension of trade preference programs to some of the poorest countries in the Andean region.[5] We continue to urge long-term extension of ATPDEA when it expires in December of this year. In the case of Bolivia, ATPDEA has been vital in promoting economic development for thousands of people. For example, Bolivia's export of palm hearts to the United States has increased exponentially in recent years. The growth of these exports has been instrumental in promoting alternative crops to replace coca.

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[5] Committee on International Justice and Peace, *Letter on Trade Measures* February 25, 2008 available at http://usccb.org/sdwp/international/2008-02tradeletter.pdf

Cardinal Julio Terrazas, Archbishop of Santa Cruz, Bolivia and President of the Bishops' Conference of Bolivia had the opportunity to visit Washington to discuss the importance of the current trade preference program for poor people in his country. In a letter addressed to the Committee, Cardinal Terrazas urged long-term extension of the preferences for Bolivia. Limiting the extension of these preferences to a short-term framework sends the wrong signal to the program's beneficiaries, he said. Investors and importing firms attracted by the opportunity of trade preferences will not invest in or source from countries if the status of the preferences is in doubt. He reported that many in Bolivia are aware of the importance of trade preferences from the United States for their livelihoods.

In his meeting with Committee staff, the Cardinal acknowledged the delicate political situation in Bolivia that centered on concern for equality and economic opportunity. But, he added that the Bolivian people know the importance of U.S. trade preferences and value the relationship they foster with the United States. Many Bolivians have come to rely on the opportunities created by trade preferences to develop viable alternatives to coca production.

**Integral Human Development – Worker Protections**

The United States Conference of Catholic Bishops has consistently engaged lawmakers and other policy makers on the importance of framing trade policy within the context of a broader development agenda. The concept of decent work is deeply embedded in the Church's social teaching. In his great message on the importance of human work, Pope John Paul II identified the centrality of human work to human identity and human community.[6] Work is inextricably linked to human flourishing and is a way of humanizing the world and fostering authentic human development. By virtue of one's work, the human person can fulfill his or her destiny of being the "protagonist of development."[7]

For work to humanize the human person and the world, both the worker and the work should enjoy fundamental protections. During the discussions of the free-trade agreements that the United States has signed over the past few years,[8] USCCB urged Congress to take more seriously the need to establish effective labor and environmental protections, ensure access to life-saving medicines and expand public participation as a way of building a democratic process respectful of the freedom of the human person.[9]

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[6] Pope John Paul II, *Laborem Exercens (On Human Work)* (Washington, DC: United States Conference of Catholic Bishops, 1981), no. 1.

[7] Pope John Paul II, *Sollicitudo Rei Socialis (On Social Concern),* (Washington, DC: United States Conference of Catholic Bishops, 1987), no. 30.

[8] See *Joint Statement Concerning the United States-Central American Free Trade Agreement (US-CAFTA) by the Bishops' Secretariat of Central America (SEDAC) and the Chairmen of the Domestic and International Policy Committees of the United States Conference of Catholic Bishops (USCCB)*July 21, 2004 *available at* http://usccb.org/sdwp/international/jointtradestatement.shtml

9 Committee on International Justice and Peace, *Letter to Speaker Pelosi, Secretary Paulson, and Ambassador Schwab on Trade Policy* May 18, 2007 http://usccb.org/sdwp/international/May182007Trade.pdf

In terms of trade preference programs, USCCB welcomes the inclusion in HOPE-II of incentives and benchmarks whose purpose is to ensure that workers in Haiti have internationally recognized protections. The new Technical Assistance Improvement and Compliance Needs Assessment and Remediation Program (TACINAR) could help achieve these protections. While USCCB does not have the expertise to make a judgment on the details of the program, this initiative is complemented by a handful of mechanisms, which also include the establishment of a Labor Ombudsman and a registry of producers benefiting from U.S. trade preferences under HOPE, that are designed to provide vigilant oversight and ensure that the well-being of workers is not traded for increased profit margins and lower costs. The new program may have the capacity to more readily discover abuses and to provide concrete directions for improving the situation of workers, including the possibility that preferences would be withdrawn if they were found to be harmful to the rights of workers. Notably, the new mechanism provides for input into how labor protections are operating from several sectors of Haitian society. Haitian authorities should be encouraged to maintain on-going conversations not only with labor organizations and the private sector, but also with church and civil society organizations. [Next month, I will accompany the Chairman of the Bishops' Committee on International Justice and Peace, the Most Reverend Thomas G. Wenski, Bishop of Orlando, on a solidarity visit to Haiti during which the implications of the new trade preference programs will be discussed.]

The Church is very committed to the rights and dignity of workers in our own country. Therefore, our Conference welcomes the assessment of the Government Accountability Office that the overall impact of U.S. trade preference programs on the U.S. economy is small, with a "minor" impact because of the Andean and Caribbean programs.[10] The overall impact of economic globalization continues to be felt in developed as well as developing countries, especially amongst those sectors of the economy ill-equipped to cope with rapid change. In the United States, the Church stands in solidarity with those who are experiencing dislocation because of globalization. As the global economy integrates, USCCB urges lawmakers to prioritize the rights and dignity of workers at home and overseas, taking meaningful steps to help workers in the United States that lose their jobs because of globalization. In addition, USCCB supports linking trade preference programs with enforceable worker protections and working conditions.

**Coordination with other Development Initiatives**

The USCCB together with the U.S. bishops' relief and development agency, Catholic Relief Services, are active supporters of the many ways in which the American people show their concern and solidarity with our most vulnerable brothers and sisters around the world. Together we support increased and more effective foreign aid programs. We are working today to urge Senators to ensure that U.S. leadership in the fight against HIV/AIDS be strengthened this year by reaching a bipartisan consensus on a greatly expanded and morally appropriate PEPFAR

[10] United States Government Accountability Office. *U.S. Trade Preference Programs Provide Important Benefits, but a More Integrated Approach Would Better Ensure Programs Meet Shared Goals*, GAO-08-443, March 2008, p. 10.

program.[11] In 2002, USCCB and CRS supported the creation of the innovative *Millennium Challenge Account* (MCA).[12] Together the Conference and CRS have engaged in extensive education and outreach with the Catholic community in the United States to increase awareness of U.S. assistance programs administered through various agencies of the United States government. We strongly support increased public investments in poor countries on vital needs like health care, education and innovative ways to promote economic development.

It is ironic that the U.S. foreign assistance contained in initiatives such as the Millennium Challenge Account can be easily undermined by the high levels of tariffs that poor countries have to pay on their exports to the United States. As Edward Gresser has pointed out, some of the world's poorest countries pay higher total amounts to the U.S Treasury on their exports to the United States than do some of our richest trading partners.

The situation of Haiti provides another example of how our development programs are not as effective as they could be. Despite regular aid commitments and recently appropriated funds to deal with Haiti's emergency food crisis,[13] Haiti is not deemed eligible for consideration as a candidate for support from the Millennium Challenge Corporation. At the same time, Haiti has only recently become eligible for multilateral debt relief and is still paying, by some estimates, up to $1 million a week in debt service payments. To help up to two dozen other poor countries that are not currently eligible for debt relief, USCCB has urged passage of the Jubilee Debt Relief Act that will deal with their continuing debt burden.[14]

From the experience of the Bishops' Conference's in working with various administrators of the preference programs, there seems to be ongoing frustration at the relatively low utilization of the programs in some very poor countries and the fact that the benefits tend to accrue to already established developing counties and not to those people and communities that need the most help. Some find the system's rules and regulations confusing and believe they discourage administrators and investors from using preferential trading programs. Others with the technical expertise can speak more directly to both the causes of and the possible remedies for these problems. USCCB has been supportive of attempts to address some of the complicated eligibility rules and to streamline the system. Earlier this year, USCCB joined many others in endorsing the New Partnership for Development Act that was introduced in the House.[15]

[11] Committee on International Justice and Peace, *Letter to Senate Committee on PEPFAR*, May 22 2008 available at http://usccb.org/sdwp/international/2008-02pepfar_cong_ltr.pdf
[12] Testimony on behalf of The United States Conference of Catholic Bishops and Catholic Relief Services Subcommittee on Foreign Operations, Export Financing, and Related Programs House Appropriations Committee May 9, 2002 available at http://usccb.org/sdwp/international/ftesap02.shtml#iii
[13] Committee on International Justice and Peace, *Letter to the Senate Leadership on the FY 08 Emergency Supplemental* April 28, 2008 available at http://www.usccb.org/sdwp/international/letter_senate_approps_leaders08.pdf
[14] Committee on International Justice and Peace, *Letter to House on Jubilee Debt Relief Act* April 9, 2008 available at http://www.usccb.org/sdwp/2008-04-09%20Letter%20to%20House%20on%20Debt%20Bill.pdf
[15] See supra note 5.

In the absence of multi-lateral agreement on global trade rules and the failure to reach a pro-development outcome of the Doha Development Agenda, trade preferences will continue to be an important way for stimulating economic growth in poor countries. Some may believe that trade preferences should become a thing of the past, ill-suited to the climate of modern trade realities where reciprocity and bilateral commitments are the norm. However, from the Church's perspective, a preferential concern for the poor and the demands of global solidarity point to continuing need for both U.S. trade preference programs and generous development programs. It would be a tragedy if support for U.S. preference programs as a mechanism for promoting development among the world's poor were to be eclipsed by an expectation that only reciprocal trade agreements were of any value.

**Public Support to U.S. Preference Programs**

As was mentioned earlier, the Conference assists the bishops in their mission of evangelization, of bringing the good news of the Gospel to the world. In a special way the Conference of Bishops seeks to bring good news into the daily lives of those who struggle to make ends meet for themselves and their families. The Conference offers support to those seeking to be in solidarity with the poor and vulnerable. As part of this effort, USCCB and Catholic Relief Services jointly sponsor the *Catholic Campaign Against Global Poverty*, an education and advocacy initiative broadly encompassing the issues of debt relief, foreign aid and trade policy.[16] From our experience with the Campaign, we have found that many Catholic Americans are deeply concerned about the plight of poor persons in developing countries and are eager to find ways to collaborate with public and private agencies to help alleviate suffering, combat disease and foster development around the world. There was tangible grassroots support for the extension of trade preferences to poor countries like Haiti and Bolivia. At a time when trade is increasingly seen as a way of exercising special interests on behalf of the privileged, the U.S. Conference of Catholic Bishops urges greater focus on U.S. preference programs and other concrete ways in which the United States can, in the words of Pope Benedict, "globalize solidarity."

**Other Countries' Preference Programs**

The United States cannot be alone in extending preferences to least-developed countries. While Europe and Japan have been involved in the Generalized System of Preferences and other similar programs for as long as the United States, emerging economies need to consider improving access to their markets for less developed poor countries with the goal of fostering development and promoting economic growth. U.S. efforts should be a benchmark of how trade can bring about development; but other countries need to take their own meaningful steps to make preferential access to their markets an integral part of their trade policy.

**Conclusion**

There is a Haitian proverb: *Beyond the Mountains, There are More Mountains*. It refers to the peasant farmer's dream of never-ending land that will yield bounty upon bounty. For many – and

[16] *Catholic Campaign Against Global Poverty* available at http://www.usccb.org/sdwp/globalpoverty/

many of those in Haiti and Bolivia – the path to stability and self-sufficiency is not laden with bounty but rather is blocked by insurmountable obstacles that appear like mountains beyond mountains. Coordinating preferential trading regimes with development programs builds an important form of solidarity between developed and developing countries. This will require a better targeting of benefits to those countries that need them most.

In 1999, Pope John Paul II addressed the theme of globalization and equitable economic integration in the context of this hemisphere. He warned: "If globalization is ruled merely by the laws of the market applied to suit the powerful, the consequences cannot but be negative."[17] Preference programs offer a unique way for countries with tremendous economic advantages, like the United States, to reach out in solidarity to least developed countries and to establish trade laws that suit not just the powerful, but also the weak. They bring hope and life to millions of people around the world, like Carlène, Samuel and Arnelle, who depend upon trade preferences for their livelihoods and for the opportunity for their families to escape grinding poverty. In many ways, these kinds of trade preferences swim against the modern tide of self-interest and personal gain. Trade preferences have a capacity to unite an ethic of solidarity with the logic of economic integration. This concrete expression of the preferential option for the poor can help build what Pope Benedict XVI has called "a new world order based on just ethical and economic relationships."[18]

Thank you for your time and attention. The United States Conference of Catholic Bishops looks forward to working with the Committee in supporting improvements to our essential trade preference programs.

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[17] Pope John Paul II, *Ecclesia in America* (The Church in America), (Washington, DC: United States Conference of Catholic Bishops, 1999), no. 20.

[18] Pope Benedict XVI, *Christmas Address, Urbi et Orbi (To the Church and the World)*, December 25, 2005 available at http://www.vatican.va/holy_father/benedict_xvi/messages/urbi/documents/hf_ben-xvi_mes_20051225_urbi_en.html

**QUESTIONS FOR THE RECORD**
**FOR FR. ANDREW SMALL**

**United States Senate**
**Committee on Finance**

**Hearing on**
**Oversight of U.S. Trade Preference Programs**

**June 12, 2008**

## Senator Grassley Questions:

### Question 1

In your testimony, you mention that preference programs contribute to the availability of alternative crops as a reason for extending trade preferences. However, between 2003 and 2006, coca cultivation in Bolivia grew and President Morales continues to pursue policies that would increase the amount of legal coca cultivation. In addition, the government continues to take actions that harm U.S. companies operating in Bolivia. In light of the foregoing, why should Bolivia merit a further extension of preferences?

*One of the goals of the system of Andean Preferences (ATPDEA) was to offer alternative forms of economic development, especially within the agriculture sector, to those small farmers who consider coca production as the only reliable way of securing resources to support themselves and their families. It is clear that removing this incentive is and will continue to be a difficult one. For example, despite the tremendous amount of resources provided through Plan Colombia as well as the cooperation of the Colombian Government, the World Drug Report 2008 compiled by the UN Office on Drugs and Crime (UNDOC) reported that coca production in Colombia has increased by 27 percent over the last year. The report also reports a general rise in coca production by 16 percent in Colombia, Peru and Bolivia. The report notes that for Colombia and Bolivia, however, cocaine production remains unchanged because of lower yields from the harvested crop.*

*According to the UNDOC report, there was a 24% increase in coca eradication in Bolivia in 2007 compared to the previous year, most of which was in the Chapare region, where it is noted in USCCB testimony that alternatives to coca production are on the increase.*

*In the testimony, USCCB does not seek to offer views on current U.S. anti-drug activities. It does remain clear, however, that despite the difficulties in pursuing eradication and interdiction, as well as stemming drug trafficking and combating the current demand for illicit drugs in the United States, any ways in which farmers in very poor countries might be encouraged to take advantage of legal crop production should be maintained. We consider increased palm production in the Chapare region of Bolivia an important, if insufficient, step in this direction and one that should not be jeopardized through suspension or termination of U.S. preferences to Bolivia.*

*Furthermore, it is our position that current preference programs should be evaluated for their impact on the small businesses and employees that actually benefit directly from the* *opportunities offered by our preference programs and less as a sign of cooperation between respective governments. Cardinal Terrazas of Santa Cruz, Bolivia, stated clearly during both of his visits to Washington that despite the periodic heated statements and actions of the Bolivian government as it engages in its own program of "reform" within Bolivia, U.S. preference programs demonstrate a real commitment by the United States to the Bolivian people, many thousands of whom depend upon them for the livelihoods. Preferences are one of the ways in which the United States can establish a direct relationship with the people of another country, offering hope to some of its poorest workers. The benefits of preferences accrue directly to the workers themselves, the loss of which would not only be disastrous for the workers and their families, but would send the wrong signal about the vision for empowerment and economic development contained within U.S. preference programs. The collateral impact that would flow from penalizing the Bolivian government for its actions with certain transnational corporations would seem, to us, to risk punishing the wrong people in Bolivia.*

**Question 2**

Some people argue that longer renewals of our trade preference programs would better promote economic development. Other people insist that more frequent renewals provide opportunities to engage beneficiary countries on important reforms, which ultimately leads to more economic development. What is your view?

*As was mentioned during the hearing, if one takes the case of a very poor country such as Bolivia, it is difficult to see how short-term extensions benefit economic growth in that country and provide meaningful opportunities to secure other changes that are contingent on the granting of U.S. preference programs. If ATPDEA preferences were to be revoked, Bolivia would remain the poorest country in the hemisphere without preference programs beyond those contained in the Generalized System of Preference (GSP).*

*In Bolivia, for example, the uncertainty provoked by the last two short-term extensions of ATPDEA has already been felt by some of the country's major exporters. Without secure access to the U.S. market, investment and orders are likely to weaken, resulting in lay-offs and the reduction of better-paying jobs. This can lead to an unintended return to illicit crop cultivation or the manufacture of less valuable products with the concomitant downward impact on wages.*

*It is also true that many of our preferential trading partners use inputs from the United States, for example the apparel sector in Bolivia. Uncertainty surrounding the longevity of trade preferences also jeopardizes exports from the United States that are used by developing countries in products that are subsequently exported to the United States. Jeopardizing these U.S. exports will likely have a negative impact on jobs in the United States.*

*Preferences should be granted to very poor countries for a long time, if not permanently. Long term extensions have the advantage of fostering a predictable investment climate and attracting long term investments that are critical to a growing economy. As a corollary, a graduation mechanism should be more strictly enforced for those countries that no longer need preferences because of the relative strength of their economies. The question of graduation and of tailoring preferences to more narrowly focus on needy countries is addressed in Question 3.*

**Question 3**

In your testimony you argue that helping less developed countries is a moral and economic priority. Under our current preference programs, advanced developing countries reap the lion's share of the benefits. Should we modify our trade preference programs so that the poorest countries have the opportunity to benefit the most? Do you have any suggestions for doing so?

*In discussion with those who administer the program, there is frustration among government officials about the low take-up rate of poor countries that are currently eligible to use the preference programs. The reasons for this are complex and beyond the purview of USCCB. However, we note that preferences should benefit those countries that need them most and be designed in such a way that they are user-friendly, predictable and reliable.*

*While preference programs are granted to certain types of exports from specified countries, it normally falls to the private sector to take advantage of U.S. preference programs as part of a rapidly integrating and highly competitive global supply chain. As we noted in the testimony, development cannot be limited to economic growth but must be complemented by other development policies regarding health, education, and housing. This requires a better integration of the entire range of development strategies so as to bring together civil society and other non-governmental organizations with the public and private sectors in target countries. Greater coordination between the Office of the United States Trade Representative, the United States Agency for International Development, the Millennium Challenge Corporation and the many other U.S. government agencies that play some part in administering U.S. trade and aid programs would be a positive step in this regard. As the GAO report notes, the current inter-agency policy mechanism could serve as a foundation for a more focused effort.*

*It is less than clear that removing preferential access from advanced developing countries would create opportunities for very poor countries to benefit from preference programs. If this could be shown to be the case, then more narrowly targeting preferences just to very poor countries would be highly recommended. As noted above, other emerging economies may, in fact, more likely benefit from a realignment of current U.S. preferences away from certain advanced developing countries.*

*A more reliable route to ensure greater use by poor countries of preferential access to the U.S. market could be secured along the lines recommended by the GAO report **U.S. Trade Preference Programs Provide Important Benefits, but a More Integrated Approach Would Better Ensure Programs Meet Shared Goals,** GAO-08-443, March 2008 regarding a simplification of the rules of origin and a broader product coverage. In this regard, USCCB has advocated for passage of the **New Partnership for Development Act** that was introduced into the House of Representatives earlier this year that expands duty-free and quota-free access to a greater product range (up to 100%), simplifies rules of origin for eligible products, promotes human rights protections in beneficiary countries and establishes an **Aid for Trade** fund to encourage greater use of U.S. preference programs. We consider passage of NPDA-like legislation an important step forward in ensuring more targeted preferences that build capacity in target countries and offer sustainable forms of economic growth.*

United States Government Accountability Office

GAO

Testimony
Before the Committee on Finance,
United States Senate

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, June 12, 2008

# INTERNATIONAL TRADE

# The United States Needs an Integrated Approach to Trade Preference Programs

Statement of Loren Yager
Director, International Affairs and Trade

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GAO-08-907T

June 2008

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# Highlights

Highlights of GAO-08-907T, a testimony before the Committee on Finance, U.S. Senate

## INTERNATIONAL TRADE

## The United States Needs an Integrated Approach to Trade Preference Programs

### Why GAO Did This Study

U.S. trade preference programs promote economic development in poorer nations by providing duty-free export opportunities in the United States. The Generalized System of Preferences, Caribbean Basin Initiative, Andean Trade Preference Act, and African Growth and Opportunity Act unilaterally reduce U.S. tariffs for many products from over 130 countries. However, two of these programs expire partially or in full this year, and Congress is exploring options as it considers renewal.

