

March 19, 2004

The Honorable Robert B. Zoellick
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 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 Textiles and Apparel (ISAC-15) on the U.S./Central America Free Trade Agreement, reflecting diverse advisory opinions on the proposed Agreement.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen Lamar". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Stephen Lamar
Chair
Industry Sector Advisory Committee
on Textiles and Apparel (ISAC-15)

The U.S./Central America Free Trade Agreement (FTA)

Report of the
Industry Sector Advisor Committee on Textiles and Apparel (ISAC-15)

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Industry Sector Advisory Committee on Textiles and Apparel (ISAC 15)

Advisory Committee Report to the President, the Congress and the United States Trade Representative on the U.S./Central America Free Trade Agreement (FTA)

I. Purpose of the Committee Report

Section 2104 (e) of the Trade Act of 2002 requires that advisory committees provide the President, the U.S. Trade Representative, and Congress with reports required under Section 135 (e)(1) of the Trade Act of 1974, as amended, not later than 30 days after the President notifies Congress of his intent to enter into an agreement.

Under Section 135 (e) of the Trade Act of 1974, as amended, the report of the Advisory Committee for Trade Policy and Negotiations and each appropriate policy advisory committee must include an advisory opinion as to whether and to what extent the agreement promotes the economic interests of the United States and achieves the applicable overall and principle negotiating objectives set forth in the Trade Act of 2002.

The report of the appropriate sectoral or functional committee must also include an advisory opinion as to whether the agreement provides for equity and reciprocity within the sectoral or functional area.

Pursuant to these requirements, the Industry Sector Advisory Committee on Textiles and Apparel (ISAC 15) hereby submits the following report.

II. Executive Summary of Committee Report

This report transmits input from the Committee, encompassing divergent opinions held by the various sectors of this industry (fiber, yarn, textiles, textile bag manufacturers, and apparel, including those with vertical textile interests). These opinions reflect the various import, export, manufacturing, and marketing interests that members hold, and which are described further in Section III. Key defining issues for members revolve around the specifics of the rules of origin – such as yarn forward, tariff preference levels (TPLs), cumulation, and short supply – market access, and customs administration. The most significant interest revolves around a desire to build a viable Western Hemisphere partnership. Fundamental to building this viable partnership are rules of origin that develop bilateral trade, their speedy and predictable implementation, and whether they encourage or discourage trade with Central American countries using inputs from the United States and the Central American region.

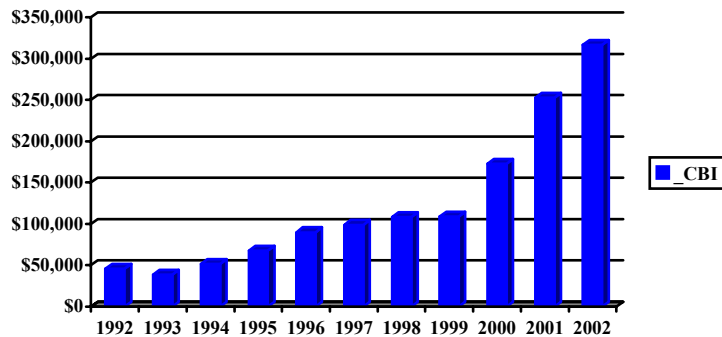
All apparel members support the agreement. Textile members presented a diversity of opinions ranging from support to opposition, offering differing views on individual provisions. As a result, the Committee is divided on whether Congress should pass the FTA into law.

Some textile members seriously question whether the FTA fosters a partnership opportunity, and whether it will enhance U.S. business interests. They believe the FTA will merely exacerbate the current global excess capacity problem for textiles and apparel, as it creates new competition for U.S. companies, without providing significant new opportunities. These members believe that the U.S./Central America FTA will exacerbate the U.S. trade deficit, due to the significant disparity in income and purchasing power of U.S. versus Central American consumers. They argued that, while the Central American countries have substantial capability to produce finished goods for export, they have little ability to consume goods manufactured in the U.S. The combined GDP of the five Central American countries is \$142 billion, or only 1.36 percent of the U.S. economy. Per capita GDP in the U.S is \$36,300, while the average per capita GDP in the Central American countries is only \$4,300.

