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 $63.8 billion	2004 $72.2 billion	2005 $76.3 billion	2006 $79.1 billion	2007 $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.