Industry Trade Advisory Committee on Distribution Services
for Trade Policy Matters (ITAC 5)

September 20, 2006

Memorandum for:

Honorable Carlos M. Gutierrez
Secretary of Commerce
U.S. Department of Commerce
Washington, DC 20230

Honorable Susan C. Schwab
United States Trade Representative
600 17th Street, N.W.
Washington, DC 20506

Regarding the Advisory Committee Report to the President, the Congress and the United States Trade Representative on the U.S.-Colombia Trade Promotion Agreement

Pursuant to Section 2104 (e) of the Trade Act of 2002 and Section 135 (e) of the Trade Act of 1974, as amended, the Industry Trade Advisory Committee on Distribution Services for Trade Policy Matters (ITAC 5) submits the following report on the substance of the U.S.-Colombia Trade Promotion Agreement (Colombia TPA).

V. Advisory Committee Opinion on Agreement

The members of ITAC 5 and its predecessor committee, ISAC 17, have supported previous Free Trade Agreements (FTAs), and have voiced strong support for commercially-viable agreements. Subject to the issues and concerns discussed below, it is the view of this committee that in broad terms the agreement with Colombia will, on balance, promote the economic interests of the United States, largely achieve the applicable overall and principle negotiating objectives, and provide for general equity and reciprocity within the distribution services sector.

Textile and Apparel Rules of Origin

Upon examination of this agreement, the Committee believes the Colombia FTA, like other FTAs before it, contains a serious deficiency with respect to the rules of origin for textiles and apparel, which is inconsistent with what should be the objectives in this agreement – commercial viability, dismantling trade barriers, promoting trade and investment in these sectors, and establishing the basis for a hemispheric production platform under a broader FTA framework encompassing the Americas.

In 2005, Colombia exported approximately $618 million worth of textiles and apparel to the United States, which was down from the 2004 trade figure $636 million. Year-to-date trade in 2006 is down approximately 15 percent from the same time period in the previous year. With small, but integrated textile and apparel industries, there was a general consensus among U.S. apparel retailers and manufacturers when negotiations commenced that a commercially-based trade agreement with Colombia FTA could have provided additional opportunities for trade and investment in this sector, and allow Colombian producers to enhance their competitive position in the post-quota environment in partnership with U.S. textile and apparel manufacturers.

1. A Yarn Forward Rule of Origin Is Not Commercially Viable

In past comments on preferential rules of origin for textile and apparel products, both ITAC 5 and its predecessor committee, ISAC 17, have argued for flexible, commercially-viable rules that reflect the realities of global production and sourcing, actually promote new trade and investment, and provide genuine benefits to American consumers. We have previously suggested that the U.S.-Israel FTA rule of origin for textiles and apparel (substantial transformation), the U.S.-Jordan FTA rules of origin for apparel (Breaux-Cardin), and the pre-Breaux-Cardin rules of origin for textiles meet these criteria and should serve as the model for all FTA negotiations, including those with Colombia. The argument for adopting these rules of origin is made more compelling by the fact that they are consistent with the rules governing origin for other manufactured products – *i.e.*, origin is determined according to the most significant production processes performed in an FTA partner country.

As with previous free trade agreements, the Colombia TPA contains rules of origin that do not meet the objectives enumerated above due in large measure to political pressure from some parts of the U.S. textile industry that continue to seek limits against any foreign competition. First, the agreement with Colombia has incorporated the so-called "yarn forward" rule of origin for textiles and apparel, which determines origin according to where the inputs used to make the final product are produced. Under this rule, only apparel made from yarn and fabric originating in Colombia or the United States can qualify for duty-free treatment. This rule has two immediate negative consequences. First, it creates the anomalous situation where the effective amount of value added processing necessary for qualifying apparel is substantially higher than for all other products – in the range of 80 to 90 percent. Second, although Colombia does have an integrated industry producing fiber, fabric, yarns and apparel, production is comparatively small. Thus, a yarn-forward rule of origin would severely constrain the flexibility of apparel makers in Colombia to service their customers' needs, thereby undercutting their ability to compete effectively with Asian manufacturers under the current "full-package" production system. The net result is that the yarn forward rule, as a general principle, will retard, rather than promote textile and apparel trade under this agreement.

As noted in other comments by this committee and its predecessor, a survey of major apparel retailers conducted by the National Retail Federation confirms the deficiencies of the yarn forward rule of origin. It was the unanimous view of survey respondents that a yarn forward rule is not cost effective and, results in a net increase in the cost of apparel production, even when the savings from the elimination of tariffs and quota charges are factored in. All retailers participating in the survey further reported that yarn forward rules of origin have affected their sourcing operations by accelerating the shift in apparel trade away from preferential trading partner countries, such as Mexico, that are subject to this rule, to certain large Asian suppliers, notably China. Although segments of the U.S. textile industry have strongly advocated a yarn-forward rule of origin in FTAs as necessary to protect domestic yarn and fabric production from Chinese competition, experience shows that such a rule has the opposite effect, and has resulted in an accelerated shift of apparel sourcing to China and other Asian countries.