A few textile members also voiced concern over the proliferation of free trade agreements at a time when U.S. textile producers are trying to adjust to the final phase of the 10-year quota elimination, much of which occurs in the 10th year, which has the potential to be devastating to the textile industry.

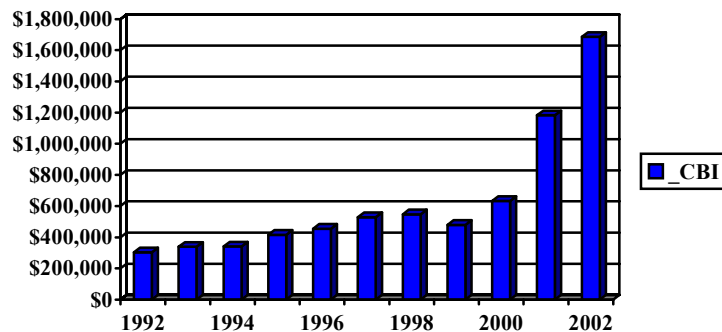
Many textile and all apparel Committee members are in agreement that a free trade agreement with the Central American countries could play a vital role in developing a strong and successful supply chain between the U.S. and Central America. These members view the U.S./Central America Free Trade Agreement as a commercially viable agreement that will not only sustain existing regional investments, but also lead to new investment in the region. They see swift passage and implementation of this FTA as driving additional demand for U.S. inputs, noting with the charts below, that the region has already created a significant market for U.S. fabrics and U.S. yarns. They believe that, without an FTA, the Central American region will be unable to maintain a vibrant center for apparel production in the post quota environment, which will result in significant losses to the U.S. textile/yarn/fiber/logistics/services industries

U.S. Yarn Exports to the CBI Region in (000's)



Source: Commerce Department

U.S. Fabric Exports to the CBI Region in (000's)



Source: Commerce Department

Many members believe that the U.S./Central America FTA, inasmuch as 90 percent of the goods traded under this agreement will be composed primarily of U.S. input, will be vital to ensure that the U.S. textile industry remains competitive in 2005 and beyond. They also believe that the agreement will open up new opportunities for U.S. inputs and U.S. services as the U.S./Central America FTA broadens the existing trade preference program to additional products (such as home furnishings), makes the current partnership reciprocal for the first time, and promotes new linkages to Mexican and Canadian markets. They view the U.S./Central America FTA as commercially viable. They believe that, if it is implemented in a timely manner, this FTA will be integral to the long-term growth and competitiveness of their companies. They also expressed support that the overall agreement is comprehensive and contains no sector or product exclusions.

Committee members noted with appreciation the extensive opportunities to interact with, and provide input to, U.S. Government negotiators during 2003 at regularly scheduled Committee meetings, conference calls, and briefings at many of the negotiating rounds themselves. Committee members noted that as many as two dozen industry advisors – many of whom were cleared advisors – participated in each of the last four textile and apparel negotiating rounds.

III. Brief Description of the Mandate of the Industry Sector Advisory Committee on Textiles and Apparel (ISAC 15)

The Industry Sector Advisory Committee on Textiles and Apparel for Trade Policy Matters was established on March 21, 1980, and extended every two years since then, most recently on March 17, 2002, by the Secretary of Commerce and the United States Trade Representative pursuant to the authority delegated under Executive Order 11846 of March 27, 1975, as an advisory committee established under Subsection 135(c)(2) of the Trade Act of 1974 (Public Law 93618), as amended by Section 1103 of the Trade Agreements Act of 1979 (Public Law 9639), and Section 1631 of the Omnibus Trade and Competitiveness Act of 1988 (Public Law 100418, 102 Stat. 1107 (1988)). In establishing the Committee, the Secretary and the USTR consulted with interested private organizations and took into account the factors set forth in Subsection

135(c)(2)(B) of the Trade Act of 1974. In accordance with the provisions of the Trade Act of 1974, as amended, and the Federal Advisory Committee Act, 5 U.S.C. App. 2, and 41 CFR Subpart 1016.1001, Federal Advisory Committee Management Rule, the Committee is rechartered.

