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April 6, 2004

The Honorable Robert B. Zoellick
U.S. Trade Representative
600 17th Street, NW
Washington, DC 20508

Dear Ambassador Zoellick:

Pursuant to Section 2104 (e) of the Trade Act of 2002 and Section 135 (e) of the Trade Act of 1974, as amended, I am pleased to transmit the report of the Industry Sector Advisory Committee on Wholesaling and Retailing for Trade Policy Matters (ISAC 17) on the U.S. Morocco Free Trade Agreement (Morocco FTA), reflecting consensus advisory opinions on the proposed Agreement.

Sincerely,

Frank X. Kelly
Chair
ISAC 17

The U.S.-Morocco Free Trade Agreement (FTA)

Report of the
Industry Sector Advisory Committee on Wholesaling and Retailing for Trade Policy Matters
(ISAC 17)

April 2004

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Industry Sector Advisory Committee on Wholesaling and Retailing for Trade Policy Matters (ISAC 17)

Advisory Committee Report to the President, the Congress and the United States Trade Representative on the U.S.-Morocco Free Trade 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 Sector Advisory Committee on Wholesaling and Retailing for Trade Policy Matters (ISAC 17) submits the following report on the substance of the U.S.-Morocco Free Trade Agreement (Morocco FTA).

V. Advisory Committee Opinion on Agreement

The members of ISAC 17 have supported previous FTAs. While it is the view of this committee that the economic benefits to the U.S. economy are likely to be modest, it is the committee's consensus that in broad terms agreement with Morocco 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. However, when we examine certain details of this agreement, the Committee believes the Morocco FTA falls well short of the mark. Specifically, like other FTAs before it, the Morocco FTA contains serious deficiencies that will result in little benefit for trade in certain consumer products, in particular textiles and apparel, which are sold at retail in the United States.

In past comments on preferential rules of origin for textile and apparel products, ISAC 17 has 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. ISAC 17 has 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 Morocco. 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. To date, our recommendations have been largely ignored.

As with previous FTAs, the Morocco FTA contains rules of origin that do not meet the objectives enumerated above. First, the agreement with Morocco 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 Morocco or the United States can qualify for duty-free treatment. As ISAC 17 has stated in comments on other FTAs, this rule 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. The restrictions and lack of flexibility under this rule is also likely to retard, rather than promote textile and apparel trade.

As noted in other comments by this committee, this conclusion is substantiated by a survey of major apparel retailers conducted by the National Retail Federation. It was the unanimous view of survey respondents that a yarn forward rule of origin 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.

To complicate matters further, the committee believes the Morocco FTA provides insufficient 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 FTA partner countries, revised short supply procedures, a list of products deemed in short supply, or workable tariff preference levels (TPLs), 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.

ISAC 17 notes that textile and apparel imports from Morocco have dropped precipitously since 2001, from 24.7 million square meter equivalents (SMEs) down to 15.9 million SMEs in 2003. The committee acknowledges that the provision of a tariff preference level of 30 million SMEs in the Morocco FTA will provide some additional flexibility. However, with a phase out of the TPL beginning after four years and total elimination after 10 years, without additional flexibilities, the committee believes that there will be little interest among American apparel retailers to take advantage of the preferences under the agreement. In particular, with FTAs currently in place or planned for other countries in the Middle East, the ability to cumulate inputs from other FTA partner countries would have been a valuable addition to the Morocco FTA and would be a major stepping stone toward the creation of a Middle East Free Trade Agreement. In comments on other FTAs, ISAC 17 has 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, opportunities for retailers to source from Morocco under this agreement will be significantly diminished and U.S. trade policy goals for the Middle East as a whole are compromised.

The Morocco FTA also fails to address recognized deficiencies in the system under which yarns and fabrics that are unavailable in commercial quantities may be used in qualifying apparel production. Unlike the U.S.-Central American FTA, there is no list of products deemed to be in

short supply. Also, the committee urges clarification regarding how affirmative short supply determinations under other FTA or preferential trade regimes would apply to the Morocco FTA. 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 Morocco FTA with respect to products already confirmed to be in short supply under other FTAs or preference programs.

ISAC 17 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, the 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.

That said, ISAC 17 acknowledges that most qualifying textile and apparel products from Morocco will be duty free upon implementation of the agreement. However, we understand that Morocco has insisted on certain restrictions and 6-year duty phaseouts on some textile and apparel categories due to concerns over import surges from the European Union. Such restrictions obviously limit benefits under this agreement, not only for U.S. apparel retailers, but also U.S. exporters. We view the circumstances under which these restrictions were added as an anomalous situation that should be studiously avoided in other FTA negotiations.

One additional positive note in the Morocco FTA that ISAC 17 would like to recognize is the retention of duty drawback for textile and apparel products. The members of ISAC 17 believe that elimination of duty drawback may be appropriate among countries with a common external tariff, but that it serves to undermine trade and investment objectives in free trade agreements. Accordingly, we would encourage the retention of duty drawback in future FTAs as well.

In sum, 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 Morocco, which is a comparatively small supplier to the United States. Such restrictions are usually employed to protect vulnerable domestic industries from significant import competition. It is evident that Morocco 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. 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.

Sincerely,

Frank X. Kelly
Chair