This testimony describes the growth in preference program imports since 1992, identifies policy trade-offs concerning these programs, and evaluates the overall U.S. approach to preference programs. The testimony is based on two recent studies on trade preference programs, issued in September 2007 and March 2008. For those studies, GAO analyzed trade data, reviewed trade literature and program documents, interviewed U.S. officials, and did fieldwork in six trade preference beneficiary countries.

### What GAO Recommends

In the March 2008 report, GAO made a number of recommendations to the U.S. Trade Representative, including to review beneficiary countries that have not been considered under the regional programs, and periodically consider preference programs jointly. In response, USTR indicated that it would undertake an interagency review of the programs and consolidate discussion of them in its annual report.

To view the full product, including the scope and methodology, click on GAO-08-907T. For more information, contact Loren Yager at (202) 512-4347 or yagerl@gao.gov.

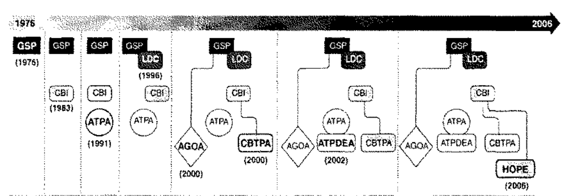
### What GAO Found

Total U.S. preference imports grew from $20 billion in 1992 to $92 billion in 2006, with most of this growth taking place since 2000. The increases from preference program countries reflect legislation passed by Congress in 1996 and 2000 that enhanced preference programs and added new eligible products.

Preference programs give rise to three critical policy trade-offs. First, preferences entail a trade-off to the extent opportunities for beneficiary countries to export products duty free must be balanced against U.S. industry interests. Some products of importance to developing countries, notably agriculture and apparel, are ineligible by statute as a result. Secondly, certain developing countries have been given additional preferential benefits for such import-sensitive products under regional programs. But some of the poorest countries, outside targeted regions, do not qualify. Third, Congress faces a trade-off between longer program renewals, which may encourage investment and undermine support for the likely greater economic benefits of broader trade liberalization, a key U.S. goal, and shorter renewals, which may provide opportunities to leverage the programs to meet evolving priorities.

Trade preference programs have proliferated over time, becoming more complex (as shown below), but neither Congress nor the administration formally considers them as a whole. Responsive to their legal mandates, the Office of the U.S. Trade Representative (USTR) and other agencies use different approaches to monitor compliance with program criteria, resulting in disconnected review processes and gaps in addressing some countries and issues. Disparate reporting makes it difficult to determine progress on programs' contribution to economic development in beneficiary countries.

**Growth of Trade Programs over Time**




AGOA African Growth and Opportunity Act
ATPA Andean Trade Preference Act
ATPDEA Andean Trade Promotion and Drug Eradication Act
CBI Caribbean Basin Initiative
CBTPA Caribbean Basin Trade Partnership Act
GSP Generalized System of Preferences
HOPE Haitian Hemispheric Opportunity through Partnership Encouragement Act
LDC Expanded GSP for Least-developed Country

Source: GAO analysis of official U.S. trade statistics

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our work on U.S. trade preference programs. Since the committee's hearing last year on this subject, GAO has completed two in-depth studies of U.S. preference programs for the Finance Committee and the Committee on Ways and Means.[1] Our findings suggest that these programs do provide benefits to recipient nations, but it is more challenging to determine programs' contribution to economic development in those nations. Our findings in those studies also support the need to consider whether a more integrated approach would better ensure programs meet shared goals.

This hearing is particularly timely, as a number of the preference programs were or are still scheduled for expiration during the current calendar year. We believe that this provides an opportunity for Congress and the administration to review the progress and performance of these programs as a group and begin to address some of the difficult questions that you posed in the last hearing. In order to contribute to that discussion, I will address three topics today. First, I will describe preference import trends. Second, I will outline key policy trade-offs between various domestic and foreign interests that are inevitable in the design of preference programs. Finally, I will summarize our recent findings and recommendations regarding the importance of considering the preference programs as a group.

My remarks are based on the two studies of the preference programs that we have published in the last year. In conducting the work for Congress, we consulted with the Office of the U.S. Trade Representative (USTR) and other executive agencies involved in implementing the programs, as well as representatives from trade and development organizations who have expertise and interest in the programs. In addition, we met with government representatives from a number of the beneficiary nations, including some of the larger beneficiaries such as Brazil, as well as poorer nations such as Haiti and Ghana. We conducted this performance audit

[1]GAO, *International Trade: U.S. Trade Preference Programs Provide Important Benefits, but a More Integrated Approach Would Better Ensure Programs Meet Shared Goals*, GAO-08-443 (Washington, D.C.: Mar. 7, 2008), and GAO, *International Trade: An Overview of Use of U.S. Trade Preference Programs by Beneficiaries and U.S. Administrative Reviews*, GAO-07-1209 (Washington, D.C.: Sept. 27, 2007).

from March 2007 to February 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Background

In an effort to promote and achieve various U.S. foreign policy objectives, trade preference programs have expanded in number and scope over the past 3 decades. The purpose of these programs is to foster economic development through increased trade with qualified beneficiary countries while not harming U.S. domestic producers. Trade preference programs extend unilateral tariff reductions to over 130 developing countries. Currently, the United States offers the Generalized System of Preferences (GSP)[2] and three regional programs, the Caribbean Basin Initiative (CBI),[3] the Andean Trade Preference Act (ATPA),[4] and the African Growth and Opportunity Act (AGOA). Special preferences for Haiti became part of CBI with enactment of the Haitian Hemispheric Opportunity through Partnership Encouragement (HOPE) Act in December 2006. The regional programs cover additional products but have more extensive criteria for participation than the GSP program. Eight agencies have key roles in administering U.S. trade preference programs. Led by USTR, they include the Departments of Agriculture, Commerce, Homeland Security, Labor, State, and Treasury, as well as the U.S. International Trade Commission (ITC).

GSP—the longest standing U.S. preference program—expires December 31, 2008, as do ATPA benefits. At the same time, legislative proposals to provide additional, targeted benefits for the poorest countries are pending. U.S. trade preference programs are widely used, but some economists and others have raised questions about them. Their concerns include the potential for diversion of trade from other countries that these programs can cause; the complexity, scope of coverage, duration, and conditionality

[2]In 1996, the number of duty-free tariff lines offered under GSP was expanded to provide additional benefits to beneficiary least-developed countries (LDC).

[3]In 2000, CBI was expanded by the Caribbean Basin Trade Partnership Act (CBTPA).

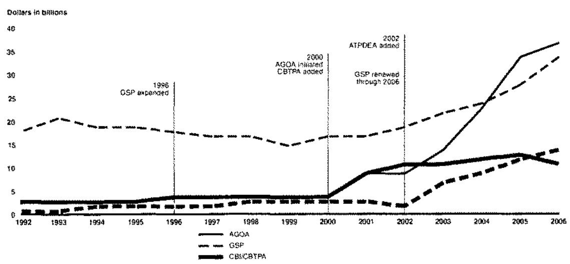
[4]In 2002, ATPA was expanded by the Andean Trade Promotion and Drug Eradication Act (ATPDEA).

of these programs; and the potential opposition to multilateral and bilateral import liberalization preferences can create.

## U.S. Preference Imports Have Increased Sharply

U.S. imports from countries benefiting from U.S. preference programs have increased significantly over the past decade. Total U.S. preference imports grew from $20 billion in 1992 to $92 billion in 2006. Most of this growth in U.S. imports from preference countries has taken place since 2000. Whereas total U.S. preference imports grew at an annual rate of 0.5 percent from 1992 to 1996, the growth quickened to an annual rate of 8 percent from 1996 to 2000, and 19 percent since 2000. This accelerated growth suggests an expansionary effect of increased product coverage and liberalized rules of origin for LDCs under GSP in 1996 and for African countries under AGOA in 2000.

**Figure 1: Trends in U.S Preference Import Levels (1992-2006)**




Source: GAO analysis of U.S. official trade statistics, based on preferences actually claimed upon entry.

Note: Values of imports are expressed in nominal dollars, not adjusted for inflation.

There is also some evidence that leading suppliers under U.S. preference programs have "arrived" as global exporters. For example, the 3 leading non-fuel suppliers of U.S. preference imports—India, Thailand, and Brazil—were among the top 20 world exporters and U.S. import suppliers in 2007, and their exports in 2007 grew faster than world exports, according to the World Trade Organization (WTO).[5]

## Critical Policy Trade-offs among U.S. Consumers, Producers, and Foreign Beneficiaries Are Inherent in Preference Programs

Preference programs entail three critical policy trade-offs. First, the programs are designed to offer duty-free access to the U.S. market to increase beneficiary trade, but only to the extent it does not harm U.S. industries. U.S. preference programs provide duty-free treatment for over half of the 10,500 U.S. tariff lines, in addition to those that are already duty-free on a most favored nation basis. But, they also exclude many other products from duty-free status, including some that developing countries are capable of producing and exporting. GAO's analysis showed that notable gaps remain, particularly in agricultural and apparel products. For 48 GSP-eligible countries, more than three-fourths of the value of U.S. imports that are subject to duties (i.e., are dutiable) are left out of the programs. For example, just 1 percent of Bangladesh's dutiable exports to the United States and 4 percent of Pakistan's are eligible for GSP. Although regional preference programs tend to have more generous coverage, they sometimes feature "caps" on the amount of imports that can enter duty-free, which may significantly limit market access. Imports subject to caps under AGOA include certain meat products, a large number of dairy products, many sugar products, chocolate, a range of prepared food products, certain tobacco products, and groundnuts (peanuts), the latter being of particular importance to some African countries.

The second trade-off is related and involves deciding which developing countries can enjoy particular preferential benefits. A few LDCs in Asia are not included in the U.S. regional preference programs, although they are eligible for GSP-LDC benefits. Two of these countries—Bangladesh and Cambodia—have become major exporters of apparel to the United States and have complained about the lack of duty-free access for their goods. African private-sector spokesmen have raised concerns that giving preferential access to Bangladesh and Cambodia for apparel might endanger the nascent African apparel export industry that has grown up under AGOA. Certain U.S. industries have joined African nations in opposing the idea of extending duty-free access for apparel from these

[5]For additional information, see WTO, World Trade 2007, Prospects for 2008: Developing, Transition Economies Cushion Trade Slowdown, Press Release No. 520, Apr. 17, 2008, p. 19.

countries, arguing these nations are already so competitive in exporting to the United States that in combination they surpass U.S. FTA partners Mexico and CAFTA, as well as the Andean/AGOA regions, which are the major export market for U.S. producers of textiles.

This same trade-off involves decisions regarding the graduation of countries or products from the programs. It relates to the original intention that preference programs would confer temporary trade advantages on particular developing countries, which would eventually become unnecessary as countries became more competitive. Specifically, the GSP program has mechanisms to limit duty-free benefits by "graduating" countries that are no longer considered to need preferential treatment, based on income and competitiveness criteria. Since 1989, 28 countries have been graduated from GSP, mainly as a result of "mandatory" graduation criteria such as high income status or joining the European Union. Five countries in the Central American and Caribbean region were recently removed from GSP and CBI/CBTPA when they entered free trade agreements with the United States.

In the GSP program, the United States also pursues an approach of ending duty-free access for individual products from a given country by means of import ceilings—Competitive Needs Limitations (CNL). Over one-third of the trade from GSP beneficiaries—$13 billion in imports in 2006—is no longer eligible for preferences because countries have exceeded CNL ceilings for those products. Although the intent of country and product graduation is to focus benefits on those countries most in need of the competitive margin preferences provide, some U.S. and beneficiary country officials observe that remaining GSP beneficiaries will not necessarily profit from another country's loss of preference benefits. We repeatedly heard concerns that China would be most likely to gain U.S. imports as a result of a beneficiary's loss of preferences. In 2007, the President revoked eight CNL waivers as a result of legislation passed in December 2006. Consequently, over $3.7 billion of trade in 2006 from six GSP beneficiaries—notably Brazil, India, and Thailand—lost duty-free treatment. Members of the business community raised concerns that revocation of these waivers would harm U.S. business interests while failing to provide more opportunities for poorer beneficiaries. GAO's analysis showed that China and Hong Kong were the largest suppliers of the precious metal jewelry formerly eligible under GSP for duty-free import by India and Thailand; Canada, Mexico, Japan, and China were the leading competitors to Brazil's motor parts.[6]

Policymakers face a third trade-off in setting the duration of preferential benefits in authorizing legislation. Preference beneficiaries and U.S. businesses that import from them agree that longer and more predictable renewal periods for program benefits are desirable. Private-sector and foreign government representatives have complained that short program renewal periods discourage longer-term productive investments that might be made to take advantage of preferences, such as factories or agribusiness ventures. Members of Congress have recognized this argument with respect to Africa and, in December 2006, Congress renewed AGOA's third-country fabric provisions until 2012 and AGOA's general provisions until 2015. However, some U.S. officials believe that periodic program expirations can be useful as leverage to encourage countries to act in accordance with U.S. interests such as global and bilateral trade liberalization. Furthermore, making preferences permanent may deepen resistance to U.S. calls for developing country recipients to lower barriers to trade in their own markets. Global and bilateral trade liberalization is a primary U.S. trade policy objective, based on the premise that increased trade flows will support economic growth for the United States and other countries. Spokesmen for countries that benefit from trade preferences have told us that any agreement reached under Doha round of global trade talks at the WTO must, at a minimum, provide a significant transition period to allow beneficiary countries to adjust to the loss of preferences.[7]

## Proliferation of Preference Programs Has Led to a Need for a More Integrated Approach

Preference programs have proliferated over time. In response to differing statutory requirements, agencies pursue different approaches to monitoring the various criteria set for programs. The result is a lack of systematic review and little to no reporting on impact.

[6]For GAO's analysis of the scope and impact of the CNL waiver terminations, see pp. 38-41 of GAO-07-1209.

[7]For additional information on these issues see GAO-08-443 and GAO-07-1209.

## Trade Preferences Have Proliferated, Creating a Complex Array of Programs, but Congress Still Considers Each Program Separately

U.S. trade preferences have evolved into an increasingly complex array of programs. Congress generally considers these programs separately, partly because they have disparate termination dates.[8]

**Table 1: Growth of Trade Preference Programs**

| Program | Enactment date | Number of eligible countries, 2007 |
|---|---|---|
| GSP | January 1975 | 131 |
| | Several amendments | |
| CBI | | |
| • Caribbean Basin Economic Recovery Act | • August 1983 | 19 |
| • Caribbean Basin Economic Recovery Expansion Act | • Amended August 1990 | |
| • CBTPA | • May 2000 | 9 |
| • HOPE | • December 2006 | 1 |
| ATPA | December 1991 | 4 |
| • ATPDEA | • Amended August 2002 | 4 |
| AGOA | May 2000 | 39 |
| | Several amendments | |

Source: GAO.

Many countries participate in more than one of these programs. Of the 137 countries and territories eligible for preference programs, as of January 1, 2007, 78 benefit from more than one program, and 34 were eligible for more than two programs.[9]

While there is overlap in various aspects of trade preference programs, each program is currently considered separately by Congress based on its

[8]For example, the Caribbean Basin Trade Partnership Act was to expire on September 30, 2008, while GSP and ATPA expire December 31, 2008.

[9]For a listing of beneficiary countries and the programs for which they are eligible, see p. 48 of GAO-08-443.

distinct timetable and expiration date. Typically the focus has been on issues relevant to specific programs, such as counternarcotics cooperation efforts in the case of ATPA, or phasing out benefits for advanced developing countries in the case of GSP. As a result, until last year's hearing before this committee, congressional deliberations have not provided for cross-programmatic consideration or oversight.

The oversight difficulties associated with this array of preference programs and distinct timetables is compounded by different statutory review and reporting requirements for agencies. Reflecting the relevant statutory requirements, two different approaches—a petition process and periodic reviews—have evolved to monitor compliance with criteria set for various programs. We observed advantages to each approach, but individual program reviews appear disconnected and result in gaps.

The petition-driven GSP reviews of country practices and product coverage have the advantage of adapting the programs to changing market conditions and the concerns of businesses, foreign governments, and others.[10] However, the petition process can result in gaps in reviews of country compliance with the criteria for participation:

- From 2001 to 2006, three-quarters of the countries eligible only for GSP did not get examined at all for their conformity with eligibility criteria.
- Long periods passed between overall reviews of GSP. USTR completed an overall review of the GSP program in fall 2006. USTR completed the last general review of the program approximately 20 years earlier, in January 1987.
- The petition-driven review process also fails to systematically incorporate other ongoing monitoring efforts. For example, the lack of review under GSP provisions of any of the 26 preference beneficiary countries cited by USTR in 2006 for having problems related to the adequate and effective

[10] In the annual GSP review process, petitions may be filed by interested parties (for example, governments, businesses, or nongovernmental organizations) to request actions allowed under the statutes and regulations governing the GSP program, including adding or removing a product from overall GSP eligibility, waiving the competitive-need-limit for a product from a specific beneficiary. Any person may file a petition requesting that the status of any eligible beneficiary be reviewed with respect to any of the designation criteria listed in the statute governing the GSP program, including worker rights and intellectual property rights. For a summary of GAO's analysis of the product and country petitions filed in recent years, see pp. 42-44 and p. 72 of GAO-07-1209.

protection of U.S. intellectual property rights (IPR) makes it appear no linkage exists between GSP and ongoing monitoring of IPR protection abroad.

The periodic reviews under the regional programs offer more timely and consistent evaluations of country performance against the criteria for participation, but may still miss important concerns. For example, 11 countries that are in regional programs were later subject of GSP complaints in the 2001 to 2006 period:

- Although AGOA has the most intensive evaluation of country performance against the criteria for participation, the GSP process later validated and resulted in further progress in resolving concerns with AGOA beneficiaries Swaziland and Uganda on labor issues.
- The African country of Equatorial Guinea has been reviewed for AGOA eligibility and found to be ineligible. Yet, Equatorial Guinea has not been subject to a GSP country practice petition or reviewed under GSP. As a result, Equatorial Guinea remains eligible for GSP and exported more than 90 percent of its $1.7 billion in exports duty free to the United States under that program in 2006.[11]

## Only One Preference Program Directly Links to Capacity Building Efforts

Many developing countries have expressed concern about their inability to take advantage of trade preferences because they lack the capacity to participate in international trade. Sub-Saharan Africa has been the primary focus of U.S. trade capacity-building efforts linked to the preference programs, with the United States allocating $394 million in fiscal year 2006 to that continent. Although AGOA authorizing legislation refers to trade capacity assistance, USTR officials noted that Congress has not appropriated funds specifically for that purpose. However, USTR has used the legislative language as leverage with U.S. agencies that have development assistance funding to target greater resources to trade

[11] AGOA requires countries to be eligible for GSP, but the reverse is not true; AGOA's criteria are more extensive than GSP. For example, AGOA requires countries to have or be making progress toward political pluralism and the rule of law and prohibits participation of countries that undermine U.S. national security and foreign policy, commit gross violations of human rights, or support international terrorism. GAO's analysis showed that all (100 percent of the value) of Equatorial Guinea's exports to the United States were eligible for GSP in 2006. Equatorial Guinea exported approximately $1.6 billion in fuel products to the United States under GSP in 2006.

capacity building. In other regions of the world, U.S. trade capacity building assistance has less linkage to preference programs.

## Separate Reporting and Examination Hinder Measuring Progress on Programs' Contribution to Economic Development

Separate reporting for the various preference programs makes it difficult to measure progress toward achieving the fundamental and shared goal of promoting economic development. Only one program (CBI) requires agencies to directly report on impact on the beneficiaries. Nevertheless, in response to statutory requirements, several government agencies report on certain economic aspects of the regional trade preference programs. However, different approaches are used, resulting in disparate analyses that are not readily comparable. Agencies do not regularly report on the economic development impact of GSP. Moreover, there is no evaluation of how trade preferences, as a whole, affect economic development in beneficiary countries.

## GAO Recommendations and Agency Response

To address the concerns I have summarized today, in our March 2008 report, GAO recommended that USTR periodically review beneficiary countries that have not been considered under the GSP or regional programs. Additionally, we recommended that USTR should periodically convene relevant agencies to discuss the programs jointly. In response, USTR is undertaking two actions. First, USTR will conduct a review of the operation and administration of U.S. preference programs to explore practical steps that might improve existing communication and coordination across programs. Second, beginning with the annual *Report of the President of the United States on the Trade Agreements Program* to be issued on March 1, 2009, the discussion of the operation of all U.S. trade preference programs will be consolidated into its own section.

We also suggested that Congress should consider whether trade preference programs' review and reporting requirements may be better integrated to facilitate evaluating progress in meeting shared economic development goals. We believe that the hearings held by the committee last year and again today are responsive to the need to consider these programs in an integrated fashion and are pleased to be able to contribute to this discussion.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions that you or other members of the committee may have.