The Committee currently consists of 27 members from the textiles and apparel industry sectors. The Committee is comprised of different perspectives, demographics, geography, and company size. They represent a full spectrum of textile and apparel interests ranging from importers to domestic manufacturers, and many combinations thereof. Collectively, they are involved in all facets of importing, exporting, and/or domestic production and, thus, present many diverse perspectives on this sector. The members, all of whom come from the U.S. private sector, serve in a representative capacity presenting the views and interests of a U.S. business in the fiber, textiles and apparel industry sectors; they are, therefore, not Special Government Employees.

The Committee advises the Secretary and the USTR concerning the trade matters referred to in Sections 101, 102, and 124 of the Trade Act of 1974, as amended; with respect to the operation of any trade agreement once entered into; and with respect to other matters arising in connection with the development, implementation, and administration of the trade policy of the United States including those matters referred to in Reorganization Plan Number 3 of 1979 and Executive Order 12188, and the priorities for actions thereunder.

In particular, the Committee provides detailed policy and technical advice, information, and recommendations to the Secretary and the USTR regarding trade barriers and implementation of trade agreements negotiated under Sections 101 or 102 of the Trade Act of 1974, as amended, and Sections 1102 and 1103 of the 1988 Trade Act, which affect the products of its sector; and performs such other advisory functions relevant to U.S. trade policy as may be requested by the Secretary and the USTR or their designees.

IV. Negotiating Objectives and Priorities of the Industry Sector Advisory Committee for Textiles and Apparel (ISAC 15)

ISAC 15 represents U.S.-based manufacturers and importers of textile and apparel products and their inputs. Because ISAC 15 members hold widely diverging views on whether rapid opening of markets in the United States and around the world through the FTA negotiations serve the best interests of this industry, they have not developed a uniform set of negotiating objectives. However, all members agree that the elimination of quotas on textile and apparel products on January 1, 2005, the final stage of the 10 year long phase out of the Agreement on Textiles and Clothing, will have a tremendous impact on the consumer and associated textile and apparel industries in countries producing and consuming textile and apparel products.

Most of the members agree that there should be greater opening of markets globally. Members have sharply divergent views how that should be accomplished, whether that involves greater U.S. market access for foreign textile and apparel products, and what interests consumer perspectives should play in this debate. There are strong differences over how the current agenda

of trade negotiations can best accommodate the industries' needs to prepare for 2005 and beyond. Nevertheless, there is broad consensus that U.S. negotiators should continue to strive to level the playing field and achieve reciprocal tariff reductions on the part of negotiating partners. The Committee views the continued existence of non-tariff barriers as a major impediment that denies market access and prevents export opportunities for U.S. products. Finally, the Committee urges clear and transparent customs procedures and anti-circumvention requirements so firms doing business under specific trading regimes can do so with predictability and certainty.

The Committee would like to better understand the fit of these individual trade agreements into a cohesive, market responsive textile and apparel trade policy. The Committee urges the Administration to articulate their plan so that businesses can reduce the uncertainty in their long range strategic planning, and make appropriate use of their limited resources and investment.

V. Advisory Committee Opinions on Agreement

1. Rules of Origin and Market Access

The Committee had very strong and diverse opinions over the market access provisions and, in particular, the rule of origin of the U.S./Central America FTA.

Several of the Committee's textile sector representatives and all the Committee's apparel sector representatives noted that the FTA has the potential to safeguard existing trade and attract new trade and investment flows to the region if the agreement is approved and implemented during 2004. They recommended swift approval of the agreement, pointing to extensive U.S./Central American textile and apparel trade partnership and investment ties that have been encouraged by Congress over the past two decades. They noted that Central America is now a key market for U.S. textile companies and that this market can grow significantly if the FTA is quickly put in place.

They noted that the agreement is broad in product coverage, contains flexible and predictable rules of origin, is permanent, and is reciprocal, all of which reflect improvements over the current Caribbean Basin Trade Preference Act (CBTPA) unilateral trade preference regime. Moreover, the agreement has the potential to cover all bilateral textiles and apparel trade, rather than the two thirds of U.S. apparel import trade that is covered now. Many of these members cautioned, however, that potential of this FTA to drive trade and investment benefits to the U.S. textile industry diminishes greatly if Congressional approval is delayed into 2005, when many Asian countries will gain an enormous competitive advantage with the elimination of costs associated with the quota regime.

