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INTERNATIONAL TRADE

Options for Congressional Consideration to Improve U.S. Trade Preference Programs

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Highlights

Highlights of GAO-10-262T, a testimony before the Subcommittee for Trade, Committee on Ways and Means, House of Representatives

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, identifies policy trade-offs, and summarizes GAO recommendations and options suggested by a panel of experts on the African Growth and Opportunity Act (AGOA). The testimony is based on studies issued in September 2007, March 2008, and August 2009. For those studies, GAO analyzed trade data, reviewed trade literature and program documents, interviewed U.S. officials, did fieldwork in nine countries, and convened a panel of experts.

What GAO Recommends

In the March 2008 report, GAO recommended that the U.S. Trade Representative review beneficiary countries that have not been considered under the regional programs, and periodically consider preference programs jointly. In response, USTR officials told us that the relevant agencies will meet at least annually. USTR also changed its annual report to discuss the preference programs in one place.

View GAO-10-262T or key components.
For more information, contact Loren Yager at (202) 512-4347 or yagerl@gao.gov.

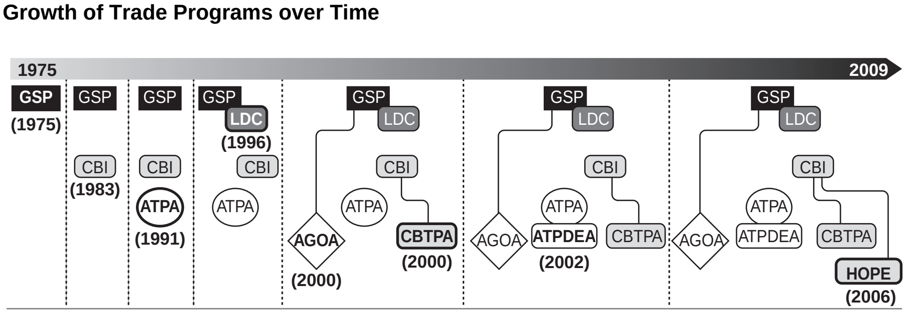
What GAO Found

Total U.S. preference imports grew from $20 billion in 1992 to $110 billion in 2008, with most of this growth taking place since 2000. The increases from preference program countries primarily reflect the addition of new eligible products, increased petroleum imports from some African countries, and the rapid growth of exports from countries such as India, Thailand, and Brazil.

Preference programs give rise to three critical policy trade-offs. First, 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. Second, some developing countries, such as Bangladesh and Cambodia, are not included in U.S. regional preference programs; however, there is concern that they are already competitive in marketing apparel to the United States and that giving them greater duty-free access could harm the apparel industry in Africa and elsewhere. Third, Congress faces a trade-off between longer preference program renewals, which may encourage investment, and shorter renewals, which may provide leverage to encourage countries to act in accordance with U.S. interests such as trade liberalization.

GAO reported in March 2008 that preference programs have proliferated and become increasingly complex, which has contributed to a lack of systematic review. Moreover, we found that there was little to no reporting on the impact of these programs. In addition, GAO solicited options from a panel of experts in June 2009 for improving the competitiveness of the textile and apparel sector in AGOA countries. Options they suggested included aligning trade capacity building with trade preference programs, modifying rules of origin to facilitate joint production among trade preference program beneficiaries and free trade partners, and creating non-punitive and voluntary incentives to encourage the use of inputs from the United States or its trade preference partners to stimulate investment 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 USTR documents on Generalized System of Preferences, African Growth and Opportunity Act,Andean Trade Preference Act, and Caribbean Basin Initiative.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our work on U.S. trade preference programs. Over the last 2 years, GAO has completed three in-depth studies on U.S. preference programs for this Committee and the Senate Committee on Finance.[1] We believe this hearing provides an opportunity for Congress and the administration to review the progress and performance of these programs as a group and consider potential opportunities to improve them. As a number of the preference programs are scheduled to expire by the end of the current calendar year, this discussion will allow for consideration of some of the difficult questions that have been posed in the past by members of this Committee.

In order to contribute to that discussion, I will address three topics. First, I will provide some background on the programs and on recent import trends. Second, I will outline some of the key trade-offs between various domestic and foreign interests that are inevitable in the design of preference programs. Finally, I will summarize some of the recommendations we have provided regarding preferences programs as well as some of the options that experts suggested to GAO that we included in our most recent report to Congress on the African Growth and Opportunity Act.

My remarks are based on the three studies noted above, and informed by our on-going work in fulfillment of a congressional mandate on the Haiti Earned Import Allowance Program.[2] We conducted our work on the cited studies from March 2007 to July 2009 in accordance with generally accepted government auditing standards and GAO's quality assurance framework, as applicable. 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

[1]GAO, U.S.-Africa Trade: *Options for Congressional Consideration to Improve Textile and Apparel Sector Competitiveness under the African Growth and Opportunity Act*, GAO-09-916 (Washington, D.C. : August 12, 2009); 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).