# QUESTIONS FOR THE RECORD
# FOR DR. LOREN YAGER

## United States Senate
## Committee on Finance

## Hearing on
## Oversight of U.S. Trade Preference Programs

## June 12, 2008

### Questions From Senator Grassley:

#### Question 1

In your testimony you cite several deficiencies with the review process under the Generalized System of Preferences, which determines whether a beneficiary country is complying with the program's eligibility criteria.

How would you modify the petition-driven review process to make it more effective? Would it be worthwhile to combine the petition-driven process with an annual designation process such as that under the African Growth and Opportunity Act?

**GAO recommends that USTR periodically review GSP beneficiaries that are not otherwise reviewed by virtue of their membership in regional programs to make the process more effective. GAO observed advantages with both the petition and annual designation approaches to monitoring compliance with program eligibility criteria. A combination of the petition-driven process with the annual designation process of AGOA may leverage those advantages. Such an approach should consider agency resources. Such consideration may include a risk-based determination as to how often a particular beneficiary requires review against the eligibility criteria.**

#### Question 2

Some people argue that longer renewals of our trade preference programs would better promote economic development. Other people insist that more frequent renewals provide opportunities to engage beneficiary countries on important reforms, which ultimately leads to more economic development. What is your view?

**GAOs March report (GAO-08-443) notes that U.S. policymakers face an inherent trade-off between the certainty associated with longer-term program renewals and reducing leverage to pursue U.S. interests with beneficiaries, including advancing reforms that help promote economic development. Generally, the greatest concern pertains to situations such as existed for GSP in the 1990s when a series of short-term renewals and periodic lapses caused considerable uncertainty for traders and investors. Our earlier report (GAO-07-1209) notes that use of GSP has increased markedly during the more recent 5-year renewal.**

**Our fieldwork suggests there have been adverse economic effects associated with the uncertainties created by program expiration and lapses in preference benefits. This was a common theme in our meetings with business people and beneficiary country officials. Moreover, USTR and other U.S. officials argued that the discretion the administration exercises over continuation of program benefits offers sufficient leverage to achieve policy goals, based on the possibility of removing benefits administratively through reviews of country conformity with eligibility requirements. Thus, while shorter renewal periods may provide increased opportunities for congressional oversight, the executive may also be able to exert leverage through the more effective use of administrative reviews that are incorporated into the preference programs.**

# COMMUNICATIONS

June 12, 2008

**An Open Letter to Congress**
**on Renewal of the U.S. Generalized System of Preferences Program**

For over three decades, the United States has extended preferential duty-free market access through the Generalized System of Preferences (GSP) program to imports from developing countries as a means of stimulating economic growth and reducing poverty. GSP and related preference programs have contributed to the development of export-oriented manufacturing and of new markets for developing country products, resulting in the creation of jobs that have helped improve the living standards of the poor. In many cases these jobs have been a primary employment engine for women, who have relatively few economic alternatives. Lower-income countries tend to benefit more, as products receiving preferential treatment make up a larger part of their exports to the United States. These preferences are thus helping the poorest countries to increase their share of U.S. imports.

In addition, GSP has become an integral component of American manufacturing competitiveness at the same time it lowers costs of consumer goods to American families. The duty savings granted by GSP affect raw materials as well as finished consumer goods. While overall U.S. tariffs are relatively low, for numerous products tariffs remain quite high. GSP duty savings frequently make the difference between profitability and survival of American companies, many of them small businesses, in a highly competitive U.S. marketplace. The additional price margin that GSP duty reduction provides also ensures that a wide range of developing countries can remain competitive with large-scale manufacturing countries in the global economy. The GSP duty savings frequently are the cost reduction needed to put developing country suppliers on a level playing field with much lower-cost producers in the more competitive exporting countries.

**GSP expires at the end of this year, and we urge Congress to renew this critical program as soon as possible, before its expiration on December 31, 2008.**

Sincerely,

Albaugh, Inc. (Ankeny, IA)

American Spice Trade Association

Association of American Chambers of Commerce in Latin America (AACCLA)

Axis Chemical (Long Beach, CA)

Brazil-U.S. Business Council

Business Roundtable
Caterpillar, Inc. (Peoria, IL)
Coalition of New England Companies for Trade
Columbia River Customs Brokers and Freight Forwarders Association
Crayola, LLC (Easton, PA)
Customs Brokers and Forwarders Assoc. of Northern California
The Dow Chemical Company (Midland, MI)
Dow Corning Corporation (Midland, MI)
Emergency Committee for American Trade (ECAT)
FMC Corporation (Philadelphia, PA)
General Electric Company (Fairfield, CT)
The Home Depot (Atlanta, GA)
J. C. Penney Company (Plano, TX)
Joint Industry Group
Leo Schachter Diamonds Complete (New York, NY)
Los Angeles Customs Brokers and Freight Forwarders Association Inc.
Lowes Companies, Inc. (Mooresville, NC)
Motor Equipment Manufacturers Association
National Customs Brokers and Forwarders Association of America
National Association of Manufacturers
National Foreign Trade Council
National Retail Federation
The ONE Campaign
Outdoor Industry Association
Oxfam America
Pacific Coast Council of Customs Brokers and Freight Forwarders Assn, Inc.
Panasonic North America (Secaucus, NJ)
Partnership to Cut Hunger and Poverty in Africa
PBI Gordon (Kansas City, MO)
Piremag (Middletown, NJ)
Resin Technology, LLC (Groton, MA)
Retail Industry Leaders Association (RILA)

S & V Industries (Akron, OH)

Target (Minneapolis, MN)

Ten Strawberry Street (Denver, Colorado)

Timex Corporation (Middlebury, CT)

Tumac Lumber Co., Inc. (Portland, OR)

U.S. Chamber of Commerce

U.S.-India Business Council

Wal-Mart Stores (Bentonville, AR)

Women Thrive Worldwide

Yazaki North America, Inc. (Canton, MI)

For more information, please contact:
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Written Statement of the

Coalition for GSP

To the United States Senate Committee on Finance

Regarding

"U.S. Trade Preferences, How Well Do They Work?"

Submitted by

Laura M. Baughman
Executive Director
Coalition for GSP

June 12, 2008

**Introduction**

The Coalition for GSP is pleased to have the opportunity to provide the following views to the Committee on Finance on the operation of U.S. preference programs. In particular, we intend to focus our comments on the importance of preference programs to American competitiveness, and on ways in which U.S. preference programs can be improved so that their contribution to American competitiveness is maximized.

The Coalition for GSP is an ad hoc group of U.S. companies and trade associations that use the Generalized System of Preferences (GSP) program to improve their competitiveness, as farmers, manufacturers, and suppliers of consumer goods to American families. Over the years, GSP has become an integral part of our businesses. Our members import a wide range of goods under GSP, from auto parts to jewelry to plywood to batteries to spices. We therefore have first-hand knowledge about how preference programs works – and don't work – in U.S. company raw material and finished good sourcing plans.

**Preference Programs Matter – to Americans**

When thinking about whether or not U.S. preference programs "work," one's focus tends to be on whether they work for the beneficiary countries. This of course is appropriate as preference programs are designed to promote poverty-eradicating development in poor countries.

Less common is a related consideration: how do they work for the American farmers, manufacturers, retailers and other importers who also use them? Preference programs succeed in their primary goal – promoting growth in developing countries through trade – only if U.S. companies find them attractive to incorporate into their sourcing and investment/production plans. U.S. companies will do so only if the benefits of the preference programs contribute positively to their "bottom lines," if the programs can be relied upon, and if the rules and regulations associated with claiming program benefits are not so complicated as to be more trouble than the benefits are worth.

*Preference Programs Reduce Costs*

U.S. preference programs extend duty-free treatment to imports of selected products from selected beneficiary countries. Although on average U.S. most-favored-nation duty rates are among the lowest in the world, for many individual products they can be quite high (see Table 1[1]). The U.S. market is very competitive, so any program that saves U.S. farmers, manufacturers, retailers and other importers money – even pennies – can be highly attractive. GSP alone saved U.S. importers nearly $1 billion in

[1] The list of products in Table 1 is by no means exhaustive, nor does it always show the highest tariff rate in a given product grouping.

duties in 2007.[2] The motivation to source from a preference-eligible country can therefore be strong.

Table 1
U.S. Tariff Rates for Selected GSP-Eligible Products

| | |
|---|---|
| Certain household porcelain/china tableware/kitchenware | 26.0% |
| Porcelain/china napkin rings | 20.8 |
| Certain nuts and seeds | 17.9 |
| Certain artificial flowers | 17.0 |
| Cotton hammocks | 14.0 |
| Railway cars | 14.0 |
| Certain silver jewelry | 13.5 |
| Ceramic roofing tiles | 13.5 |
| Flashlights | 12.5 |
| Screws made of iron/steel, for wood | 12.5 |
| Wood blinds, shutters | 10.7 |
| Metal drilling tools | 8.4 |
| Umbrellas | 8.2 |
| Machine tool parts | 8.0 |
| Christmas tree lights | 8.0 |
| Glass paving blocks | 8.0 |
| Certain transmission belts | 8.0 |
| Certain plywood | 8.0 |
| Paint rollers | 7.5 |
| Aluminum alloy sheets/plates | 6.5 |
| Various chemicals and mixtures | 6.5 |
| Polyvinyl chloride | 6.5 |
| Average U.S. tariff | 4.4 |

Source: Harmonized Tariff System of the United States, 2008; U.S. Census Bureau.

2 See http://tradepartnership.com/pdf_files/2008%20GSP%20Update.pdf. p. 12.

*Preference Programs Improve U.S. Competitiveness and Support U.S. Jobs*

A study conducted by The Trade Partnership for the U.S. Chamber of Commerce and attached to this submission found that the impact of GSP on a variety of sectors of the U.S. economy is significant.[3] It concluded:

- GSP keeps American manufacturers and their suppliers competitive. In 2005, three quarters of U.S. imports using GSP were raw materials, parts and components, or machinery and equipment used by U.S. companies to manufacture goods in the United States for domestic consumption or for export. Electrical equipment and parts, and transportation vehicle parts are significant imports under GSP.

- American families also benefit from GSP. Finished consumer goods typically sold by retailers accounted for 25 percent of GSP imports in 2005. Jewelry sold at lower price points was the most significant item.

- GSP is particularly important to U.S. small businesses, many of which rely on the program's duty savings to compete with much larger companies.

- Annual sectoral benefits to consumers of GSP products range up to $273 million.

- GSP imports support U.S. jobs. Direct and indirect jobs associated with moving aggregate GSP imports from the docks to farmers, manufacturers and ultimately to retail shelves totaled nearly 82,000 in 2005.

Therefore, when thinking about ways in which U.S. preference programs might be changed to achieve certain development policy goals, U.S. policy makers need to consider closely the impacts of those changes on American companies and their workers. While some thought in 2006 that it would be beneficial to narrow the focus of preference programs to the least developed countries or to eliminate benefits extended to imports of certain products (like auto parts from Brazil or jewelry from India or Thailand), these changes have had an adverse effect on U.S. manufacturers and retailers, who now face higher tariffs at the same time raw material costs have soared and domestic demand has slowed.

**Preference Programs Can Be Improved**

As key as duty savings can be, however, our preference programs suffer from some important flaws that can lessen the enthusiasm for their use, and consequently

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3 The Trade Partnership, "Estimated Impacts of the U.S. Generalized System of Preferences on U.S. Industry and Consumers," prepared for the U.S. Chamber of Commerce, November 1, 2006, http://www.tradepartnership.com/pdf_files/2006NOV_GSP_Impacts.pdf.

limit their effectiveness in contributing to U.S. competitiveness and in promoting development that ultimately opens new markets for U.S. exports and investment. These include their temporary nature, their inapplicability to many of the products made by developing countries, and their complicated nature.

*The Frequent Expirations of Preference Programs Discourage Importers and Investors from Using Them*

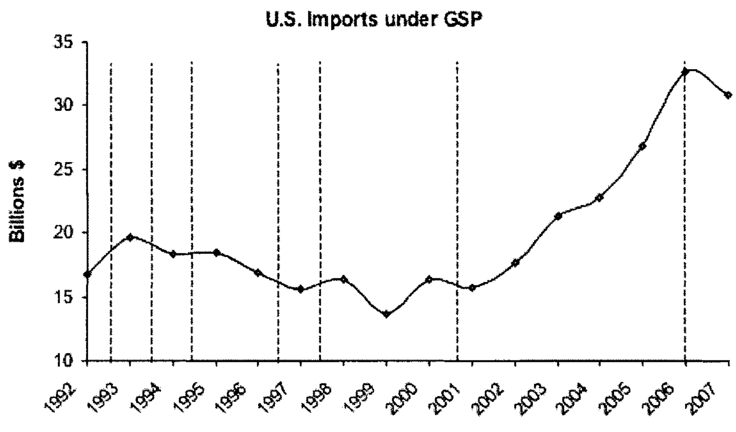
American companies' ability to use the duty-free benefits available under U.S. preference programs is most effective when they know those benefits will be available by the time they need to import the products of interest to them. While the time from design to order to importation varies for each company, for some it can be quite long. For example, some products take as long as one year from design to importation. For others, the products are advertised in catalogues with a shelf life of at least six months. In all cases, U.S. importers need to know what the duty-status will be for the imported product at the very beginning of that process.

If American companies can count on receiving duty savings under a preference program, they can incorporate those important cost savings into their pricing. But if the program expires mid-stream in the order-to-delivery process, importers can be caught with a serious financial burden. They cannot always adjust prices to customers to pass on the unexpected duties. So American companies have to evaluate the risk of losing the preferences mid-stream against the benefits of the duty savings. If the program is likely to expire, they often cannot incorporate the duty savings into their sourcing plans, and prices to customers will need to be higher to offset the risk.

The damage frequent program expiration causes to investment decisions can be just as great, if not greater. Needless to say, the pay-back from a foreign investment – e.g., opening a new factory, ensuring that there is adequate infrastructure to support it, training workers – can take several years to happen. U.S. companies would thus be reluctant to begin new sourcing relationships that require such investment if they are predicated on the need for duty-free benefits under a preference program that may expire.

With those planning constraints in mind, it is not surprising that the short-term renewals of GSP in the 1990s, compared to the long-term period from 2001-2006, affected usage of that program. From July 1993 through September 2001, Congress renewed GSP in fits and starts (largely due to the need to meet "pay-go" constraints). Planning sourcing using GSP was difficult if not impossible. Over this period, from 1994 to 2001, U.S. imports under GSP actually declined an average 2.2 percent annually. But in 2001 Congress renewed GSP for six years, and as a result, imports from GSP beneficiary countries to the United States increased by an average of 13.2 percent annually.

A long term for any preference program (the ideal of course would be permanence) is therefore important in encouraging sourcing from countries that do not yet have the infrastructure or production capability to be competitive suppliers of preference-eligible products. The Chart below shows how the long-term renewal of GSP increased interest in sourcing from beneficiary countries. To the extent that some of Coalition members are interested in investing in new overseas production relationships, they need time to grow these suppliers. Short-term renewals of the program do not encourage this, and keep them focused on existing sources, whether they are GSP beneficiaries or not.




*Vertical lines mark GSP expirations and renewals

*The Inapplicability of Preference Programs to Important Products Made by Poor Countries Encourages Sourcing from More-Competitive Suppliers in Asia*

One of the greatest frustrations for both developing country producers and U.S. purchasers is that the longest-lived and biggest U.S. preference program – GSP – does not cover imports of products best produced by labor-intensive developing countries. Most notably, these products include apparel and footwear.

Bangladesh – a "least-developed country" by any measure -- offers a perfect example. U.S. GSP benefits applied to just 0.7 percent of Bangladesh's total exports to the United States in 2007, while 87 percent of Bangladesh's total exports to the United States are dutiable apparel products. Similarly, only 0.1 percent of Cambodia's total exports received GSP duty-free treatment, with 98 percent of the total exports to the United States being dutiable apparel products. Despite their classifications as least-developed beneficiary countries, Bangladesh and Cambodia face trade-weighted tariffs averaging 15 and 17 percent, respectively, compared to an average of 0.7 percent on imports from the United Kingdom.

The benefits of extending preferences to products developing countries are best positioned to make are demonstrated by the impact of the African Growth and Opportunity Act (AGOA). AGOA provides U.S. duty-free treatment (under stringent conditions, see below) to apparel imported from beneficiary countries. AGOA is widely viewed as responsible for the development of tens of thousands of jobs in apparel production in Lesotho, for example. The 2007 U.S. Trade Representative report on the operation of AGOA listed five new textile or apparel-related investments motivated by AGOA benefits, in Lesotho, Malawi, Mali, Swaziland, and Uganda.[4]

From the U.S. perspective, Members of the Committee should consider that an importer considering whether to source apparel with duties applied will evaluate the costs and benefits offered by Bangladesh, for example, compared to China or Vietnam, for example. For many apparel products, China or Vietnam offer cost, quality and/or delivery advantages Bangladesh cannot replicate. A savings of the 15 percent average duty on imports from Bangladesh therefore would be meaningful, increasing the incentive to source from Bangladesh rather than China or Vietnam.

*Complicated Rules of Origin Frustrate the Use of Preferences*

Another problem with U.S. preference programs is the variety of rules of origin, some of which can be quite complicated, particularly for new-to-export foreign producers. The simplest of all rules of origin is GSP's 35 percent value added rule. To qualify for benefits, a product must be the growth, product or manufacture of a beneficiary country and the sum of the cost or value of materials produced in the beneficiary country plus the direct costs of processing must equal at least 35 percent of the appraised value of the good.

But the rules get much more complicated for apparel imported under AGOA or the Caribbean Basin Trade Partnership Act (CBTPA) preference program. (Remember that apparel generally is not eligible for GSP benefits.) Under AGOA, for example, U.S. importers must ensure that apparel meets *11 separate detailed requirements*.[5] Because these rules of origin are so restrictive, a special – but limited -- more liberal rule of origin had to be established (the so-called "third country fabric" rule). It is that rule that has promoted the development of apparel sourcing in sub-Saharan Africa.

The documentary evidence required by the various rules of origin requirements can be burdensome. It is not uncommon for U.S. importers to conclude that the

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4 Office of the U.S. Trade Representative, "2007 Comprehensive Report on U.S. Trade and Investment Policy Toward Sub-Saharan Africa and Implementation of the African Growth and Opportunity Act," May 2007, p. 27.

5 For the excruciating details, see http://www.customs.gov/linkhandler/cgov/import/international_agreements/special_trade_programs/agoa_african_growth/2002agoa.ctt/2002agoa.pdf.

paperwork involved in ensuring that a product complies with the preference program's rules of origin represents a "cost" – and a risk if U.S. Customs finds the evidence insufficient – that is not worth the effort. When the whole cost package is evaluated – purchasing from a preference country with duty savings but risk associated with demonstrating that the rules of origin have been met, versus purchasing from a non-preference country that offers less risk, higher cost (from duties) but better quality or delivery certainty -- the latter supplier often wins the order. Therefore, we recommend that Congress simplify the rules of origin used to qualify for preferences.

**Conclusion**

GSP is a preference program that generally works. It works for very poor countries and it works for American farmers, manufacturers and consumers. There are changes the Committee could enact to make preference programs work better, for beneficiary countries *and* for their U.S. customers. In evaluating those changes, Members should consider their impacts not only on beneficiary countries but also on U.S. companies and workers.

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This statement is submitted by the Mauritius-U.S. Business Association (MUSBA) for the record of the Senate Finance Committee's June 12, 2008 hearing entitled "Oversight of U.S. Trade Preference Programs." MUSBA is a non-profit trade association of Mauritian and U.S. companies involved in trade and investment between the two countries, particularly under the African Growth and Opportunity Act (AGOA).

Prior to the end of the Multi-Fiber Arrangement (MFA) in 2005, AGOA's duty-free preferences had been tremendously successful in spurring increased apparel imports from Africa. During 2000-2004, U.S. apparel imports from Africa increased by more than 130%, leading to the creation of an estimated 200,000 jobs in Africa. Following the end of the MFA, however, U.S. apparel imports from Africa had fallen by a shocking 25% by the end of 2007, leading to the closing of dozens of apparel factories and the loss of an estimated 100,000 jobs.

The post-MFA contraction of the African apparel sector has been especially severe in Mauritius, where more than 30 apparel factories have closed, costing more than 30,000 jobs. That represents fully one-third of the apparel sector jobs Mauritius had before AGOA was enacted. The impact on the Mauritian economy has been staggering because the apparel sector is by far the largest employer in the country. U.S. apparel imports from Mauritius have declined by 52%, so that, today, Mauritius exports substantially less apparel to the United States today than it did before AGOA was enacted.