Other textile representatives also noted the importance of Central America to the U.S. textile industry and identified the potential for a U.S./Central America FTA that is structured to benefit solely the United States and Central America. They believe the FTA, as negotiated, does not achieve this goal and that the trade and investment incentives of the FTA are undermined due to provisions that permit the use of non-originating inputs. They believe these provisions create

“loopholes” that have the potential to benefit third party countries and create opportunities for illegal transshipment. In addition, a few textile members questioned if the agreement disproportionately benefits Central America since those countries gain access to a market that is considerably wealthier than their own. Many of these textile members state the FTA is unacceptable to them. Some suggested it be defeated while others suggested it be renegotiated.

a. Yarn Forward

With some exceptions, textile members applauded the general “yarn forward” rule of origin as well as certain specific provisions, including the elastomeric yarn requirement, the visible linings requirement, and certain fiber forward provisions. Some, however, expressed concern that the yarn forward concept only applies to the essential character of a garment (as in NAFTA) instead of to all fabric elements of a garment (as in the CBTPA). Many textile members complained that a number of products (brassieres, woven boxers, woven PJs, and woven girls dresses) were granted a “cut and sew” rule, meaning the yarn and fabric can originate in any country without limitation even though some of the fabrics and yarns may be available in the United States, and the business is vital to some U.S. firms. They believe this rule denies U.S. textile interests opportunities to trade under this FTA. Several also believe this particular rule with respect to brassieres negates a recent decision by the United States to impose safeguards on similar products imported from China.

Some textile representatives criticized the yarn forward requirement as too restrictive, suggesting that a better approach for the entire agreement would have been a “fabric forward” rule of origin, such as what was included with respect to narrow elastics and wool articles. Some yarn and fiber members, however, believe that those fabric forward provisions are a “damaging deviation” to the rule of origin.

Several textile and apparel Committee members commented that the agreement does not include a “workable” special regime mechanism that was established under the NAFTA model (a fabric forward rule if the garment is made entirely of U.S. fabrics, regardless of the source of the yarn). They noted that articles made under the Central America FTA’s special regime (unlike a similar provision in NAFTA) do not have the same duty free benefits as the balance of the agreement and will likely be unusable by complex and inconsistent Customs regulations. U.S. yarn producers noted that this “partial duty free treatment” for this provision was necessary to ensure the basic yarn forward rule of origin is not undermined.

Although some apparel members stated that the yarn forward rule is still too “restrictive,” and noted particular concerns over the inclusion of elastomeric yarn and sewing thread requirements, most felt that the overall approach taken in this particular FTA represented a balanced outcome, and all commended the Administration for the creative approach it took to achieve a commercially viable outcome. Several members noted that the yarn forward essential character rule is combined with limited “flexibilities” (such as the selected fabric forward provisions noted above) that collectively create incentives for textile and apparel production and investment. Apparel members responsible for producing the specific articles applauded the inclusion of the

targeted “cut and sew” rules for brassieres (which is identical to the NAFTA rule) and certain woven garments (reflecting their view that most of the fabrics used for those items are not available in the United States and that such a rule helps bring production back to the hemisphere that is otherwise sourced from Asia). Several commented that the decision on brassieres is particular appropriate in light of Chinese safeguards on these products since it will encourage that former Chinese bra production to migrate back to this hemisphere.

b. Trade Preference Levels (TPLs)

Most textile companies criticized the inclusion and the magnitude of TPLs for Nicaragua (100 million square meter equivalents) and a special third country wool fabric provision for Costa Rica. Many U.S. textile members see these provisions as “harmful loopholes” that attract “free-rider” inputs from non-participants who contribute nothing to the accord and who offer the U.S. no reciprocal benefits. They feel that TPLs directly disadvantage U.S. producers operating with unused capacity in an already badly depressed market. Some noted that the lack of sublimits (i.e., restrictions on particular articles or fibers) increases the potential harm these provisions can do. Some members believe that items that are truly unavailable in the U.S. or the region could be accommodated via the short supply mechanism, rendering TPLs unnecessary.