[2]In response to the statutory mandate in the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2008 (HOPE II), Title XV of P.L. 110-234, GAO is conducting a review of the Earned Import Allowance Program for Haiti.

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, Congress has expanded trade preference programs 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) [1] and three regional programs, the Caribbean Basin Initiative (CBI),[2] the Andean Trade Preference Act (ATPA),[3] 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 the United States Trade Representative (USTR), they include the Departments of Agriculture, Commerce, Homeland Security, Labor, State, and Treasury, as well as the U.S. International Trade Commission (ITC).

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 $110 billion in 2008. Most of this growth in U.S. imports from preference countries has taken place since 2000. This accelerated growth suggests an expansionary effect of increased product coverage and liberalized rules of origin for least-developed countries (LDC) under GSP in 1996 and for African countries under AGOA in 2000. In particular, much of the growth since 2000 is due to imports of petroleum from certain oil producing nations in Africa, accounting for 79.5 percent of total imports from Sub-Saharan Africa in 2008. For example, in that same year, U.S. imports from the oil producing

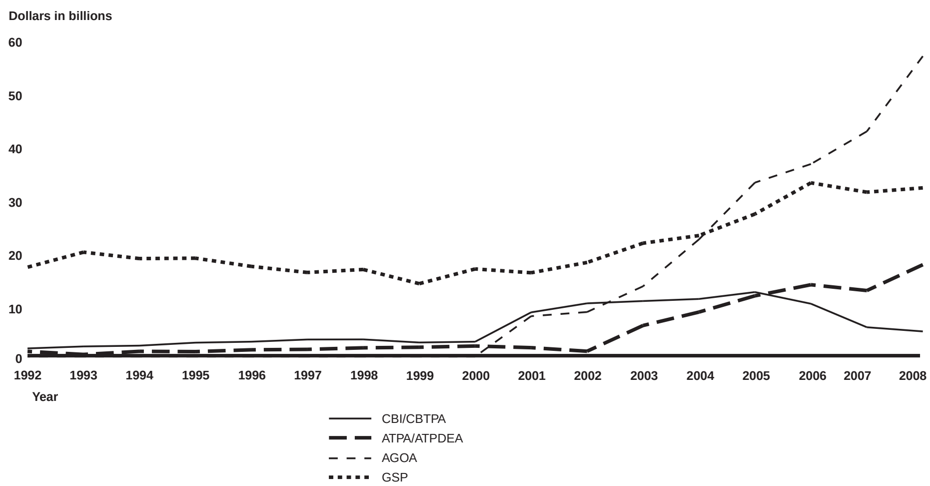
[1] In 1996, the number of duty-free tariff lines offered under GSP was expanded to provide additional benefits to beneficiary least-developed countries (LDC).

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

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

countries of Nigeria grew by 16.2 percent, Angola by 51.2 percent, and the Republic of Congo by 65.2 percent.

Figure 1: Trends in U.S Preference Import Levels (1992-2008)



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

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

There is also evidence that leading suppliers under U.S. preference programs have "arrived" as global exporters. For example, based on a World Trade Organization (WTO) study in 2007,[1] the three leading non-fuel suppliers of U.S. preference imports—India, Thailand, and Brazil—were among the top 20 exporters in the world, and were also major suppliers to the U.S. market. Exports from these three countries also grew faster than world exports as a whole. However, these countries have not reached World Bank "high income" level criteria, as they range from "low" to "upper middle" levels of income.

GSP—the longest standing U.S. preference program—expires December 31, 2009, as do ATPA benefits. At the same time, legislative proposals to provide additional, targeted benefits for the poorest countries are pending.

[1]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.

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

Preference programs entail a number of difficult policy trade-offs. For example, the programs are designed to offer duty-free access to the U.S. market to increase beneficiary trade, but only to the extent that access 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 in preference program coverage 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 not included in 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.

A second, related, trade-off 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 representatives 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 countries, arguing these nations are already so competitive in exporting to the United States that in combination they surpass U.S. free trade agreement partners Mexico and those in CAFTA, as well as those in the Andean/AGOA regions.

This trade-off concerning what countries to include also involves decisions regarding the graduation of countries or products from the programs. The original intention of preference programs was to provide temporary trade advantages to 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, at least 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 into free trade agreements with the United States. In addition to country graduation, the United States GSP program also includes a process for ending duty-free access for individual products from a given country by means of import ceilings—Competitive Needs Limitations (CNL). These ceilings are reached when eligible products from GSP beneficiaries exceed specified value and import market share thresholds (LDCs and AGOA beneficiaries are exempt). Amendments to the GSP in 1984 gave the President the power to issue (or revoke) waivers for CNL thresholds under certain circumstances, for example through a petition from an interested party, or when total U.S. imports from all countries of a product are small or "de minimis." In 2006 Congress passed legislation affecting when the President should revoke certain CNL waivers for so called "super competitive" products. In 2007, the President revoked eight CNL waivers.