## U.S. Apparel Imports from the AGOA LDCs and Mauritius

| Country | 2000 (msme) | 2007 (msme) | % Growth 2000-2007 |
|---|---|---|---|
| Swaziland | 7.166 | 39.841 | 456.07% |
| Kenya | 12.556 | 68.791 | 447.9% |
| Madagascar | 20.495 | 74.292 | 262.5% |
| Lesotho | 34.365 | 95.143 | 176.9% |
| Botswana | 2.167 | 5.451 | 151.6% |
| Malawi | 3.311 | 5.868 | 77.2% |
| Namibia | -0- | 8.955 | >100% |
| Ghana | -0- | 5.530 | >100% |
| Ethiopia | -0- | 2.892 | >100% |
| Uganda | -0- | 0.224 | >100% |
| Mozambique | -0- | 0.058 | >100% |
| Tanzania | -0- | 0.565 | >100% |
| **Mauritius** | **39.771** | **19.186** | **-51.8%** |

On the theory that the AGOA LDCs needed an extra competitive advantage to develop successful apparel industries, the original AGOA allowed the African LDCs to use more available, less expensive yarns and fabric from any origin ("third-country fabric"). The non-LDCs, including Mauritius, however, were limited to using either U.S. or African-origin yarns/fabrics, which has proven to be a serious competitive disadvantage.

Botswana and Namibia were also classified as non-LDCs in the original AGOA and were, therefore, disqualified from using third-country fabric. When it became evident that Botswana and Namibia were not benefiting from AGOA, in the so-called "AGOA II" amendments enacted in 2002, Congress reclassified Botswana and Namibia to LDCs to enable them to compete on equal terms with the LDCs.

Recognizing that Mauritius was actually losing its apparel industry, Congress extended the same relief to Mauritius in the 2004 Miscellaneous Tariff Bill (MTB). However, unlike Botswana and Namibia, which were given permanent LDC status, the 2004 MTB gave Mauritius LDC status only for 12 months, October 2004-September 2005. And in fact, U.S. Customs and Border Protection did not implement the Mauritius LDC provision until March 2005, reducing the benefits to just six months. This temporary LDC status has proven to be far too short to provide the intended transitional assistance to allow the Mauritian apparel industry to adjust to increased competition with the end of the MFA. Rather, apparel exports from Mauritius to the United States have continued to decline, falling by a further 34% since Mauritius' 2004 LDC derogation expired. Indeed, since the expiration of the 2004 LDC derogation, Mauritian exports of garments made with third-country fabric have essentially disappeared, falling from 14.508 million square meter equivalents (sme) in 2004 to just 880,000 sme in 2007, a shocking decline of 94%.

The initial contraction in the Mauritius apparel sector was caused in large part by the increased competition from China, Bangladesh, Vietnam, Cambodia and other super-efficient Asian apparel producers with the termination of the MFA system of quotas effective January 1, 2005.

## Realignment of U.S. Apparel Imports Post-MFA

| **Country** | **2004** | **2007** | **% Change 2004-2007** |
|---|---|---|---|
| World | 19,950.996 | 23,335.117 | 16.96% |
| China | 2,972.523 | 8,033.631 | 170.26% |
| Bangladesh | 941.685 | 1,354.101 | 43.80% |
| Vietnam | 777.055 | 1,273.657 | 63.91% |
| India | 609.338 | 867.881 | 42.43% |
| Cambodia | 634.683 | 866.625 | 36.54% |
| Pakistan | 519.282 | 695.545 | 33.94% |
| Sub-Saharan Africa | 440.300 | 332.310 | -24.53% |
| Mauritius | 37.332 | 19.186 | -48.61% |

With the safeguard quotas on China scheduled to expire at the end of this year, it seems virtually certain that a further concentration of U.S. apparel sourcing will occur. Those traditional suppliers that are at a competitive disadvantage – including Mauritius without access to third-country fabric – will be hard hit and may not survive.

In the long term, Mauritius is committed to restoring its international competitiveness through vertical integration, as is illustrated by the fact that a new denim fabric plant has recently opened in Mauritius. Other similar projects to increase efficiency are also underway. But these new investments will be rendered moot if the apparel sector loses critical mass in the meantime. Obviously, investors will not risk their capital in upstream textile plants if there are not enough downstream apparel customers to utilize the output of yarn and fabric.

Because the apparel factory closings and job losses in Mauritius have continued since its LDC derogation expired in 2005 and will almost certainly worsen when the safeguard quotas on China expire at the end of the year, Mauritius now needs the LDC derogation more than ever. Legislation to renew the Mauritius LDC provision is currently pending before the House of Representatives, H.R. 5059. Chairman Baucus introduced legislation to renew the Mauritius provision in the 109th Congress, S. 3904, but it was not enacted for unrelated reasons.

Respectfully Submitted,

Paul Ryberg
President

June 20, 2008

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The Honorable Jim McDermott
Testimony for the Record
Senate Committee on Finance
June 12, 2008

Chairman Baucus, Ranking Member Grassley, and Members of the Committee:

Our trade policy toward poor countries is more important today than at any time since 1974's enactment of the Generalized System of Preferences (GSP).

Just consider that in 1980, the incomes of those living in the world's developed economies were 67 times the average incomes of those living in the Least Developed Countries (LDCs). Today's income gap is larger by nearly 40 percent. It should come as no surprise to us to know that LDCs' share of world trade has decreased 30 percent since 1980 and 80 percent since the 1950s.

Our trading system and development policies are failing the world's poorest of the poor: one billion of the earth's inhabitants live on less than one dollar per day.

Using the tools at our disposal to promote development, like our trade policy, is a moral imperative, and one that is in our own national interest. For example, the World Bank estimates that countries with economies that rely on a single economic sector for growth is over 20 times more likely to experience civil conflict and war. When we consider regions like West Africa, where in coming years 50 percent of our oil imports will originate, we should understand the importance in deploying policies to encourage economic diversification and growth as a means to alleviate poverty, and to strengthen stability in a region that is continually more important to our own national interests.

In the words of President Kennedy, American apathy toward development "would be disastrous to our national security, harmful to our comparative prosperity, and offensive to our conscience."

In foreign policy terms alone, our development assistance and trade preferences allow the United States to help shape outcomes that are consistent with our values and beneficial to the world.

In 2000, as we entered a new millennium with the success and lessons of the industrial and the green revolutions, we committed ourselves to the United Nations Millennium Development Goals (MDGs). These goals included a pledge to help halve global extreme poverty.

By committing to the MDGs, the community of nations found leadership in the United States. We are an agent in which the LDCs put their faith to promote the common good.

We have a lot of work to do to live up to our goal, our promise, and our potential. The way we implement our trade policies and deploy tools to enable poor countries to leverage our trade policies deserves our immediate attention.

We need to reform our preferences in the following ways.

First, the MDGs incorporated a pledge for the developed world to provide market access to essentially all products that originate in LDCs. We should fulfill that promise. The African Growth and Opportunity Act (AGOA) was a start, but it falls short because non-African LDCs are not included, and because AGOA excludes important products. Legislation is pending before the Congress that would provide 100 percent duty-free quota-free access to the LDCs. By enacting this legislation, this year, we can regain our leadership on trade and development and put pressure on other developed countries to follow our example.

Second, the Generalized System of Preferences (GSP) needs reform. The program's temporary and unpredictable nature discourages private and public investment in sectors that could benefit from the preferences, enabling job creation and export-led growth. GSP's Competitive Need Limit (CNL) process is broken, and CNL has proved to be an instrument that is far too blunt. The manner by which by which GSP is reformed may provide us the ability to simplify and hone other preference schemes.

Third, all of our preferences have eligibility criteria that are important, because meeting these criteria is the reciprocity that we receive from developing countries in exchange for access to our market. Combating corruption and promoting the rule of law in developing countries is beneficial to our national interests. Unfortunately, Congress and the executive branch have done a poor job in measuring whether countries are meeting the eligibility criteria, or in helping countries meet the criteria and understand what is expected. As we consider the renewal, reform, and expansion of our trade preferences, conditions on eligibility need to be taken seriously by the Congress.

Fourth, the benefits of trade preferences are limited. We cannot expect that by providing a trade preference that the world's poorest – perhaps landlocked – countries are suddenly going to be able to produce a surplus good that is competitive in our market or others. Therefore, trade capacity assistance is vital. It is this assistance that can leverage the preference we provide. The Government Accountability Office, however, has found that our trade capacity building (TCB) programs lack direction, cohesiveness and oversight. This is the fault of the Congress, and the executive branch. I believe the committees with jurisdiction over trade need to do a better job of working with the authorizing and appropriations committee to ensure that the nation's development and TCB programs are better designed and implemented to augment our trade preferences.

In conclusion, I commend the committee for holding this hearing and continually focusing on the issue of trade preferences. I encourage the committee to consider expanding preferences to the LDCs this year. When people say to us that we should wait until next year, or the year after, because time is running out for the 110th Congress, I believe we should remind ourselves, and this great legislative body, that time is really running out for the billion people living in extreme poverty. Time has always been on the side of America and other rich nations, but the billion people living in the Least Developed Countries fall deeper into relative poverty with every passing day. In Africa hunger is a key factor in more deaths than those caused by the entire continent's infectious diseased, combined. Yet, every cow in Europe receives almost two dollars each day in a government subsidy.

The only thing more scandalous than the contrast between the lives led by those in rich countries and those in poor countries would be Congress's decision to continue delaying consideration of legislation to improve our trade and development policies toward the world's most vulnerable people. Thank you.

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National Retail Federation®
*The Voice of Retail Worldwide*

June 12, 2008

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Dirksen Building
Room 219
Washington, DC 20510

RE: Hearing: Oversight of U.S. Trade Preferences – June 12

Dear Chairman Baucus:

On behalf of its members in the U.S. retail industry, the National Retail Federation (NRF) submits these comments to the Committee on Finance regarding the operation of U.S. preference programs and, in particular, how U.S. preference programs fit into retailers' sourcing plans. The **National Retail Federation** (**NRF**) is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.6 million U.S. retail companies, more than 25 million employees - about one in five American workers - and 2007 sales of $4.5 trillion. As the industry umbrella group, NRF also represents over 100 state, national and international retail associations.

**Importance of Preference Programs to U.S. Retailers**

Retailers source the globe for the products they sell to price conscious customers. For better or for worse, U.S. government policies, rules and programs play an important role in retail sourcing decisions. While the weight of each varies with the retailer, in general, retailers look at a number of factors in deciding who will supply the products they sell: quality, reliability in meeting our deadlines for having the merchandise on our floors, ability to meet our order size requirements, compliance with our codes of conduct, and cost. Cost is not usually the driving factor, but it is an increasingly important consideration with the rapid rise in prices for commodities and oil. In addition, U.S. tariffs are quite high for many consumer goods sold by retailers. These products include apparel

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(trade-weighted average non-preference tariffs averaging 15.8 percent), glassware (14.2 percent), footwear (10.4 percent) and bicycles (9.8 percent), among many, many others. Preference programs can contribute significantly to lowering some of these costs by eliminating the tariffs.

Retailers make use of every U.S. preference program offered. They include the Generalized System of Preferences (GSP) program, the African Growth and Opportunity Act (AGOA), the Caribbean Basin Trade Preferences Program (CBTPA), the Andean Trade Preferences and Drug Eradication Act (ATPDEA), and the Haitian Hemispheric Opportunity through Partnership Encouragement (HOPE) program. Our enthusiasm for these programs varies. GSP has a workable rule of origin and applies to most developing countries; however, it does not cover products of major importance to retailers, including apparel and footwear. AGOA, CBTPA and ATPDEA cover apparel and footwear; however, they have complicated rules of origin that more often than not discourage retailers from using them. Each of these programs expires from time to time, inserting unpredictability into our sourcing plans, which is costly to retailers who must maintain complicated supply chains and make long-range business decisions in a just-in-time environment.

Congress approved a two-year extension of the CBTPA and HOPE preference programs as part of the recently passed farm bill. However, GSP and the ATPDEA expire on December 31, 2008. NRF and the retail industry strongly support a long-term renewal of these programs before that date, and would like to suggest ways those and other preference programs can be improved.

**How to Make Preference Programs Better**

We have learned much, both good and bad, from the many preference programs the United States has extended to developing countries since 1974. In contemplating how U.S. preference programs could be revised, we should aim to keep the good and jettison the bad.

Among the "good" lessons, we know that many U.S. duties do present significant cost hurdles to importing products from any country, but particularly least developed countries, and programs that eliminate those duties do encourage trade with the beneficiary countries. We know that those costs savings, creating business for poor countries, also get passed down to the final prices of the goods retailers sell.

The "bad" lessons include restrictions inserted into the preference programs, typically to appease the protectionist objectives of some domestic industry that feels threatened by import competition. These restrictions make sourcing from developing countries under the preference program difficult for importers as well as developing country exporters, as they require knowledge of the rules of origin many do not have, and an exposure to legal and financial penalties for even small mistakes. Examples include the "yarn forward" rule of origin in AGOA, which made sourcing apparel from sub-Saharan Africa nearly impossible and necessitated the inclusion of an exception to that rule to ensure that this initiative could actually promote trade in these products.

Other, more sweeping restrictions include the exclusion from GSP benefits of broad categories of products that just happen to be those goods that least developed countries are most competitive at making. Apparel and footwear are two significant examples. The conclusion is that the value and commercial viability of market access is directly dependent on what the rules are – bad rules that are overly complicated and restrictive kill trade; good rules that are consistent with how companies actually conduct business and manage their supply chains will promote trade and investment.

Another significant problem associated with current trade preference programs is their temporary nature. Congress must pass legislation to authorize them and typically this legislation has an expiration date. Lead-times for retailers from the time a product is ordered to the time it arrives on a store shelf are typically six to nine months. Therefore, as a preference program expiration date approaches and the ability of Congress to pass a timely extension becomes questionable, retailers and others are forced to make alternative sourcing plans.

Thus, the chief goal of preference programs -- poverty reduction through increased trade – is frustrated by product restrictions and narrow rules of origin in current U.S. preference programs, and by their temporary nature. We should not make the same mistakes with any changes Congress contemplates to our preference programs.

**Objections**

Not surprisingly, some objections have been raised from the usual quarters to including certain products of key importance to least developed countries within the scope of preferences targeted at the least developed countries, such as the so-called "duty-free, quota-free" (DFQF) proposal pending at the Doha round. The objectors claim that they would be adversely impacted should their products be among the eight-digit tariff lines included in the U.S. DFQF program. Objectors notably include the U.S. textile industry.

NRF strongly believes it would be a mistake for the United States to accept the objections of U.S. textile interests to the inclusion of textile and apparel products from the initiative. U.S. Government data show the industry to profitable over the last two years, and strongly profitable even as other manufacturing sectors were hit hard by the slowing economy in the last half of 2007 The textile sector is not an industry that is vulnerable to import competition from least developed countries, including Bangladesh and Cambodia.

NRF appreciates the opportunity to comment on U.S. preference programs and looks forward to working with the Committee on any legislative initiatives it may take to improve the operation of these programs. Should you have any questions please contact me at (202) 626-8104 or by e-mail at autore@nrf.com.

Sincerely,

Erik O. Autor
Vice President, Int'l Trade Counsel

Oxfam America

**United States Senate Committee on Finance**
**Hearing on Oversight of U.S. Trade Preference Programs**
**June 12, 2008**

**Written Comments Submitted by:**
**Stephanie Burgos**
**Senior Policy Advisor**
**Oxfam America**

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*Oxfam America is an international development and humanitarian relief agency committed to working for lasting solutions to poverty, hunger and social injustice. We are part of a confederation of 13 Oxfam organizations working together in over 120 countries around the globe with an annual budget over half a billion dollars.*

*Oxfam believes that trade can be an important engine for development and poverty reduction. Well-managed trade has the potential to lift millions of people out of poverty. We believe it is important that trade agreements, which set the rules for ongoing trade relations, work to improve livelihoods and reduce poverty in developing countries.*

International trade is a significant factor shaping the welfare of people in this country as well as across the globe. Conditions of poverty, ill health and lack of economic opportunities in developing countries are a human tragedy, and Oxfam believes we have a moral obligation to reduce this poverty and suffering. But these conditions also have implications for America's long-term security and prosperity. While U.S. foreign policy and foreign aid seek to improve these problems, U.S. trade policy also plays an important role.

Trade can contribute to economic growth and to the reduction of poverty in poor countries. For this reason, Oxfam believes that U.S. trade policy should have, at its core, a manifest concern for promoting sustainable development. Trade that serves to strengthen developing country economies ultimately helps to generate economic growth abroad, which will, in turn, help reduce poverty. Bringing people out of poverty is an important goal in itself, but it has additional salutary benefits for the U.S. economy, through the generation of demand for U.S.-produced goods and services abroad. It can also contribute to reducing the social and political tensions that result from economic exclusion both in the United States and in our trading partners.

For more than three decades, the United States has extended preferential duty-free market access to imports from developing countries as a means of stimulating economic growth and poverty reduction. These trade preference programs have contributed to the growth of manufacturing and agricultural sectors in many developing countries. They have also helped create jobs, in many cases for women, who have relatively few economic alternatives.

Businesses in the United States have also benefited from preference programs, relying on goods imported duty-free to be used as inputs into products that are manufactured here. In fact, fuel now accounts for more than half of the value of U.S. imports under trade preference programs. Particularly at a time of high energy costs, benefits from these programs are as important to the U.S. as they are to developing countries.

U.S. preference programs have been successful in bringing about greater respect for workers' rights. When violations of labor standards occur, organizations can petition to have trade benefits withdrawn. Merely the threat of withdrawal of trade preferences can be a powerful incentive for countries to ensure that they comply with internationally recognized worker rights.

Oxfam believes that, for these reasons, trade preference programs remain an important pillar of U.S. trade policy and should be renewed. We applaud the Senate Finance Committee for having initiated an important process to review and potentially improve these programs. At the same time, we believe it is critical that this review and discussion of reform not become an obstacle to the timely renewal of the two programs set to expire this year – the General System of Preferences (GSP) and the Andean Trade Preferences Act (ATPA).

The testimony provided by the GAO to this Committee, based on two recent studies on trade preference programs (GAO-07-1209 and GAO-08-443), identified three policy trade-offs to be considered when deciding on the future of these programs. We would like to take this opportunity to comment on those issues, as they go to the heart of questions raised by several Committee Members in the process of reviewing U.S. trade preference programs.

**Country eligibility**

Oxfam believes that all developing countries that comply with existing criteria under the GSP should remain eligible for trade preferences. While the GAO found that preference imports are still concentrated in a small number of countries, the share of imports from poorer countries has risen recently. The study found that preference programs have enabled the poorest countries to increase their shares in total U.S. imports and have generally contributed to increased and more diversified trade for many developing countries.

GSP remains an important vehicle for many developing countries to access the U.S. market. Although their exports under GSP may represent a very small part of U.S. imports, the contribution that these exports make to their economies and their overall development can be significant. It is important to recognize that a number of these countries are low and middle income and are not "least development countries" (LDCs), which are limited to a set group of countries as defined by the UN system. Many of these countries still face significant levels of poverty, inequality, and major development challenges. Trade preferences can help them to address these development needs, through greater income at the national and family level.

Low and middle income countries such as Thailand, Pakistan, Paraguay, the Philippines, Indonesia, India and Brazil should continue to be eligible for trade preferences under GSP. In particular, over 900 million people in India continue to live on less than $2/day, while Brazil has one of highest levels of inequality worldwide.

Oxfam believes that it would be a grave mistake to remove any of these countries from GSP eligibility or to limit GSP only to LDCs. The current GSP program has worked to help some countries graduate from eligibility by enabling them to attain higher levels of development. Other countries should have this same opportunity and should not be shut out from a program that is providing real benefits to both U.S. businesses and poor people abroad.

Contrary to assertions that larger developing countries such as Brazil and India are the main obstacles to a conclusion of the World Trade Organization (WTO) Doha Development Round and thus should not remain eligible for GSP, those primarily responsible for lack of progress are in fact developed countries. The United States, Europe, and Japan continue to maintain trade-distorting agricultural subsidies, while insisting that developing countries lower their tariffs in industrialized and agricultural products. It is this lack of political will by developed countries that is truly blocking the conclusion of a WTO agreement.

Brazil and India are actually among developing countries with the most to gain from the Doha Round, in terms of market access. Because of this, they have been active in trying to further the negotiations. The benefits that they receive from GSP are small in relation to the market access they stand to gain through a WTO agreement. Imports from both countries under GSP only receive a 4 percent lower tariff rate than would otherwise be available, on average, while other products in which they are competitive – such as orange juice concentrate and ethanol – continue to face much higher tariffs that could be reduced under a WTO agreement. Removing India and Brazil from GSP would be very unlikely to influence their negotiating positions at the WTO, but would adversely affect thousands of families whose livelihoods depend on the export of products that benefit from GSP.

**Scope of product coverage**

Regional preference programs provide additional important trade benefits to some LDCs in sub-Saharan Africa and the Caribbean by covering more products and in some cases providing more flexible rules of origin. This is important because many LDCs rely on the production of goods that are not eligible under GSP, but which employ millions of people, such as apparel. Yet a number of LDCs, particularly in Asia, remain excluded from regional trade preference programs and are therefore unable to take advantage of lower tariffs for products that are among the most important to building their economies.

