The Duty Drawback Coalition

499 South Capitol Street, Suite 600
Washington, D.C. 20003

"Working to preserve export promotion programs for U.S. manufacturers and workers."

June 12, 2017

PUBLIC DOCUMENT (filed electronically via www.regulations.gov)

The Honorable Robert Lighthizer
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20006

Re: NAFTA Negotiations—Written Comments
Requests for Comments on Negotiating Objectives Regarding Modernization of the North American Free Trade Agreement with Canada and Mexico, 82 Fed. Reg. 23699 (May 23, 2017), Docket No. USTR-2017-0006

Dear Ambassador Lighthizer:

The Duty Drawback Coalition[1] (the "Coalition") submits these comments to assist the Trade Policy Staff Committee ("TPSC") as it develops negotiating objectives regarding the modernization of the North American Free Trade Agreement ("NAFTA"). In short, aside from having broad support by U.S. manufacturers and exporters, the removal or elimination of the NAFTA Article 303 restrictions over use of duty drawback and duty deferral export promotion programs (1) will help to reduce the U.S. trade deficit with both Canada and Mexico by increasing U.S. exports and making them more competitive in those two markets, (2) will help to update and modernize NAFTA, making it consistent with all other Free Trade Agreements ("FTAs") entered into subsequent to the U.S. Chile FTA to ensure that our U.S. manufactures, exporters and workers are given "every tool in the free trade tool box" available to them to promote U.S. exports, and (3) has bi-partisan support by Members of Congress recognizing these issues.[2] Drawback is the incremental driver of exports, and the program does not work and refunds of import duties, taxes, and fees are not granted without a U.S. export.

[1] *See* Exhibit 1, List of Members of The Duty Drawback Coalition.

[2] *See* Exhibit 2-3, Letters from Members of Congress to USTR sent in December 2016 and immediately after Ambassador Lighthizer was confirmed this year. Also attached as Exhibit 4 is a September 4, 2003 letter from Members of Congress to USTR, Commerce, and Treasury supporting duty drawback and deferral programs.

I. Executive Summary

The modernization of NAFTA and any free trade agreement ("FTA") necessarily entails, among other things, repeal of the current duty drawback and deferral restrictions for U.S. manufacturers and exporters.[3] These restrictions dating back to 1994 were intended to prevent non-NAFTA countries from using Canada or Mexico as an "export platform" for component parts for the manufacture of goods to be exported to the U.S. But this concern would never be realized and, to the contrary, the empirical evidence coupled with sidestep measures by Canada and Mexico to avoid the restrictions has encouraged the creation of export platforms to the direct detriment of U.S. manufacturers and exporters. Altogether, the restrictions place U.S. manufacturers at a substantial disadvantage as compared to foreign competitors when exporting products to Canada or Mexico. The duty drawback and deferral restrictions in NAFTA should be repealed to place U.S. manufacturers on a level playing field with their foreign competitors and to facilitate free trade.[4] Furthermore, if the Trans Pacific Partnership does move forward without the U.S., and this Administration does not negotiate the elimination of Article 303 of NAFTA during the renegotiation process, then all of our U.S. manufacturers, exporters and workers will be at a significant competitive disadvantage versus the TPP countries because those foreign manufacturers and exporters will have the benefit of zero duties when exporting to Canada and Mexico, plus they will receive the duty drawback and deferral benefits of their countries' programs, while our U.S. manufacturers, exporters and workers will be crippled by Article 303 if it is left in place.

II. Duty Drawback

Duty drawback was established by the First Session of the First Congress in 1789 to support U.S. manufacturers and exporters. Duty drawback allows for the refund of Customs duties, taxes, and fees paid on imported goods that are used as inputs in the production of manufactured products that are later exported, or where the imported good is substituted for the same or similar good that is later exported.[5] This allows U.S. manufacturers and exporters to reduce the cost of inputs, and thus reduce manufacturing costs to remain competitive in pricing their exported goods.

U.S. manufacturers operating in foreign trade zones (considered outside of U.S. Customs territory) can use duty deferral to defer the payment of import duties, taxes and fees on imported foreign component parts or raw materials until those goods or the finished product incorporating those goods are entered into the U.S. market for consumption. If such goods are never entered for consumption, but rather exported, the duties, taxes and fees are not paid. In either situation,

---

[3] The Coalition's comments are specifically addressed to the matters identified in Parts 2.(a)-(c)(2), (d)-(e), (k), and (o) of USTR's notice published in the Federal Register. *See Requests for Comments on Negotiating Objectives Regarding Modernization of the North American Free Trade Agreement with Canada and Mexico*, 82 Fed. Reg. 23699-700 (May 23, 2017).

[4] Exhibit 5 are the Coalition's public comments to Commerce relating to recommendations for reduction in regulatory burdens on U.S. manufacturers.

[5] *See* 19 U.S.C. § 1313.

its gives a cost of production and pricing advantage to U.S. manufacturers competing in the global market.

Duty drawback and duty deferral are not unique to the United States. In fact, duty drawback and deferral regimes are utilized by most countries around the world, including all nations that were included in the Trans-Pacific Partnership and NAFTA. Duty drawback is the last remaining export promotion program allowed by the World Trade Organization (WTO).

A. The Intent of Drawback

The policy rationale supporting duty drawback is as simple as it is powerful: to increase the competitiveness of U.S. manufacturers that export and to create and maintain U.S. jobs. Congress stated the rationale for duty drawback:

> "The purpose of [duty drawback] is to permit American-made products to compete more effectively in world markets. It enables domestic manufacturers . . . to select the most advantageous sources for their raw materials and component requirements without regard to duties, thereby permitting savings in their production costs. It also encourages domestic production and, as a result, the utilization of American labor and capital."[6]

The U.S. Customs Service recognizes that the drawback program was initiated to create jobs and encourage manufacturing and exporting:

> "Historically, the word "drawback" has denoted a situation in which the duty or tax, lawfully collected, is refunded or remitted, wholly, or partially, because of a particular use made of the commodity on which the duty or tax was collected.
>
> Drawback was initially authorized by the first tariff act of the United States in 1789. Since then, it has been part of the law, although from time to time the conditions under which it is payable have changed.
>
> **The rationale for drawback has always been to encourage American commerce or manufacturers to compete in foreign markets without the handicap of including costs, and**

---

[6] Committee on Ways and Means U.S. House of Representatives, WMCP 111-6, *Overview and Compilation of U.S. Trade Statutes* 84 (2010 ed.), *available at* https://www.gpo.gov/fdsys/pkg/CPRT-111WPRT63130/pdf/CPRT-111WPRT63130.pdf.

> **consequently in his sales price, the duty paid on imported merchandise.**”[7]

Further, below are additional excerpts from various sources revealing the intent behind duty drawback:

- Customs Ruling Letter HQ 227994

> A review of the legislative history to the drawback laws, with respect to exportation, shows that **the object of the drawback laws was to build up an export trade**. Specifically, the following statements leave no doubt regarding the purpose of the drawback provisions:
>
>> “**By way of encouraging exportation to other countries and extending our markets, the committee have liberalized the drawbacks** given upon articles or products imported from abroad and used in manufactures here for the export trade.
>>
>> **We have also extended the drawback provision** to apply to all articles imported which may be finished here for use in the foreign market. Heretofore this privilege was limited. **This**, it is believed, **will effectually dispose of the argument so often made that our tariff on raw materials**, so called, **confines our own producers to their own market and prevents them from entering the foreign market, and will furnish every opportunity to those of our citizens desiring it to engage in the foreign trade**.
>>
>> That is, **we give to the capital and labor of this country *substantially free trade* in all foreign materials for use in the markets of the world** . . .
>>
>> **We have extended this provision and in every way possible liberalized it**, so that the domestic and foreign product can be combined and still allow to the exporter 99 per cent upon the duty he pays upon his foreign material intended for export; **which is, in effect, what free traders** and our political opponents **are clamoring for, namely, *free raw material for the foreign trade***. And if you are desirous of seeing what you can do in the way of entering the foreign market, here is the opportunity for you.”[8]

[7] 1 Int’l Management for Business Executives Handbook, Export-Import and Trade, Int’l Business Publications 117 (2013 ed.).

[8] Customs Ruling Letter HQ 227994, *available at* https://rulings.cbp.gov/index.asp?ru=227994&qu=227994&vw=detail (emphasis added).

- *Tidewater Oil Co. v. United States*

> The purpose of drawback was described in 1898, by the U.S. Supreme Court in the case of *Tidewater Oil Co. vs. United States,* 171 U.S. 210 (1898), as being "not only **to build up an export trade**, but to encourage manufactures in this country, where such manufactures are intended for exportation, ***by granting a rebate of duties*** **upon the raw or prepared materials imported, and thus enabling the manufacturer to compete in foreign markets with the same articles manufactured in other countries**."[9]

- Texport Oil Co. v. United States

> "The purpose of drawback is to place those who export from the United States on an equal footing with overseas competitors, by largely ***refunding the sums paid to import certain materials, thus eliminating or diminishing the cost disadvantage resulting from the presence of import duties***, taxes, or fees."[10]

- House Report 103-361, 103d Cong.

> "The Committee maintains that **the purpose of drawback continues to be to promote** economic activity in the United States, resulting in **increased exports**."[11]

- S. Rep. 103-189, 103d Cong.

> "Section 632 of the implementing bill contains provisions **intended to expand** U.S. **exports** and facilitate the use of drawback by easing administrative burdens while ensuring improved compliance (through increased penalties and informed compliance provisions) with the laws and regulations governing drawback."[12]

The purpose of free trade (i.e., duty-free trade) is to increase aggregate trade, consisting of both exports and imports, by means of removing duty as a barrier to trade. It is clear from the aforementioned sources that the purpose of duty drawback is to increase trade through exports by means of refunding the applicable duty, thereby removing duty as a barrier to trade and making

---

[9] *Tidewater Oil Co. v. United States*, 171 U.S. 210 (1898) (emphasis added).

[10] *Texport Oil Company v. United States*, Nos. 98-1352, -1353, -1373 (Fed. Cir. 1999) (emphasis added).

[11] H. Rpt. 103-361(I) at 130, appearing in 1993 U.S.C.C.A.N. 2550, 2680, *available at* http://www.ncbfaa.org/images/ncbfaa/files/TTBDrawbackLetter.htm (emphasis added).

[12] S. Rep. 103-189, 103d Cong., *available at* https://www.finance.senate.gov /imo/media/doc/rpt103-189.pdf (emphasis added).

such trade essentially free trade (i.e., duty-free trade). Thus, the purpose of free trade (i.e., duty-free trade) and duty drawback (i.e., essentially duty-free trade) are synonymous.

Because free trade and duty drawback share an identical purpose, they must be treated as complementary in nature in order to bring about the maximum increase in trade between the member countries of the FTA. They are not two distinct and contrary concepts in such conflict with each other that we must choose either one or the other, but not both. The restriction or elimination of drawback on the supposed basis that it constitutes a "double benefit" when paired with free trade would be an illogical decision. Duty drawback and free trade serve together as counterparts to each other to affect the **single** benefit of an FTA, namely, free trade that results in increased trade among the member countries. ***As in all other FTAs[13] U.S. manufacturers and exporters must be given every "free trade tool in the tool box" in order to compete and WIN when exporting to our FTA partner countries***. Unless both free trade and duty drawback are employed to function cooperatively, free trade (i.e., duty-free trade) cannot be maximized, and therefore the goal of our FTAs cannot be met.

Additionally, the intent of Congress is to grant drawback when and wherever possible to benefit U.S. companies, not to limit drawback simply because the United States enters into a FTA that reduces import tariffs with the FTA partner. This was the mistake made by the Administration when NAFTA was originally negotiated. This mistake was not corrected until after negotiation of the U.S. Chile FTA when in response to a Federal Register notice published by the Trade Policy Staff Committee on July 2, 2003[14], numerous U.S. manufacturers and exporters submitted written comments on the "Treatment of Duty Drawback and Deferral Regimes in Free Trade Agreement Negotiations Currently Underway with Central America, Australia, Morocco, the Southern African Customs Union and the Countries Participating in the Free Trade Area of the Americas". Those comments all had a single theme and request of the TPSC, USTR and the White House –

> *There exists <u>no</u> valid reason to restrict or eliminate duty drawback and deferral programs in any FTA, which programs even the U.S. Government states are maintained in order to stimulate and encourage growth in U.S. manufacturing, exports and jobs, and enhance our global competitiveness. We strongly urge that the U.S. negotiating objective for <u>all</u> FTAs and in advocacy before the World Trade Organization ("WTO") be <u>for</u> the inclusion of full duty drawback and duty deferral rights for U.S. manufacturers and exporters, as these programs are necessary to the U.S.' global competitiveness. FTAs should not restrict, limit or otherwise eliminate duty drawback or duty deferral rights for U.S. manufacturers and exporters when exporting to FTA or WTO member countries.*[15]

---

[13] Except for the U.S.-Chile FTA in which the Coalition also believes the same restrictions should be removed.

[14] *See* 68 FR 39614-39615.

[15] *See* Exhibit 6, Written Comments on the Treatment of Duty Drawback and Deferral Regimes in Free Trade Agreement Negotiations Currently Underway With Central America, Australia, Morocco, the

The most efficient way to ensure that free trade and duty drawback/deferral work together to maximize U.S. trade with member countries of an FTA is to exclude any language about duty drawback/deferral in the FTA. This would provide the desired effect of allowing each member country's duty drawback/deferral program to continue to function in an unrestricted manner, thereby serving to increase and make more competitive U.S. exports.

B. Drawback Benefits

Duty drawback and duty deferral programs directly benefit U.S. manufacturers and exporters, and encourage and support growth in U.S. manufacturing and jobs for the export market. U.S. companies that rely on duty paid foreign inputs to manufacture or produce finished goods for export significantly benefit from drawback through either reduced costs of production and/or price advantages when selling into the global market.

The majority of drawback claims filed relate to substitution drawback. For example, a U.S. manufacturer importing and paying duties, taxes, and fees on foreign goods that are consumed in the U.S., and then producing and exporting a wholly originating U.S. good to Mexico or Canada, cannot claim drawback or use duty deferral of an FTZ and thus is subject to greater production costs and higher export prices compared to a factory located in any other non-NAFTA country. For example, there will always be U.S. imports of foreign wine on which duties, taxes and fees must be paid upon importation or entry. Through substitution drawback if our U.S. wine producers had drawback refunds on their exports to Canada and Mexico, with Canada being their largest export market, they could further reduce production costs and prices for those exports allowing them to better compete and hopefully undersell exports of French, Italian, Chilean and Argentinean wine to our NAFTA trading partners. This would increase the demand for U.S. wine, and in turn increase U.S. wine production and exports. The same holds true for our dairy producers and our petroleum refiners that import finished dairy or petroleum products from other countries and can match them with exports of wholly originating U.S. goods exported to Canada or Mexico. For petroleum refiners this means greater competitiveness in the global market for many Gulf Coast refiners, among others. For our dairy producers, the positive impact of duty drawback for dairy exports to Canada can reach from Wisconsin all the way to Texas. The same holds true for U.S. chemical producers as noted in the attached Exhibit 13. Thus, the restrictions are more problematic and more harmful to our U.S. manufacturers and workers as the dollar strengthens against other currencies, making the cost to purchase U.S. goods abroad more expensive.[16]

Southern African Customs Union and the Countries Participating in the Free Trade Area of the Americas (FTAA), July 30, 2003, Coalition for Duty Drawback in Free Trade Agreements. Also attached as Exhibits 7-12 are filings related to Exhibit 6.

[16] As described further herein, Canada and Mexico have created duty relief programs that circumvent the Article 303 drawback restrictions – this does not equal fair trade or a fair agreement and NAFTA must be modernized through the repeal of these outdated restrictions. The programs are much more robust than our Miscellaneous Tariff Bill process which has limitations and must move through the U.S. ITC and then the legislative process. In Canada and Mexico, the governments through a purely administrative process is petitioned by a manufacturer or industry and the government then eliminates the duties at the border on

Drawback also makes a significant difference to the margins of U.S. companies when competing against foreign producers that either have substantially lower costs of production (e.g., China) compared to U.S. companies, or that enjoy low or zero import duty rates, when exporting to our partners in FTAs. This advantage must be maintained as part of U.S. policy to foster growth and development within the United States and to increase U.S. export competitiveness abroad.

C. Data from U.S. Government Sources on Drawback Benefits to U.S. Companies

Data from U.S. Government sources show that duty drawback provides a significant degree of profitability for U.S. companies. The restriction of drawback in NAFTA places U.S. businesses in a disadvantageous position in terms of export trade. Allowing full drawback serves the purpose of the drawback laws, enabling U.S. companies to compete more effectively in foreign markets without the handicap imposed by duty drawback restrictions.

1. Jobs affected by drawback

In equation II.B),[17] we find that approximately 250,000 jobs are related to exported goods benefited by drawback. These quarter million jobs, an average of 5,000 jobs per state, are among the highest quality jobs, since wages and benefits are significantly higher for export workers than for other domestic workers.[18]

These jobs and their respective industries have been, and will continue to be, the ones that are the most adversely affected by any restrictions to, or elimination of, duty drawback in a free trade agreement. Although the total number of jobs in the labor force might theoretically remain constant, closer analysis will show that the jobs that will be gained will be lower quality jobs in the retail and services sectors, while those that are lost will be the higher quality jobs in the manufacturing sector, particularly those jobs involved in exported goods.[19]

2. The profitability of drawback

Drawback has always been related to profitability. The significance of this fact has become increasingly important to U.S. companies over time due to NAFTA. Sometimes this fact is stated in a double negative way, such as Customs' statement that drawback "permits the American manufacturer to compete in foreign markets *without the handicap of including* in his costs, and consequently *in his sales price*, the duty paid on imported merchandise." Sometimes it

---

raw material inputs brought into those countries for use in the manufacture of goods that are then exported to the U.S.

