November 15, 2005

The Honorable Rob Portman
U.S. Trade Representative
600 17th Street, NW
Washington, DC 20508

Dear Ambassador Portman:

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 Trade Advisory Committee on Distribution Services for Trade Policy Matters (ITAC 5) on the U.S.-Oman Free Trade Agreement (Oman FTA), reflecting consensus advisory opinions on the proposed Agreement.

Sincerely,

Erik O. Autor
Co-Chair
ITAC 5

November 15, 2005

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

Advisory Committee Report to the President, the Congress and the United States Trade Representative on the U.S.-Oman 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 Trade Advisory Committee on Distribution Services for Trade Policy Matters (ITAC 5) submits the following report on the substance of the U.S.-Oman Free Trade Agreement (Oman FTA).

V. Advisory Committee Opinion on Agreement

The members of ITAC 5 and its predecessor committee, ISAC 17, have supported previous 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, while the economic benefits to the U.S. economy of a free trade agreement between the United States and Oman are likely to be modest, it is the committee's consensus that in broad terms the agreement with Oman 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 Oman FTA, like other FTAs before it, contains a serious deficiency with respect to the rules of origin for textiles and apparel that are inconsistent with the objective of commercial viability, dismantling trade barriers, and promoting trade and investment in this sector.

With a rank of 58th among apparel exporters to the United States, Oman is not a major supplier of clothing to the U.S. market. Nonetheless, Oman did export $125.4 million of textiles and apparel to the United States in 2004 – a not insignificant sum for a small country. Therefore, the Oman FTA could have provided additional opportunities for trade and investment in this sector and allow Omani producers to enhance their competitive position after textile and apparel quotas expired at the beginning of the year.

In past comments on preferential rules of origin for textile and apparel products, ISAC 17, the predecessor committee to ITAC 5, 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 Oman. 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 FTAs, the Oman FTA contains rules of origin that do not meet the objectives enumerated above. First, the agreement with Oman 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 Oman 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, since Oman has no yarn or fabric production, this rule essentially requires the use of U.S. yarn and fabric in the production of qualifying apparel. The net result is that the yarn forward rule, as a general principle, will retard, rather than promote textile and apparel trade under this FTA.

As noted in other comments by the predecessor to this committee, 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.

To complicate matters further, the committee believes the Oman 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.

The agreement with Oman does include an annual tariff preference level (TPL) of 50 million square meter equivalents that provides benefits under the FTA for 10 year to products made from third country yarn and fabric. The committee acknowledges that this TPL will provide additional flexibility. However, with textile and apparel exports from Oman to the United States totaling nearly 60 million square meter equivalents (SMEs) in 2004, this TPL allows for no real growth in trade and investment. Moreover, with elimination of the TPL 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.

We also note that the agreement does contain language stating that the United States and Oman will "endeavor to develop" a regional cumulation regime, that, presumably, would also include textiles and apparel. 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 will be a valuable addition to the Oman FTA and would be a major stepping stone toward the creation of a Middle East Free Trade Agreement. In comments on other FTAs, this committee 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 Oman under this agreement will be significantly diminished and U.S. trade policy goals for the Middle East as a whole are compromised. Therefore, ITAC 5 urges U.S. trade negotiators to follow through on the commitments in this provision as soon as possible.

The Oman 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 (CAFTA), 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 Oman 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 Oman FTA with respect to products already confirmed to be in short supply under other FTAs or preference programs.

The Oman FTA also contains a de minimis rule for the use of some foreign yarns of up to 7 percent of total weight of the component. However, the CAFTA contains a more generous 10 percent de minimis rule. There is no reason why the Oman FTA should contain a more restrictive rule than under the CAFTA.

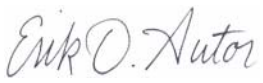
ITAC 5 is also concerned that, in this and other FTA negotiations, U.S. negotiators have focused too much on simply ensuring that existing trade levels for textiles and apparel are maintained, rather than trying to fashion an agreement that will promote trade and investment and allow our FTA partners to build more viable textile and

apparel industries. Besides the disturbing mercantilist philosophy underpinning this approach, 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, ITAC 5 acknowledges that most qualifying textile and apparel products from Oman will be duty free upon implementation of the agreement. One additional positive note in the Oman FTA is that, as in other agreements, the Oman FTA has retained the use of duty drawback for textile and apparel products.

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 Oman, 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 Oman 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,



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