As the GAO notes, 34 of the 46 LDCs eligible for preference programs are barely able to use them, in part due to a mismatch of product coverage. For example, very few exports from Bangladesh and Cambodia benefit from GSP. As a result, these countries pay on average 15-17 percent of the value of their exports to the US in tariffs, which ends up being about the same amount paid by exports from the UK and France, which have an average tariff rate of one percent or less.

Oxfam strongly supports legislation, such as the Trade Act of 2007 (S. 652) introduced by Senator Gordon Smith, that would extend product coverage with more flexible rules of origin to all LDCs, in a manner similar to benefits available through other regional programs.

Oxfam also supports elimination of the ceilings or "competitive need limits" that are placed on eligible products for certain GSP beneficiaries when imports of those products exceed specified thresholds for value and market share. U.S. businesses have reported that revoking benefits for these products often fails to benefit other GSP eligible countries, U.S. businesses or consumers. Instead, use of competitive need limits can harm burgeoning new industries that provide employment to many people facing conditions of poverty in developing countries.

**Trade capacity building**

Additionally, more is needed to help poor countries use trade preference programs to further their development. Many face capacity problems that prevent them from being able to benefit from trade. Trade capacity building assistance can help overcome these constraints, providing economic aid that enables countries to more effectively take advantage of trade preference programs. Yet as the GAO notes, AGOA is the only preference program to provide some link to capacity building efforts, although it provides no funds.

Oxfam believes further trade capacity building assistance should be provided together with preference programs in order to help poorer countries to better utilize trade opportunities. Such assistance can include enhancing worker skills, modernizing customs systems, building roads and ports, improving agricultural productivity and export diversification. Aid should be recipient-driven, additional to existing development aid, free of economic conditions and adequate to address identified needs. It should also be reliably delivered once committed and provided in a manner that is transparent, well-coordinated, and consistent with recipient countries' development strategies.

**Duration of benefits**

The purpose of trade preference programs is to promote economic growth and improve standards of living in developing countries, while making U.S. businesses more competitive and lowering prices for U.S. consumers. Only long-term programs with timely renewal processes well in advance of their expiration dates will serve this purpose. For this reason, Oxfam strongly believes that trade preference programs should be made permanent, with countries graduating when they reach a sufficient level of economic development.

Sustainable economic development and reduction of poverty and inequality, historically, have not been processes that move quickly over a few years, but at best advance gradually over several decades. This can be illustrated by the fact that the world is woefully behind meeting the United Nations' Millennium Development Goals, including halving extreme poverty and hunger by 2015. Furthermore, both businesses in developing countries and U.S. importers rely on multiple year preference programs with timely and transparent renewal processes to enable them to plan for and take advantage of trade opportunities. Short-term programs and last-minute renewals undermine the primary purpose of trade preferences and make them far less useful to their intended beneficiaries.

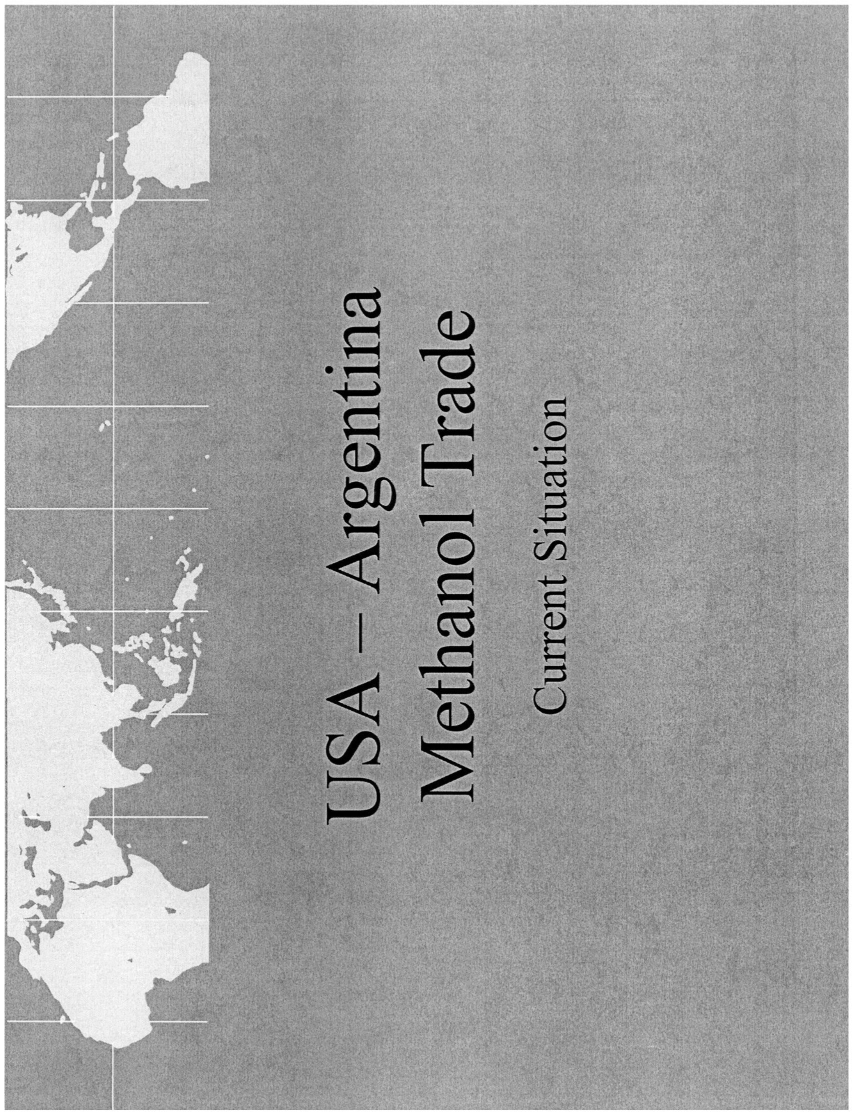
Long-term preference programs will not undermine broader trade policy objectives, in particular the conclusion of the WTO negotiations. In fact, the WTO's Doha Development Round was initially launched with the expectation that it would deliver on the long-standing promise of benefits to developing countries, particularly through elimination of trade-distorting agricultural subsidies and reforms that respect the principle of "special and differential treatment" for developing countries. Yet the text on agriculture and non-agricultural market access that is currently on the negotiating table still falls far short of what is needed to produce a development-oriented outcome and, instead, would primarily serve the interests of industrialized countries over the needs of the developing world. Developing countries are only likely to reach agreement on a conclusion of the Doha Round if it delivers outcomes that support their development, regardless of the status of their access to benefits under U.S. trade preference programs.

**Conclusion**

Oxfam recommends that the Senate:

- Renew the Generalized System of Preferences and Andean Trade Preferences Act as soon as possible before the end of 2008.
- When considering reform of the GSP program, maintain coverage for all countries currently included in the program based on their levels of economic development and poverty, and eliminate competitive need limits.
- Make trade preference programs permanent.
- Expand preferences for all LDCs through a new program that includes additional product coverage similar to what is available under other regional preference programs, for example by passing the Trade Act of 2007 (S. 652).
- Link assistance for trade capacity building with existing preference programs, and ensure this aid is recipient-driven, additional to existing development aid, free of economic conditions, adequate to address identified needs, and reliably delivered once committed.

**SUBMITTED BY REPSOL YPF**



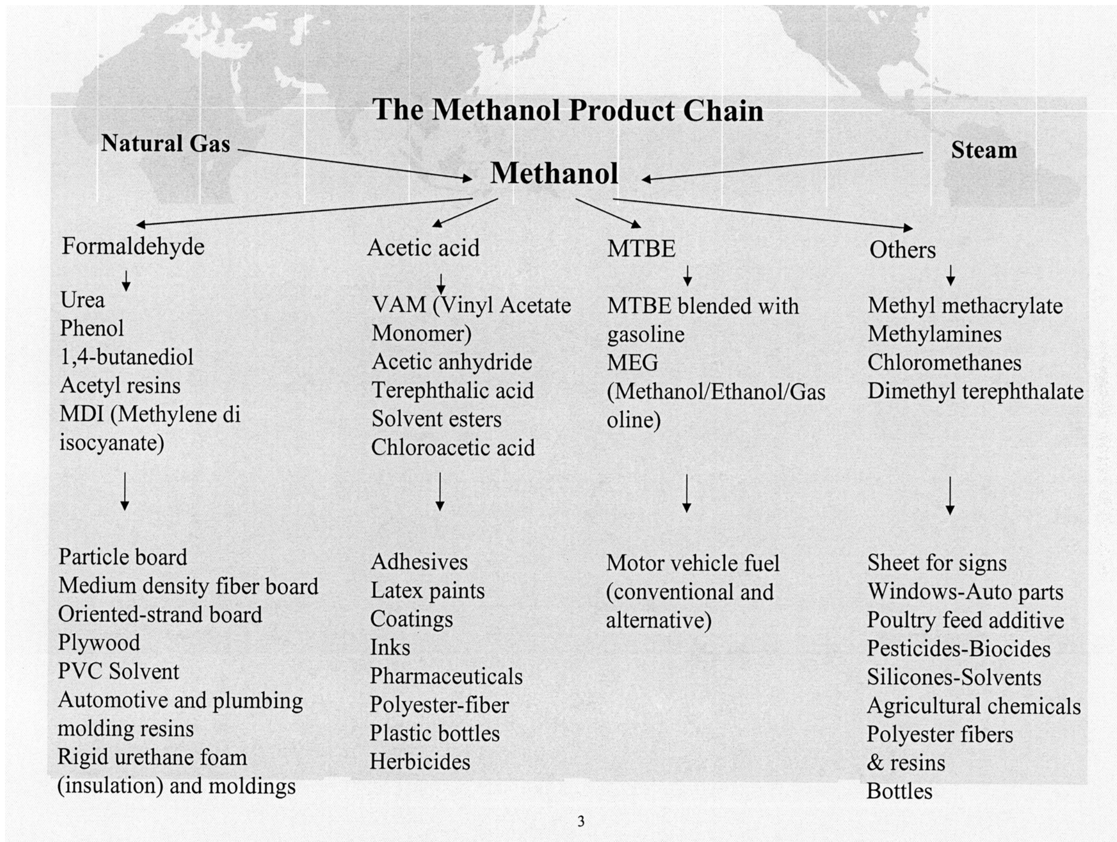
## Methanol

Description of the Product:

- Methanol is the simplest form of alcohol. It is a colorless, tasteless liquid with a very faint odor.
- Natural gas is the feedstock used in most of the world's production of methanol, and represents the most significant component. Methanol is synthesized under pressure in a catalytic process, and the crude methanol is purified to chemical grade by distillation.

Uses for Methanol:

- Its most important uses are as a chemical building block for derivatives such as formaldehyde, methyl tertiary butyl ether and acetic acid. These chemicals are incorporated in a very wide variety of industrial and consumer products such as synthetic textiles, recyclable plastics, household paints, adhesives and many healthcare and pharmaceutical products.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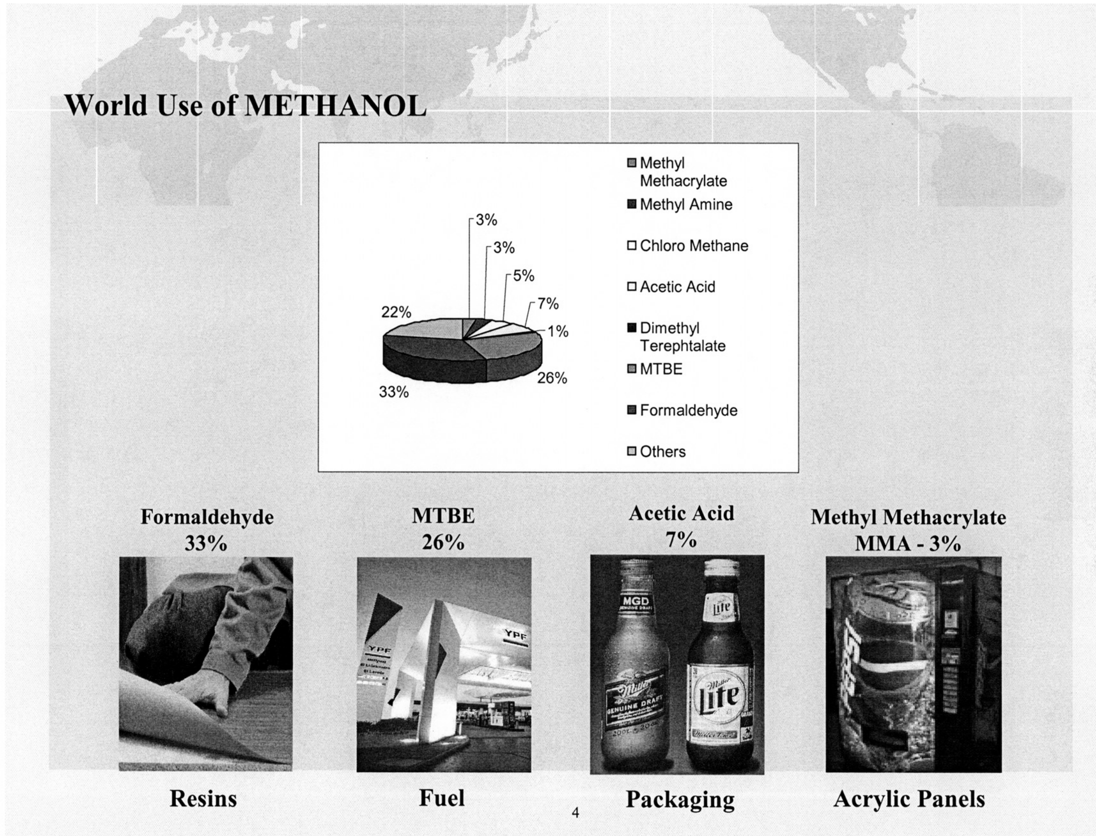
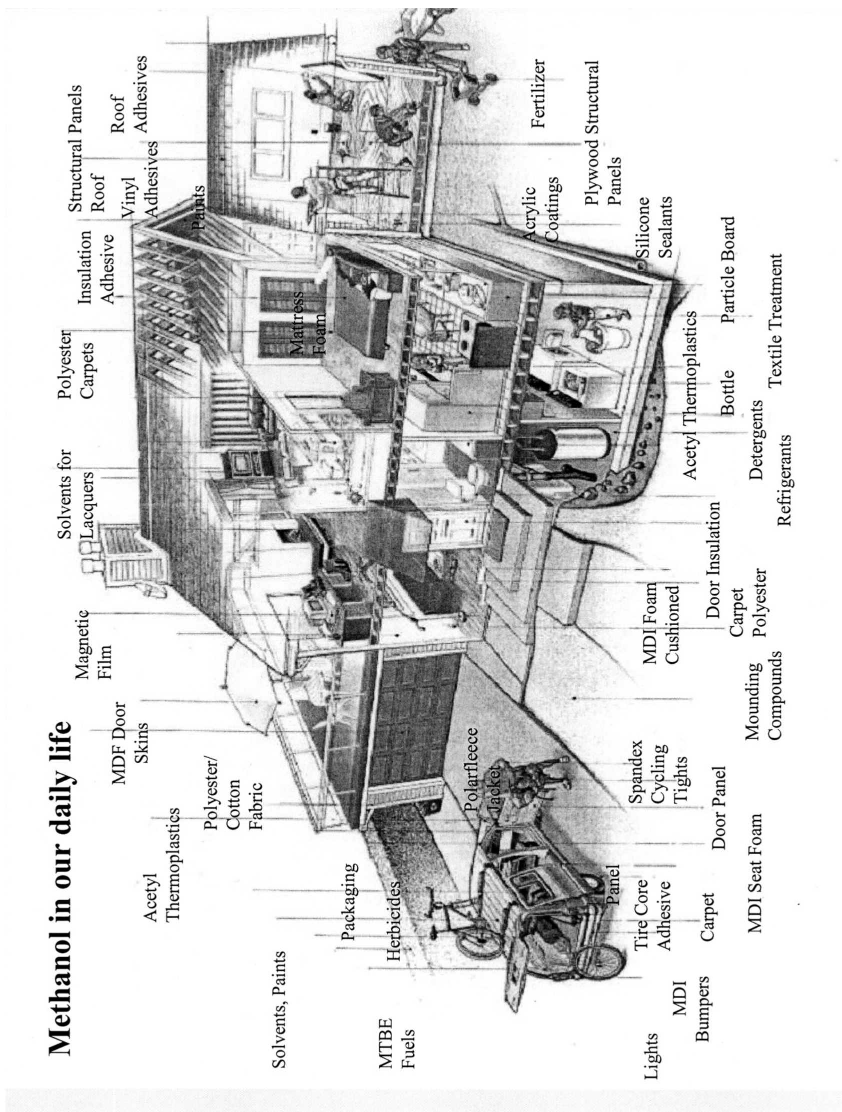
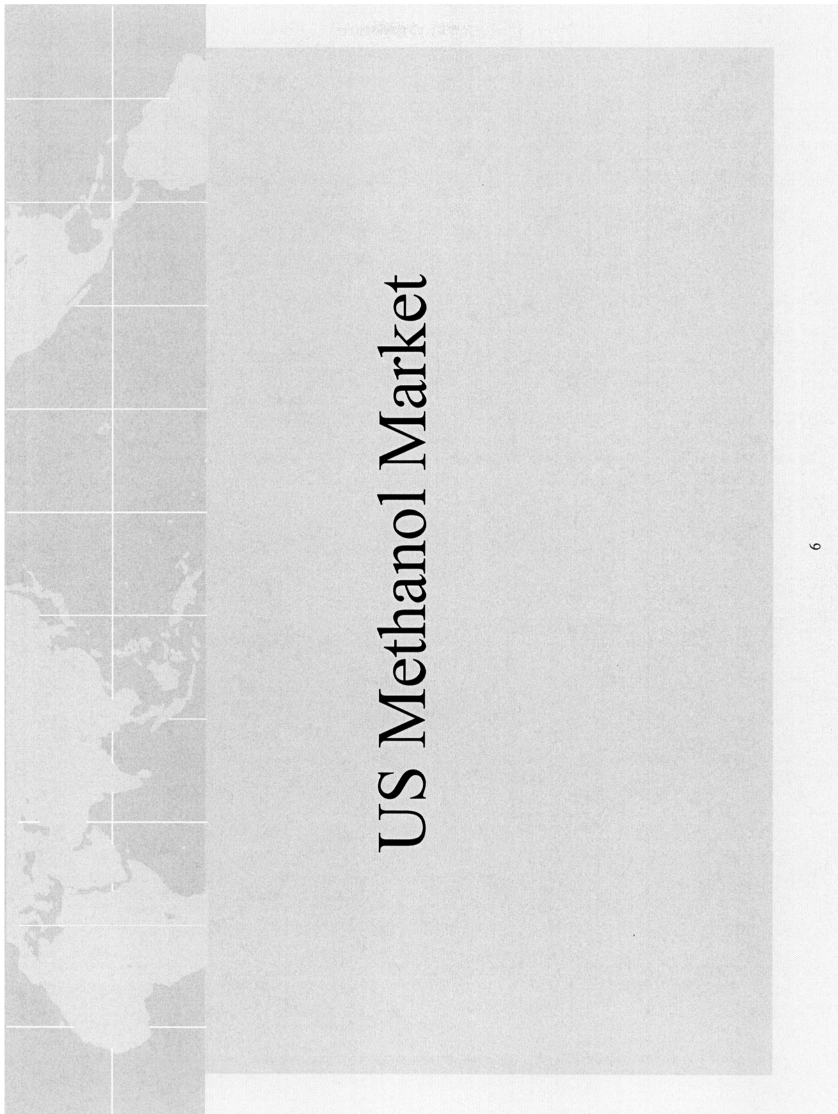
Steam
Methanol
Formaldehyde
Urea
Phenol
1,4-butanediol
Acetyl resins
MDI (Methylene di isocyanate)
Particle board
Medium density fiber board
Oriented-strand board
Plywood
PVC Solvent
Automotive and plumbing molding resins
Rigid urethane foam (insulation) and moldings
Acetic acid
VAM (Vinyl Acetate Monomer)
Acetic anhydride
Terephthalic acid
Solvent esters
Chloroacetic acid
Adhesives
Latex paints
Coatings
Inks
Pharmaceuticals
Polyester-fiber
Plastic bottles
Herbicides
MTBE
MTBE blended with gasoline
MEG
(Methanol/Ethanol/Gasoline)
Motor vehicle fuel (conventional and alternative)
Others
Methyl methacrylate
Methylamines
Chloromethanes
Dimethyl terephthalate
Sheet for signs
Windows-Auto parts
Poultry feed additive
Pesticides-Biocides
Silicones-Solvents
Agricultural chemicals
Polyester fibers & resins
Bottles
3