All apparel members, including those vertically integrated with textiles, noted that only one of the five countries received a TPL. Although they expressed some concern over this approach, they noted that, Nicaragua, the country that received this TPL treatment, is the second poorest country in the Hemisphere and the FTA partner with the smallest level of textile and apparel trade. They noted further that the TPL is limited, that it phases out, and that it does not prohibit the use of U.S. or regional inputs. They also note that the TPL is set at a level less than the current level of non-qualifying trade. With this creative solution, they believe that this Nicaragua TPL and the Costa Rica provision could keep selected apparel factories competitive in the short term, which will ensure their continued ability to purchase U.S. inputs and services over the long term.

c. Cumulation

Some textile members expressed concerns over a "cumulation" provision that could qualify up to 200 million square meters of Mexican or Canadian product that directly would replace inputs from U.S. mills. Some feel that these provisions disproportionately benefit certain U.S. producers that have investment in Mexico at the expense of those who do not. Others, while supportive of the cumulation concept, are concerned it was drafted in such a way and at such low levels that the benefit for U.S. firms will be lessened while the benefit for Mexican firms will potentially be significant. Yet, other textile producers are concerned that the lack of direct integration of existing agreements like NAFTA will ultimately stifle the full regional integration needed to keep the U.S. as competitive as needed to compete with Asia. The potential for stranding assets in individual countries without fuller integration is a major concern.

Apparel members and some textile members were pleased with the inclusion of a cumulation provision and believe it will pave the way for a larger, more integrated market for U.S. textile

and apparel interests. They note that, when fully implemented, it will lead to additional U.S. fabric and yarn sales to Canada and Mexico, which have declined in recently years, by permitting duty free import into those markets of a range of products with U.S. content. They expressed concern, however, over the low levels, including the low sublimits, and limited number of countries negotiated into the cumulation provision. Several apparel and textile interests expressed support for the inclusion of a secondary cumulation provision (reflecting a provision in the CBTPA) that permits certain inputs from Israel that in turn support U.S. textile production for Central America.

For both textile and apparel members, there is still uncertainty as to how the growth, anti-transshipment, and reciprocity provisions in the cumulation chapter will work so as to protect and promote U.S. interests. Many textile members expressed deep concerns that the cumulation provisions could create transshipment opportunities, citing extensive Chinese transshipment problems in Mexico. Apparel members noted that the cumulation provisions do not take effect until the Mexican and Canadian governments implement anti-transshipment and reciprocity measures, but questioned whether this conditionality may also lead to significant delays in the implementation of this provision. They also expressed concern that the administration of such a provision could eliminate any potential benefit and result in a loss of U.S. textile inputs.

d. Short Supply

Although there is broad agreement among textile and apparel members that a short supply provision can have positive aspects on the overall agreement, there remains considerable confusion over how the petition process will work to add short supply products to the list. Textile interests were pleased that the process envisions a procedure to “graduate” short supply items from the list but, without specifics as to how this procedure would work, were unwilling to take a specific position. Some textile members contend that several articles on the stipulated list are incorrectly included and are currently available in the United States. Those articles are: certain woven fabrics of polyester and wool; certain worsted fabrics of wool, fine animal hair, and man-made fibers; certain rayon herringbone weave fabrics; and yarns of carded cashmere or carded camel hair.

Apparel members and some textile members believe the process appears to represent an improvement over the time frame of the existing process. Apparel members are also pleased that the short supply list has been updated to reflect additional fabrics, fibers, and yarns that are no longer available in commercial quantities in the U.S. market, and that existing and certain prospective trade preference program short supply determinations will be added. They note that some U.S. textile companies have lost sales under NAFTA or the CBTPA because the rules of those trade regimes forbid the commingling of U.S. components with a number of products that are unavailable (but have not yet been so recognized by a government entity) in the United States.

e. Other

Apparel members were particularly pleased to see that the effective date of duty free access for textile and apparel products set at 1/1/04. They believe this early effective date provides a powerful incentive to anchor apparel sourcing in the region in preparation for the 1/1/05 phase out of quotas. They believe this incentive is much more powerful, and therefore is much more likely to generate U.S. yarn and fabrics sales to the region, than the existing trade preference program, which is overly complicated and restrictive, which is still not governed by final and predictable rules, and which currently only covers two-thirds of apparel imports from the region. They believe that, without this early effective date, apparel companies are likely to shift more of their sourcing away from Central America to other offshore locations that use less U.S. input. Textile companies expressed concern that the early effective date would diminish U.S. fabric and yarn sales under the existing program since the FTA provides opportunities that currently do not exist to import articles using non-U.S. inputs.