[17] *See* Appendix.

[18] *See, e.g.*, A. Bernard and J. B. Jensen, *Brookings Papers on Economic Activity*, 1995, pp. 67-1112.

[19] In a paper entitled "Fast track to lost jobs: Trade deficits and manufacturing decline are the legacies of NAFTA and the WTO", author Robert E. Scott of the Economic Policy Institute writes that "The manufacturing sector, where the trade deficit rose 158.5% between 1994 and 2000, shouldered 65% of the surge in job losses during that period."

is stated more positively and more directly related to the obvious correlation between drawback and profitability.

The equation in II.C) of the Appendix shows the approximate profit percentage that drawback accounts for in an average drawback claimant's sales. A figure of 2.5% might not seem to be very significant at first glance. However, its magnitude becomes evident when we learn that the average net profit margin for S&P 500 companies in 2000 was 7.0%,[20] and that the corresponding average net profit margin in 2002 was only 5.7%. This means that for those companies who took advantage of the duty drawback provisions, drawback accounted for more than one third of their profit margin. For companies with even lower profit margins, drawback could make the difference between profitability and loss.

The numbers in the preceding paragraph provide a realistic view of the profitability, or profit margin, that drawback adds to a company that exports goods and claims drawback on those goods. The profit margin of a company determines its ability to withstand competition and adverse conditions like rising costs, falling prices or declining sales in the future.

Companies that claim drawback are maximizing their profit margins. Companies that do not claim drawback, but are eligible to do so, could be increasing their profit margin on all export sales on which they claim drawback. The restriction of drawback in NAFTA is tantamount to telling these U.S. companies that their government has decided to decrease their profit margin on their export sales by 2.5%. This is in direct conflict with what U.S. Customs has said from the beginning about the purpose of duty drawback, as well as the positive effects of duty drawback that have been attested to for more than 200 years by the U.S. Congress, U.S. courts, and, more recently, even the WTO.

III. Restrictions on Duty Drawback in NAFTA

NAFTA was the first U.S. multilateral trade agreement, which entered into force on January 1, 1994. Article 303 of NAFTA restricts duty drawback and deferral on U.S. exports to Canada and Mexico. The duty drawback restriction of NAFTA was implemented in 19 U.S.C. 1313(j)(4)(A).

The drawback and deferral restrictions were included in NAFTA to prevent China from using Mexico as an "export platform" for component parts for the manufacture of goods to be exported to the United States, but this fear would not be realized. The restrictive language in NAFTA was carried over to the U.S. Chile Free Trade Agreement. In 2003, after U.S. manufacturers, exporters and workers voiced their opposition to drawback and deferral restrictions to USTR, Treasury/CBP and Commerce, the U.S. negotiating objective for FTAs was changed to no longer seek such restrictions. Since that time, no FTAs subsequent to NAFTA and USCFTA have such restrictive language.

Because duty drawback is restricted under NAFTA, a U.S. manufacturer importing and paying duties on foreign components and exporting a finished U.S. good to Mexico or Canada,

---

[20] *See* www.fool.com/foolish8/2000/foolish8001208.htm.

would be subject to greater production costs and higher export prices compared to a factory located in any other non-NAFTA country. This is more problematic and more harmful to our U.S. manufacturers and workers as the dollar strengthens against other currencies, making the cost to purchase U.S. goods abroad more expensive. U.S. manufacturers and workers need every advantage to ensure that they can compete on a fair and level playing field in the global market. Duty drawback and duty deferral programs are a major factor for companies to achieve these goals.

A. Legislative History for NAFTA Implementation Act (Public Law 103-182)

The reasons for NAFTA's restrictions on duty drawback are given in the legislative history reports. The Coalition provides the comments below in response to these reasons.

1. House Ways & Means Committee Report: Reasons for change

> "Section 203, when fully implemented, serves to remove the trade distorting provisions of the drawback laws by placing restrictions on duty drawback on trade between NAFTA countries. This is critical to ensure that none of [the] NAFTA countries can become an "export platform" for materials produced in other regions of the world."
>
> "The NAFTA drawback formula will also have the benefit, in practice, of limiting the amount of drawback for components imported from non-NAFTA countries, thus further ensuring that the benefits of NAFTA preferential duty treatment only accrue to NAFTA parties."

Coalition Comment: While there are benefits for the United States and the other NAFTA countries because of preferential duty treatment, these benefits are diminished when duty drawback is restricted because product costs are not reduced as much as they otherwise would be. Therefore, the profit margin of sales is lessened and, more importantly, the ability to sell these products at competitive prices is hampered. Ultimately, U.S. companies suffer because of restrictions on duty drawback.

2. Senate Finance Committee Report: Reasons for change

> "The limitations on duty drawback are designed to promote NAFTA's goal of creating an integrated market for North American products. The changes to the duty drawback regimes of NAFTA countries will ensure that MFN tariffs will be assessed by all NAFTA countries on non-NAFTA components for final goods manufactured in their territories, whether those goods are ultimately sold in a NAFTA country's domestic market or sold in the markets of the other NAFTA countries."

Coalition Comment: The restrictions on duty drawback have no direct bearing on the assessment of MFN tariffs.

> "The requirement that duties must be paid on non-NAFTA components will create an incentive to use North American inputs and will help guard against the establishment of export platforms in Mexico by companies seeking to take advantage of NAFTA tariff preferences."

Coalition Comment: The overall cost savings for U.S. companies when they source from countries like China overwhelm any "incentive" that paying duty would create. This rationale in the legislative history would only hold true if: A) Mexico could consistently provide the lowest cost product of any country in the world; or B) if every product required by the United States for manufacturing were able to be sourced from Mexico. However, because neither of these situations are true, neither can the rationale for the restrictions on drawback be valid.

> "At the same time, NAFTA duty drawback formula eliminates double taxation on non-NAFTA inputs; tariffs will be collected only once for non-NAFTA inputs used in goods traded among NAFTA Parties. This will help ensure that North American producers whose goods are not eligible for NAFTA tariff preferences (because they do not meet NAFTA rules of origin) will not be disadvantaged when they compete with non-North American producers in the U.S. market."

Coalition Comment: Double taxation with opportunities for duty drawback after each taxation is more cost-advantageous than a single taxation with either no drawback or restricted drawback. The net comparative result is a higher cost when drawback is restricted.

B. Circumvention Measures for Manufacturers and Exports in Canada and Mexico

In addition, Canada and Mexico have created duty relief programs that effectively circumvent the drawback restrictions in Article 303 of NAFTA. This does not equal fair trade or a fair agreement. Canada and Mexico minimize the duty drawback restrictions on their manufacturers and workers through the use of programs that target duty rate reductions for inputs used in specific export industries. These programs include Sectoral Promotion Program in Mexico and targeted duty reductions in Canada.

Thus, U.S. exporters and workers are further disadvantaged under NAFTA. ***Without a correction, there will remain an incentive to shift manufacturing operations to non-U.S. locations, such as Canada or Mexico, where drawback is not restricted.***

IV. Duty Drawback Restrictions Should Be Removed From NAFTA

Because many imports are subject to Normal Trade Relations (NTR) duty rates when imported into the United States, the drawback restriction in NAFTA places U.S. companies at a significant competitive disadvantage compared to our trading partners. The elimination of duty drawback and duty deferral benefits in NAFTA amounts to a form of *unilateral disarmament* of U.S. manufacturers, exporters, and workers who compete in the global marketplace. Such restrictions only serve to make U.S. manufacturers less competitive and result in the loss of U.S. exports and U.S. jobs. Other than the U.S. Chile Free Trade Agreement (Article 3.8), no other

FTA negotiated by the United States includes restrictions on duty drawback and deferral. This includes the Trans-Pacific Partnership (TPP) currently being finalized between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. With the U.S.'s withdrawal from TPP, the NAFTA drawback limitations remain as to these countries.

The purpose of both FTAs and drawback is to provide the greatest overall benefits to U.S. manufacturers and exporters. To impose arbitrary restrictions on duty drawback/deferral is antithetical to the concept of free trade itself. Duty drawback (substitution) or duty deferral restrictions under Article 303 of NAFTA should be eliminated in order to ensure that U.S. producers and manufacturers can take advantage of this last remaining WTO export promotion program when competing against foreign competitors in exporting U.S. goods to Canada and Mexico. Our competitors have full access to these programs. Thus, U.S. manufacturers are disadvantaged under NAFTA because foreign manufacturers in Japan, China, and India receive these drawback benefits when exporting to Canada and Mexico. ***Our government must give, U.S. manufacturers and workers must be able to take advantage of, every available program to not only compete on a fair and level playing field in the global market, but to have every advantage to WIN in the global market***.

As the U.S. dollar strengthens, our exports become more costly to consumers in Canada and Mexico. Accordingly, our U.S. manufacturers and workers need full use of the drawback and deferral programs to help offset rising production costs and reduce export prices of U.S. goods. Reinstating these programs for use with exports to Canada and Mexico will give the competitive advantage needed to level the playing field for our U.S. manufacturers and workers. If the duty drawback restrictions of NAFTA are allowed to continue to undermine U.S. manufacturers competing for export sales to Canada and Mexico, many of the high-quality, good-paying U.S. jobs associated with exports will be lost. U.S. policymakers should not allow such an outcome.

As part of any renegotiation process of NAFTA, we urge the U.S. government to engage in consultations with the governments of Canada and Mexico to develop a pathway to eliminate the duty drawback and deferral restrictions in NAFTA.

A. The Rationale for Restricting Drawback Rights in FTAs No Longer Exists and All FTAs Subsequent to NAFTA and the U.S. Chile FTA Have No Such Restrictions

The rationale for restricting drawback rights in FTAs no longer exists, and no empirical evidence has surfaced that would lead one to believe otherwise. There were two primary reasons for restricting drawback in an FTA, both of which have been proven false. First, it was believed that drawback restrictions were necessary to create a disincentive for the development of export platforms; yet such restrictions have had an effect adverse to that intent. Second, drawback was considered an export subsidy that should be eliminated. However, according to the WTO's

Agreement on Subsidies and Countervailing Measures,[21] drawback does not constitute an export subsidy.[22]

1. Restricting Drawback Actually Encourages, Rather than Discourages, the Creation of an Export Platform

The continued proliferation of FTAs makes the U.S. position about export platforms a moot point, with no empirical evidence to substantiate the premise. The negotiating position of the United States in NAFTA was that the elimination of duty drawback was necessary to create a disincentive for Asian and European countries to establish export platforms in Mexico or Canada to the detriment of U.S. manufacturers and suppliers. However, in anticipation of the restrictions on duty drawback, a number of companies with maquiladora and Temporal Importation Program to Produce Articles for Exportation ("PITEX") operations in Mexico convinced suppliers in Asia and Europe to establish parts production facilities in North America to replace imports from non-NAFTA sources. Furthermore, many maquiladora representatives from Japan, Korea, Taiwan, the United States, and Mexico have been unable to locate suitable component suppliers in North America. These officials requested Mexican officials to consider additional financial incentives. Without incentives to compensate for increased costs due to the drawback restrictions in NAFTA Article 303, some companies using maquiladora operations have searched for opportunities in other countries.

Over time, and with the imposition of NAFTA Article 303 drawback restrictions, our NAFTA trading partners have instituted trade policies to diminish the financial impact on domestic manufacturers of the duty drawback restrictions contained in NAFTA. The United States has done nothing to counter the same adverse impacts on U.S. manufacturers and exporters. For example, in anticipation of the adverse economic impact that Article 303 would have on its maquiladoras, Mexico instituted its Sectoral Promotion Programs ("PPS"). Under the PPS, Mexico reduced many of its NTR duty rates so that domestic manufacturers could obtain non-NAFTA inputs with the least adverse economic impact as drawback became restricted. In addition, Canada reduced its NTR duty rates so that the imposition of the drawback restrictions under NAFTA had the least adverse economic impact upon domestic manufacturers. These actions not only circumvent the original intent of drawback restrictions as relates to the creation of an export platform, but also demonstrate that the premise is fallible.

---

[21] *See* https://www.wto.org/english/docs_e/legal_e/24-scm.pdf.

[22] It is unfortunate that a review of the last published National Export Strategy 2016, by the Trade Promotion Coordinating Committee (TPCC) as Chaired by the Secretary of the U.S. Department of Commerce, failed to include any reference to or support for export promotion programs such as duty drawback and duty deferral. The Coalition urges the TPSC to raise with the TPCC a request that the TPCC include in the National Export Strategy 2017 the need to employ and enhance the use of duty drawback as an export promotion program.

2. Duty Drawback is Not an Export Subsidy, and It Creates Incentives and Advantages for Domestic Manufacturers and Exporters

Almost every country has a drawback program. Duty drawback is one of the few GATT/WTO-sanctioned programs used by the United States. The WTO has commented that the drawback programs in other countries, as well as that in the United States, have the following positive effects: "Creates an export incentive; counteracts the negative effects of high import tariffs; establishes a strong magnet for export-oriented foreign direct investment; provides benefits to exporters and manufacturers; and, removes a bottleneck to private sector development."

According to the WTO, as well as to the intention of Congress and over 200 years of experience, duty drawback promotes, encourages and benefits exports. Workers in exporting industries have greater productivity and higher wages than do workers in other industries. Export promotion programs such as drawback are necessary to encourage exports and enhance U.S. competitiveness abroad.

B. Report by the U.S. International Trade Commission (ITC) on Drawback Restrictions in NAFTA

In an article entitled "Regulatory Changes in Mexico Affecting U.S.-Affiliated Assembly Operations - NAFTA Article 303 and Restrictions on Duty Drawback" author Ralph Watkins, in the ITC publication number 3443, comments on "Article 303 of NAFTA, which restricted duty drawback for goods traded between Mexico and its NAFTA partners effective January 1, 2001". He states that "[i]n anticipation of the restrictions on duty drawback, a number of companies with Maquiladora and PITEX operations **have convinced suppliers in Asia and Europe to establish parts production facilities in North America** to replace imports from non-NAFTA sources."[23] These companies took action in order to help offset the added costs that they would incur because of the impending restrictions on duty drawback.

Mr. Watkins continues: "Maquiladora and PITEX operations that continued to rely on non-North American inputs expressed concern to the Ministry of the Economy **that Article 303 of NAFTA would increase their costs** to the point of making their goods noncompetitive in the North American market relative to finished goods imported directly into the United States and Canada from sources other than Mexico."[24] Because restrictions on duty drawback reduce the cost-effectiveness of manufacturing operations, companies are left with higher costs, which are unable to be offset by duty drawback.

The ITC article goes on to say that "[m]any maquiladora representatives from Japan, Korea, Taiwan, *the United States*, and Mexico reportedly have been unable to locate suitable component suppliers in North America. These officials claim that the PPS [Mexico's Sectoral

---

[23] USITC Pub. 3443 (July 2001), *available at https://usitc.gov/publications /332/pub3443.1.pdf* (emphasis added).

[24] *Id.* (emphasis added).

Promotion Program] as currently constituted *is inadequate to meet their competitive needs, and have requested Mexican officials to consider additional financial incentives. Without incentives to compensate for increased costs due to NAFTA Article 303, some companies currently using maquiladora operations reportedly will start searching for opportunities in other countries.*"[25]

V. Conclusion

Duty drawback and deferral programs encourage commerce, manufacturing, and exportation. Duty drawback adds *profitability* to companies that export their goods. NAFTA imposed arbitrary restrictions on the drawback/deferral programs of each of the member countries, with the unfortunate result of reducing companies' profitability and competitiveness while Mexico and Canada developed work arounds.

As part of any renegotiation process of NAFTA, we urge the U.S. government to negotiate the elimination of Article 303 of NAFTA. The repeal of the NAFTA's drawback and deferral restrictions would give U.S. manufacturers and exporters the ability to use the duty drawback/deferral programs that have proven value for increasing the growth and competiveness of U.S. exports. Unrestricted drawback and free trade are designed to operate side-by-side. To impose arbitrary restrictions on duty drawback is antithetical to the concept of free trade itself. NAFTA should allow for the unrestricted use of duty drawback/deferral programs to their fullest extent.

Please contact the undersigned should you have any questions or require further information. Thank you.

Respectfully submitted,

Marc C Hebert

Marc C. Hebert
Christopher Cazenave

Jones Walker, LLP, on behalf of the
Duty Drawback Coalition

[25] *Id.* (emphasis added).

APPENDIX

I. Data and sources

A. Import duties paid in 2000: $ 19,858,000,000
(Source: U.S. Customs Fiscal Year 2001 Annual Report)

B. Value of Exported Goods in 2000: $785,600,000,000
(Source: Department of Commerce, International Trade Administration)

C. Drawback paid in 2000: $432,546,825
(Source: Department of the Treasury, U.S. Customs Service)

D. Number of jobs per every $1 billion in export goods: 14,500
(Source: Economic Policy Institute)

II. Equations

A) Drawback paid / Import duties x Value of exported goods $\equiv$[26]X

where X is the value of exported goods benefited by drawback.

$432,546,825 / $19,858,000,000 x $785,600,000,000 = $17,111,934,000

B) 14,500 jobs per $1 billion of exported goods[27] x Value of exported goods benefited by drawback = X

where X is the number of jobs related to exported goods benefited by drawback.

14,500 / $1,000,000,000 x $17,111,934,000= 248,000.

