April 25, 2007

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

Dear Ambassador Schwab:

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 Free Trade Agreement between the United States and the Republic of Korea (Korea FTA), reflecting consensus advisory opinions on the proposed Agreement.

Sincerely,

Richard N. Holwill
Chair
ITAC 5

April 25, 2007

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 Free Trade Agreement between the United States and the Republic of Korea (Korea FTA).

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 Korea FTA.

IV. Membership

Industry Trade Advisory Committee On Distribution Services – ITAC 5

Chairman
Mr. Richard N. Holwill
Vice President, Public Policy
Alticor, Inc.

Primary Vice-Chairman
Erik O. Autor, Esq.
Vice President, International Trade Counsel
National Retail Federation

Secondary Vice-Chairman
Mr. Richard L. Crawford
Corporate Vice President, Government Relations
McDonald's Corporation

Mr. Steven Becker
First Vice President, Treasurer
Southern Wine & Spirits of America, Inc.

Ms. Devry S. Boughner
Director, International Business Relations
Cargill, Inc.

Mr. Albert A. Gallegos
Director, International Affairs
National Automobile Dealers Association

Mr. Peter V. Handal
President and Chief Executive Officer
Dale Carnegie and Associates

Mr. Peter T. Mangione
President
Footwear Distributors and Retailers
of America

Ms. Angela J. Marshall Hofmann
Director of International Corporate Affairs
Wal-Mart Stores, Inc.

Ms. Linda A. Miller
Consultant
The Mills Corporation

Ms. Josephine I. Mills
Executive Director, Global Government Affairs
Avon Products, Inc.

Joel R. Platt, Esq.
Vice-President
BGE, Ltd.

Mr. Charles A. Prescott
Vice President, International Business Development and Government Affairs
The Direct Marketing Association, Inc.

Mr. Matthew R. Shay
President
International Franchise Association

Mr. James C. Tuttle
Chairman and Chief Executive Officer
Tuttle International Group

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 in broad terms the agreement with the Republic of Korea 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.

Market Access for Distribution Services

While meaningful market access commitments are important for all U.S. service industries, it is the opinion of this committee that there are two keystone services sectors in trade agreements, which generate a wide range of ancillary benefits. In turn, those ancillary benefits help provide the foundation for economic reform in trade partner countries and enhanced market access for other goods and services sectors in the United States. The first of those keystone sectors is financial services; the second is distribution services.

There are numerous benefits from good market access commitments in distribution services that accrue well beyond those companies solely in retailing, wholesaling, franchising, and commission agents. Distribution services represent the last link on the trade chain to the ultimate consumer. As such, distribution service companies create new markets for U.S. manufacturers, agricultural and food processors, and other types of service providers to foreign customers.

Distribution is also the only services sector that involves the movement and sale of goods, thereby providing an important nexus between market access for services and goods. Finally, retailers, wholesalers, and other distribution service providers require a large network to support their business and commercial operations in such diverse areas as transportation, warehousing, financial services, communications, advertising, and professional services.

However, our system of trade agreements has developed as a hub-and-spoke model – with each agreement operating independently with slightly different rules. As agreements proliferate, the resulting system is making trade more, not less, complicated and expensive, and is largely inconsistent with the way U.S. distribution services companies do business and manage their supply chains. We urge U.S. negotiators to seek options to include increased levels of cross trade in future trade agreements so that distribution services companies can benefit from the economies of scale by serving multiple markets from single service points.

Looking specifically at the Korea FTA, the agreement may facilitate U.S. distribution services providers to enter the increasingly wealthy Korean market. However, U.S. retailers that have sought to open retail services in South Korea have largely abandoned the effort due to problems that go beyond the commitments in this agreement within the distribution services sector. However, there are a number of specific situations in which other distribution services providers will benefit from the U.S. Korea FTA. For example, heretofore, U.S. franchise restaurants operating in Korea have developed local operations utilizing local suppliers, including domestic agricultural interests. Unfortunately, when suitable local supply was unavailable or of insufficient quality, U.S. companies faced high duties and restrictive quotas to satisfy their distribution needs. The U.S. Korea FTA strikes a balance that will benefit these operations as they will be able to utilize an international supply and distribution network to obtain necessary products while remaining sensitive to local production options for products including agricultural products.

In addition, we note with pleasure that the Investment Chapter of the FTA includes provisions to ensure the transparency of Korean laws and regulations. These provisions provide for comments by stakeholders prior to the adoption of new regulations, a much needed reform. Most critically, the Investment Chapter requires publication of Ministerial Guidance and legal opinions that amend such guidance so that companies can rely on readily available material as the controlling legal authority for business decisions in a regulatory context.

One challenge in particular for U.S. retailers is the ability to stock stores, outlets and restaurants that they open in foreign markets in the face of trade barriers that many countries, including Korea, impose on imported goods through non-tariff barriers, antidumping and safeguards actions. These barriers can present a sizable obstacle to maintaining a viable retail operation.

This situation is not helped by the unwillingness of the United States to address any meaningful reform to trade remedies laws in its trade agreements. Although it will not correct this particular problem, one good start would be to exempt bilateral trade agreement partner countries from the antidumping law. Since a trade agreement precludes the ability of a country to maintain a sanctuary market, the major argument underpinning the application of antidumping remedies ceases to exist.

Textile and Apparel Rules of Origin

The Committee is also of the view that the Korea FTA, like other FTAs before it, contains a serious deficiency with respect to the rules of origin for textiles and apparel. In its comments on other trade agreements, ITAC 5 has repeatedly expressed its opposition to the yarn-forward rule of origin for textiles and apparel, which is also contained in the Korea FTA. Under this rule, only apparel made from yarn and fabric originating in South Korea or the United States can qualify for duty-free treatment.[1]

Evidence clearly shows that a yarn forward rule of origin retards rather than promotes textile and apparel trade with our trade partner countries. Indeed, textile and apparel trade has fallen with every FTA partner country subject to this rule of origin.

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[1] For a more detailed analysis of the deficiencies of the yarn-forward rule of origin, refer to the ITAC 5 comments on the Colombia FTA.

From 2003 - 2006, the value of apparel exports from South Korea to the United States fell dramatically from $1.81 billion to $913 million, as Korea has moved into the developed country ranks and has shifted into higher value production. Given this clear downward trend, this committee is extremely disappointed that the United States negotiated one of the most restrictive free trade agreements to date with respect to the textile and apparel sector. First, the Korea FTA contains the yarn-forward rule of origin with all its attendant flaws that virtually guarantees trade in these products will continue to fall even more quickly. Second, the agreement contains no additional flexibility in the use of non-originating inputs in the production of qualifying apparel. Among these additional flexibilities, the ability to cumulate inputs from other trade partner countries in the production of qualifying goods is particularly critical as it could also provide a means to link our system of trade agreements. Finally, at the insistence of certain Members of Congress from textile districts, who in any event are unlikely to support this or any other FTA, the Agreement contains a ten-year duty phase out for many key apparel categories.

In conclusion, we believe that the agreement will provide some additional incentives for U.S. distribution services providers to increase trade and investment with South Korea, but that the agreement could have been much better. The fundamental issue is that we need to rethink our bilateral trade agreement model. In particular, we need to rationalize, simplify, and link our trade agreements to provide U.S. companies greater economies of scale from our trade agreement system, which would, in turn, enhance their global competitiveness. We also need to abandon counterproductive and clearly flawed rules governing trade in textiles and apparel that hinder trade and investment while doing nothing to improve the competitiveness of the U.S. textile industry.

Sincerely,

Richard N. Holwill
Chair
ITAC 5