



Trade Preference Program Reform: Questions and Responses for Congressional Staff

Prepared by Kimberly Elliott, Center for Global Development—November 2009

Are trade preference programs still necessary for developing countries?

Yes. Trade regimes in rich countries, including the U.S., discriminate disproportionately against poorer countries by imposing higher-than-average tariffs against their exports, especially from agriculture and labor-intensive manufacturing sectors. This restricts developing countries' ability to stimulate investment, to create jobs, and to participate in the global economy, contrary to the U.S.'s interest in promoting global prosperity and stability.

Should U.S. trade preference programs be made permanent?

Yes, preference programs should be permanent and predictable, at least for the least-developed countries (LDCs). Frequent renewals and occasional lapses—or the threat of a lapse—undermine the certainty of access to U.S. markets, and therefore the incentives to invest in potential export sectors.

Why should Congress approve 100% duty-free, quota-free market access for LDCs?

Exports from LDCs tend to be concentrated in a few product lines. Even a small number of exclusions rob these countries of export opportunities, which in turn denies them opportunities to develop the private sector and expand economic activity.

Should eligibility for 100% DFQF treatment be expanded beyond LDCs?

Potentially, but the distribution of benefits will vary, depending on which countries are included. Norway extends DFQF access to all low-income countries with populations below 75 million, the United Nations' threshold for designating countries as LDCs. Switzerland extends its program to a number of "highly-indebted poor countries." The U.S. Congress has expressed interest in expanding preferential market access for a number of fragile states with strategic significance, such as Pakistan and Georgia.

Research conducted at the Center for Global Development (CGD) and the International Food Policy Research Institute (IFPRI) suggests that adopting the Norway model would have little impact on current preference beneficiaries because it would only extend DFQF access to a handful of small, poor countries in Africa and Central Asia. Pakistan and Vietnam, designated as low-income in 2007 by the World Bank, would benefit greatly from inclusion in the U.S. program, but at the expense of current beneficiaries, especially in Africa. Similar effects would occur on a larger scale if the U.S. expands DFQF to include other small and poor countries, for example, those falling below the World Bank's low middle-income category (roughly \$3500 in 2007) and with total national incomes less than \$50 billion.

What economic impact, if any, would 100% DFQF reform have on U.S. industries? Which U.S. industries would gain and which would lose?

Overall, the impact on the U.S. economy would be small because these countries are small. Products from LDCs currently account for less than 1% of total U.S. non-oil imports. The CGD-IFPRI research suggests that U.S. production in potentially-sensitive sectors, such as sugar and textiles, would decline by less than 1%. While some jobs could be lost in those sectors, jobs would be gained in other sectors. For example, while sugarcane and beet production is mostly mechanized, thousands of jobs in the confectionary industry have been lost in recent years due to plant closures blamed on high sugar prices.

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Will the provision of 100% DFQF treatment to all LDCs have negative economic effects on Africa?

Not according to CGD-IFPRI research. Many African countries do not currently derive significant benefits from AGOA. Moving to 100% DFQF access in the U.S. and elsewhere could further open markets for African agricultural exports, encouraging development of the sector that employs most of the continent's poor.

What role do rules of origin play in effective trade preference programs?

Rules of origin are necessary to prevent beneficiary countries from serving simply as trans-shipment locations for non-beneficiaries attempting to exploit preference programs. However, overly-restrictive rules prevent beneficiaries from taking advantage of preference programs.

Global supply chains are increasingly fragmented—many items are assembled in one country from inputs sourced from numerous other countries. Moreover, many small and poor countries lack the economies of scale or the human or physical capital to achieve vertical integration, whereby they supply many of the inputs themselves. Thus, it is risky to use these rules as a form of industrial policy to try and encourage vertical integration when it does not make sense for many poor countries.

Rather, beneficiary countries need substantial flexibility in how they meet rules of origin. An example of necessary flexibility in rules of origin is AGOA, which permits the duty-free import of apparel cut and sewn in a beneficiary country, even if the fabric originates in another country. Canada loosened its rules of origin as part of an effort to expand access for LDCs in 2003. The export response to these two programs was noticeably greater than that generated by the EU's "Everything But Arms" initiative, which provides 100% nominal access to LDCs, but retains restrictive rules of origin.

What can be done to increase the low utilization rates of U.S. trade preference programs by LDCs?