C) Drawback paid / Value of exported goods benefited by drawback x 100 = X

where X is the percentage of the value of drawback-benefited exports attributable to drawback.

$432,546,825 / $17,111,934,000 x 100 = 2.5%

---

[26] Note that the mathematical operator is "≡" (equivalent to), instead of "=". The dictionary defines "equivalent" as: "(1) having logical equivalence <*equivalent* statements>; or (2) corresponding or virtually identical especially in effect or function". If the equivalent equation is written as "DRAWBACK (I.E., A PORTION OF TOTAL IMPORT DUTIES, REFUNDED ON PARTICULAR EXPORTED GOODS) divided by TOTAL IMPORT DUTIES is equivalent to THE VALUE OF THE PARTICULAR EXPORTED GOODS THAT ARE BENEFITED BY DRAWBACK divided by THE VALUE OF ALL EXPORTED GOODS", the logical equivalence becomes clear.

[27] Economic Policy Institute estimate.

Exhibit List

1. Members of the Duty Drawback Coalition

2. Letter from Members of Congress to USTR (December 13, 2016)

3. Letter from Members of Congress to USTR (Sent Immediately after Ambassador Lighthizer's Confirmation)

4. Letter from Congress to USTR (September 4, 2003)

5. Public Comments Submitted to the Department of Commerce on March 31, 2017 in Response to Request for Comments on Reduction of Regulatory Burdens and Deferral Restrictions

6. National Association of Manufacturers Duty Drawback FR Response (July 30, 2003)

7. National Association of Manufacturers Market Access Submission – Americas Business Forum – Miami (November 17 – 19, 2003)

8. National Association of Manufacturers Market Access Abstract – Americas Business Forum – Miami (November 17 – 19, 2003)

9. Duty Drawback Coalition FTA Comments and List of Representative Entities (July 30, 2003)

10. USITC Article from ITTR Publication regarding NAFTA and Restrictions on Duty Drawback (July 2001)

11. Floor Statement from Senator John Breaux (July 31, 2003)

12. Presentation by Steve Lamar of AAFA regarding Loss of Duty Drawback in NAFTA and Impact on Textile & Apparel Industry (September 2003)

13. Live Example of NAFTA Drawback Limitations on a U.S. Chemicals Manufacturer

Exhibit 1

MEMBERS OF THE DUTY DRAWBACK COALITION

- American Association of Exporters and Importers
- American Petroleum Institute
- American Association of Port Authorities
- American Apparel and Footwear Association
- International Dairy Foods Association
- National Association of Manufacturers
- National Customs Brokers and Freight Forwarders Association
- National Retail Federation
- National Wine Institute
- Society of Chemical Manufacturers and Affiliates
- United States Fashion Industry Association
- BASF
- Charter Brokerage, L.L.C.
- Cerny & Associates
- C.J. Holt & Company
- Coca Cola
- Comstock & Theakston
- Constellation Brands, Inc.
- Fanwood Chemical, Inc.
- Jones Walker, LLP
- Port of New Orleans
- Sony Corporation

Exhibit 2

Congress of the United States
Washington, DC 20515

The Honorable Robert Lighthizer
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20006

Dear Ambassador Lighthizer,

We are writing to express our support for preserving duty drawback and deferral rights for U.S. manufacturers and exporters in our free trade agreements. Duty drawback and deferral rights are among the last remaining World Trade Organization (WTO) sanctioned export promotion programs available to U.S. manufacturers. These programs should remain available and unrestricted to U.S. manufacturers and exporters, allowing them to compete on a level playing field with foreign manufacturers who utilize similar programs. Our manufacturers and workers exporting U.S. made goods to foreign markets need and deserve every available export promotion program to keep them competitive in the global market – the duty drawback and deferral programs help accomplish such objective.

This issue was recently raised by a number of constituent companies with respect to the likely modernization of certain aspects of the North American Free Trade Agreement (NAFTA). The duty drawback program is restricted by Article 303 of the NAFTA such that U.S. manufacturers and exporters do not have the full benefits of this export promotion program when sending U.S. made goods to Canada or Mexico. In addition, Canada and Mexico have created duty relief programs that effectively circumvent the Article 303 drawback restrictions – this does not equal fair trade or a fair agreement. Other than the U.S. Chile FTA (Article 3.8) which entered into force more than a decade ago, no other FTAs negotiated by the U.S. have such antiquated restrictions which decrease the competitiveness of U.S. manufacturers and workers by increasing the costs of the U.S. goods they produce.

The ability to fully participate in the duty drawback and deferral programs is critical for U.S. manufacturers and exporters, as well as the thousands of Americans those industries employ nationwide, to level the playing field and maintain their competitiveness when exporting to foreign markets including Canada, Mexico, and Chile. As part of any NAFTA modernization process, we urge you to engage in consultations with the governments of Canada and Mexico, and Chile, to develop a pathway to eliminate the duty drawback and deferral restrictions in their respective Free Trade Agreements with the United States.

Thank you for your consideration of our request. We look forward to working with you to get this issue resolved.

Sincerely,

Jim Renacci
Member of Congress

Mike Thompson
Member of Congress

Ralph Abraham, M.D.
Member of Congress

Henry C. "Hank" Johnson
Member of Congress

Todd Rokita
Member of Congress

Pat Tiberi
Member of Congress

Erik Paulsen
Member of Congress

Carlos Curbelo
Member of Congress

Sam Johnson
Member of Congress

Jackie Walorski
Member of Congress

Tom Reed
Member of Congress

Mike Kelly
Member of Congress

Ron Kind
Member of Congress

R. P. Frelinghuysen
Rodney Frelinghuysen
Member of Congress

Cc: Secretary Wilbur Ross, Department of Commerce

Secretary John F. Kelly, Department of Homeland Security

Secretary Steven Mnuchin, Department of the Treasury

Exhibit 3

Congress of the United States
Washington, DC 20515

The Honorable Robert Lighthizer
United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20006

Dear Ambassador Lighthizer,

We are writing to express our support for preserving duty drawback and deferral rights for U.S. manufacturers and exporters in our free trade agreements. Duty drawback and deferral rights are among the last remaining World Trade Organization (WTO) sanctioned export promotion programs available to U.S. manufacturers. These programs should remain available and unrestricted to U.S. manufacturers and exporters, allowing them to compete on a level playing field with foreign manufacturers who utilize similar programs. Our manufacturers and workers exporting U.S. made goods to foreign markets need and deserve every available export promotion program to keep them competitive in the global market – the duty drawback and deferral programs help accomplish such objective.

This issue was recently raised by a number of constituent companies with respect to the likely modernization of certain aspects of the North American Free Trade Agreement (NAFTA). The duty drawback program is restricted by Article 303 of the NAFTA such that U.S. manufacturers and exporters do not have the full benefits of this export promotion program when sending U.S. made goods to Canada or Mexico. In addition, Canada and Mexico have created duty relief programs that effectively circumvent the Article 303 drawback restrictions – this does not equal fair trade or a fair agreement. Other than the U.S. Chile FTA (Article 3.8) which entered into force more than a decade ago, no other FTAs negotiated by the U.S. have such antiquated restrictions which decrease the competitiveness of U.S. manufacturers and workers by increasing the costs of the U.S. goods they produce.

The ability to fully participate in the duty drawback and deferral programs is critical for U.S. manufacturers and exporters, as well as the thousands of Americans those industries employ nationwide, to level the playing field and maintain their competitiveness when exporting to foreign markets including Canada, Mexico, and Chile. As part of any NAFTA modernization process, we urge you to engage in consultations with the governments of Canada and Mexico, and Chile, to develop a pathway to eliminate the duty drawback and deferral restrictions in their respective Free Trade Agreements with the United States.

Thank you for your consideration of our request. We look forward to working with you to get this issue resolved.

Sincerely,

Jim Renacci
Member of Congress

Ralph Abraham , M.D.
Member of Congress

Todd Rokita
Member of Congress

Erik Paulsen
Member of Congress

Sam Johnson
Member of Congress

Tom Reed
Member of Congress

Mike Thompson
Member of Congress

Henry C. "Hank" Johnson
Member of Congress

Pat Tiberi
Member of Congress

Carlos Curbelo
Member of Congress

Jackie Walorski
Member of Congress

Mike Kelly
Member of Congress

Ron Kind
Member of Congress

R. P. Frelinghuysen
Rodney Frelinghuysen
Member of Congress

Cc: Secretary Wilbur Ross, Department of Commerce

Secretary John F. Kelly, Department of Homeland Security

Secretary Steven Mnuchin, Department of the Treasury

Exhibit 4

Congress of the United States
Washington, DC 20515

September 4, 2003

The Honorable Robert Zoellick
U.S. Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

Secretary Donald L. Evans
U.S. Department of Commerce
1401 Constitution Avenue, N.W.
Washington, D.C. 20230

Secretary John W. Snow
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington D.C. 20220

Dear Ambassador Zoellick, Secretary Evans and Secretary Snow:

In response to the July 2, 2003 Federal Notice requesting public comments concerning the Treatment of Duty Drawback and Deferral Regimes in Free Trade Agreements and for consideration during the interagency process, we would like to take the opportunity to submit to you the following comments. We strongly support free trade agreements (FTA) as they encourage growth in domestic manufacturing, jobs and exports. We also strongly support maintaining duty drawback and duty deferral programs as they encourage growth and development in U.S. manufacturing, exports and jobs. In that regard, as the U.S.- Singapore, U.S.-Jordan and U.S.-Israel FTAs were silent on, and thus allowed, the application of full duty drawback and duty deferral programs to U.S. manufacturers, any FTA negotiations currently underway and all future FTAs also should provide for the application of full duty drawback and deferral programs.

Duty drawback and duty deferral programs reduce production and operating costs by allowing our manufacturers and exporters to recover duties that were paid on imported materials when the same or similar materials are exported either whole or as a component part of a finished product. Duty drawback positively affects nearly $16 billion of U.S. exports each year. Additionally, nearly 300,000 U.S. jobs are directly related to exported goods that benefit from drawback, and these high quality jobs could be adversely affected by eliminating or restricting drawback in FTAs.

Duty drawback and duty deferral programs provide substantial benefits to local industries, allowing them to compete on a level playing field in the global market:

Drawback makes a significant difference to U.S. companies at the margin when exporting to our FTA partners where they compete against foreign producers that either have substantially lower costs of production or enjoy low or zero import duty rates. This export promotion program is one of the last WTO-sanctioned programs which provides a substantial advantage to U.S. manufacturers participating in the export market. The application of these programs to U.S. manufacturers and exporters should not be restricted or eliminated in future FTAs that we negotiate with our trading partners.

We need to work hard to complete FTAs that provide as many competitive advantages as we can to U.S. manufacturers competing in the global market, encourage growth in U.S. exports, and create U.S. jobs. We look forward to working with your office in this regard. Please do not hesitate to contact us or our staff if we can assist you in any way.

Sincerely,

Kevin Brady

William J. Jefferson

Wally Herger

Donald A. Manzullo

Rob Portman

Steven R. Rothman

Phil Crane

Jim Turner

Steve Chabot

David Vitter

Exhibit 5

The Duty Drawback Coalition

499 South Capitol Street, Suite 600
Washington, D.C. 20003

"Working to preserve export promotion programs for U.S. manufacturers and workers."

March 31, 2017

PUBLIC DOCUMENT

The Office of Policy and Strategic Planning
Department of Commerce
H.C. Hoover Building Rm. 5863
1401 Constitution Ave. NW.
Washington, D.C. 20230

Re: Impact of Federal Regulations on Domestic Manufacturing: The Need to Repeal Duty Drawback and Deferral Restrictions in NAFTA
83 Fed. Reg. 43, pp. 12786-12788 (Mar. 7, 2017); FR Doc No: 2017-04516
Docket Number: 170302221-7221-01

Dear Department of Commerce:

Pursuant to Federal Register Volume 82, Number 43 dated March 7, 2017, the Duty Drawback Coalition (the "Coalition") provides this submission to recommend a reduction in the regulatory burdens on U.S. manufacturers. Specifically, the Coalition urges the Department to include in its regulatory burden reduction proposal the repeal of the Article 303 duty drawback and deferral restrictions in the North American Free Trade Agreement ("NAFTA").

I. Executive Summary

For the past 13 years the Duty Drawback Coalition has been a staunch supporter of export promotion programs that benefit U.S. manufacturers and trade associations representing numerous sectors of the economy. We write to express our strong support for the duty drawback and deferral program and urge that all language in existing free trade agreements that restrict the application of those programs be removed. These programs enable U.S. firms to remain competitive in the global marketplace and are the last remaining WTO sanctioned export promotion programs available to U.S. manufacturers. We believe that they should remain available in an unrestricted manner to U.S. manufacturers, allowing them to compete on a level playing field with foreign manufacturers. The NAFTA and U.S.-Chile Free Trade Agreement ("USCFTA") are the only U.S. free trade agreements ("FTAs") that contain restrictions on duty drawback and deferral for U.S. exports. All subsequent U.S. FTAs, including the Trans-Pacific Partnership ("TPP") agreement, do not restrict the duty drawback and deferral programs in any manner.

NAFTA includes restrictions to duty drawback and deferral restrictions for U.S. manufactures exporting to Canada and Mexico. These provisions place U.S. manufacturers at a substantial disadvantage as compared to foreign competitors when exporting products to Canada or Mexico. Duty drawback benefits U.S. exporters by allowing a refund of Customs duties, taxes and other fees imposed on imported goods that are used as inputs in the production of manufactured products that are later exported, or where the imported good is substituted for the same or similar US made good that is later exported. This allows U.S. manufacturers and exporters to reduce costs and remain competitive in pricing their goods when exported. The policy rationale supporting duty drawback is as simple as it is powerful: to increase the competitiveness of U.S. manufacturers that export and to create and maintain U.S. jobs.

The duty drawback and deferral restrictions in NAFTA should be repealed to place U.S. manufacturers on a level playing field with their foreign competitors and to help increase growth in U.S. manufacturing and jobs, and thus increase U.S. exports to Mexico and Canada. Both Canada and Mexico have provided circumvention measures for their domestic manufacturers exporting to the other NAFTA-member countries. **Drawback supports 331,168 U.S. manufacturing and export jobs, based on $55.5 billion in exports**.[1]

[1] These jobs (and their respective industries) have been, and will continue to be, the ones that are the most adversely affected by any restrictions to, or elimination of, duty drawback in a free trade agreement. Although the total number of jobs in the labor force might theoretically remain constant, closer analysis will show that the jobs that will be gained will be lower quality jobs in the retail and services sectors, while those that are lost will be the higher quality jobs in the manufacturing sector, particularly those jobs involved in exported goods. In a paper entitled "Fast track to lost jobs: Trade deficits and manufacturing

II. The Establishment of Duty Drawback

Duty drawback was established by the U.S. Congress through enactment of the first tariff bill in 1789 in order to support U.S. manufacturers and exporters. Duty drawback allows for the refund of Customs duties, taxes, and fees paid on imported goods that are used as inputs in the production of manufactured products that are later exported, or where the imported good is substituted for the same or similar good that is later exported.[2] This allows U.S. manufacturers and exporters to reduce the cost of inputs, and thus reduce manufacturing costs to remain competitive in pricing their exported goods. [3]

U.S. manufacturers operating in foreign trade zones (considered outside of U.S. Customs territory) can use duty deferral to defer the payment of import duties, taxes and fees on imported foreign component parts or raw materials until those goods or the finished product incorporating those goods are entered into the U.S. market for consumption. If such goods are never entered for consumption, but rather exported, the duties, taxes and fees are not paid. In either situation, its gives a cost of production and pricing advantage to U.S. manufacturers competing in the global market.

Duty drawback and duty deferral are not unique to the United States. In fact, duty drawback and deferral regimes are utilized by most countries around the world, including all nations that were included in the Trans-Pacific Partnership and NAFTA. Duty drawback is the last remaining export promotion program allowed by the World Trade Organization (WTO).

A. The Intent of Drawback: Legislative History Supporting the Program

---

decline are the legacies of NAFTA and the WTO", author Robert E. Scott of the Economic Policy Institute writes that "The manufacturing sector, where the trade deficit rose 158.5% between 1994 and 2000, shouldered 65% of the surge in job losses during that period."

[2] 19 U.S.C. § 1313.

[3] The following industries/market sectors benefit from duty deferral programs: Agricultural products and equipment/machinery, Airlines, Apparel, Automobiles, Automotive parts, Beverages, Chemicals, Civilian and military aircraft, Cosmetics, Ecommerce, Electronics, Food products, Footwear, Jewelry, Juice products (e.g., OJ), Petroleum, Pharmaceuticals, Machinery, Metals, Retail distributors, Sporting goods, Tobacco. Vessel supplies and Wine.

The policy rationale supporting duty drawback is as simple as it is powerful: to increase the competitiveness of U.S. manufacturers that export and to create and maintain U.S. jobs. Congress stated the rationale for duty drawback:

> "The purpose of [duty drawback] is to permit American-made products to compete more effectively in world markets. It enables domestic manufacturers … to select the most advantageous sources for their raw materials and component requirements without regard to duties, thereby permitting savings in their production costs. It also encourages domestic production and, as a result, the utilization of American labor and capital."[4]

The U.S. Customs Service recognizes that the drawback program was initiated to create jobs and encourage manufacturing and exporting:

> "Historically the word drawback has denoted a situation in which a duty or tax that has been lawfully collected is refunded or remitted, wholly or partially, because of a particular use made of the commodity on which the duty or tax was collected.
>
> Drawback was initially authorized by the first tariff act of the United States in 1789. Since then, it has been part of the law, although from time to time the conditions under which it is payable have changed. The rationale for drawback has always been to **encourage American commerce or manufacturing, or both**. It permits the American manufacturer to compete in foreign markets without the handicap of including in his costs, and consequently in his **sales price**, the duty paid on imported merchandise.
>
> The purpose of drawback is to enable a manufacturer to compete in foreign markets. To do so, however, the manufacturer must know,

[4] "Overview and Compilation of U.S. Trade Statutes" (2003 edition), pp. 78-79.