2. The Colombia TPA Lacks the Additional Flexibilities in DR-CAFTA that Could Help Ameliorate The Deficiencies of a Yarn Forward Rule of Origin

To complicate matters further, the Colombia TPA provides little additional flexibility to use non-originating inputs. Such flexibility is essential, as apparel manufacturing has evolved from the old "cut-and-sew" model to the so-called "full package" production. Due to these significant changes in production, those producers who have access to the widest range of yarns and fabrics will be the most competitive. Some additional flexibility can be achieved through a cumulation provision for inputs from other free trade partner countries, revised short supply procedures, a list of products deemed in short supply, workable tariff preference levels (TPLs), and other exceptions that might ameliorate the inherent deficiencies of the yarn forward rule of origin under current production models, provide sufficient incentives to protect current levels of trade, and perhaps generate new trade and investment.

Unlike the Dominican Republic-Central American FTA (DR-CAFTA), the agreement with Colombia contains no TPLs and no real ability to cumulate inputs from other free trade agreement partner countries in the production of qualifying apparel. While there is hortatory language in the agreement that the issue of cumulation will be discussed by the parties at some point in the future, the exclusion of a substantive commitment on cumulation from the Colombia TPA is especially troubling as cumulation is particularly critical for the commercial success of this agreement. With FTAs currently in place or planned with other countries in Latin America, the ability to cumulate inputs from other free trade agreement partner countries in the region will be an essential element for the creation of a hemispheric-wide production platform under a Free Trade Area of the Americas, which would allow regional apparel and textile manufacturers to compete more effectively with China and other Asian countries.

In comments on other FTAs, this committee has also advised that cumulation is necessary in order for U.S. companies to realize economies of scale and take full advantage of the U.S. preferential trade regime. Without cumulation in this agreement, there will likely be

little interest among or opportunity for American apparel retailers to take advantage of the preferences by sourcing from Colombia. As a result the benefits of the agreement will be significantly diminished, and U.S. trade policy goals for Colombia and the region as a whole seriously compromised.

The Colombia TPA lists approximately 20 textile products deemed to be in short supply. However, the agreement fails to address certain recognized deficiencies in the system under which yarns and fabrics that are unavailable in commercial quantities may be used in qualifying apparel production. Notwithstanding the urging of this committee, the Colombia TPA fails to clarify how affirmative short supply determinations under other FTA or preferential trade regimes, such as the Andean Trade Preferences and Drug Eradication Act (ATPDEA), would apply to the Colombia TPA. The list of components in the agreement that are deemed to be in short supply does not even cover those products found to be in short supply under the ATPDEA. In our view, it makes little sense for U.S. companies and government bodies to jump through the hoop of a separate administrative short supply procedure under the Colombia TPA with respect to products already confirmed to be in short supply under other FTAs or preference programs. A preferable approach would be to establish a rule under which any product found in short supply under another FTA or preference program would be deemed to be in short supply under the Colombia TPA, unless one of the parties objected and offered evidence refuting the short supply finding.

ITAC 5 is also concerned that, in this and other FTA negotiations, U.S. negotiators have focused too much on simply ensuring that existing trade levels for textiles and apparel are maintained, rather than trying to fashion an agreement that will promote trade and investment and allow our FTA partners to build more viable textile and apparel industries. Besides the disturbing mercantilist philosophy underpinning this approach, one curious aspect of this strategy is that it ends up subjecting existing trade to more onerous compliance requirements in order to claim duty free treatment. However, as pointed out above, the costs of compliance in these situations are often greater than the duty-free benefit, with a net result of a decline in trade. Another basic problem with this approach is that it essentially places the U.S. Government rather than the market in the inadvisable position of dictating to manufacturers what products they may produce.

ITAC 5 does acknowledge that most qualifying textile and apparel products from Colombia will be duty free upon implementation of the agreement. In addition, we note with approval one important exception to the yarn forward rule of origin – *i.e.*, the single transformation rule for brassieres. Two more additional positive provisions of note are that, as in other agreements, the Colombia TPA has retained the use of duty drawback for textile and apparel products. Moreover, as under DR-CAFTA, the Colombia TPA also contains a de minimis rule for the use of some foreign yarns of up to 10 percent of total weight of the component. In at least one respect, however, even this de minimis provision is less than what is available under the ATPDEA in that it does not apply to elastomeric yarns.

3. Conclusion

It is disturbing to this committee that the United States has continued to insist on overly restrictive rules on textiles and apparel even for countries, such as Colombia, which are not large suppliers to the United States. Such restrictions are usually employed to protect vulnerable domestic industries from significant import competition. It is evident that Colombia poses no threat whatsoever to domestic textile manufacturers and restrictive rules of origin are unwarranted. Indeed, by insisting upon such restrictions, the U.S. textile industry has ensured that it will see little or no economic benefit from our system of FTAs, including the Colombia TPA. If the rules of origin act to stifle trade in textiles and apparel, another group that will see few benefits from our system of FTAs is American consumers.

In conclusion, this committee is extremely disappointed that these rules of origin issues could not be more effectively addressed in the agreement with Colombia. Congress has already passed FTAs that provide for better rules on textile and apparel trade than under this agreement, and there is no reason to believe that a less restrictive agreement with Colombia would also not pass Congressional muster. In the future, it should not be assumed that this committee will continue to support new FTAs unless these issues are addressed more fully to our satisfaction.

Sincerely,

Richard N. Holwill
Chair, ITAC 5