World Use of METHANOL
3%
3%
5%
7%
1%
22%
26%
33%
Methyl Methacrylate
Methyl Amine
Chloro Methane
Acetic Acid
Dimethyl Terephtalate
MTBE
Formaldehyde
Others
Formaldehyde 33%
MTBE 26%
Acetic Acid 7%
Methyl Methacrylate MMA - 3%
Resins
Fuel
Packaging
Acrylic Panels
4

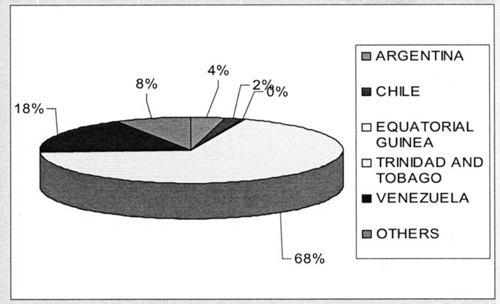

Methanol in our daily life
Solvents, Paints
Acetyl Thermoplastics
MDF Door Skins
Magnetic Film
Solvents for Lacquers
Polyester Carpets
Insulation Adhesive
Structural Panels
Roof
Vinyl Adhesives
Roof Adhesives
MTBE Fuels
Herbicides
Packaging
Polyester/ Cotton Fabric
Paints
Mattress Foam
Polarfleece Jacket
Panel
Tire Core Adhesive
Carpet
Spandex Cycling Tights
Door Panel
MDI Foam Cushioned
Door Insulation
Acetyl Thermoplastics
Acrylic Coatings
Plywood Structural Panels
Silicone Sealants
Fertilizer
Lights
MDI Bumpers
MDI Seat Foam
Mounding Compounds
Carpet Polyester
Bottle
Detergents
Refrigerants
Particle Board
Textile Treatment


US Methanol Market
6

## U.S. Methanol Market:

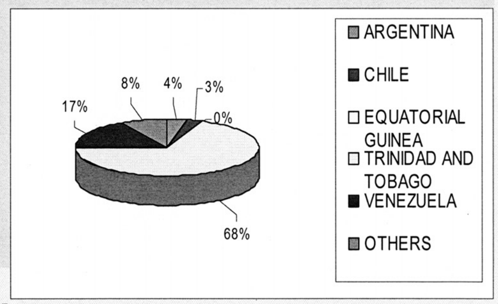
- USA Imports 2006

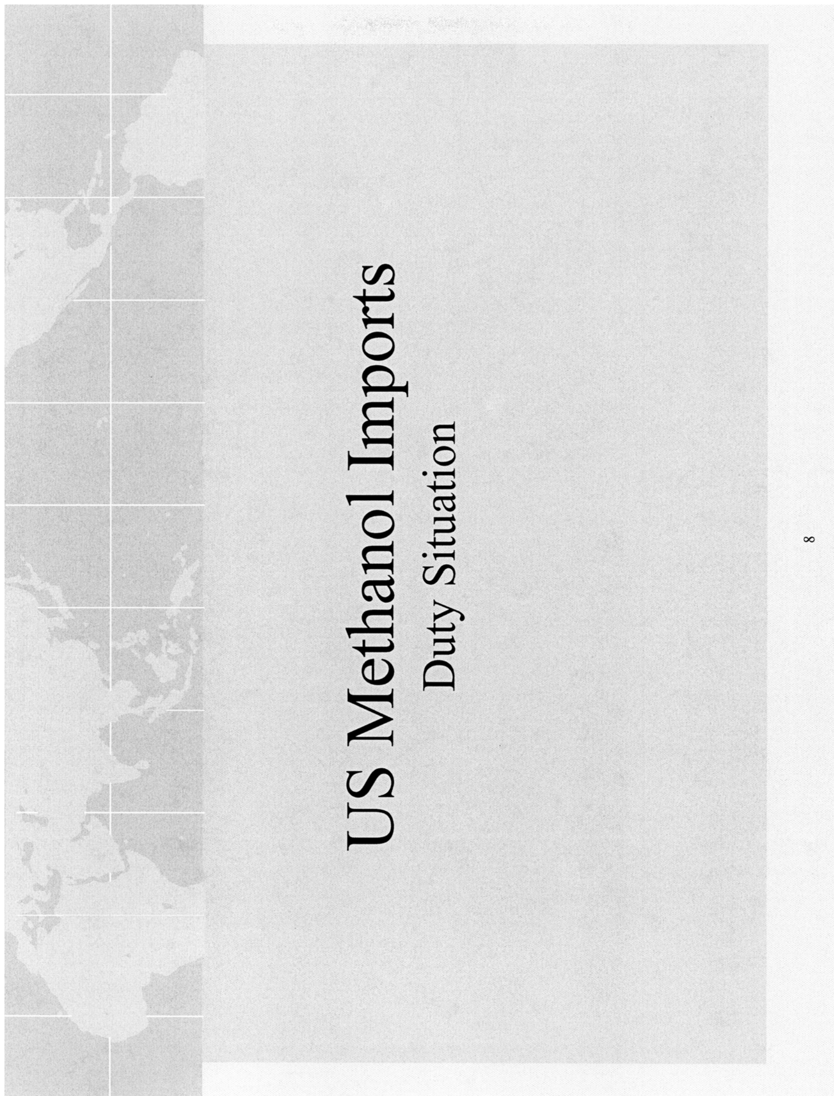
| COUNTRY | QUANTITY (tons) |
|---|---|
| ARGENTINA | 215,742 |
| CHILE | 119,382 |
| EQUATORIAL GUINEA | 20,704 |
| TRINIDAD AND TOBAGO | 4,129,116 |
| VENEZUELA | 1.058,083 |
| OTHERS | 665.576 |
| TOTAL IMPORTS | 6,037,506 |
| TOTAL US PRODUCTION | 840,000 |
| TOTAL DEMAND | 6,877,506 |




- USA Imports 2007

| COUNTRY | QUANTITY (tons) |
|---|---|
| ARGENTINA | 200,070 |
| CHILE | 296,624 |
| EQUATORIAL GUINEA | 495,667 |
| TRINIDAD AND TOBAGO | 3,648,407 |
| VENEZUELA | 824,206 |
| OTHERS | 284,204 |
| TOTAL | 5,749,178 |
| TOTAL US PRODUCTION | 740,000 |
| TOTAL DEMAND | 6,489,178 |




US Methanol Imports
Duty Situation
8

## Methanol

Duty-free Methanol:

•Nearly all methanol imports are duty-free. This preferential tariff treatment comes under three different types of programs and agreements:

- FTAs: Imports from Bahrain, Canada and Chile enter duty-free under free trade agreements, as does a small amount imported from México and Australia.
- CBI: Imports from Trinidad & Tobago enter under the Caribbean Basin Initiative.
- **GSP: Imports from Argentina, Bahrain, Indonesia, Romania, and Russia enter under the Generalized System of Preferences.**

## Generalized System of Preferences (GSP)

- The program is intended to give preferential tariff treatment to developing countries until their exporters are able to compete on world markets with normal, nonpreferential tariffs.

- U.S. Companies and consumers who use products that benefit from duty-free treatment are strong supporters of legislation to reauthorize GSP because it reduces costs of production, costs for companies that import components and parts under the program and lowers the prices that consumers pay.

- Argentina is one of the 13 countries benefited by the Generalized System of Preferences (GSP), which may see its benefits limited, suspended or withdrawn at the end of the current year.

## **GSP – Generalized System of Preferences** (continued)

- The main four products exported in 2005 from Argentina to the U.S. under the GSP were leather (2), **methanol** and beef. They account for 29 % of total exports under the GSP, while fifteen products account for 60% of total exports under the program.

- In the case of an expiration of the GSP program, the tariff for exporting Methanol from Argentina would be 5.5% ad valorem instead of the current 0%.

# Methanol Argentine Exports

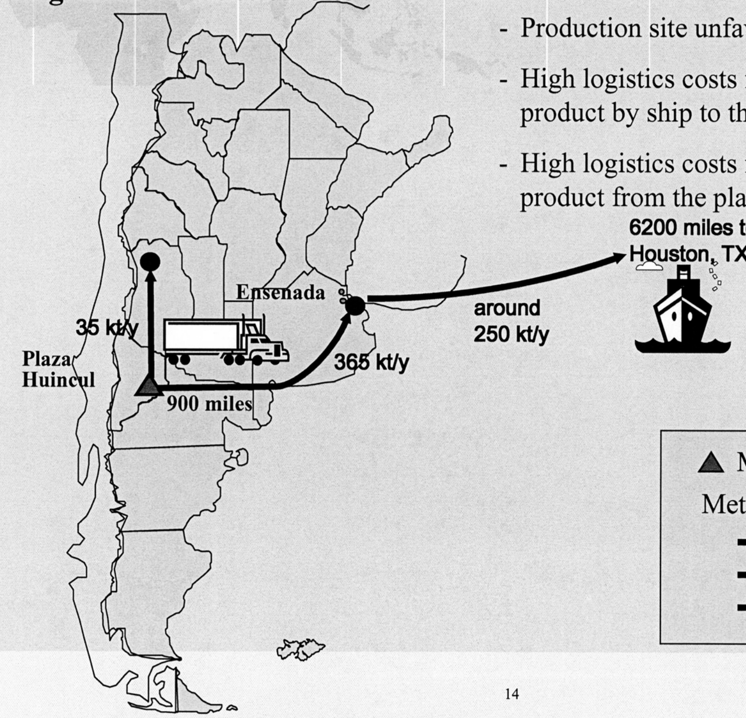
## Current Situation and Competitiveness

## Methanol

<u>Plaza Huincul production site</u>

- Plaza Huincul is a region of 40,000 inhabitants.
- The methanol plant was located in Plaza Huincul as a consequence of a political negotiation made between the government of the province of Neuquen and YPF for developing the regional economy.
- It is located far away from the port and main consumption centers.
- Distance to the export port is 900 miles.
- This plant has a capacity of 400 kt/year, very small compared with the worldscale capacity (1.000/1.500 kt/y).
- It occupies 500 people including indirect jobs.
- Approximately, 70% of its total production is exported to the U.S. market through an off-take agreement signed with the Chilean METHANEX company.

## Argentine Production Site




- Production site unfavorable location.
- High logistics costs for transporting the product by ship to the US Gulf.
- High logistics costs for transporting the product from the plant to the port.

▲ Methanol Plant

Methanol Transport

→ Road
→ Road
→ Sea

# Production Site

- Plaza Huincul / Average rates from 2002/2003 Survey

## Methanol

Plaza Huincul

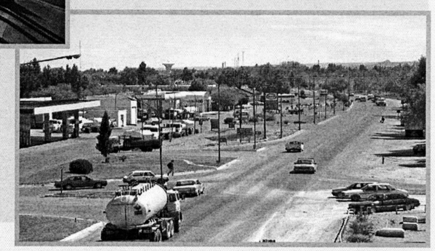
- Rates of activity, employed, under-employed, unemployed:

| Rates | % |
|---|---|
| Activity | 36 |
| Employed | 29 |
| Unemployed or under-employed | Over 30% |

- Rates of employment by education level:

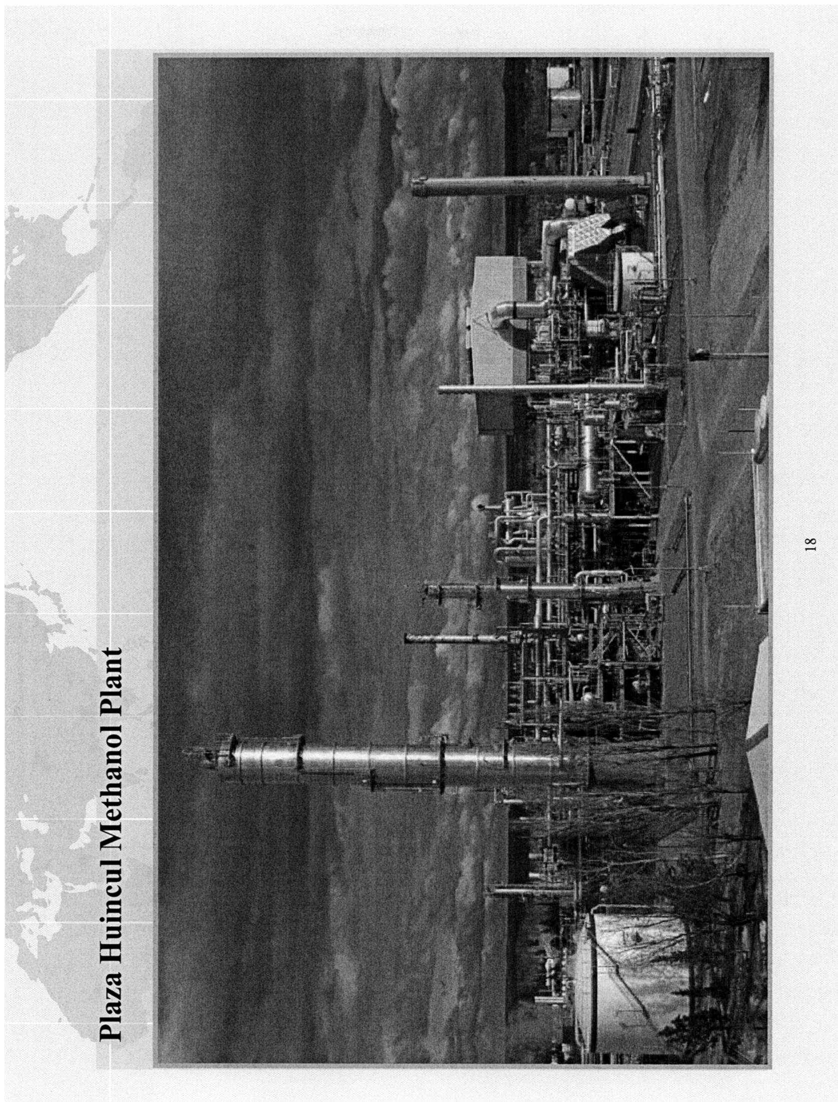
| Education | % |
|---|---|
| Primary School Incomplete | 15.3 |
| Primary School Complete/Secondary Incomplete | 50.2 |
| Secondary Complete/University Incomplete | 21.9 |
| University Complete | 12.6 |

## Plaza Huincul – City/People



Pictures from "diario La Mañana del Sur"


Plaza Huincul Methanol Plant
18

## Conclusion / Summary

- Production site unfavorably located.
- Location as a consequence of a political decision for developing the poor economy of the region.
- Very far away from the export port (900 miles) and US Market.
- High logistics cost to get the market.
- Unfavorable cost structure compared with other US Suppliers.
- **Expiration of the GSP program, would severely affect our competitiveness because we would be competing with product coming from other countries that benefit from a 0% tariff in the US as a result of bilateral agreements: (Australia, Bahrain, Chile), NAFTA (Canada and Mexico) or other agreements of preferences (Trinidad and Tobago under the Caribbean Basin Initiative). Most of them with a high level of development and with best worldscale and logistics location.**
- It could jeopardize the continuity of methanol production, with its negative effects on poverty and unemployment rates in the region.

# GSP Benefits

## GSP Benefits

- The US market is facing a high demand (in 2007, the US imported around 90% of its needs) and short supply of methanol. If methanol imported from Argentina were made subject to a 5.5 percent duty, the inevitable result would be to shut Argentina out of the U.S. market, thus leading to a further reduction in supply and a more dramatic increase in the cost of this product.
- More expensive methanol means more expensive plywood, paint, fuel and other goods that are important to U.S. Consumers.
- U.S. Imports of duty-free methanol from Argentina aid the development of Argentina while providing a quality product at a reasonable price to U.S. Producers and consumers. Removing GSP treatment for this item would not be in the interest of either country.

# GSP Renewal

What have the Argentine national entities argued to the USTR?

## National Entities

CERA - "Argentine Republic Exporters Chamber"

- *"Keeping Argentina within the GSP program, constitutes a 'win-win' situation for the United States".*
- *"The GSP should continue to include Argentina because it is one of the few countries that does not contribute to the U.S. trade deficit. Argentina exports goods and services basically to import goods and services, especially from the U.S.".*
- *"An interruption of the GSP program for Argentina may have significant consequences for U.S companies that use Argentine products".*
- *"Argentina, as a developing country, has structural disadvantages in its competitiveness (weak financial system, lack of technology, insufficient infrastructure, etc.)".*
- *"The main Argentine products included in the program are primary products, produced in the backward regions of the country".*
- ***"Consequently, curtailing the benefits of the GSP program will delay economic recovery and aggravate social exclusion. Although the worst of the 2001-2002 crisis is over now, in the second half of 2005, 33,8 % of Argentina's population was below the poverty line".***

## National Entities

<u>CIQyP - "Petrochemical and Chemical Industry Chamber"</u>

- *"Exports of chemical and petrochemical goods under the GSP Program have increased up to 213 % during the 2001-2005 period, as the result of an important development of users in the US, compared with only 52 % increase of exports of goods not included".*
- *"That growth has certainly helped Argentina overcome the recent crisis. Nevertheless, poverty and unemployment rates still remain relatively high, therefore sustainable continuity of growth rates is still essential. Besides, our country needs to generate foreign currency from its exports, which are necessary to comply in future with the restructuring of its external debt, which was declared in default in 2002".*

Embassy of the Republic of Mauritius

**June 20, 2008**

**Statement for the Record**
**Senate Committee on Finance**
**June 12, 2008 Hearing entitled "Oversight of US Trade Preference Programs"**

The Embassy of the Republic of Mauritius is pleased to submit the following statement for the record of the above-named hearing of the Senate Finance Committee.

The Government of Mauritius strongly supports the African Growth and Opportunity Act (AGOA) and in that context wishes to emphasize the need for a renewal of the Mauritius LDC derogation. Indeed, given the major role of the apparel sector in the economy, renewal of the Mauritius LDC derogation is important for the continued economic development of the country.

**Background**

Since the successful growth of apparel industries in the AGOA LDCs required providing them an extra competitive edge, the original AGOA allowed the African LDCs to use "third-country fabric", i.e. more easily available, less expensive yarns and fabric from any origin. In 2002 it became apparent that Botswana and Namibia, classified like Mauritius as non-LDCs in the original AGOA, were not benefiting from the apparel provisions of AGOA. Congress amended AGOA to reclassify Botswana and Namibia as LDCs to enable them to compete on equal terms with the AGOA-eligible LDCs by giving them access to third-country fabric.

Prior to the enactment of AGOA, Mauritius had been one of the largest African apparel exporters to the United States. Because U.S. apparel imports from Mauritius began to decline sharply in 2004 in anticipation of the expiration of the Multi-Fiber Arrangement (MFA) at the end of that year, Congress included in the 2004 MTB a provision allowing Mauritius to utilize third-country fabric. However, unlike Botswana and Namibia which were given permanent LDC status, the 2004 MTB gave Mauritius LDC status only for 12 months, October 2004-September 2005. Furthermore, the U.S. Customs started implementing the Mauritius LDC provision in March 2005, thus reducing the period to only slightly over six months. This was too short a period for Mauritius to benefit from the LDC status intended to assist the Mauritian apparel industry adjust to increased competition with the end of the MFA.

**The current situation**

Following the expiration of the MFA on January 1, 2005, U.S. apparel imports from Africa have decreased by 25% through year-end 2007, resulting in the closing of dozens of apparel factories and estimated job losses of 100,000. The post-MFA contraction of the African apparel sector has been starkly evident in Mauritius: U.S. apparel imports from Mauritius have declined by 52%; and more than 30 apparel factories have ceased operations, leading to loss of more than 30,000 jobs, which accounts for one-third of the apparel sector jobs Mauritius had before the enactment of AGOA. In 2007, Mauritius exported substantially less apparel to the United States than it did before AGOA was enacted.

With the scheduled expiration of the safeguard quotas on China at the end of 2008, increased concentration of U.S. apparel sourcing will most likely occur. Suppliers which are at a competitive disadvantage, such as Mauritius without access to third-country fabric, will be find it hard to survive.

Mauritius has embarked on a strategy of vertical integration to restore its international competitiveness. A new denim fabric plant has recently started in Mauritius. Other projects to improve the competitiveness of the industry are underway. For these new investments to succeed, the apparel sector must maintain a critical mass. A vertical integration strategy necessitates a healthy downstream apparel industry that can purchase and utilize the output of yarn and fabric made by the upstream. The Mauritius LDC derogation will contribute to the success of the vertical integration strategy by assuring the continued existence and growth of the downstream sector.

As the factory closings and job losses in the Mauritius apparel sector have continued since the expiration of its LDC derogation in 2005 and will in all likelihood increase when the safeguard quotas on China expire at the end of the year, the LDC derogation becomes critical for Mauritius. Renewal of the LDC derogation for Mauritius is a provision of H.R. 5059 pending in the House of Representatives. In the 109th Congress, Chairman Baucus introduced legislation for renewal of the Mauritius LDC provision in S. 3904.