Several apparel and textile companies questioned how future expected FTA partners (i.e., the Dominican Republic) and other CBTPA countries (i.e., Jamaica and Haiti) are addressed so that market access opportunities that currently involve those countries are not diminished. They urged that consideration be given to a mechanism to ensure that garments that are currently eligible to qualify for preferential access under the CBTPA continue to receive such preferences, and that opportunities to grow trade with these partners not be lost.

Apparel companies were also pleased that the final agreement permits U.S. and Central American companies to use duty drawback/duty deferral mechanisms. They note that the loss of a similar program under NAFTA led to a 25 percent decline in the U.S. textile exports to Mexico when Mexican apparel maquilas were unable to obtain reimbursements for duties they had paid on non-originating inputs that were permissible under the NAFTA rule of origin. Apparel companies believe the integrated export zone/duty free zone in Central America has created a physical infrastructure that supports apparel production and consumption of U.S. textile inputs. Textile companies are concerned that the retention of duty drawback provisions promotes the use of non-originating inputs.

2. Customs Enforcement/Operations

Some textile members believe the complexity of this agreement, with its many exceptions, makes it difficult to police, and provides an invitation for illegal activity designed to take advantage of duty free access to the U.S. market. Many textile producers believe a “kick-out clause is necessary which could be applied to countries that repeatedly refuse to enforce the U.S./Central America FTA textile rules of origin. Under a “kick-out” clause, a country could have some or all its textile benefits removed if that country allows illegal smuggling through its territory. The need for such a clause has increased as evidence of widespread smuggling in the NAFTA region has been exposed.

Apparel members, including those that are vertically integrated with textile production, and some textile members note the agreement contains extensive customs cooperation language to ensure proper vigilance on the part of U.S. and Central American customs officials. They note as well that the agreement contains a provision that permits the denial of benefits to firms that are

engaged in transshipment activities. They also note that the customs provisions appear to streamline documentation requirements to ensure that an excessive or redundant documentation requirement does not discourage trade that use U.S. or regional inputs or expose companies to security threats or loss of confidential information, as is currently the case under the CBTPA. Some members also question how the agreement's customs requirements interact with existing Customs' compliance ratings, given that the great majority of apparel importers effectively control and assure legitimate production. They also question what burden these customs requirements place on yarn and fabric suppliers, including those in the United States, to ensure proper shipment validation so the burden is not placed entirely on the apparel company.

Several textile and apparel members expressed support for a concept that surfaced during the negotiations that would enable the operation of U.S. ports, particularly those that service the Central American markets, on a 24/7 basis. They also questioned whether it would be possible for a Central American port to receive designation under an initiative similar to the Container Security Initiative (CSI). They noted that one of the competitive advantages of Central America is its proximity to the U.S. market and that such Customs and port measures could facilitate greater trade flows, which would promote greater U.S., input usage.

VI. Membership of Committee

The members of ISAC 15 are Gerald Andersen, Neckwear Association of America; James Cook, Sara Lee Branded Apparel; Joe Deadwyler, Hagggar Clothing Corporation; Shawn Dougherty, Dillon Yarn Corporation; Robert Ecker, Cordage Institute; Charles Hansen III, Consultant to Pillowtex; Michael Hubbard, American Yarn Spinners Association; Mark Jaeger, Jockey International, Inc.; Cass Johnson, American Textile Manufacturers Institute, Inc.; Jane Johnson, Unifi, Unifi, Inc.; Robert Kaplan, Clothing Manufacturers Association of the U.S.; Stephen Lamar, American Apparel & Footwear Association; Lance Levine, MFI International Manufacturing, LLC; Connie McCuan-Kirsch, Textile Bag and Packaging Association; Wendy Wieland Martin, Kellwood Company; Richard Martino, Russell-Newman, Inc.; Peter Mayberry, Association of the Nonwoven Fabrics Industry; John Miller III, Esq., Carpet and Rug Institute; Carlos Moore, Consultant to Galey and Lord; John Nash Jr., Milliken and Company; Paul O'Day, American Fiber Manufacturers Association; Theodore Sattler, Phillips-Van Heusen Corporation; George Shuster, Cranston Print Works Company; Karl Spilhaus, National Textile Association; Augustine Tantillo, American Manufacturing Trade Action Coalition; Mary Vane, Invista, Inc.; and Richard Williams, Sr, Williams Companies.