> prior to making contractual commitments, that he will be entitled to drawback on his exports. The drawback procedure has been designed to give the manufacturer this assurance and protection."[5] [emphases added]

From *Tidewater Oil Co. v. United States*, 171 U.S. 210 (1898)

"The purpose of drawback was described in 1898, by the U.S. Supreme Court in the case of *Tidewater Oil Co. vs. United States*, 171 U.S. 210 (1898), as being "not only **to build up an export trade**, but to encourage manufactures in this country, where such manufactures are intended for exportation, **by granting a rebate of duties upon the raw or prepared materials imported, and thus enabling the manufacturer to compete in foreign markets with the same articles manufactured in other countries**." [emphases added]

From *Texport Oil Co. v. United States*

"The purpose of drawback is to place those who export from the United States **on an equal footing with overseas competitors, by largely refunding the sums paid to import certain materials, thus eliminating or diminishing the cost disadvantage resulting from the presence of import duties,** taxes, or fees."[6] [emphases added]

From the legislative history report of the Customs Mod Act from the House Ways and Means Committee (House Report 103-361, 103d Cong., 1st Sess. (1993)):

"The Committee maintains that **the purpose of drawback continues to be to promote** economic activity in the United States, resulting in **increased exports**." [emphases added]

From the legislative history report of the Customs Mod Act from the Senate Finance Committee (S. Rep. 103-189, 103d Cong., 1st Sess. (1993)):

"Section 632 of the implementing bill contains provisions **intended to expand** U.S. **exports** and facilitate the use of drawback by easing administrative burdens while ensuring

[5] Department of the Treasury, U.S. Customs Service.
[6] *Texport Oil Company v. United States*, Nos. 98-1352, -1353, -1373 (Fed. Cir. 1999).

improved compliance (through increased penalties and informed compliance provisions) with the laws and regulations governing drawback." [emphasis added]

The intent of Congress is to grant drawback when and wherever possible to benefit U.S. companies, not to limit drawback simply because the United States enters into a FTA that reduces import tariffs with the FTA partner. The most efficient way to ensure that an FTA and duty drawback/deferral work together to maximize trade between member countries of an FTA is not to include any language restricting duty drawback/deferral in the FTA.

III. Restrictions on Duty Drawback/Deferral in NAFTA

NAFTA was the first U.S. multilateral trade agreement, which entered into force on January 1, 1994. Article 303 of NAFTA restricts duty drawback and deferral on U.S. exports to Canada and Mexico. The duty drawback restriction of NAFTA was implemented in 19 U.S.C. § 1313(j)(4)(A).

The drawback and deferral restrictions were included in NAFTA to prevent China from using Mexico as an "export platform" for component parts for the manufacture of goods to be exported to the United States, but this fear would not be realized. The restrictive language in NAFTA was carried over to the U.S. Chile Free Trade Agreement. In 2003, after U.S. manufacturers, exporters and workers voiced their opposition to drawback and deferral restrictions to USTR, Treasury/CBP and Commerce, the U.S. negotiating objective for FTAs was changed to no longer seek such restrictions. Since that time, no FTAs subsequent to NAFTA and USCFTA have such restrictive language.

Because duty drawback is restricted under NAFTA, a U.S. manufacturer importing and paying duties on foreign components and exporting a finished U.S. good to Mexico or Canada, would be subject to greater production costs and higher export prices compared to a factory located in any other non-NAFTA country. This is more problematic and more harmful to our U.S. manufacturers and workers as the dollar strengthens against other currencies, making the cost to purchase U.S. goods abroad more expensive. U.S. manufacturers and workers need every advantage to ensure that they can compete on a fair and level playing field in the global market.

Duty drawback and duty deferral programs are a major factor for companies to achieve these goals.

A. Legislative History for NAFTA Implementation Act (Public Law 103-182)

The reasons for NAFTA's restrictions on duty drawback are given in the legislative history reports. The Coalition provides the provided comments in response to these reasons.

1. House Ways & Means Committee Report: Reasons for change

"Section 203, when fully implemented, serves to remove the trade distorting provisions of the drawback laws by placing restrictions on duty drawback on trade between NAFTA countries. This is critical to ensure that none of NAFTA countries can become an "export platform" for materials produced in other regions of the world."

"The NAFTA drawback formula will also have the benefit, in practice, of limiting the amount of drawback for components imported from non-NAFTA countries, thus further ensuring that the benefits of NAFTA preferential duty treatment only accrue to NAFTA parties."

<u>Coalition Comment</u>: While there are benefits for the United States and the other NAFTA countries because of preferential duty treatment, these benefits are diminished when duty drawback is restricted because product costs are not reduced as much as they could be. Therefore, the cost of production increases and either sales are lost or profit margins are decreased and, more importantly, the ability to sell these products at competitive prices is hampered. Ultimately, U.S. manufacturers, workers and exporters suffer because of restrictions on duty drawback.

B. Work Around Measures Created by Canada and Mexico

To their credit, Canada and Mexico have created duty relief programs that work around the drawback restrictions in Article 303 of NAFTA. This does not equal fair trade or a fair agreement. Canada and Mexico minimize the duty drawback restrictions on their manufacturers and workers through the use of programs that target duty rate reductions for inputs used in specific export industries. These programs include Sectoral Promotion Program in Mexico and targeted duty reductions in Canada. Thus, U.S. exporters and workers are further disadvantaged under NAFTA. ***Without a correction, there will remain an incentive to shift manufacturing operations to non-U.S. locations, such as Canada or Mexico, where drawback is not restricted.***

IV. The Rationale for Restricting Drawback Rights in FTAs No Longer Exists

The rationale for restricting drawback rights in FTAs no longer exists, and no empirical evidence has surfaced that would lead one to believe otherwise. There were two primary reasons for restricting drawback in a FTA, both of which have been proven false. First, it was believed that drawback restrictions were necessary to create a disincentive for the development of export platforms; yet such restrictions have had an effect adverse to that intended. Second, drawback was considered an export subsidy that should be eliminated. However, according to the WTO's Agreement on Subsidies and Countervailing Measures, drawback does not constitute an export subsidy.

1. Restricting Drawback Actually Encourages, Rather than Discourages, the Creation of an Export Platform

The continued proliferation of FTAs makes the U.S. position about export platforms a moot point, with no empirical evidence to substantiate the premise. The negotiating position of the United States in NAFTA was that the elimination of duty drawback was necessary to create a disincentive for Asian and European countries to establish export platforms in Mexico or Canada to the detriment of U.S. manufacturers and suppliers of inputs. However, in anticipation of the restrictions on duty drawback, a number of companies with maquiladora and PITEX operations in Mexico convinced suppliers in Asia and Europe to establish parts production facilities in North America to replace imports from non-NAFTA sources. Furthermore, many maquiladora representatives from Japan, Korea, Taiwan, the United States, and Mexico have been unable to locate suitable component suppliers in North America. These officials requested Mexican officials to consider additional financial incentives. Without incentives to compensate for increased costs due to the drawback restrictions in NAFTA Article 303, some companies using maquiladora operations have searched for opportunities in other countries.

Over time, and with the imposition of NAFTA Article 303 drawback restrictions, our NAFTA trading partners have instituted trade policies to diminish the financial impact on domestic manufacturers of the duty drawback restrictions contained in NAFTA. The United States has done nothing to counter the same adverse impacts on U.S. manufacturers and exporters. For example, in anticipation of the adverse economic impact that Article 303 would have on its maquiladoras, Mexico instituted its Sectoral Promotion Programs ("PPS"). Under the PPS, Mexico reduced many of its NTR duty rates so that domestic manufacturers could obtain non-NAFTA inputs with the least adverse economic impact as drawback became restricted. In addition, Canada reduced its NTR duty rates so that the imposition of the drawback restrictions under NAFTA had the least adverse economic impact upon domestic manufacturers. These actions not only circumvent the original intent of drawback restrictions as relates to the creation of an export platform, but also demonstrate that the premise is fallible.

2. 2001 Report by the U.S. International Trade Commission (ITC) on Drawback Restrictions in NAFTA

In an article entitled "Regulatory Changes in Mexico Affecting U.S.-Affiliated Assembly Operations - NAFTA Article 303 and Restrictions on Duty Drawback" author Ralph Watkins, in the ITC publication number 3443, comments on "Article 303 of NAFTA, which restricted duty drawback for goods traded between Mexico and its NAFTA partners effective January 1, 2001". He states that "[i]n anticipation of the restrictions on duty drawback, a number of companies with Maquiladora and PITEX operations *have convinced suppliers in Asia and Europe to establish parts production facilities in North America* to replace imports from non-NAFTA sources." [emphasis added] These companies took these actions in order to help offset the added costs that they would incur because of the impending restrictions on duty drawback.

The ITC stated that: "Maquiladora and PITEX operations that continued to rely on non-North American inputs expressed concern to the Ministry of the Economy **that Article 303 of NAFTA would increase their costs** to the point of making their goods noncompetitive in the North American market relative to finished goods imported directly into the United States and Canada from sources other than Mexico." [emphasis added] Because restrictions on duty drawback reduce the cost-effectiveness of manufacturing operations, companies are left with higher costs (which are unable to be offset by duty drawback).

The ITC article goes on to say that "[m]any maquiladora representatives from Japan, Korea, Taiwan, *the United States*, and Mexico reportedly have been unable to locate suitable component suppliers in North America. These officials claim that the PPS [Mexico's Sectoral Promotion Program] as currently constituted *is inadequate to meet their competitive needs, and have requested Mexican officials to consider additional financial incentives. Without incentives to compensate for increased costs due to NAFTA Article 303, some companies currently using maquiladora operations reportedly will start searching for opportunities in other countries*". [emphases added]

3. Duty Drawback Creates Incentives and Advantages for Domestic Manufacturers and Exporters

Almost every country has duty deferral mechanisms, inclusive of drawback program. Duty drawback is the only GATT/WTO-sanctioned export promotion programs used by the United States. The WTO has commented that the drawback programs in other countries, as well as that in the United States, have the following positive effects: "Creates an export incentive; counteracts the negative effects of high import tariffs; establishes a strong magnet for export-oriented foreign direct investment; provides benefits to exporters and manufacturers; and, removes a bottleneck to private sector development."

According to the WTO, as well as to the intention of Congress and over 200 years of experience, duty drawback promotes, encourages and benefits exports. Workers in exporting industries have greater productivity and higher wages than do workers in other industries. Export promotion programs such as drawback are necessary to encourage exports and enhance U.S. competitiveness abroad.

V. Duty Drawback and Deferral Restrictions Should Be Removed From NAFTA

The elimination of duty drawback and duty deferral benefits in NAFTA amounts to a form of *unilateral disarmament* of U.S. manufacturers, exporters, and workers who compete in the global marketplace. Such restrictions only serve to make U.S. manufacturers less competitive and result in the loss of U.S. exports and U.S. jobs. Other than the U.S. Chile Free Trade

Agreement (Article 3.8), no other FTA negotiated by the United States includes restrictions on duty drawback and deferral.

The purpose of both FTAs and drawback is to provide the greatest overall benefits to U.S. manufacturers and exporters. To impose arbitrary restrictions on duty drawback is antithetical to the concept of free trade itself. Duty drawback (substitution) or duty deferral restrictions under Article 303 of NAFTA should be eliminated in order to ensure that U.S. producers and manufacturers can take advantage of this last remaining WTO export promotion program when competing against foreign competitors in exporting U.S. goods to Canada and Mexico. Our competitors have full access to these programs. Thus, U.S. manufacturers are disadvantaged under NAFTA because foreign manufacturers in Japan, China, and India receive these drawback benefits when exporting to Canada and Mexico. U.S. manufacturers and workers must be able to take advantage of every program possible to compete on a fair and level playing field in the global market. Restrictions on their ability to do so is not considered fair trade, and results in increased cost of production of U.S. goods and an increase in the price of U.S. exports.

As the U.S. dollar strengthens, our exports become more costly to consumers in Canada and Mexico. Accordingly, our U.S. manufacturers and workers need full use of the drawback and deferral programs to help offset rising production costs and reduce export prices of U.S. goods. Reinstating these programs for use with exports to Canada and Mexico will reintroduce fair trade, and will help level the playing field for our manufacturers and workers.

If the duty drawback restrictions of NAFTA are allowed to continue to undermine U.S. manufacturers competing for export sales to Canada and Mexico, many of the high-quality, good-paying U.S. jobs associated with exports will be lost. U.S. policymakers should not allow such an outcome. As part of any renegotiation process of NAFTA, we urge the U.S. government to engage in consultations with the governments of Canada and Mexico to develop a pathway to eliminate the duty drawback and deferral restrictions in NAFTA.

VI. Conclusion

At a time when U.S. manufacturers' economic health is being threatened by many different forces around the world, we believe that the Administration should be doing everything within its power to ensure that U.S. manufacturing, distribution and exporting manufacturers are given every possible opportunity to not only survive, but also to prosper. Until all tariffs into the U.S. are eliminated, U.S. exporters and manufacturers require and should be granted every possible advantage to not only compete on a level-playing field against their foreign competitors, but to <u>win</u> in the global market.

Duty drawback encourages commerce, manufacturing, and export. NAFTA imposed arbitrary restrictions on the drawback programs of each of the member countries, with the unfortunate result of reducing U.S. companies' profitability while increasing costs of production and pricing in the export market. If U.S. trade policy is to identify and provide mechanisms with which to pursue greater market access for U.S. exports of goods and services,[7] then duty drawback and duty deferral should not be restricted in FTAs. Duty drawback and duty deferral comports with U.S. trade policy in a number of areas, including export promotion, export growth and increased productivity and development in U.S. manufacturing and refining operations. The inclusion of full and unrestricted duty drawback and duty deferral rights in FTAs will strengthen U.S. competitiveness and productivity.

As part of any renegotiation process of NAFTA, we urge the U.S. government to engage in consultations with the governments of Canada and Mexico to develop a pathway to eliminate the duty drawback and deferral restrictions in NAFTA. The repeal of the NAFTA's drawback restrictions would allow each country the freedom to continue its own duty drawback program that has proven its value for that country. To maintain the imposition of arbitrary restrictions on duty drawback is antithetical to the concept of export promotion and growth in U.S. manufacturing.

The duty drawback and deferral program is critical for U.S. manufacturers and exporters and the regulatory restrictions on these programs should be eliminated in NAFTA and 19 U.S.C. Sec. 1313(j)(4).

---

[7] *See* NAFTA Sec. 108 - Congressional Intent Regarding Future Accessions.

Please contact the undersigned Marc Hebert at mhebert@joneswalker.com or Wes Coulam at Wes.Coulam@wc.ey.com should you have any questions or require further information. Thank you.

Respectfully submitted,

Marc C. Hebert
Jones Walker, LLP
On behalf of the Duty Drawback Coalition

Member companies of the Duty Drawback Coalition:

American Association of Exporters and Importers
National Customs Brokers and Freight Forwarders Association
American Association of Port Authorities
American Apparel and Footwear Association
National Retail Federation
United States Fashion Industry Association
National Wine Institute
American Petroleum Institute
Society of Chemical Manufacturers and Affiliates
Port of New Orleans
Constellation Brands, Inc.
Fanwood Chemical, Inc.
Sony Corporation
Charter Brokerage, L.L.C.
Jones Walker, LLP
Cerny & Associates
C.J. Holt & Company
Comstock & Theakston

APPENDIX

I. Data and sources

A. Import duties paid in 2015: $ 37 Billion
(Source: U.S. Customs Fiscal Year 2015 Annual Report)

B. Value of Exported Goods in 2000: $1.5 Trillion
(Source: Department of Commerce, International Trade Administration)

C. Drawback paid in 2000: $1 Billion
(Source: Department of the Treasury, U.S. Customs Service)

D. Number of jobs per every $1 billion in export goods: 5,967
(Source: Economic Policy Institute)

II. Equations

A) Drawback paid / Import duties x Value of exported goods ≡[8] X

where X is **the value of exported goods benefited by drawback**.

$1 Billion/ $37 Billion x $1.5 Trillion **= $55.5 Billion**

B) 5,967 jobs per $1 billion of exported goods[9] x Value of exported goods benefited by drawback = X

where X is **the number of jobs related to exported goods benefited by drawback.**

5,967/ $1 Billion x $55.5 Billion = **331,168**

C) Drawback paid / Value of exported goods benefited by drawback x 100 = X

where X is **the percentage of the value of drawback-benefited exports attributable to drawback**.

$1 Billion / $55.5 Billion x 100 = **1.8%**

---

[8] Note that the mathematical operator is "≡" (equivalent to), instead of "=". The dictionary defines "equivalent" as: "(1) having logical equivalence <*equivalent* statements>; or (2) corresponding or virtually identical especially in effect or function". If the equivalent equation is written as "DRAWBACK (I.E., A PORTION OF TOTAL IMPORT DUTIES, REFUNDED ON PARTICULAR EXPORTED GOODS) divided by TOTAL IMPORT DUTIES is equivalent to THE VALUE OF THE PARTICULAR EXPORTED GOODS THAT ARE BENEFITED BY DRAWBACK divided by THE VALUE OF ALL EXPORTED GOODS", the logical equivalence becomes clear.
[9] Economic Policy Institute estimate.