In addition to increased market access, better coordinated and targeted aid for trade is needed to address supply-side challenges in poor countries, such as inadequate infrastructure. Many poor countries need to reform their own policies, for example reducing red tape in customs, to take full advantage of market access, and those willing to do so should receive financial and technical assistance. Specific targets for this assistance should be worked out through dialogue between the U.S. and other donor governments and recipient governments and key stakeholders in those countries.

In Africa, in particular, agriculture is a vital sector for reducing poverty. However, many exporters in poor countries cannot access the U.S. market, even when tariffs are low, because of the burdensome approval process to export under regulations to protect human, animal, and plant health. More resources, for example on-the-ground U.S. food safety inspectors, could both increase U.S. food safety and improve poor exporters' utilization of preferences.

Would eliminating preferences for petroleum exports have an economic impact on beneficiary countries?

No. The normal tariff on U.S. petroleum imports is less than one-half of one percent.

What should be expected of emerging economies regarding new trade preference programs?

Although they are under no legal obligation to do so, China, India, and Turkey have expanded duty-free access for LDCs in recent years and Brazil has announced plans to do so. The U.S. should lead by example, by adopting 100% DFQF access for LDCs, and then encourage other G-20 members to follow.

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How should Congress address the issue of graduation from U.S. trade preference programs?

Preference program rules should be transparent and predictable. They should also address the fact that low income and high poverty rates may prevail in countries that nevertheless become competitive in a few sectors. Thus, countries should only graduate completely when they reach a designated high-income level. With respect to product-specific limits, the threshold for competitive need limits (CNLs) should increase proportionally with the overall growth in total imports, rather than by an arbitrary dollar value that shrinks every year.

Should the promotion of intra-African trade be a priority of U.S. trade preference program reform?

Yes. Given the high number of small, land-locked countries in sub-Saharan Africa, regional integration is critical for development. The U.S. should encourage integration by ensuring that AGOA rules of origin permit sourcing of inputs from any country in the region. In addition, South Africa might be granted additional AGOA benefits for products using inputs from its less-developed neighbors.

Should U.S. unilateral trade preferences become more reciprocal? Should the U.S. pursue free trade agreements with poor countries instead?

Unilateral preferences remain an important tool for helping developing countries take advantage of the global economy, especially the poorest countries that often do not have the capacity to implement the deep integration commitments involved in FTAs. The EU is attempting to undertake a more reciprocal approach in Africa and elsewhere and it is proving to be highly controversial. Affected countries, economists, and development-oriented NGOs have expressed concerns including the disruption of regional integration efforts in Africa, trade diversion in favor of less competitive EU suppliers, loss of fiscal revenue, and inadequate institutional capacity to implement some of the commitments demanded by EU negotiators. Rather than encouraging the efforts to reduce intra-African barriers to trade, the EU economic partnership agreements are creating new obstacles.

How should Congress address conditionalities in U.S. trade preference programs, especially LDCs?

Conditionality related to foreign assistance is now generally recognized as not being very effective. Unlike aid, which can have perverse effects in weak institutional environments if not carefully managed, increased trade opportunities can strengthen the private sector and create incentives for reform that are more likely to be sustainable than those arising from external pressure. Thus, the current standard of “taking steps,” for example as applied to worker rights, is appropriate as it recognizes the capacity constraints and institutional weaknesses in poor countries, and that fixing them takes time. But, the petition process for allowing private parties to challenge whether certain countries are making sufficient progress should be reformed to make it more timely and responsive, so that petitions do not languish for years with no meaningful action.

About the Center for Global Development

The Center for Global Development (CGD) is an independent, non-partisan and non-profit think tank working to reduce global poverty and inequalities through rigorous research and active engagement with the policy community. CGD aims to improve the policies and practices of the United States, other rich countries, and international institutions by conceiving and advocating for practical innovations. For more information, please contact Kaci Farrell, Outreach and Policy Assistant, at kfarrell@cgdev.org.

Additional Resources

[U.S. Trade Policy and Global Development](#) (*White House and the World Policy Brief*)

[Trade Preference Reform CGD Initiative](#)

[Working Group Letter to G-20 Leaders on Duty Free Quota Free Market Access for LDCs](#)

[Opening Markets for Poor Countries: Are We There Yet? - Working Paper 184](#)