Respectfully submitted,

**Keerteecoomar Ruhee**
**Ambassador**

**Senate Committee on Finance**
**Attn. Editorial and Document Section**
**Room SD-219**
**Dirksen Senate Office Building**
**Washington DC 20510**

# Estimated Impacts of the U.S. Generalized System of Preferences to U.S. Industry and Consumers

November 1, 2006

# Estimated Impacts of the U.S. Generalized System of Preferences on U.S. Industry and Consumers

## Executive Summary

The U.S. Generalized System of Preferences (GSP) program is a trade preference program that extends duty-free treatment to selected goods imported from specified developing countries. Its purpose is to promote economic development in developing countries by expanding their trade with the United States. Congress established GSP in 1974 and legislation authorizing the program has been in effect for the last 32 years. By 2005, U.S. imports under GSP totaled $27 billion.

Over its 30 years of operation, GSP has become an important component of the competitiveness of American manufacturers and an integral part of sourcing for those who sell a range of consumer goods to American families. This study examines the impacts of GSP from the U.S. perspective. It finds:

- GSP keeps American manufacturers and their suppliers competitive. In 2005, three quarters of U.S. imports using GSP were raw materials, parts and components, or machinery and equipment used by U.S. companies to manufacture goods in the United States for domestic consumption or for export. Electrical equipment and parts, and transportation vehicle parts are significant imports under GSP.

- American families also benefit from GSP. Finished consumer goods typically sold by retailers accounted for 25 percent of GSP imports in 2005. Jewelry sold at lower price points was the most significant item.

- GSP is particularly important to U.S. small businesses, many of whom rely on the program's duty savings to compete with much larger companies.

- We estimate that annual sectoral benefits to consumers of GSP products range up to $273 million.

- GSP imports support U.S. jobs. We estimate that direct and indirect jobs associated with moving aggregate GSP imports from the docks to the retail shelves totaled nearly 82,000 in 2005.

# Estimated Impacts of the U.S. Generalized System of Preferences on U.S. Industry and Consumers*

## I. Introduction

The U.S. Generalized System of Preferences (GSP) program is a trade preference program that extends duty-free treatment to selected goods imported from specified developing countries. Its purpose is to promote economic development in developing countries by expanding their trade with the United States. Congress established GSP in 1974 and legislation authorizing the program has been in effect for the last 32 years.[1] By 2005, U.S. imports under GSP totaled $27 billion.

Many have attempted to examine the economic impacts of GSP on beneficiary developing countries.[2] Estimates of the effect of the GSP program on U.S. imports from developing countries range from increases of 11 percent to 64 percent.

Over its 30 years of operation, GSP has become an important component of the competitiveness of American manufacturers and an integral part of sourcing for those who sell a range of consumer goods to American families. While the enormous size of the U.S. economy relative to total U.S. imports under GSP limits the national economic impact of GSP, at the sector-specific level, the impact can be significant. This study updates and expands earlier research that measures that U.S. economic impact of GSP from the perspective of U.S. national welfare, and jobs supported. We focus on U.S. sectors that account for 75 percent of total non-oil U.S. imports under GSP in 2005 (see Table 1). These industries represent a wide range of products, from popular consumer goods

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* This study was prepared for the U.S. Chamber of Commerce by The Trade Partnership and Dr. Kara M. Reynolds, Assistant Professor of Economics, The American University.

1 A detailed description of the U.S. GSP program can be found in The Trade Partnership, "The U.S. Generalized System of Preferences Program: An Update," March 2006, www.tradepartnership.com/pdf_files/2006_GSP_update.pdf, as well as Office of the U.S. Trade Representative, "U.S. Generalized System of Preferences Guidebook," January 2006, www.ustr.gov/assets/Trade_Development/Preference_Programs/GSP/asset_upload_file890_8359.pdf.

2 See, for example, R.E. Baldwin and T. Murray, "MFN Tariff Reductions and Developing Country Trade Benefits Under the GSP," *The Economic Journal* 87: 30-46, 1977; Craig R. MacPhee and Victor I. Ogulego, "The Trade Effects of the U.S. Generalized System of Preferences," *Atlantic Economic Journal* 19: 19-26, 1991.

(e.g., jewelry and televisions) to basic raw materials (e.g., ferroalloys and plastics) used to produce other goods in the United States. In fact, approximately 75 percent of all GSP imports are non-finished goods that U.S. companies and workers use to stay competitive in world markets; the remaining 25 percent are finished consumer goods typically sold by retailers directly to American families.

The analysis illustrates the extent to which GSP products lower costs for consumers, not only of finished products sold by retailers, but also of raw materials used by U.S. manufacturers to produce goods in the United States. Section 2 of this study outlines those benefits. The analysis also indicates that the GSP program supports many thousands of jobs in the United States, particularly in small businesses, one of the primary drivers of employment growth. Section 3 estimates U.S. employment related to total GSP imports. Appendix A describes the methodology used to estimate the economic effects of GSP by sector; Appendix B describes the methodology used to estimate the number of U.S. jobs linked to imports under GSP.

**Table 1**
**Leading U.S. Imports Under GSP by Sector, 2005**
(Millions)

| **Products** | **Customs Value** | **Tariff Savings** | **Share of Non-Oil Imports** |
|---|---|---|---|
| Jewelry and jewelry parts | $3,584.8 | $202.5 | 17.2% |
| Electrical equipment and parts | 2,224.4 | 75.9 | 10.6 |
| Transportation vehicle parts | 1,617.4 | 40.6 | 7.7 |
| Chemicals | 1,351.6 | 60.5 | 6.5 |
| Plastics and plastic products | 1,350.2 | 65.9 | 6.5 |
| Iron and steel materials and products | 1,253.1 | 45.6 | 6.0 |
| Wood and wood products | 921.8 | 47.4 | 4.4 |
| Machinery and parts | 907.2 | 26.3 | 4.3 |
| Aluminum mill products | 791.6 | 26.9 | 3.8 |
| Copper and copper products | 653.6 | 15.5 | 3.1 |
| Rubber and rubber products | 619.5 | 21.3 | 3.0 |
| Stone and plaster products | 487.6 | 19.1 | 2.3 |
| **TOTAL, Top 75% of GSP Imports** | **$15,762.6** | **$647.5** | **75.4%** |
| **TOTAL, All GSP Imports** | **$26,747.1** | **$923.3** | **100.0%** |

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

## II. Effects of GSP: U.S. Sectoral Perspective

Twelve sectoral categories accounted for 75 percent of non-oil GSP imports in 2005. Among those categories, jewelry is the only product primarily sold direct to American consumers, although consumer goods fall within several other categories as well (e.g., televisions under electrical equipment, picture frames under wood products). The other 11 categories primarily represent raw materials, components or other goods (like machinery) used by American manufactures in U.S.-based production.

### A. Jewelry and Jewelry Parts

Jewelry and parts were the most significant (in terms of total value) single product category that benefited from GSP duty-free treatment. Imports of these products reached more than $3.5 billion in 2005 (see Table 2). Most ($3.4 billion, or 96 percent) of the goods imported in this sector were precious metal jewelry items, notably diamond rings from India largely sold at relatively low retail prices ($50 to $300). Extension of GSP to this product in 2001 made it possible to supply consumers who find this range of price points attractive – consumers who previously could not afford diamond engagement rings because of their cost. GSP benefits are also important for purchases of costume and imitation jewelry, the second-largest category of jewelry products imported under GSP. U.S. jewelry retailers and those who supply them rely on India for low-cost diamond jewelry (50 percent of total U.S. GSP jewelry imports), Thailand for colored stone jewelry (23 percent), and Turkey for gold jewelry (11 percent).

Tariff savings afforded by GSP are significant for these products. We estimate that GSP benefits for jewelry saved consumers a total of $273 million in 2005. This estimate reflects not only passed-through tariff savings, but also other positive benefits to the U.S. economy specifically linked to GSP benefits for jewelry (e.g., U.S. producer benefits and overall efficiency gains).[3] The average trade-weighted tariff saved by GSP for this group of imports was 6.5 percent, although the tariff rates for some individual products are much higher (e.g., 13.5 percent for silver necklaces, 10.5 percent for certain pearls or semi-precious stones).

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[3] For detailed information the methodology for determining overall economic gains for specific sectors, please see Appendix A.

*Small Business Profile:*

**Mary Haltom Jewelers**
Ft. Worth, TX

As an independently owned jewelry store with five employees, Mary Haltom Jewelers must constantly compete with larger discount jewelry chains. Without the luxury of large-scale purchasing operations, small jewelers find GSP to be of critical importance to their profitability, since it allows them to save duties of nearly 6 percent on imports from India, Thailand, and Turkey.

At a time when jewelers face an increase in gold, silver, and diamond prices—and consumers face budget squeezes of their own—businesses like Mary Haltom Jewelers worry that further cost increases, such as re-imposed tariffs on jewelry, could lead to a significant slowdown in customer purchases.

**Table 2**
**U.S. Imports of Jewelry and Other Parts Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Precious metal jewelry and parts | $3,432.5 | $189.4 | India, Thailand, Turkey |
| Imitation Jewelry | 102.8 | 11.1 | India, Thailand, Philippines |
| Pearl, semiprecious stone jewelry | 41.3 | 1.7 | India, Thailand, Philippines |
| Articles of precious metals | 8.2 | 0.3 | India, Indonesia, Brazil |
| TOTAL | $3,584.8 | $202.5 | |

* This table covers Harmonized Tariff System (HTS) Nos. 7113, 7114, 7115, 7116, and 7117.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

### B. Electrical Equipment and Parts

Electrical equipment and parts is the second most important category of total GSP imports in terms of value. Imports of these products totaled $2.2 billion in 2005 (see Table 3). GSP benefits consumers of both household electrical products as well as U.S. manufacturers who use industrial electrical equipment and parts in their U.S. manufacturing operations. For consumer products, the most important products benefiting from GSP were televisions, which were valued at $184 million and represented 29 percent of consumer electronics imported under GSP, and lamps, with imports valued at $151 million in 2005. For non-consumer electrical equipment and parts, insulated wire and cable was the largest import under GSP, with nearly $450 million in imports in 2005. The largest suppliers of electrical equipment and parts to the United States under GSP are Thailand (25 percent), the Philippines (21 percent), Brazil (18 percent), and India (14 percent).

GSP duty savings matter to importers and consumers of electrical equipment and parts. We estimate that imports of electrical equipment and parts under GSP saved U.S. households $26 million in 2005 and manufacturers an additional $50 million, including tariff savings and benefits resulting from the tariff savings. Although the average trade-weighted tariff saved by GSP for this group of imports is a relatively low 3.5 percent, the tariff rates for some individual products are much higher (e.g., 12.5 percent for certain flashlights, 5.3 percent for insulated cables). Forgone duties on select consumer products include more than $9 million on TVs and $8.5 million on lamps, while foregone duties on insulated wire and cable exceeded $17 million.

**Table 3**
**U.S. Imports of Electrical Equipment and Parts Under GSP, 2005**
(Millions)

| **Products*** | **Value** | **Tariff Savings** | **Top GSP Sources** |
|---|---|---|---|
| Other electronics and parts | $1,589.6 | $49.1 | Philippines, Brazil, Thailand, India |
| Consumer electronics and parts | 634.8 | 26.8 | Thailand, Indonesia, India |
| TOTAL | $2,224.4 | $75.9 | |

* Consumer electronic and parts: Harmonized Tariff System (HTS) Nos. 8510, 8513, 8516, 8518, 8519, 8522, 8524-8529, 9006-9008, 9405; other electronics and parts: 8501-8506, 8509, 8511, 8514, 8515, 8531, 8535-8539, 8543, 8544, 8546, 8547.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

## C. Transportation Vehicle Parts

The third most significant category of imports under GSP in 2005 was transportation vehicle parts. These products, with a total value of $1.6 billion in 2005 (see Table 4), are vital components for Tier 1 automotive companies, their suppliers, and the auto parts aftermarket. The largest category of goods were parts and accessories that fall under HTS codes 8708, which represented 80 percent of U.S. imports under GSP in this category and were valued at $1.3 billion. GSP has become an important tool that U.S. parts manufacturers have used to alleviate the "cost-price squeeze" they face from their customers, U.S.

car manufacturers. Parts suppliers have been unable to pass on rising costs for steel and energy by raising parts prices, and instead have turned to duty-savings from GSP on imported parts to cut costs.

Parts suppliers must spend time and money to qualify their sub-suppliers in GSP-eligible countries. Today, strong relationships have been developed and integrated into the sourcing and production operations of U.S. producers with parts producers in Brazil (42 percent of total transportation parts imports under GSP in 2005), India (18 percent), and Venezuela (9 percent). Relationships with these suppliers through GSP has helped to keep U.S. producers based in the United States more competitive with alternative transportation parts suppliers in other countries, most notably China.

This enhanced competitiveness arises from significant duty savings afforded by GSP. We estimate that transportation vehicle parts imports under GSP saved U.S. purchasers (largely motor vehicle manufacturers) approximately $45 million in 2005, including tariff savings and benefits resulting from the tariff savings. While the average trade-weighted tariff saved by GSP for this group of imports was 2.6 percent, the tariff rates for some individual products are much higher (e.g., 10 percent for certain motorcycle parts).

*Small Business Profile:*
**S&V Industries Inc.**
Akron, OH

S&V Industries markets and distributes engineering and polymeric products for original equipment manufacturers (OEMs) in the U.S. transportation industry. Despite its small size—only 20 employees—S&V provides more than 50 North American OEMs with low-cost, just-in-time products, including castings, forgings, and rubber belts and seals.

S&V imports these products from India under GSP and saves duties of nearly $100,000 every year. Despite the hardships faced by the U.S. automotive industry in the recent past, the advantages provided by GSP have helped S&V to grow from just 4 to 20 employees over the last several years.

**Table 4**
**U.S. Imports of Transportation Vehicle Parts Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Other parts and accessories | $1,304.1 | $32.6 | Brazil, India, Venezuela |
| Engine parts | 251.4 | 6.3 | Brazil, India, South Africa |
| Electrical motor vehicle parts | 61.9 | 1.7 | Philippines, Brazil, Indonesia |
| TOTAL | $1,617.4 | $40.6 | |

* This table covers Harmonized Tariff System (HTS) Nos. 8407-8409, 8507, 8512, 8707, 8708, 8714.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

D. Chemicals

Chemical product manufacturers are significant users of the GSP program. Chemicals imported under GSP totaled $1.3 billion in 2005 (see Table 5). These products are used to make a variety of products, such as herbicides and pesticides. Of the organic chemicals, the largest category of goods was acyclic alcohols, which were valued at $539 million, and ether alcohols, with imports totaling $119 million. Among the inorganic chemicals, carbides was the largest category of goods imported under GSP with a value of nearly $75 million. The largest suppliers of chemical imports to the United States under GSP are Venezuela (27 percent), South Africa (17 percent), and Brazil (12 percent).

Duty-savings afforded by GSP contribute positively to costs savings for those who use the imported chemicals as raw materials. We estimate that organic chemical imports under GSP saved U.S. manufacturers $59 million in 2005, while inorganic chemicals saved an additional $13 million, including tariff savings and benefits resulting from the tariff savings. The average trade-weighted tariff saved by GSP for this group of imports was 4.8 percent, one of the highest of the major groups. Select foregone duties on organic chemicals imports included $23 million for acyclic alcohols and $6.5 million for ether alcohols; foregone duties for inorganic chemicals included $3 million for imports of hydrogen and other rare gases.

*Small Business Profile:*
**Albaugh, Inc.**
Ankeny, IA

Albaugh, Inc. manufactures herbicides for use by U.S. farmers, employing 75 people. GSP enables this small business to compete with larger chemical makers. Albaugh imports raw materials, some of which are not made in the United States, duty free from Argentina. It then produces end products in U.S. plants, supporting jobs in seven states.

GSP has enabled Albaugh to build up a long-term relationship with its Argentine supplier that has kept the company competitive in the U.S. market and a reliable supplier of herbicides to American farmers. The Argentine supplier of raw materials to Albaugh has undergone a lengthy certification process to meet U.S. Environmental Protection Agency standards and then to receive approval to export to the United States. Thanks to GSP, Albaugh has grown not only in volume of sales but also in number of employees.

**Table 5**
**U.S. Imports of Chemicals Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Organic chemicals | $991.6 | $47.0 | Venezuela, Equat. Guinea, Brazil |
| Inorganic chemicals | 360.0 | 13.5 | South Africa, Russia, Brazil |
| TOTAL | $1,351.6 | $60.5 | |

* Organic chemicals: Harmonized Tariff System (HTS) Nos. 2903-2910, 2912, 2914-2935, 2938, 2940, 2942; inorganic chemicals: 2801, 2804, 2805, 2810-2813, 2816, 2818-2827, 2829, 2830, 2832-2836, 2839-2843, 2846, 2849-2851.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

E. Plastics and Plastic Products

Plastics and plastic products—both consumer items and materials used by U.S. manufacturers—are important GSP products, with 2005 imports totaling more than $1.3 billion. These products are sold directly to consumers as well as used in a variety of industries, such as construction, shipping and manufacturing.

The largest category of goods imported under GSP in this sector was primary plastics, which represented 38.5 percent of U.S. plastics imports under GSP and was valued at approximately $520 million. Packaging materials are also significant. The primary suppliers of plastic and plastic products to the United States under GSP are Thailand (36 percent), India (16 percent), and Indonesia (15 percent).

U.S. duties on some plastic products are high, and GSP savings help to keep American producers competitive and to lower the costs for American households. We estimate that plastic products and parts imported under GSP saved U.S. consumers $61 million in 2005, including tariff savings and benefits resulting from the tariff savings. While the average trade-weighted tariff saved by GSP for this group of imports is 4.7 percent, the tariff rates for some individual products are notably higher (e.g., 6.5 percent for plastic tableware and certain primary plastics).

**Table 6**
**U.S. Imports of Plastics Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Primary plastics | $519.7 | $31.3 | Thailand, India, Brazil |
| Packing materials | 304.2 | 9.8 | Thailand, Sri Lanka, Indonesia |
| Other constructions materials | 298.2 | 14.4 | India, Brazil, Indonesia |
| Other plastics | 134.5 | 6.8 | Thailand, Domin. Republic, India |
| Consumer products | 66.4 | 2.5 | Thailand, India, Venezuela |
| Sheets, tubes, pipes | 27.0 | 1.1 | India, Brazil, Bulgaria |
| TOTAL | $1,350.2 | $65.9 | |

* This table covers Harmonized Tariff System (HTS) Nos. 3901-3914, 3916-3926.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

Constar International, Inc.
(Philadelphia, PA)

Constar is one of the largest manufacturers of soda and water bottles in the United States, with 14 production locations employing a total of about 1,800 people. Constar imports a raw material for these bottles, bottle-grade PET resin, from India, Indonesia and Thailand. GSP saves the manufacturer – and its customers – a 6.5 percent duty. This cost savings is very important in the highly price-competitive food products business.

F. Iron and Steel Materials and Products

Iron and steel producers benefit from GSP.[4] More than $1.2 billion of iron and steel raw materials and products were imported duty-free under GSP in 2005 (see Table 7). Raw materials—ferroalloys in particular—were the largest category of goods imported in this sector and represented more than half of total iron and steel imports under GSP with a value of $668 million. More than 36 percent of all U.S. ferroalloy imports in 2005 came in under the GSP program. The largest suppliers of iron and steel imports to the United States under GSP are India (21 percent), South Africa (18 percent), and Brazil (14 percent).

Duty-savings under GSP lower raw material costs for U.S. manufacturers. We estimate that GSP saved purchases of iron and steel raw materials imported under GSP nearly $27 million in 2005, and manufacturers purchasing iron and steel products another $29 million, including tariff savings and benefits resulting from the tariff savings. While the average trade-weighted tariff saved by GSP for this group of imports is 4.1 percent, the tariff levels for some individual products are much higher (e.g., 12.5 percent for certain screws, 8.2 percent for certain kitchenwares).

**Table 7**
**U.S. Imports of Iron and Steel Under GSP, 2005**
(Millions)

| **Products*** | **Value** | **Tariff Savings** | **Top GSP Sources** |
|---|---|---|---|
| Ferroalloys | $668.8 | $23.9 | South Africa, Kazakhstan, Russia |
| Other products of iron or steel | 190.2 | 5.8 | Brazil, India, |

[4] It is important to note that the GSP statute specifically precludes from eligibility for benefits "import-sensitive steel articles." See 19U.S.2463(b)(1)(D).

| | | | |
|---|---|---|---|
| | | | Thailand |
| Consumer products | 182.6 | 5.2 | India, Thailand, Indonesia |
| Tubes or pipe fittings | 128.0 | 6.7 | India, Philippines, Thailand |
| Screws, bolts, and springs | 83.5 | 4.0 | India, Thailand, Brazil |
| TOTAL | $1,253.1 | $45.6 | |

* This table covers Harmonized Tariff System (HTS) Nos. 7202, 7307, 7315, 7318-7321, 7323-7326.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

*Small Business Profile:*
**Con-Tech International**
New Orleans, LA

Con-Tech International, with 12 employees based out of New Orleans, imports and distributes cold roll steel circles and other component parts used in the manufacture of 55 gallon barrels. GSP allows Con-Tech to import drum closures from India and stamped steel discs from Brazil, and save duties of 2.6 percent and 2.9 percent, respectively.