Exhibit 6

National Association of Manufacturers

July 30, 2003

Ms. Gloria Blue
Executive Secretary, Trade Policy Staff Committee
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508
VIA ELECTRONIC MAIL: FR0079@ustr.gov

RE: Written Comments on the Treatment of Duty Drawback and Deferral Regimes in Free Trade Agreement Negotiations Currently Underway With Central America, Australia, Morocco, the Southern African Customs Union and the Countries Participating in the Free Trade Area of the Americas (FTAA)

The National Association of Manufacturers (NAM) makes this submission in response to the request for public comments by the Office of the U.S. Trade Representative published in the July 2, 2003 *Federal Register* (68 *Federal Register* 39614-39615). The NAM represents 14,000 manufacturers with operations in the United States, including 10,000 small and medium sized U.S. manufacturers.

The NAM strongly supports the retention of duty drawback and duty deferral regimes in free-trade agreement negotiations that are currently underway or that may be launched in the future. In this respect, the NAM endorses the detailed submission made by the Coalition for Duty Drawback in Free Trade Agreements, of which it is a member. In this submission, the NAM would like to highlight a few points in the debate that we deem particularly critical to American manufacturing.

The purpose of duty drawback and deferral programs – which rebate, defer or reduce duties paid on material inputs contingent upon exportation of the processed or finished goods – is to assist American business and labor to compete more effectively in foreign markets by assuring that the cost of doing business in such markets is free from the additional cost of U.S. Customs duties. As such, duty drawback provides significant cost advantages to U.S.-based exporters of manufactured goods that incorporate some foreign components. Moreover, duty drawback is a worldwide practice employed by all of our international competitors, and selective disarmament by the United States puts our exporters at a significant disadvantage. Given the increasingly globalized nature of production today, more U.S. manufacturers source a greater portion of their components from abroad than in the past. Intensified international competition has also squeezed profit margins for U.S. manufacturers, who face rising costs but cannot raise prices. Since 1994, prices for U.S. manufactured goods have fallen six percent, while prices for other goods and services, including many which make up manufacturers' cost structure, have risen 18 percent. In this context, duty drawback's importance as a factor in the competitiveness of U.S. manufacturing exports has grown significantly.

Under such circumstances, it becomes even more important that the concrete benefits provided by duty drawback and duty deferral programs for U.S.-based manufacturing not be removed. We remain unconvinced of the arguments for removing drawback outlined in the USTR *Federal Register* notice. NAM members have reported no evidence or concerns, for instance, that retention of drawback in FTAs could "distort investment decisions by creating an incentive for investors to locate in the FTA partner country in order to benefit from duty drawback when exporting processed goods for sale in the U.S. market," or that "export platforms" would be created for third-country materials. Prevention of the latter potential practice, we note, would seem to lie more in the province of rules of origin than via removal of a long-standing, concrete benefit for manufacturers in the FTA.

In our view, the current U.S. policy of elimination of drawback and duty deferral regimes under FTAs is more likely to lead to outcomes that are prejudicial to U.S.-based manufacturing than it is to lead to prevention of alleged “investment distortions” or “export platforms.” On the one hand, there is significant evidence – outlined more completely in the Coalition submission – that our FTA trading partners (in NAFTA) readily circumvent the prohibition on drawback, restoring essentially equivalent benefits for their manufacturers while leaving ours without a similar benefit. On the other hand, the removal of drawback in our expanding number of FTAs raises the specter that the whittling away of the scope of trade for which duty drawback can be used will increasingly act as an incentive for shifting manufacturing operations to non-U.S. locations where drawback is not restricted.

Duty drawback and deferral regimes are one of the few incentives for manufactured exports that remain legal under World Trade Organization rules. As such, these programs should be preserved, even for trade with our bilateral or regional free-trade partners, because they can make a significant difference to U.S. manufacturers that export to our FTA partners in cases where they compete against foreign producers that either have substantially lower costs of production or that enjoy low or zero import duty rates. The elimination of duty drawback, on the other hand, will make many U.S. export sales more costly and less competitive.

As most-favored-nation tariffs are eliminated, duty drawback will die a natural death. In the meantime, however, removing duty drawback prematurely and unilaterally only for trade between the United States and its FTA partners, negatively impacts U.S. manufacturers that export in several important ways: 1) By unnecessarily undermining the preferential advantage in FTA markets achieved by U.S.-based manufacturers that export over third-country, non-FTA exporters that retain their domestic drawback on inputs used in competing exports to U.S. free-trade partners; 2) By putting U.S.-based manufacturers that export at a disadvantage as compared to exporting manufacturers based in our FTA partners, given that FTA partners in practice find ways to restore drawback benefits (through targeted sectoral tariff eliminations, for instance); and 3) By imposing a tax increase on U.S. manufacturers that export during a time of increasing international competition, i.e. when they can least afford it.

In conclusion, the NAM urges that U.S. policy be recast to favor retention of duty drawback and duty deferral regimes in all bilateral, sub-regional, and regional free-trade agreements currently under negotiation, as well as in future trade negotiations. This includes the potential agreements with Central America, Morocco, Australia, Southern African Customs Union, and Bahrain, as well as the Free Trade Area of the Americas.

Thank you for the opportunity to comment on this important issue of vital interest to American manufacturing.

Prepared by:	International Economic Affairs Department National Association of Manufacturers
Please direct questions to:	Scott Otteman Director, International Trade Policy National Association of Manufacturers Tel. (202) 637-3078 Fax (202) 637-3182 E-mail: sotteman@nam.org

Exhibit 7

NATIONAL ASSOCIATION OF MANUFACTURERS[1]

SUBMISSION TO THE MARKET ACCESS WORKSHOP OF THE VIII AMERICAS BUSINESS FORUM

NOVEMBER 17-19, 2003 – MIAMI, FLORIDA – USA

TARIFFS & NON-TARIFF MEASURES

Tariffs

1) The base tariffs from which tariffs would be phased out should be applied rates rather than bound rates under the WTO. Specifically, the base tariffs should be either individual-country applied rates or common external tariffs applied by sub-regional customs unions, whichever is lower. In this respect, we strongly support the sections pertaining to the Negotiating Group on Market Access contained in the June 20, 2002 derestricted negotiating document on "Methods and Modalities for Negotiations" (FTAA.TNC/20), which reflects the desire of the large majority of FTAA delegations to use applied rates as the basis for the negotiations. The decision to use applied rates as base rates should be expressed in Section Two, Paragraph 4.2 of the Tariffs and Non-Tariff Measures chapter (p. 5.2).

2) We also strongly urge Ministers to instruct the market access negotiating group to agree on a package of sectors for immediate duty

1 The NAM represents approximately 14,000 manufacturing firms with operations in the United States.

elimination upon the FTAA's entry into force. Among the sectors that the NAM would like to see included in the immediate tariff-elimination basket are the following: agricultural equipment; carpets & rugs; chemicals; construction & mining equipment; copper & copper alloy brass mill products; cosmetics; distilled spirits; electrical equipment; energy products; environmental products; fertilizer; information technology & electronics products; gems & jewelry; medical equipment; paper products; pharmaceuticals; printing, publishing & converting technologies; processed foods; soda ash; sporting goods; steel products; toys; travel goods; wood machinery; and wood products. The negotiated results would be expressed by listing the Harmonized System tariff lines of items in agreed sectors in the immediate-elimination basket of the Tariff Elimination Program Annex referenced in Section Two, Art. 4 (p. 5.2).

3) Phaseouts of industrial tariffs should be front-loaded rather than back-loaded. We support the decision to have four basic phaseout baskets, but believe most hemispheric trade should become tariff-free sooner rather than later.[2] This commitment by Ministers should be expressed in the Miami Ministerial Declaration and instructions to the Negotiating Group on Market Access. Fulfillment of that commitment would be reflected in the

2 In derestricted document FTAA.TNC/20 of June 20, 2002, the FTAA Trade Negotiations Committee (TNC) agreed that tariffs would be eliminated in four phases: 1) immediate; 2) no more than five years; 3) no more than 10 years; and 4) longer. The TNC also agreed that all FTAA countries would make "significant" offers in the immediate tariff elimination category.

ongoing request-offer process and, ultimately, in the Tariff Elimination Program Annex referenced in Section Two, Art. 4 (p. 5.2).

4) FTAA trade ministers in Miami should jointly issue a standstill commitment not to raise duties and related charges on trade with FTAA partners during the duration of the negotiations.

5) The FTAA should not restrict the ability of Parties to use duty drawback or duty deferral regimes with respect to trade with other FTAA Parties. In this respect, we support Paragaph 5.1.1A (p. 5.4) and advocate the removal of Paragraph 5.1.1B (p. 5.4).

6) The FTAA Parties should commit to maintain zero duties and non-discriminatory treatment for electronic transmissions. The zero-duty commitment could be expressed in a new Article to be inserted after Article 4 in Section One of the Market Access chapter (p. 5.4). The new article should read: *No Party may apply customs duties on digital products of another Party.* More broadly, the FTAA should require Parties to accord non-discriminatory treatment to digital products of another Party, similar to the treatment provided in U.S.-Chile FTA Article 15.4.

7) A new Paragraph 7.7 (p. 5.9) should be added on Customs Valuation. It would read: *For purposes of determining the customs value of carrier media bearing content, each Party shall base its determination on the cost or value of the carrier media alone. 2. For purposes of the effective*

imposition of any internal taxes, direct or indirect, each Party shall determine the tax basis according to its domestic law.

8) Paragraph 7.1 should be strengthened to emphasize that the *customs valuation of goods shall be based on transaction value* in addition to being [governed by/determined in accordance with] the WTO Agreement on Implementation of Article VII of GATT 1994.

9) As soon as possible, and certainly no later than the entry into force of the FTAA, all FTAA nations should join the existing WTO Information Technology Agreement (ITA). This commitment could be expressed in a new Article to be inserted after Article 4 in Section One of the Market Access chapter (p. 5.4).

   Additionally, important information technology products not covered by the original ITA – the classification of convergence products, including those in the multi-media arena, and harmonization of classifications of all information technology products – are of very high priority as well.

10) FTAA nations should sign on as soon as possible to the WTO Basic Telecommunications Agreement, which is designed to increase competition and create pro-competitive regulatory structures. This commitment could be incorporated in a new Article after Article 4 in Section One of the Market Access chapter (p.5.4) or in any stand-alone telecom section.

Non-Tariff Measures

1) Import and Export Restrictions – Paragraphs 8.1 thru 8.4 of Section Three (p. 5.9) should be simplified to read as follows:

8.1 Except as otherwise provided in this Agreement, no Party may adopt or maintain any prohibition or restriction on the importation of any good of another Party or on the exportation or sale for export of any good destined for the territory of another Party, except in accordance with Article XI of the GATT 1994 and its interpretative notes and to this end Article XI of GATT 1994 and its interpretative notes are incorporated into and made a part of this Agreement, mutatis mutandis.

8.2 The Parties understand that the GATT rights and obligations incorporated by paragraph 8.1 prohibit, in any circumstances in which any other form of restriction is prohibited, a Party from adopting or maintaining:

a) export and import prices requirements, except as permitted in enforcement of countervailing and antidumping orders and undertakings;

b) import licensing conditioned on the fulfillment of a performance requirement;

c) voluntary export restraints not consistent with Article VI of GATT 1994, as implemented under Article 18 of the WTO Agreement on Subsidies and Countervailing Measures and Article 8.1 of the WTO Agreement on Implementation of ArticleVI of the GATT 1994.

8.3 In the event that a Party adopts or maintains a prohibition or restriction on the importation from or exportation to a non-Party of a good, nothing in this Agreement shall be construed to prevent the Party from:

a) limiting or prohibiting the importation from the territory of the other Party of such good of that non-Party; or

b) requiring as a condition of export of such good of the Party to the territory of the other Party, that the good not be re-exported to the non-Party, directly or indirectly, without being consumed in the territory of the other Party.

8.4 In the event that a Party adopts or maintains a prohibition or restriction on the importation of a good from a non-Party, the Parties, on the request of any Party, shall consult with a view to avoiding undue interference with or distortion of pricing, marketing, and distribution arrangements in the other Party.

2) Charges, taxes and fees – A paragraph should be inserted into Article 8 (pp. 5.9-5.10) to read: *Parties shall not impose any charges, taxes and fees that nullify or impair the benefits of the agreement.*

3) Import Licensing – For transparency purposes, we support the notification requirements for existing and new import licensing procedures and changes to import licensing procedures contained in Paragraphs 8.5 & 8.6 of Section Three (p. 5.9).

4) Remanufactured Goods – Restrictions on the importation of remanufactured goods should be removed, as called for in Art. 9 of Section Three (p. 5.10).

5) Dealer Protection Laws – The prohibition contained in Art. 13.1 of Section Three (p. 5.11), against dealer protection laws that accord greater protection to local distributors of local suppliers than to local distributors of foreign suppliers, should be retained and strengthened. Discrimination based on the <u>nationality of the product in question</u> should be dealt with in this article, whereas discrimination based on the <u>nationality of the distributor</u> might best be proscribed in the FTAA services chapter.

6) Distinctive Products – The NAM supports the inclusion of Section Four, Article 14.1 (p. 5.12) on Distinctive Products, in particular as respect to requiring that U.S.-made spirits such as Bourbon Whisky and Tennessee Whisky be recognized as distinctive products.

RULES OF ORIGIN AND ORIGIN PROCEDURES

1) The ultimate goal of FTAA negotiators should be to create a single, uniform set of FTAA origin rules that eventually will completely replace sub-regional origin rules for the purposes of determining eligibility for preferential tariffs. Creating hemisphere-wide origin rules that overlay the multiple sets of already-existing sub-regional rules merely adds another layer of complexity to doing business in the Americas. An FTAA agreement that does not bring significant commercial benefits by simplifying the conduct of business sacrifices one of the primary benefits of a regional agreement. (pp. 5.29-5.49)

2) In creating the new uniform FTAA origin rules, efforts should be made to limit the negative impact on companies that have made investments and developed trading relationships based on the assumption of the permanency of sub-regional origin rules, such as those in effect under the NAFTA. (pp. 5.29-5.49)

3) To help expand the potential benefits of the FTAA, a new Article should be inserted after Article 8 (p. 5.44). It would read:

9) TECHNICAL ASSISTANCE TO SMALL & MEDIUM BUSINESS

9.1 Parties agree to finance through the appropriate international financial institutions significant technical assistance of *[x] U.S. dollars per year for [x] years to help small and medium businesses learn how to apply the rules of origin of the Agreement through a centralized web site, web-based learning, and national outreach seminars.*

4) Tariff shift rules to determine origin are simpler and facilitate compliance in a more preferable manner than content calculation approaches. The tariff shift system has particularly proven itself in the existing NAFTA rules, and believe that the FTAA should adopt an origin-rule system that builds on and improves on the approach used within NAFTA by limiting, to the extent possible, product categories for which no tariff shift rule is provided. In most cases, value tests should be avoided as the sole criterion for any product category, as they can be excessively influenced by minor changes in production process and input values, and are difficult to predict due to fluctuation in exchange rates and factor prices. At the same time, they can provide an important degree of flexibility, and ordinarily should be provided as an alternative to tariff shift tests. However, value content tests should not incorporate the concept of "tracing," which can require complex and costly accounting procedures with little or no benefit. (Origin Regime chapter, pp. 5.29-5.49)

5) As it will help make the FTAA truly a force for economic integration, accumulation should be allowed for purposes of establishing

hemispheric origin. (pp. 5.37-5.38)

6) A consistent and standardized approach within the hemisphere in determining origin, marking, and labeling requirements for hemispheric products is an absolute necessity. Such consistency would benefit all hemispheric producers by facilitating understanding by Customs officials and expediting the clearance of imports without undue delays.

CUSTOMS PROCEDURES

1) The VIII ABF Market Access Workshop should request from FTAA trade ministers a status report on implementation of the voluntary customs-related business facilitation measures that all Parties have already agreed to put in place.[3]
2) Other business facilitation provisions that are binding on Parties should be incorporated into the FTAA agreement itself. These provisions should fully reflect the consensus recommendations achieved on Customs Procedures last year in the VII ABF Market Access Workshop in Quito, Ecuador.
3) Customs measures in the FTAA should be founded in measurement of

3 These measures included provisions for temporary admission; expedited procedures for express consignments; facilitative measures for low value shipment transactions; provision for electronic data exchange; establishment of codes of conduct for customs officials; and implementation of risk management.

release time, and should provide flexibility to hemispheric customs administrations to adopt measures to reduce cycle time that are most efficient and effective within their own systems, and commensurate with their level of development.

4) Article 21 (p. 5.58) of the FTAA Customs chapter, on Express Shipments, should be included in the final agreement, but should be strengthened by being rewritten along the lines of Article 5.7 of the U.S.-Chile FTA on Express Shipments.

SAFEGUARDS

1) Similar to the U.S.-Chile FTA, safeguards should allow for restoration of MFN duties and no imposition of non-tariff measures [Paragraph 3.1 of FTAA Safeguards Chapter (p. 5.17)]. This type of safeguard should be used to deal with problems where increases in imports of originating goods from one country to another "*constitute a substantial cause of serious injury, or threat thereof, to a domestic industry producing a like or directly competitive good*" [Paragraph 2.1 of FTAA Safeguards Chapter (p. 5.16)].