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 stated 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 the 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.[2]

Potential Areas of Improvement for U.S. Trade Preference Programs

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

GAO found that preference programs have proliferated over time and have become increasingly complex, which has contributed to a lack of systematic review. In response to differing statutory requirements, agencies involved in implementing trade preferences pursue different approaches to monitoring the various criteria set for these programs. We observed advantages to each approach but individual program reviews appeared disconnected and resulted in gaps. For example, some countries that passed review under regional preference programs were later subject to GSP complaints. Moreover, we found that there was little to no reporting on the impact of these programs. To address these issues, GAO recommended that USTR periodically review beneficiary countries, in particular those that have not been considered under GSP or regional programs. Additionally, we recommended that USTR should periodically convene relevant agencies to discuss the programs jointly.

In our March 2008 report, we also noted that even though there is overlap in various aspects of trade preference programs, Congress generally considers these programs separately, partly because they have disparate termination dates. As a result, we 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.

In response to the recommendations discussed above, USTR officials told us that the relevant agencies will meet at least annually to consider ways to improve program administration, to evaluate the programs' effectiveness jointly, and to identify any lessons learned. USTR has also changed the format of its annual report to discuss the preference

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

programs in one place. In addition, we believe that Congressional hearings in 2007 and 2008 and again today are responsive to the need to consider these programs in an integrated fashion.

Experts Provided a Range of Options for Improving AGOA

In addition to the recommendations based on GAO analysis, we also solicited options from a panel of experts convened by GAO in June 2009 to discuss ways to improve the competitiveness of the textile and apparel sector in AGOA beneficiary countries. While the options were developed in the context of AGOA, many of these may be applicable to trade preferences programs in general.

- **Align Trade Capacity Building with Trade Preferences Programs**: 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. AGOA is the only preference program for which authorizing legislation refers to trade capacity building assistance; however, funding for this type of assistance is not provided under the Act.[3] In the course of our research on the textile and apparel inputs industry in Sub-Saharan African countries, many experts we consulted considered trade capacity building a key component for improving the competitiveness of this sector.
- **Modify Rules of Origin among Trade Preference Program Beneficiaries and Free Trade Partners**: Some African governments and industry representatives of the textile and apparel inputs industry in Sub-Saharan African countries suggested modifying rules of origin provisions under other U.S. trade preference programs or free trade agreements to provide duty-free access for products that use AGOA textile and apparel inputs. Similarly, they suggested simplifying AGOA rules of origin to allow duty-free access for certain partially assembled apparel products with components originating outside the region.
- **Create Non-Punitive and Voluntary Incentives**: Some of the experts we consulted believe that the creation of non-punitive[4] and voluntary incentives to encourage the use of inputs from the United States or its trade preference partners could stimulate investment in beneficiary

[3]For additional information on trade capacity building see GAO-09-916.

[4]The non-punitive focus of this suggestion is a direct response to the negative results of the previously implemented "abundant supply" provision in AGOA. (See GAO-09-916 for more detail.)

countries. One example of the incentives discussed was the earned import allowance programs currently in use for Haiti and the Dominican Republic. Such an incentive program allows producers to export certain amounts of apparel to the U.S., duty free, made from third-country fabric, provided they import specified volumes of U.S. fabric.[5] Another proposal put forth by industry representatives was for a similar "duty credit" program for AGOA beneficiaries. A simplified duty credit program would create a non-punitive incentive for use of African regional fabric. For example, a U.S. firm that imports jeans made with African origin denim would earn a credit to import a certain amount of jeans from Bangladesh, duty free. However, some experts indicated that the application of these types of incentives should be considered in the context of each trade preference program, as they have specific differences that may not make them applicable across preference programs.

While these options were suggested by experts in the context of a discussion on the African Growth and Opportunity Act, many of these options may be helpful in considering ways to further improve the full range of preference programs as many GSP LDCs face many of the same challenges as the poorer African nations. Some of the options presented would require legislative action while others could be implemented administratively.

Mr. Chairman, thank you for the opportunity to summarize the work GAO has done on the subject of preference programs. I would be happy to answer any questions that you or other members of the subcommittee may have.

GAO Contact and Staff Acknowledgments

For further information on this testimony, please contact Loren Yager at (202) 512-4347, or by e-mail at yagerl@gao.gov. Juan Gobel, Assistant Director; Gezahegne Bekele; Ken Bombara; Karen Deans; Francisco Enriquez; R. Gifford Howland; Ernie Jackson; and Brian Tremblay made key contributions to this statement.

[5]The earned import allowance programs for Haiti and the Dominican Republic vary in some aspects, for example a 3 for 1 ratio of qualified inputs to earned credits is used for Haiti, while a 2 for 1 ratio is used for the Dominican Republic.

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