Con-Tech estimates that about 90 percent of total sales, or $40 million annually, are made up of products imported under GSP. In an industry that operates on very small margins, GSP savings help both Con-Tech and its customers—the U.S. steel drum manufacturing industry—stay competitive in the global market.

## G. Wood and Wood Products

Wood and wood products imported under GSP are important supplies to the U.S. construction sector, in particular. In 2005, these imports reached more than $900 million (see Table 8). GSP products are used primarily for homebuilding and other construction projects. The largest category of goods imported under GSP was wood for construction (e.g., particleboard, plywood, veneer), which represented nearly a third of wood imports under GSP and was valued at $306 million. Imports of other construction materials were also significant, valued at $300 million. The largest suppliers of wood and wood products to the United States under GSP are Brazil (49 percent), Indonesia (21 percent), and Thailand (13 percent).

*Small Business Profile:*
**Liberty Woods International, Inc.**
Carlsbad, CA

Even though it employs only 30 people at its Carlsbad headquarters, thanks to GSP Liberty Woods is one of the largest importers of hardwood lumber into North America, serving customers throughout the United States, Canada, and Mexico. Liberty Woods imports lumber duty free from Indonesia and Brazil under GSP, saving the company more than $2 million annually. GSP has helped Liberty Woods remain competitive and expand its operations.

For a price-sensitive market like lumber, GSP savings not only affect the price of wood purchased from GSP beneficiaries, but it also provide an incentive for exporters in non-GSP countries (e.g., those in Malaysia and China) to keep prices competitive.

We estimate that wood and wood products imports under GSP saved U.S. purchasers $57 million in 2005, including tariff savings and benefits resulting from the tariff savings. The average trade-weighted tariff saved by GSP for this group of imports is 5.3 percent, although the tariff rates for some individual products are much higher (e.g., 8 percent for certain plywood, 10.7 percent for shipping pallets). Foregone duties on plywood alone were more than $24 million.

**Table 8**
**U.S. Imports of Wood and Wood Products Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Particle board, fiberboard, plywood, veneer | $306.5 | $24.0 | Brazil, Indonesia, Ecuador |
| Other construction materials | 300.4 | 11.4 | Brazil, Indonesia, South Africa |
| Consumer products | 201.2 | 7.3 | Thailand, Indonesia, India |
| Other products | 81.1 | 3.6 | Brazil, Indonesia, Thailand |
| Continuously-shaped wood | 32.6 | 1.1 | Brazil, Paraguay, Indonesia |
| TOTAL | $921.8 | $47.4 | |

* This table covers Harmonized Tariff System (HTS) Nos. 4409-4421.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

H. Machinery and Parts

Manufacturers and services providers benefit from machinery and parts products imported under GSP. In 2005, those imports exceeded $900 (see Table 9). These products are used in a variety of industries, such as heating and cooling systems manufacturing, textiles and apparel production, and basic service industries (e.g., office equipment). The largest category of goods was machinery parts, which were valued at $450 million and represented approximately half of all machinery imports under GSP. The largest suppliers of machinery and parts to the United States under GSP are Brazil (32 percent), India (22 percent), and Thailand (19 percent).

Tariff savings afforded by GSP matter. We estimate that machinery and parts imported under GSP saved U.S. purchasers $28 million in 2005, including tariff savings and benefits resulting from the tariff savings. While the average trade-weighted tariff saved by GSP for this group of imports is 3.3 percent, the tariff level for some individual products are higher (e.g., 6.7 percent for rotors).

**Table 9**
**U.S. Imports of Machinery and Parts Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Other various parts for machines | $449.9 | 13.6 | Brazil, India, Thailand |
| Pumps, heating and cooling equipment and parts | 173.5 | 3.8 | Thailand, Indonesia, Brazil |
| Other various machines | 134.6 | 3.7 | Thailand, Brazil, India |
| Machine tools and parts | 108.6 | 4.5 | Brazil, Thailand, India |
| Computer and other office equipment and parts | 22.8 | 0.5 | Brazil, Indonesia, Afghanistan |
| Textile and footwear machines and parts | 17.8 | 0.3 | Brazil, Thailand, India |
| TOTAL | $907.2 | $26.3 | |

* This table covers Harmonized Tariff System (HTS) Nos. 8401, 8402, 8406, 8410, 8411, 8413-8415, 8417-8424, 8438, 8442, 8443, 8445, 8448, 8450-8452, 8455-8468, 8472, 8473, 8477, 8479-8485.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

I. Aluminum Mill Products

American manufacturing and construction firms benefit from aluminum mill products imported under GSP. These imports totaled $800 million in 2005 (see Table 10). The largest category of goods was aluminum plates, sheets, and strip, which represented nearly 80 percent of U.S. aluminum imports under GSP with a valued of $629 million. The primary suppliers of aluminum mill products to the United States under GSP are Russia (25 percent), South Africa (19 percent), and Brazil (14 percent).

Duty savings afforded by GSP lower costs for American manufacturers and construction firms. We estimate that aluminum mills products imports duty-free thanks to GSP saved U.S. purchasers $35 million in 2005, including tariff savings and benefits resulting from the tariff savings. While the average trade-weighted tariff saved by GSP for this group of imports is 3.6 percent, the tariff rates for some individual products are much higher (e.g., 6.5 percent for certain aluminum plates).

**Table 10**
**U.S. Imports of Aluminum Mill Products Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Plates, sheets, and strip | $629.3 | $20.4 | Russia, South Africa, Brazil |
| Foils | 51.4 | 2.3 | Russia, Brazil, Indonesia |
| Bars, rods, and profiles | 39.6 | 1.1 | Brazil, Russia, Argentina |
| Wire | 34.5 | 1.0 | Argentina, Russia, Brazil |
| Tubes, pipes, and fittings | 33.3 | 1.9 | India, Brazil, Russia |
| Powders and flakes | 3.5 | 0.2 | Bahrain, Brazil, India |
| TOTAL | $791.6 | $26.9 | |

* This table covers Harmonized Tariff System (HTS) Nos. 7603-7609, Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

**Alcoa, Inc.**
(New York, NY)

GSP keeps Alcoa, the world's leading producer and manager of primary aluminum, fabricated aluminum and alumina, competitive in the U.S. market. Aluminum markets are highly price-sensitive global markets. Alcoa uses GSP to import from Brazil, Russia and Venezuela a number of raw materials and aluminum products it would not have the capacity to make in the United States. GSP enables Alcoa to deliver the broad range of competitively-priced aluminum products that its U.S. customers expect it to offer.

The duty savings afforded by GSP are important: this is a business where a cost increase of pennies per pound is a threat to continued operations and profitability. Alcoa's customers in the aerospace, automotive, packaging and construction industries thus benefit from Alcoa's GSP imports and its ability to deliver them at competitive prices.

J. Copper and Copper Products

Copper and copper products—important to both manufacturers and consumers—also benefits from GSP. Copper and copper products imports under GSP totaled more than $650 million in 2005 (see Table 11). Imports include manufacturing inputs (e.g., copper wire and refined copper and alloys) and consumer goods (e.g., kitchen wares). Wire represented approximately 60 percent of U.S. copper imports under GSP and was valued at $407 million. The primary suppliers of copper products to the United States under GSP are Brazil (39 percent), Russia (32 percent), and Turkey (10 percent).

We estimate that copper products imports under GSP saved U.S. purchasers $13 million in 2005, including tariff savings and benefits resulting from the tariff savings. These savings come despite low tariff rates, as the average trade-weighted tariff saved by GSP for this group of imports is only 1.7 percent.

*Small Business Profile:*
**Piremag Corporation**
Middletown, NJ

The Piremag Corporation is one of only four companies selling copper magnet wire in the U.S. market. To provide its customers -- mostly small- to medium-sized U.S. manufacturers – with a high-quality product at a competitive price, Piremag imports its wire duty-free from Brazil under GSP, saving its customers the 3.5 percent duty cost.

Like many other American companies, Piremag is facing rising costs associated with increasing commodity prices. As a result of falling supplies and increased demand from China and India, copper has more than quadrupled in price over the past four years. While companies like Piremag could remain competitive previously with a 3.5 percent tariff, higher raw material costs would in effect also quadruple the impact of the tariff, so the GSP savings are more important than ever.

In short, the duty savings keep Piremag competitive and its doors open for business. Winners include not only its employees in New Jersey and Fort Wayne, Indiana, but its hundreds of customers that have come to depend on Piremag to fill a niche in the magnet wire market for small- and medium-sized companies.

**Table 11**
**U.S. Imports of Copper and Copper Products Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Wire | $407.6 | $12.0 | Russia, Brazil, Turkey |
| Refined copper and alloys | 133.8 | 0.5 | Brazil, Kazakhstan, Uruguay |
| Consumer goods | 50.6 | 1.5 | Thailand, Turkey, Indonesia |
| Tubes, pipes, and fittings | 34.9 | 0.9 | Thailand, India, Serbia/Monten. |
| Bars, rods, and profiles | 14.6 | 0.3 | South Africa, Brazil, Turkey |
| Other copper products | 12.1 | 0.2 | India, Brazil, Serbia/Monten. |
| TOTAL | $653.6 | $15.5 | |

* This table covers Harmonized Tariff System (HTS) Nos. 7403, 7407-7419.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

K. Rubber Products

Both consumers and manufacturers benefit from the savings on rubber and rubber products imported under GSP. Rubber and rubber products imports under GSP in 2005 totaled nearly $620 million (see Table 12). The largest category of goods was tires, which represented more than half of U.S. rubber imports under GSP and was valued at $334 million. The primary suppliers of rubber products to the United States under GSP are Thailand (36 percent), Indonesia (15 percent), and India (11 percent).

AS noted, duty savings under GSP are particularly important to motor vehicle producers and their customers. Many rubber products imported through GSP are used by motor vehicle producers. We estimate that rubber products imported under GSP saved U.S. purchasers $25 million in 2005, including tariff savings and benefits resulting from the tariff savings. While the average trade-weighted tariff saved by GSP for this group of imports is 3.6 percent, the tariff rate for some individual products are much higher (e.g., 8 percent for certain conveyor belts).

**Table 12**
**U.S. Imports of Rubber and Rubber Products Under GSP, 2005**
(Millions)

| Products* | Value | Tariff Savings | Top GSP Sources |
|---|---|---|---|
| Tires | $334.3 | $13.5 | Thailand, Sri Lanka, Indonesia |
| Apparel and accessories | 96.8 | 3.1 | Thailand, Sri Lanka, Indonesia |
| Tubes, pipes, and hoses | 65.4 | 1.6 | Thailand, Brazil, Turkey |
| Other rubber products | 113.0 | 3.0 | India, Thailand, Brazil |
| TOTAL | $619.5 | $21.3 | |

* This table covers Harmonized Tariff System (HTS) Nos. 4006, 4008-4017.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

L. Stone and Plaster Products

Stone and plaster products—used primarily for construction—are important GSP items. They accounted for more than $488 million of imports under GSP in 2005 (see Table 13). The largest category of goods was worked monumental or building stone (e.g., mosaic stones), which represented more than 95 percent of U.S. imports under GSP and was valued at $470 million. Key suppliers of stone and plaster products to the United States under GSP are India (38 percent), Brazil (24 percent), and Turkey (21 percent).

We estimate that stone and plaster products imports under GSP saved U.S. purchasers $22 million in 2005, including tariff savings and benefits resulting from the tariff savings. The average trade-weighted tariff saved by GSP for this group of imports is 3.9 percent, but the tariff rate for some individual products are much higher (e.g., 9 percent for certain cements).

**Table 13**
**U.S. Imports of Stone and Plaster Products Under GSP, 2005**
(Millions)

| **Products*** | **Value** | **Tariff Savings** | **Top GSP Sources** |
|---|---|---|---|
| Worked monumental or building stone | $471.5 | $18.6 | India, Brazil, Turkey |
| Other stone products | 16.1 | 0.5 | India, Brazil, Turkey |
| TOTAL | $487.6 | $19.1 | |

* This table covers Harmonized Tariff System (HTS) Nos. 6801-6807, 6809, 6810, 6814.

Source: The Trade Partnership from official statistics of the U.S. Department of Commerce

*Small Business Profile:*

**Stone International, Inc.**
East Greenwich, RI

Stone International ("Stonetrade") works with owners, architects, and contractors to identify and supply the best stone for construction projects. GSP allows Stonetrade to source competitively from India and Brazil, despite the fact that Chinese companies can often supply the stone for less money. Last year, GSP saved Stonetrade duties ranging from 4.5 to 6.5 percent on more than a million dollars worth of imports of high quality stone, such as soapstone.

GSP savings are very significant for companies like Stonetrade, which—despite having only four employees—has successfully supplied materials for large-scale projects as far away as the U.S. Embassy in Venezuela and the Heiwa Golf Club in Heiwa, Japan.

## III. The Job Impact of GSP

GSP imports support U.S. jobs. These include jobs related to unloading the products at U.S. ports of entry, transporting them to their first purchasers (manufacturers, wholesalers or retailers), and then ultimately getting them to their final purchaser (manufacturers or American consumers). Also linked to these imports are jobs related to designing, ordering, marketing, and servicing the imports. In addition, jobs related to GSP imports include farm, manufacturing, wholesaling and retailing jobs linked to the need to manufacture cash registers, trucks, warehouses, and a range of other goods and services – the so-called "up and downstream" impacts that economists include when examining U.S. national economic output.

For this study, we examined these "up and downstream" impacts of GSP (described in detail in Appendix B) to estimate the number of U.S. jobs linked to transporting and selling imports that benefited from GSP in 2005. The results are impressive: the $28 billion imported under GSP in 2005 supported nearly 82,000 jobs (see Table 14).

This estimate, however, understates the true number of jobs positively impacted by GSP. It does not reflect all of the manufacturing jobs maintained in the United States because U.S. companies are able to incorporate lower-cost inputs procured with duty-savings under GSP to produce greater quantities of competitively priced end products. The manufacturing jobs identified in Table 14 are only those manufacturing jobs supported by the process of transporting and selling, from wholesalers to retailers to final consumers, GSP imports.

**Table 14**
**Estimated Number of U.S. Jobs Associated with Imports under GSP, 20**

| | |
|---|---|
| Manufacturing | 3,983 |
| Wholesaling | 31,703 |
| Retailing | 21,489 |
| Services (including transportation) | 21,223 |
| Other (agriculture, mining, etc.) | 3,416 |
| TOTAL | 81,814 |

Source: Estimated by The Trade Partnership

## IV. Conclusion

GSP is an important tool to encourage economic development in poor countries. But it is also an important contributor to American competitiveness. The duty-savings it affords U.S. manufacturers lowers the costs of inputs used to make goods in the United States. The duty-savings on finished consumer goods benefit household who purchase goods ranging from pots and pans to moderately-priced engagement rings.

Policy makers typically view GSP through the lens of its impacts on beneficiary countries. This study demonstrates that they should also consider with equal weight its benefits to the American economy.

## Appendix A

### Methodology for Estimating the Sectoral Economic Effects of GSP

The Trade Partnership used the "Global Simulation Model" (GSIM) to estimate the impact of the Generalized System of Preferences (GSP) on U.S. consumers and producers. The model was developed by Joseph Francois and H. Keith Hall to analyze global, regional, and unilateral trade policy changes at the industry level.

GSIM is a static, multi-region, partial-equilibrium model that assumes that imports from different regions of the world are imperfect substitutes for one another. There is a single world price for each region's goods, but domestic prices for these regional goods will differ due to the level of trade protection. We calculated the impact of the GSP program on the U.S. economy by simulating the effect of an increase in the U.S. tariff rate on current GSP-imports from zero to the average prevailing MFN tariff rate in the industry. The new equilibrium is defined by a world price for products from each region of the world that ensures that total import demand is equal to the export supply of the product.

Like other partial equilibrium models, GSIM does not take into account inter-sectoral linkages. In other words, the impact on each industry is calculated holding trade and prices in all other sectors of the economy constant. As a result, the model may either overestimate or underestimate the impact of the GSP program were the sectoral results to be added together. **The estimates provided for individual industries therefore should not be aggregated to calculate a total for the U.S. economy as a whole.**

The model estimates the impact of trade policy changes using data on current trade flows between regions, tariff rates, and elasticities of import demand, export supply and substitution. For the purposes of this analysis, we defined regions using three categories of U.S. imports: imports under the GSP program, other imports from GSP-eligible countries, and imports from those countries that are not eligible for the GSP program. Trade data are taken from the U.S. Census Bureau and United Nation's Commodity Trade Statistics Database. Elasticities and tariff levels are estimated using the sources listed below.

An interesting finding of the modeling is that GSP benefits have in most cases a positive impact on U.S. manufacturers of competing products. Tariff elimination causes U.S. import demand for GSP goods to increase, which in turn causes the world price for GSP goods to rise (but not by as much as the tariff rate). The higher world prices result in a decrease in the quantity demand for these GSP goods in other countries, which in turn causes demand for goods from other countries (including the United States) to increase.

**Estimated Sectoral Impact of GSP, 2005**
(Millions)

| | Passed-Through Tariff Savings | Producer Loss/ Benefit | Dead-Weight Loss | Total |
|---|---|---|---|---|
| Jewelry | $213.2 | -$2.3 | $62.2 | $273.1 |
| Electrical equipment and parts | | | | |
| Consumer | 24.7 | +0.5 | 0.4 | 25.6 |
| Other | 42.5 | +1.0 | 6.0 | 49.5 |
| Plastics and plastic products | 56.0 | -1.4 | 6.7 | 61.3 |
| Chemicals | | | | |
| Organic | 47.7 | +0.7 | 11.0 | 59.4 |
| Inorganic | 12.6 | -0.2 | 0.8 | 13.2 |
| Iron and steel | | | | |
| Raw materials | 22.2 | +0.1 | 4.4 | 26.7 |
| Iron and steel products | 22.7 | +0.7 | 5.8 | 29.2 |
| Wood and wood products | 43.2 | +0.4 | 13.4 | 57.0 |
| Transportation vehicle parts | 39.6 | +1.7 | 3.6 | 44.9 |
| Machinery parts | 27.5 | +0.8 | 0.0 | 28.3 |
| Aluminum mill products | 26.2 | +0.8 | 8.0 | 35.0 |
| Rubber products | 20.5 | 0.4 | 3.6 | 24.5 |
| Stone/plaster products | 16.4 | +0.3 | 5.6 | 22.3 |
| Copper products | 10.5 | +0.1 | 2.8 | 13.4 |

Source: The Trade Partnership

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**Appendix B**

**Methodology for Employment Calculations**

The Trade Partnership derived the estimates of the number of jobs related to goods imported under GSP in 2005 using the Bureau of Labor Statistics' "Nominal Domestic Employment Requirements, 2004" spreadsheet. This spreadsheet quantifies the number of jobs at detailed sectoral levels associated with the output (as measured by value added) in a given industry in current dollars. It is based on historical input-output relationships, factoring in employment and productivity variables. The spreadsheet is based on a 1997 input-output table and 1997 employment-output ratios.

The spreadsheet can be used to evaluate the employment impact of GSP imports following these steps:

- Calculate the gross margin (value added) associated with sales at the wholesale and retail levels of trade for the items imported under GSP. To do this, The Trade Partnership separated GSP imports into two categories: those for which the first purchaser is likely a wholesaler, and those which are likely first purchaser is a retailer. Raw materials, components and parts, and machinery and equipment fell into the first category, as well as half of finished consumer goods imported under GSP. The remaining half of finished consumer goods imported was assumed to be imported directly by retailers. Then, wholesaler gross margin rates for disaggregated products (for 2004, from the Census Bureau) were applied to the relevant import categories, and the retailer gross margins for specific products (for 2004 from the Census Bureau) were applied to the direct imports by retailers. Consumer goods imported by wholesalers and then sold to retailers were further market up with the relevant retail gross margin.

- The resulting gross margin values were multiplied by the coefficients provided in the employment requirements table for wholesale trade, and retail trade.

- Imported goods are transported around the country, and the transportation margins need as well to be estimated. We know from input-output tables that every dollar of value added in wholesaling and retailing generates about 2 cents of value added in the transportation and warehousing sector. So the gross margin data for wholesaling and retailing were multiplied by this factor to estimate the transportation margin for imported goods.

- The resulting transportation margin value was multiplied by the average employment coefficient for each mode of transportation, and added to the coefficients for warehousing. The resulting coefficient was applied to the transportation margin to get the employment estimate.

- The three employment estimates were totaled to derive the overall employment impact of GSP imports.

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