2) WTO rules that allow for global relief above MFN levels when third country imports cause the problem should be left intact. In this regard, Part II, Art. 10 (pp. 5.26-5.27) should be simplified to read as follows:

Article 10. Global Safeguards

1. Each Party retains its rights and obligations under Article XIX of GATT 1994 and the WTO Agreement on Safeguards.

2. *This Agreement does not confer any additional rights or obligations on the Parties with regard to actions taken pursuant to Article XIX of GATT 1994 and the WTO Agreement on Safeguards.*

STANDARDS AND TECHNICAL BARRIERS TO TRADE

1) Parties must have accepted and be fully implementing the WTO Agreement on Technical Barriers to Trade in order to be a member of the FTAA. Adoption of Paragraph 2.3 (p. 5.81) of the FTAA Standards & TBT chapter should help achieve this objective, but it could be strengthened to make clear that *full implementation of TBT obligations, or good-faith movement toward full implementation of TBT obligations is a prerequisite to FTAA membership*.

3) The FTAA should clarify how the WTO TBT agreement can best be interpreted. For instance, it should aid Parties' determination of the existence of applicable international standards, guides or recommendations by incorporating language identical to U.S.-Chile FTA Article 7.3 on International Standards. This could be inserted as a new

Article after Article 2 (p. 5.82) in the current draft FTAA TBT text. A TBT-plus approach would also commit the Parties to promote transparency and due process in national and regional standards-setting bodies, and to advocate those principles jointly on a global basis.

4) A new Article on Trade Facilitation with respect to standards, technical regulations, and conformity assessment procedures should be incorporated after Article 3 on Standards (p. 5.82). It should read:

The Parties shall intensify their joint work in the field of standards, technical regulations, and conformity assessment procedures with a view to facilitating access to each others' markets. In particular, the Parties shall seek to identify bilateral initiatives that are appropriate for particular issues or sectors. Such initiatives may include cooperation on regulatory issues, such as convergence or equivalence of technical regulations and standards, alignment with international standards, reliance on a supplier's declaration of conformity, and the use of accreditation to qualify conformity assessment bodies, as well as cooperation through mutual recognition.

4) Parties should commit to utmost transparency in implementing the FTAA TBT Chapter and its provisions. At a minimum, Article 7 on Transparency Requirements and Information Systems (pp. 5.88-5.89) should incorporate the transparency provisions of Article 7.7 of the U.S.-Chile FTA.

5) Products and sectors should be identified where hemispheric agreements covering mutual recognition, harmonization and equalization would be appropriate. Manufacturers should not have to wait until the conclusion of the FTAA before these are negotiated.

6) Manufacturers should not have to wait until the conclusion of the FTAA for its members to agree to the elimination of redundant testing and certification of Information Technology and other products. There are many ways to provide the appropriate level of conformity assessment that minimizes delays and duplication while maintaining adequate protection of safety, health, and the environment. To this end, Paragraph 5.12 (p. 5.85) should be amended to read: *Parties are urged to accept, where possible, suppliers' declaration of conformity, third party certification, and the IECEE CB scheme, among others.*

- NAM -

For more information, please contact:

National Association of Manufacturers
International Economic Affairs Department
1331 Pennsylvania Ave. NW, Suite 600
Washington, DC 20004 USA

FTAA Contact:
Scott Otteman
Director, International Trade Policy
Tel. (202) 637-3078
Fax (202) 637-3182
E-mail: sotteman@nam.org

Exhibit 8

SUBMISSION TO THE MARKET ACCESS WORKSHOP
OF THE VIII AMERICAS BUSINESS FORUM
NOVEMBER 17-19, 2003 — MIAMI, FLORIDA — USA

ABSTRACT

The National Association of Manufacturers, which represents approximately 14,000 manufacturing firms with operations in the United States, seeks a Free Trade Area of the Americas that achieves seamless regional economic integration through the rapid, comprehensive removal of market access barriers among the 34 FTAA nations.

To achieve this basic goal, the FTAA must:

- Phase out tariffs from applied rates, sooner rather than later, and include a package of sectors whose duties will be immediately eliminated upon entry into force of the FTAA.
- Not restrict the use of duty drawback or duty deferral regimes.
- Maintain zero duties and non-discriminatory treatment for electronic transmissions and require membership in the WTO's Information Technology and Basic Telecommunications agreements.
- Ensure that customs valuation is based on transaction value and, in the case of carrier media bearing content, is based on the value of the carrier media alone.
- Eliminate or strongly discipline non-tariff measures, including import & export restrictions; charges, taxes & fees; import licensing; & dealer protection laws.
- Remove prohibitions on the import of remanufactured goods.
- Require recognition of distinctive spirits products.
- Include hemisphere-wide rules of origin that are simple and easy to administer, are based "tariff-shift" methodology with allowance of value content alternative calculations where appropriate, permit accumulation but do not employ "tracing," eventually replace sub-regional origin rules, and limit the negative impact on companies that have made investments and developed trade based on sub-regional rules.
- Provide technical aid to help small and medium firms use FTAA origin rules.
- Include Customs Procedures that fully reflect the consensus recommendations of the VII ABF Market Access Workshop, facilitate reduction of release time, and provide for express shipments.
- Employ safeguards against import surges that allow for restoration of MFN duties and no imposition of non-tariff measures, while leaving global safeguards intact.
- Incorporate the U.S.-Chile FTA's improvements and clarifications to the WTO Technical Barriers to Trade Agreement to make the FTAA's TBT chapter more transparent, trade-facilitating, and a curb to redundant testing and certification.

Exhibit 9

COALITION FOR DUTY DRAWBACK IN FREE TRADE AGREEMENTS

JULY 30, 2003

<u>VIA ELECTRONIC MAIL: FR0079@ustr.gov</u>

Ms. Gloria Blue
Executive Secretary, Trade Policy Staff Committee
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

RE: Written Comments on the Treatment of Duty Drawback and Deferral Regimes in Free Trade Agreement Negotiations Currently Underway With Central America, Australia, Morocco, the Southern African Customs Union and the Countries Participating in the Free Trade Area of the Americas (FTAA)

We hereby file these comments pursuant to the Office of the United States Trade Representative's ("USTR") Request for Public Comments on the treatment of duty drawback and deferral regimes[1] in free trade agreement ("FTA") negotiations, published at 68 Federal Register 39614-39615 (July 2, 2003).[2] These comments describe in detail and with specificity the position taken on the above issue with supporting evidence provided herein, and apply to <u>all</u> FTA negotiations currently underway as well as <u>all</u> future FTA negotiations. We hereby reserve the right to supplement these comments as additional information is made available from the Coalition's members for submission to USTR.

I. <u>Full</u> Duty Drawback and Duty Deferral Rights <u>Must</u> Be Maintained in Free Trade Agreements and in Advocacy Before the World Trade Organization

There exists <u>no</u> valid reason to restrict or eliminate duty drawback and deferral programs in any FTA, which programs even the U.S. Government states are maintained in order to stimulate and encourage growth in U.S. manufacturing, exports and jobs, and enhance

[1] Including Foreign-Trade Zones.

our global competitiveness. We strongly urge that the U.S. negotiating objective for <u>all</u> FTAs and in advocacy before the World Trade Organization ("WTO") be <u>for</u> the inclusion of full duty drawback and duty deferral rights for U.S. manufacturers and exporters, as these programs are necessary to the U.S.' global competitiveness. FTAs should not restrict, limit or otherwise eliminate duty drawback or duty deferral rights for U.S. manufacturers and exporters when exporting to FTA or WTO member countries.

Maintaining full duty drawback and duty deferral rights in FTAs would be of great benefit to U.S. manufacturers that rely in part on foreign inputs to manufacture or produce finished goods for export. Many foreign imports are subject to Most Favored Nation ("MFN") duty rates when imported into the U.S. for inclusion in the manufacturing process. <u>Eliminating or restricting duty drawback and duty deferral</u> in future FTAs, as in NAFTA and the U.S.-Chilé FTA, <u>would place U.S. manufacturers at a significant competitive disadvantage</u> against other trading partners that export to the Americas and elsewhere.

When exporting to FTA partners, where U.S. manufacturers compete against foreign producers that either have substantially lower costs of production compared to U.S. manufacturers, or that enjoy lower or zero import duty rates, duty drawback and duty deferral regimes make a significant difference to U.S. manufacturers either at the margin for pricing goods in the export market or through lower overall costs of production. The elimination of duty drawback and duty deferral will make these manufacturers' export sales more costly and less competitive, ultimately adversely affecting U.S. manufacturing and related jobs. Therefore, <u>language restricting or eliminating the use of duty drawback or duty deferral programs in FTAs must be removed in favor of text that has no such limitations or restrictions</u>.

The position taken by the Coalition has been raised before the Congress and the Administration at various times during the past several months and by many U.S. trade

[2] Please see Attachment 1 for the list of U.S. companies and trade associations who recently participated in meetings with USTR and the U.S. Department of Commerce on July 2, 2003 in support of the Coalition's position.

associations and U.S. manufacturers, and we are now pleased to see the Trade Policy Staff Committee ("TPSC") reconsider the current policy on treatment of duty drawback and deferral in FTAs.[3]

II. The Current U.S. Negotiating Objective Must Be Changed

The current U.S. negotiating objective is to restrict, limit or otherwise eliminate duty drawback and duty deferral for U.S. manufacturers and exporters in each FTA, as was accomplished in NAFTA and U.S.-Chile FTA, to the detriment of U.S. manufacturers. There also is consideration by the U.S. to submit a proposal at Doha to eliminate drawback entirely, among all member countries, by 2006. The U.S. Government has advocated a number of reasons for eliminating or restricting duty drawback and duty deferral programs between FTA countries. However, the U.S. Government's policies regarding duty drawback and duty deferral are and have been based on theories and hypotheses, which are outdated and inconsistent with commercial realities.

The U.S. policy, or rationale, for restricting or eliminating duty drawback and deferral rights in FTAs is not valid, and no empirical evidence has surfaced that would lead us to believe otherwise. In fact, there are more than ample data demonstrating that the original theories and hypotheses that formed the U.S. Government's decision to restrict or eliminate duty drawback and duty deferral have been disproved. Therefore, it is essential that the U.S. Government reformulate its policy based on the data now available and allow for full duty drawback and duty deferral rights in all FTAs.

III. Duty Drawback and Duty Deferral Programs Benefit U.S. Manufacturers, Exporters and Jobs

All FTAs, including those currently under negotiation and future, must maintain full duty drawback and duty deferral rights because both programs provide significant export incentives to U.S. manufacturers and exporters while increasing their global competitiveness. Benefits attributed to duty drawback are often analogous to those

[3] See Attachements 2 and 3 for a list of comments filed in regard to this issue.

offered by duty deferral programs, as both programs are designed to promote exports, enable American business to compete more effectively, and to create jobs through domestic manufacturing. Accordingly, duty drawback and duty deferral rights must coexist in FTAs in order to provide maximum benefits for U.S. manufacturers, exporters and job creation.

A. The Benefits of Duty Deferral Programs to U.S. Manufacturers

Incentives provided by duty deferral programs are the primary raison d'être for establishing Foreign Trade Zones ("FTZ"). FTZs are designated sites licensed by the FTZ Board at which special customs procedures may be used. These special procedures allow deferral of customs duties and federal excise taxes, if applicable, which are paid only when merchandise is transferred from an FTZ to the Customs territory of the U.S.[4] Additionally, goods may be imported into, and then exported from, an FTZ without the payment of duty and excise taxes.[5]

The United States Customs and Border Protection ("Customs") states that

> **"[i]t is the intent of the U.S. foreign-trade zone program to stimulate economic growth and development in the United States. In an expanding global marketplace there is increased competition among nations for jobs, industry, and capital. The FTZ program was designed to promote American competitiveness by encouraging manufacturers to maintain and expand their operations in the United States."**[6]

In addition to helping U.S. manufacturers by offsetting customs cost advantages available to plants abroad, FTZs help facilitate and expedite international trade, provide special Customs procedures as a public service to help firms conduct international trade related operations in competition with foreign plants, encourage and facilitate exports, help

[4] Under NAFTA, duties are levied when merchandise is transferred to a NAFTA country (Canada or Mexico).
[5] Under NAFTA, when goods are exported from an FTZ to NAFTA countries (Canada or Mexico), any applicable duty and excise tax are levied.
[6] *See* Foreign-Trade Zones web page on U.S. Customs & Border Protection, U.S. Department of Homeland Security, at http://www.customs.gov/xp/cgov/import/cargo_control/ftz/about_ftz.xml.

attract offshore activity, encourage retention of domestic activity, and help create employment opportunities within the U.S. by supporting domestic manufacturing.[7]

B. Duty Drawback Benefits U.S. Manufacturers

Duty drawback[8] is the refund of Customs duties, taxes, and fees imposed on imported goods that are later exported, whether in the same condition as imported, as part of a finished good, or in which the imported good is substituted for the same or a similar good that is later exported.[9] Customs administers the refund after the exportation or destruction of either the imported or a substituted product, or the article manufactured from the imported or substituted product.[10]

Customs, the courts and Congress have consistently stated that the purpose of drawback is to assist American business and labor to compete more effectively in foreign markets. In 1898, the U.S. Supreme Court described the purpose of drawback as being "not only to build up an export trade, but to encourage manufactures in this country, where such manufactures are intended for exportation, by granting a rebate of duties upon the raw or prepared materials imported, and thus enabling the manufacturer to compete in foreign markets with the same articles manufactured in other countries."[11] (Emphases added.) Custom states that,

> "In administratively prescribing a method of identification for drawback, effect should be given to **the general purpose underlying the drawback law**. This purpose **is to assist American business and labor to compete more effectively in foreign markets by assuring that whatever enters into the cost of doing business in such markets is free from the additional cost of U.S. Customs duties. As a result, U.S. export trade**

---

[7] *See* Foreign-Trade Zones Board at http://ia.ita.doc.gov/ftzpage/ftzinfo.html.
[8] Historically the word drawback has denoted a situation in which a duty or tax that has been lawfully collected is refunded or remitted, wholly or partially, because of a particular use made of the commodity on which the duty or tax was collected. Drawback was initially authorized by the Continental Congress in the first tariff act of the United States in 1789. Since then, it has been part of the law. Drawback was initially limited to specific articles, such as salt used to cure meats, that were directly imported and exported. Subsequently, drawback has been expanded to include numerous products as U.S. production and manufacturing has grown in different industrial sectors. *See* Customs' Drawback web page.
[9] *See Id.*
[10] *See Id.*
[11] *See Tidewater Oil Co. vs. United States*, 171 U.S. 210 (1898).

> **is facilitated; the balance of trade is improved; jobs are created; and consequently the general economy thereby benefits.”** (Emphases added.)[12]

The Court of Appeals for the Federal Circuit echoed this point as well when it stated that “[t]he purpose of drawback is to place those who export …on an equal footing with overseas competitors, by largely refunding the sums paid to import certain materials, thus eliminating or diminishing the cost disadvantage resulting from the presence of import duties, taxes, or fees.”[13] From the quotes above, it is clear that the purpose of duty drawback is to increase trade in exports, as also indicated by Congress,[14] by means of refunding the applicable duty, thereby removing duty as a barrier to trade and making such trade to be essentially free (i.e., duty-free trade). The purpose of duty drawback and the purpose of the FTAs are therefore counterparts to each other. To limit drawback in the context of FTAs would thus defeat the purpose of both FTAs and the drawback program.

The drawback program was also initiated to create jobs and encourage manufacturing and exports. Customs recognizes this by stating that, “[t]he rationale for drawback has always been to encourage American commerce or manufacturing, or both. It permits the American manufacturer to compete in foreign markets without the handicap of including in his costs, and consequently in his sales price, the duty paid on imported merchandise.”[15] Customs further states that, “[t]he purpose of drawback is to enable a manufacturer to compete in foreign markets. To do so, however, the manufacturer must know, prior to making contractual commitments, that he will be entitled to drawback on his exports. <u>The drawback procedure has been designed to give the manufacturer this assurance and protection</u>.”[16] Drawback has a significant positive affect on the maintenance and creation of U.S. jobs. Approximately 250,000 jobs are related to

---

[12] *See* U.S. Custom Ruling Letter HQ 216658.
[13] *See Texport Oil Co. v. United States*, 185 F.3d 1291 (Fed. Cir. 1999).
[14] “… the purpose of drawback continues to be to promote economic activity in the United States, resulting in increased exports.” *See the Legislative History Report of the Customs Mod Act from the House Ways and Means Committee*, House Report 103-361, 103d Cong., 1st Sess. (1993).
[15] *See supra*, note 6.
[16] *Id.*

exported goods benefited by drawback.[17] These quarter million jobs (an average of 5,000 jobs per state) are among the highest quality jobs, since wages and benefits are significantly higher for export workers than for other domestic workers.

Almost every country maintains a drawback program. Duty drawback is one of the few GATT/WTO-sanctioned programs used by the U.S. The WTO has commented that the drawback programs in other countries, as well as that in the U.S., have the following positive effects: "[c]reates an export incentive; counteracts the negative effects of high import tariffs; establishes a strong magnet for export-oriented foreign direct investment; provides benefits to exporters and manufacturers; and, removes a bottleneck to private sector development." For those manufacturers who take advantage of the duty drawback provisions, drawback can account for more than one third of their profit margin. For manufacturers with low profit margins, drawback could make the difference between profitability and loss. Restricting drawback will require U.S. manufacturers to establish customs bonded warehouses in <u>each</u> FTA partner country for transshipment and distribution of goods, substantially increasing the cost burden and decreasing the competitiveness of U.S. manufacturers exporting abroad.

The American Association of Importers and Exporters in its September 2002 statement to the Trade Policy Staff Committee, when commenting on the FTAA, best described how drawback (the same approach should be taken with duty deferral as well) should be treated in FTA negotiations:

> The FTAA should not repeat those arbitrary restrictions [of NAFTA], but rather should allow each country to maintain its own duty drawback program that has proven effective in encouraging manufacturing, expanding exports and increasing profitability. The simplest way to do this is to ignore this subject completely in the FTAA, thereby allowing each member country the freedom to continue its own duty drawback program that has proven its value for that country. Unrestricted drawback and free trade are designed to operate side-by-side. To impose arbitrary restrictions on duty drawback is antithetical to the concept of free trade itself. Let's keep it simple and allow each member country the

[17] *See* Attachment 4, which is an analysis demonstrating the link between drawback, exports and U.S. jobs

unrestricted freedom to use its own duty drawback program to its fullest extent.[18]

IV. It is Advantageous for the U.S. to Maintain Duty Drawback and Duty Deferral Programs in FTAs

U.S. policy in negotiating FTAs must include maintaining full drawback and duty deferral rights. Drawback is rationally supported by the need for U.S. manufacturers and exporters to remain competitive in the global market. Without these programs, U.S. manufacturers realize an increase in production costs, in pricing of goods for export, and in costs associated with duties (taxes) paid on component parts used in the manufacturing process. The result is that U.S. manufacturers, exporters and workers lose when duty drawback and duty deferral programs are eliminated.

A. Duty Drawback/Duty Deferral Equals U.S. Competitiveness: Duty Drawback and Duty Deferral Help U.S. Manufacturers to Remain Competitive in the Global Market by Decreasing Cost of Production and Pricing

The rationale for duty drawback and deferral has always been to encourage U.S. manufacturing. They permit the U.S. company to compete in foreign markets without the handicap of including in its costs, and subsequently in its sales price, the duty paid on the imported merchandise. These programs provide a significant degree of profitability for U.S. manufacturers, and to restrict or eliminate duty drawback and deferral in U.S. FTAs would result in placing U.S. businesses in a disadvantageous position in terms of export trade. On the other hand, to allow full drawback and duty deferral would serve the purpose of the drawback laws by enabling U.S. manufacturers to compete more effectively in foreign markets without the handicap that restricting the programs would impose.

As an example of other programs intended to enhance U.S. competitiveness, the primary intent of the Foreign Sales Corporation (FSC) and Extraterritorial Income (ETI) regimes was to ensure that the U.S. tax system did not hinder United States manufacturers from effectively competing in the global markets. The concerns about competitiveness that led

[18] *See Statement of the American Association of Exporters and Importers to the Trade Policy Staff*

to the enactment of the FSC/ETI regime are no less pressing today. Because the WTO has declared the FSC/ETI regime illegal and has ruled that it must be either eliminated or replaced, duty drawback and duty deferral programs become by default the only WTO-legal program the U.S. Government has that can significantly help U.S. manufacturers to remain competitive in today's global markets.

Whether U.S. manufacturers can continue to compete globally with foreign manufacturers is becoming an increasingly serious issue. The U.S.-China Commission ("USCC")[19] identified twenty-four (24) barriers to accessing China's market, as reported in the 2002 National Trade Estimate Report on Foreign Trade Barriers, noting that:

> "Though China promises to reduce those barriers as part of its WTO accession, the transition will likely take many years and will be exceedingly difficult at best.
>
> In the face of such import barriers, the most profitable route for most foreign investors is to use China as a low-cost, high-quality export platform, while seeking permission to make whatever local sales may be possible."[20]

The USCC's 2002 Annual Report noted that:

> "Attracted in part by the low wages in China, a growing number of U.S. manufacturers are now operating in China, many of whom are utilizing China as an "export platform" to compete in U.S. and global markets."

U.S. manufacturers need every available program that promotes domestic manufacturing and exports in order that they maintain a competitive advantage in global markets, and these programs are ever more critical to the retention of a U.S. manufacturing base and U.S. jobs. Thus U.S. manufacturers must be granted every possible advantage that can be provided by our Government to allow them to compete and win in the global market against completion from China and other similarly situated markets. Duty drawback and deferral programs provide such an advantage, and they should not be eliminated.

Committee, Market Access in the Free Trade Area of the Americas, September 9, 2002.

[19] Created on October 30, 2000 by Public Law 106-398~~.~~

[20] *An Analysis: The US Industrial Base and China*. Authored by Pat Choate and Edward Miller; which paper was commissioned by the USCC in 2002.

B. <u>Duty Drawback/Duty Deferral Equals Profitability:</u> Duty Drawback and Duty Deferral Help U.S. Manufacturers Remain Profitable~~.~~

Drawback and deferral equals profitability. In recent years, because of NAFTA and globalization, the significance of this fact has become increasingly important to U.S. manufacturers. The numbers in the following paragraph provide a realistic view of the profitability, or profit margin, that drawback adds to a manufacturer that exports goods and claims drawback on those goods. The profit margin of a manufacturer determines its ability to withstand competition and adverse conditions like rising costs, falling prices or declining sales in the future.

For example, research indicates that the approximate profit percentage that drawback accounts for in an average drawback claimant's sales is 2.5%. A figure of 2.5% might not seem to be very significant at first glance. However, its magnitude becomes evident when we learn that the average net profit margin for S&P 500 manufacturers in 2000 was 7.0%,[21] and that the corresponding average net profit margin in 2002 was only 5.7%. This means that for the average company that takes advantage of the duty drawback provisions, drawback accounts for more than one third of their profit margin. For U.S. manufacturers with even lower profit margins, drawback could make the difference between profitability and loss.

To restrict or eliminate drawback in the FTAs with Central America, Australia, Morocco, the Southern African Customs Union and the countries participating in the Free Trade Area of the Americas (FTAA), as has been done in NAFTA and in the U.S. – Chile Free Trade Agreement, is, in effect, telling U.S. manufacturers that their Government has decided to *decrease* their profit margin on their export sales by approximately one third. This is in direct conflict with the purpose of duty drawback, as well as the positive effects of duty drawback that have been attested for more than 200 years by the U.S. Congress, U.S. courts, and, more recently, the World Trade Organization.

[21] *See* www.fool.com/foolish8/2000/foolish8001208.htm.

C. Duty Drawback/Duty Deferral Preserves Domestic Manufacturing and Jobs: Duty Drawback and Duty Deferral Help to Maintain a Domestic Manufacturing Base and Create Jobs in Export Growth.

Research indicates that approximately 250,000 jobs are related to exported goods benefited by drawback. These quarter million jobs (an average of 5,000 jobs per state) are among the highest quality jobs, since wages and benefits are significantly higher for export workers than for other domestic workers (between 15%-17% higher according to various Government sources). These jobs have been, and will continue to be, the ones that are the most adversely affected by the elimination of duty drawback and deferral in FTAs.

The USCC states in its 2002 Annual Report that U.S. manufacturers are now operating in China for export to the U.S. and other markets, due in large part to lower labor costs.

With conditions such as these facing U.S. manufacturers and exporters, it should come as no surprise that U.S. jobs are moving out of the U.S. and into foreign countries. U.S. manufacturers laid off 56,000 workers in June 2003 – the 35th consecutive month of decline, and the longest such stretch since the Great Depression. Since July 2000, U.S. manufacturing has lost 2.6 million jobs, almost 13 percent of the total manufacturing workforce. Retaining full duty drawback and deferral programs in FTAs will not single-handedly reverse this trend or solve this problem. But it can contribute by enabling U.S. manufacturers to remain competitive in the global market by not being forced to include duties as a cost factor in their production and sales, thus increasing or maintaining our domestic manufacturing base, and thus U.S. jobs.

The drawback and deferral programs were initiated to create U.S. jobs by encouraging manufacturing and exports. To limit drawback simply because the U.S. enters into an FTA that reduces import tariffs with the FTA partner defeats the purpose of the programs and the FTA, i.e., to provide the greatest overall benefits to U.S. manufacturers, exporters and thus workers.

D. Specific Examples of How Duty Drawback/Duty Deferral Increases U.S. Competitiveness in the U.S. and Abroad

Prior to the NAFTA drawback phase out, Gulf Coast refiners obtained significant drawback benefits annually on exported gasoline to Mexico through the duty drawback program. The implementation of the full NAFTA drawback restrictions decreased this amount to zero. The loss of drawback benefits has stranded any duties paid on feedstocks to the refinery that could have been recovered had drawback continued. This is true regardless of whether the gasoline exported to Mexico qualifies for NAFTA benefits and the lesser of duties rule. In the real world, getting the unrelated importer to provide the U.S. exporter with proof of payment of the duties in the importing country in order to establish a claim against the lesser of duties is impossible. Therefore, drawback benefits disappear regardless of NAFTA qualification.

The above is similarly applicable to a manufacturing drawback claim. The NAFTA drawback elimination is just as punitive under a substitution drawback claim. Petroleum manufacturers have a wide range of imports (the U.S. has more imports than exports of petroleum products) and fewer export outlets. Removing drawback benefits on any export for this industry, reduces the ability of the importer to claim against any import that is in the company's name. Prior to the NAFTA drawback limitations, the U.S. refining industry would claim drawback benefits on some gasoline imports on the East Coast against the gasoline exports into Mexico. These benefits were terminated with the NAFTA provisions. This has had a direct result of changing the economics of the deal for gasoline imports into the East Coast. The elimination of drawback results in either lost sales in export markets or adds to the cost of goods imported into the U.S., ultimately adversely impacting the cost of finished product sold in U.S. markets.

Dynamet, a metals company south of Pittsburgh, PA employs about 275 people with $50 to $100 million in sales. Dynamet uses the Duty Drawback program extensively in determining the cost of goods when bidding on sales projects to customers overseas. Without duty drawback the cost of goods would increase and export sales would be lost. Loss of export sales would lead to loss of jobs. Dynamet is currently trying to enter the medical market in South America. Removal or restriction of drawback would affect its competitiveness in this new market as well as globally and would impact employment in the US.

Apollo Metals (Apollo), a metals company in Bethlehem, PA employs 129 people and exports about 20% of their product. With export sales being such a large percent of total sales, duty drawback is a necessary part of Apollo's operations. The business relies on imported steel, due to the fact that the American mills cannot manufacture the high-end quality steel necessary to service customers in the Pre-Finished metals, electroplating industry. The Duty Drawback program has aided Apollo to sustain break even numbers and sometimes-profitable annual financials. Costs for operating manufacturing facilities are constantly increasing, and it is difficult to make profits on pounds of steel, when customers cannot support annual pricing increases. Every income dollar is vital to keeping the doors open for Apollo's 129 employees.

Duty drawback and deferral restrictions also place an unfair burden on U.S. chemical manufactures. In the case of chemicals, many of the needed components are not available from domestic sources. In these cases, the U.S. producer is at a competitive disadvantage since the C.I.F. port value of these components is roughly the same worldwide. When a U.S. producer pays a duty, it is penalized to the extent of this duty when competing for sales against producers of the same or a similar product in other countries. This is especially painful in situations where the Rules of Origin for preferential treatment are not met. Furthermore, other chemical producers have realized a loss in profits, an increase in operating costs, and a decrease in their competitiveness upon the implementation of NAFTA drawback and deferral elimination in 1996 when exporting to Canada.

It is also a serious issue for distribution since in the case of NAFTA, same condition drawback is also not allowed. Therefore, in order to avoid paying duties twice on non-origin merchandise, materials need to be stored either in a bonded warehouse or companies need to have separate warehouses in each of the three NAFTA nations. This is difficult enough in NAFTA, but in an FTA such as the FTAA, this provision is unworkable.

V. The Current U.S. Negotiating Policy Harms U.S. Manufacturers, Exporters and Workers

The current U.S. policy concerning the restriction or elimination of duty drawback and deferral programs in FTAs is not consistent with commercial realities and the needs of U.S. manufacturers, exporters and workers as they seeks to remain competitive in the U.S. and global markets.

A. Duty Drawback and Duty Deferral Restrictions Do Not Discourage Export Platforms

The current policy is based upon the faulty premise that duty drawback and deferral restrictions will somehow discourage our FTA partners from creating export platforms. First, even if this platform theory were valid, the proposed remedy of restricting drawback and deferral programs would have no effect because our partner countries easily evade these restrictions by creating duty reduction programs targets towards manufacturers that source imports from third countries and manufacture for export. Second, our experience with NAFTA does not support the theory that drawback or deferral programs will lead to export platforms due to the creation of these programs. Third, U.S. industry today is much more dependent on imports and exports to maintain and grow the U.S. manufacturing base, making drawback and deferral programs significantly more important than the theoretical possibility that these programs might encourage the development of an export platform.

1. Our FTA Partners Can Easily Evade Duty Drawback and Duty Deferral Restrictions

Our experience with NAFTA shows that FTA partner countries can easily implement legal “evasion” schemes providing their export industries with effective drawback or deferral while U.S. manufacturers continue to suffer from the loss of an important export benefit. Mexico and Canada provide excellent examples of how two very different "evasion" schemes achieve the same goal of providing an FTA partner's export industries with effective drawback or deferral at the expense of U.S. manufacturers who do not receive similar benefits upon the elimination of duty drawback and deferral programs.

As the January 1, 2001 effective date of NAFTA duty deferral restrictions approached in Mexico, the Maquila industry was faced with the possibility that it would have to pay duty on components at Mexico's very high duty rates. In order to counter this, Mexico developed the "Sectoral" or PPS program.[22] Under that program, industries or sectors applied to the Government identifying by harmonized tariff number the finished goods manufactured and the components used in those finished goods. The Government then created special duty reductions by harmonized tariff number on the inputs used in that sector's manufacturing processes, targeted towards export industries. Duties on these inputs were either drastically reduced or made free if the company was approved for the program. While the program on its face is available to all manufacturers whether or not they export, the sectors chosen were targeted to manufacturing done in the Maquiladora programs. Mexico did not reduce its MFN duty rates, it instead created a duty reduction program targeted to the Mexican export industries. Thus, Mexico provided its export manufacturers with effective duty drawback while U.S. manufacturers suffered with the loss of duty drawback and deferral rights.

Similarly, in 1995, Canada targeted approximately 1,500 manufacturing inputs for reduced duty. One of the express purposes of this reduction was to offset the loss of duty drawback rights under NAFTA. The Government consulted with major Canadian industries to identify the specific inputs for tariff reduction. Significantly, without regard to NAFTA partner countries, tariffs were only eliminated completely where inputs were not made in Canada. Thus, Canadian export manufacturers found a legal method to obtain effective duty drawback or deferral for manufacturing inputs while U.S. manufacturers did not.

[22] ITC Report

The success of Canada and Mexico in evading drawback and deferral restrictions will almost certainly result in our future partner countries developing similar evasion schemes to the detriment of U.S. manufacturers and exporters. In fact, the significant economic differences between the economies of the U.S. and the proposed partner countries almost assure this result. The countries in the proposed FTAs are much smaller than the U.S. with most of the industry being export-based. This makes it very easy to establish evasion programs in a short period of time. For example, Australia recently eliminated its drawback law in favor of a program called the Tradex Scheme, designed to identify for duty reduction specific export industries and their inputs. With a few changes, this program would look very similar to the Sectoral Program in Mexico.

Given the size of the U.S. economy, similar programs would face significant opposition, would be unlikely to provide the broad-based relief available to smaller countries, and would take years to develop. Furthermore, it is impossible for the U.S. to craft treaty language that would effectively prevent partner countries from implementing an evasion strategy.

Thus, drawback and deferral restrictions in FTAs will always provide an unfair advantage to export manufacturers in partner countries to the detriment of U.S. exporters. Our partner countries will immediately implement evasion schemes to provide their export industries with effective drawback and deferral. Meanwhile, U.S. exporters will suffer with drawback restrictions that increase their costs and give foreign manufacturers a competitive advantage.

2. Our Experience With NAFTA Does Not Support the Theory ~~T~~that Duty Drawback or Duty Deferral Programs Lead to the Creation of Export Platforms

Despite retaining full drawback and deferral rights for the first seven years of the NAFTA treaty, and de facto rights thereafter through the PPS program, Mexico has not developed into an export platform. In fact, since 1999, both Maquiladora employment and total Maquiladoras have remained relatively flat, actually decreasing in 2001. More recently, many Maquiladoas have relocated their manufacturing operations to countries such as

China, Malaysia, Thailand, Vietnam, Ecuador, Guatemala, the Dominican Republic, Haiti and Honduras.[23] These facts seriously undermine the theory that export platforms are linked to duty drawback and deferral programs.

3. Duty Drawback and Duty Deferral Programs Are More Important to U.S. Industry Today than the Theoretical Possibility that an Export Platform Could Develop

Our economy has changed significantly since the negotiation of the NAFTA treaty. From 1993 to 2001, U.S. imports have grown by 70% and exports have grown by 30%. Our industry is, therefore, much more reliant on imported inputs and export sales. It is more important for our industry today to maintain the benefits of drawback and duty deferral programs. Fears of the theoretical possibility that an export platform could develop in a partner country are now substantially outweighed by the export incentives provided by duty drawback and deferral programs.

B. Duty Drawback and Duty Deferral Restrictions Do Not Encourage Reduction of Global MFN Rates

Drawback and deferral restrictions do not encourage partner countries to reduce global MFN rates. What they do encourage is evasion schemes that target rate reductions for inputs and components used in specific export industries within the partner country. This is not the type of "MFN" reduction (if it can even be called that) that is beneficial. All that it does is place industries in the FTA partner country in a better position relative to U.S. manufacturers handcuffed by duty drawback restrictions. As a result, the FTA partner country is encouraged to reduce its applied rates on imports used in export driven manufacturing while maintaining MFN rates for other products. Such action is counterintuitive to the current U.S. policy upon which the elimination of drawback an deferral programs are based.

[23] *See* Attachment 5.

While creating an incentive for MFN reduction is a legitimate goal, the targeted reductions implemented by partner countries in response to drawback and deferral restrictions are achieved at a very high cost to U.S. exporters. Drawback restrictions make U.S. manufacturers less competitive and result in the loss of U.S. jobs. For those manufacturers that use drawback, we estimate that drawback accounts for approximately 1/3 of their profit margin. We further estimate that approximately 250,000 jobs are related to exported goods benefited by drawback. These jobs are among the highest quality jobs because wages and benefits are significantly higher for export workers. If you eliminate drawback and duty deferral programs, you will lose a portion of those jobs.

C. Duty Drawback and Duty Deferral Restrictions Do Not Distort Investment Decisions

The U.S. Government also theorizes that the availability of drawback and deferral programs in a partner country could create an incentive to take advantage of these programs to reach the U.S. market. According to both the WTO web site and two WTO officials,[24] there is no specific definition of trade "distortion." One WTO official said that to understand the concept of distortion, whether it is related to trade, investment or some other factor, one must begin with the concept of a completely free market economy. A distortion would be anything that would change the completely free market economy in a way that would cause it to become less than completely free (or less free than it was before the distortion was created or introduced).

It should be noted here that the Treasury Department has expressed to members of the Coalition for Duty Drawback in Free Trade Agreements that they consider duty drawback to be an export subsidy. If, in fact, drawback were an export subsidy, then it would be understandable why the USTR might conclude that drawback could therefore cause distortions in trade and investment. However, according to the WTO's Agreement on Subsidies and Countervailing Measures, it is clear, provided that the amount of drawback refunded upon exportation does not exceed the amount of import charges actually levied on inputs, that drawback does not constitute an export subsidy.

In an FTA, one factor to be considered in terms of trade is that of duties. In a hypothetical "completely free market economy," the assessment of duties on a good imported into such an economy would constitute a distortion, since it would make the free market economy less than completely free. However, if that duty were refunded, then that refund, whether made unconditionally or conditioned upon exportation or some other event, would serve to mitigate the distortion and move the economy back towards a free market economy. Conversely, the absence of the possibility of a duty refund or deferral would embed into that economy a permanent condition of distortion.

The WTO makes no rule concerning whether a bilateral or multilateral free trade agreement must or must not include a duty drawback or duty deferral program. The WTO leaves this decision totally in the hands of the specific countries negotiating the particular FTA. If duty drawback, in the context of an FTA, were inherently a distortion to trade or investment, the WTO guidelines would not permit it to be an optional component of an FTA. But this is clearly not the case.

The USTR actually comes closer than the WTO in making a declaration as to whether a duty drawback program, in the context of a trade agreement, does or does not cause a distortion. As background, the USTR in its request for comments states that "[t]rade barriers or other trade distorting practices affect U.S. exports to another country because these measures effectively impose costs on such exports that are not imposed on goods produced domestically in the importing country." We strongly urge the USTR to consider that its own NTE reports state that the USTR identifies <u>restrictions</u> on duty drawback as "non-tariff barriers" to trade. The USTR, in the 2000, 2001, 2002 and 2003 editions of its National Trade Estimate Report On Foreign Trade Barriers (NTE), states that U.S. exports to several European countries are <u>hampered</u> by the Pan-European Cumulation system, <u>particularly the removal of the availability of customs duty drawback</u> on products originating in the U.S. The USTR identifies this as a non-tariff barrier to trade between the U.S. and these countries, which in fact it is. But this is

[24] In a conversation with Bill Hagedorn of Comstock & Theakston, Inc. on July 14, 2003.

similar to the situation that NAFTA (and soon the U.S. – Chile FTA) has created for non-FTA countries. This affirms our conclusion above that it is not duty drawback and deferral programs that can potentially distort trade and investment decisions, but rather it is the restriction or elimination of these programs that can cause distortion.

The USTR's Federal Register Notice refers to a hypothetical investor who locates in a U.S. FTA partner country. One of the most relevant examples of this in actual practice is that of the many U.S. manufacturers that relocated to Mexico, primarily to the Maquiladoras. (The example of U.S. manufacturers investing in Mexico is highly relevant because from 1994 through 2000, U.S. investment in Mexican maquiladoras accounted for 87.5 percent of the total world investment in the maquiladora sector.[25]) In a paper by James Gerber from the Economics Department at San Diego State University,[26] the author makes use of a USITC report[27] that discusses reasons why U.S. firms engaged in production sharing arrangements with Mexico. The reasons given for investment in maquila operations include strategic alliances, product specialization, vertical integration, contracting out, regional manufacturing centers, and closer coordination between producers and suppliers. Mr. Gerber also states that in making decisions (that could involve relocation or investment), manufacturers consider the factors of comparative advantage, economies of scale, and purely strategic behavior. In addition to these factors, he finds that manufacturers also considered such things as transportation, technology, property rights, cost structure, labor markets, infrastructure of industrial parks, Government regulations, utilities, and the availability of important service providers such as lawyers, accountants, equipment repair and maintenance personnel. Neither Mr. Gerber's paper nor the USITC report mentions duty drawback as a reason that the manufacturers invested in the U.S. FTA partner country of Mexico. Therefore, the assertion by the USTR that investors locate in a U.S. FTA partner country "in order to benefit from duty drawback" is without merit.

[25] "The Structure of U.S. Outward Foreign Direct Investment in Mexico's Export Processing Industry," a paper prepared for 2001 International Conference, Latin American Studies Association of Korea Sogang University, Seoul July 22-25, 2001 by James Gerber, Economics Department, San Diego State University.
[26] *Id*.
[27] Production sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1995-1998 - Investigation 332-237: (USITC publication 3265; December 1999).

As described above, drawback and deferral restrictions are doomed to failure as a policy tool because our partners can easily implement evasion schemes. Once these evasion schemes are in place, U.S. exporters continue to pay duties on imported components while competitors in partner countries obtain effective drawback. The result is that the proposed remedy has the opposite effect, making an investment in a U.S. location an even more costly proposition than before the restrictions. Even in the unlikely situation where the sole purpose of the facility is to reach the U.S. market only, locating in a partner country would provide effective drawback under an evasion scheme while locating in the United States provides no relief at all.

However, the more likely scenario in today's economy is a facility that will reach multiple markets, one of which happens to be the United States. The USTR's theory fails to take into account that investment decisions in our global economy are not based on reaching the U.S. economy alone. Manufacturing and distribution facilities are expected to reach multiple markets today. If a partner country provides effective drawback or duty deferral, that location is much more attractive to any business seeking to reach multiple countries.

Taking the proposed FTAA as an example, it would be unusual to invest in a facility in South America or Central America to export solely to the U.S. market, just like it is unusual to do so in Canada or Mexico today. Faced with an investment decision, a company is far more likely to locate in a country that has implemented an evasion scheme to help its exporters avoid drawback and deferral restrictions. The evasion scheme could be as simple as a targeted reduction in MFN rates for inputs used by that specific industry. This allows a facility located in a partner country to get its effective drawback for exports to the United States and every other FTAA country. By contrast, a United States location would provide no drawback or deferral for exports to other FTAA countries. If the FTAA had no restrictions on drawback or duty deferral, then the United States location would look more attractive as a location because it offered full drawback for exports to FTAA countries.

The USTR puts forth the hypothetical case that duty drawback programs can distort investment decisions. Because the USTR offers no empirical evidence for its position, this assertion is limited to only the possibility that such distortion could exist. A hypothetical case could be made that duty drawback could influence an investment decision such as that stated in the Federal Notice. But drawback cannot distort such a decision because, as we have shown, drawback does not move countries in an FTA away from a free market economy, but rather closer to it. A better case could be made that the elimination of drawback and duty deferral constitutes a distortion of investment or trade decisions, in that it allows a barrier to trade, namely, duties, to remain in the transaction. Moreover, the actual history and evidence relating to U.S. investment in Mexico within NAFTA indicates a plethora of motivations and reasons for such investment. The fact that duty drawback and deferral programs are not included in these findings attest that they are, at most, relatively insignificant factors in decisions related to locating in a U.S. FTA partner country.

D. Duty Drawback and Duty Deferral Restrictions Should Not Be Used As a Negotiating Tool

Duty drawback and duty deferral programs should not be used as a "negotiating tool" or otherwise negotiated "away" by the U.S. Government. As does the U.S., almost every potential partner for an FTA with the United States has long-established duty remission, that is duty drawback and deferral, programs for exports.

As in the U.S., these programs are important to each country's export competitiveness and are strongly supported by domestic manufacturers and exporters. For example, Mexico and Chile both began their respective FTA negotiations with the objective of maintaining these programs in FTAs they negotiated with the U.S. and most if not all of the Central American countries have entered the CAFTA negotiations with the same objective. Thus, in seeking elimination of these programs the U.S. will be in a supplicant posture and likely will be expected by the other government(s) to offer concessions to secure its objective. As discussed previously, there are no benefits only disadvanatges to U.S. manufacturers and exporters from elimination of duty drawback and deferral programs in FTA partner countries that justify any concessions.

Moreover, many of the contemplated FTAs have dual goals: improving market access for U.S. exporters and stimulating the economies of the partner countries. While the first goal is achieved by the elimination of tariff and non-tariff barriers, achievement of the second goal requires recognition that the growth of the partner country economies, as with the U.S. economy, will be export driven. There can be no realistic expectation that the growth of these economies will be driven by domestic demand. Provisions such as the elimination of duty drawback and duty deferral programs that are forced into FTAs by the U.S. that reduce incentives for growth in manufacturing within and exports and export competitiveness from both the U.S. and the FTA partner countries largely thwart the greater U.S. objective of increasing global trade and market integration.

E. Eliminating Same Condition, Substitution Drawback Is Not a Legitimate Goal for the Proposed FTAs

In both NAFTA and the U.S.-Chile FTA, the USTR has included language that attempts to eliminate substitution drawback for products exported to a partner country in the same condition as imported. This language makes the drawback law less accessible to U.S. manufacturers, more complicated to administer, is contrary to the Congressional intent of the drawback law, and only results in U.S. exporters losing drawback refunds.

Substitution drawback allows manufacturers with U.S. large distribution centers to obtain duty drawback. Without this type of drawback, it is difficult or impossible for U.S. exporters to obtain duty drawback refunds to which they are legitimately entitled. In the absence of substitution drawback, our distribution centers must match exports to specific import shipments using complicated and costly inventory accounting methods. The cost of doing this often outweighs the drawback or so discourages claimants that they fail to file for refunds.

This language actually creates more complexity in the drawback law making it more difficult for claimants to use and for Customs to administer. Two separate types of drawback with new and separate regulations and requirements had to be created to accommodate the NAFTA and U.S.-Chile FTA language. In fact, the whole concept of "same condition" drawback is arcane and was replaced by unused merchandise drawback in the Customs Modernization Act in 1994.

Moreover, this separate type of drawback is almost impossible to reconcile with simplification procedures currently being discussed in the Trade Support Network. In fact, continuing this type of drawback restriction jeopardizes any of the drawback simplification that may be achieved under the new Customs Automated Commercial Environment ("ACE") system.

The USTR has not provided any legitimate reason why this language was included in the U.S.-Chile FTA. Chile sought no restrictions on drawback. If the USTR or Treasury desire to eliminate this type of drawback, it is improper to do so through the language FTAs submitted to Congress under Trade Promotion Authority.

VI. Free Trade Agreements Entered Into By Our Trading Partners Have Limited or No Drawback Restrictions

The U.S. now seeks to eliminate drawback rights in all of its free trade agreements under the pretext that the elimination of drawback programs would deter export platforms, promote investment and global MFN reduction, and encourage sourcing between the trading partners. As the Administration is aware, this strategy has proven illusory at best in past negotiations and generally, its negotiating partners have resisted agreements requiring elimination of their domestic drawback programs. Yet, the U.S. Government seeks to continue this flawed policy, not for trade reasons, but to support a long promoted domestic agenda to eliminate the so-called administrative burden of drawback that the

Congress has imposed upon the Treasury. If successful, the U.S. Government will abandon the one remaining WTO sanctioned export program enjoyed by U.S. exporters while their competitors continue to benefit from drawback or special programs designed to replace drawback rights.

Under the *WTO Agreement on Subsidies*, drawback programs are permitted programs to encourage export. This multilateral recognition of drawback programs has carried over into most bi-lateral free trade agreements negotiated within the context of the WTO agreements. The overwhelming majority of the free trade agreements that the U.S. has entered into have not eliminated duty drawback rights for U.S. manufacturers or exporters. Even in the case of NAFTA, drawback was eliminated on a selective basis. Similarly, the EU in most instances has not eliminated drawback programs under its agreements.

In the U.S. bilateral agreements with Israel and Jordan neither party wished to eliminate any aspect of their respective duty drawback programs. Indeed, the duty drawback programs were unaffected by the implementation of the agreements and continued to function as they had previously. These trading partners advocate the continuation of drawback programs with no restrictions in all their trade agreements. This position was recently adopted in the Singapore FTA as well.

When a provision for duty drawback elimination has been included in U.S. bilateral agreements, they have been limited to restrictions on drawback and have never allowed for its complete elimination. These programs have been limited because of their essential role in promoting competitive exports and in the preservation of specific domestic industries. Exemptions have been negotiated for a variety of political and economic reasons, but there are always exceptions. For example, exemptions for many textile products were included in the NAFTA to protect the sensitive textile industry in the U.S. Most recently, in the U.S.-Chile agreement restrictions have been placed on most, but not all, of the duty drawback programs that will be phased out over twelve years. Clearly, even under the current U.S. negotiating objective, neither complete nor immediate elimination of the drawback programs proved attainable.

The reality that the U.S. cannot achieve total elimination of drawback has resonated with those trading partners with whom the U.S. has sought to impose drawback elimination. NAFTA has created the blueprint for our other trading partners to reintroduce drawback in other forms. In response to the elimination of drawback under NAFTA, Mexico implemented what it termed as "sectoral programs" to provide certain industries benefits equivalent to those enjoyed under the Mexican drawback program. The U.S. has not and will not implement similar programs and thus, U.S. exporters have been placed at a significant disadvantage to its Mexican competitors.

The U.S. policy seeking to eliminate drawback seems to be set with blinders on, ignoring the realities of international trade competition. Simply stated, elimination of drawback in U.S. FTAs does not translate to elimination of drawback by our trading partner when negotiating FTAs with its other trading partners. Chile is a perfect example of this reality. The U.S. in its FTA negotiation with Chile insisted that Chile eliminate its drawback rights and has severely limited U.S. drawback programs. The U.S. persisted in this negotiating position in spite of the fact that Chile had already concluded separate bilateral agreements with Canada and the EU that do not incorporate these same restrictions. As the U.S. must have known, drawback and duty deferral programs were completely exempted from the Canada-Chile agreement. In the EU-Chile agreement, drawback or exemption from customs duties can still be applied to all agricultural products. Notwithstanding these realities, the U.S. continued to insist that Chile forgo drawback thus putting U.S. exporters at a significant disadvantage to Canadian, EU and Chile exporters. This negotiating flaw appears to persist in the case of Morocco where the U.S. seeks elimination of drawback rights while Morocco and the EU have concluded an agreement that has no such requirement.

The disadvantages presented exporters under the Chile example are not limited to bi-lateral trade. For example, a Chilean exporter selling into Canada continues to receive drawback rights for its exports while a U.S. competitor producing the same product cannot. This is fundamentally unfair and as a policy pursued only by the U.S. it is in effect abdicating export markets to U.S. trade competitors.

VII. Conclusion

At a time when U.S. manufacturers' economic health is being threatened by many different forces around the world, we believe that the Administration should be doing everything within its power to ensure that U.S. manufacturing, distribution and exporting manufacturers are given every possible opportunity to not only survive, but also to prosper. Until all tariffs into the U.S. are eliminated, U.S. exporters and manufacturers require and should be granted every possible advantage to not only compete on a level-playing field against their foreign competitors, but to win in the global market.

If U.S. trade policy is to identify and provide mechanisms with which to pursue greater market access for U.S. exports of goods and services,[28] then duty drawback and duty deferral should not be restricted in FTAs. Duty drawback and duty deferral comports with U.S. trade policy in a number of areas, including export promotion, export growth and increased productivity and development in U.S. manufacturing and refining operations. The inclusion of full and unrestricted duty drawback and duty deferral rights in FTAs will strengthen U.S. competitiveness and productivity.

The U.S. policy, or rationale, for restricting duty drawback and duty deferral rights in FTAs is not valid. Without drawback, U.S. manufacturers realize an increase in production costs, pricing of goods for export, and duties (taxes) paid on component parts used in the manufacturing process. The removal of WTO-approved export promotion programs such as the drawback program simply decreases what would otherwise be an enhanced competitive advantage that U.S. manufacturers would have under an FTA. Duty drawback has been shown to facilitate U.S. export trade, improve the balance of trade, and create jobs. This advantage must be maintained as part of U.S. policy to foster

[28] *See* NAFTA Sec. 108 - Congressional Intent Regarding Future Accessions.

growth and development within the U.S. and increase U.S. export competitiveness abroad.

We greatly appreciate and thank the USTR and the TPSC for the opportunity to comment on this extremely important issue. Please do not hesitate to contact the undersigned with any questions or comments concerning this submission. Thank you.

Respectfully submitted,

Marc C. Hebert, Esq.
Zviad Guruli, Esq.

Preis, Kraft & Roy
601 Poydras Street, Suite 1855
New Orleans, Louisiana 70130
Phone: (504) 581-6062
Fax: (504) 522-9129
Email: mhebert@pkrlaw.com

Exhibit 10

Regulatory Changes in Mexico Affecting U.S.-Affiliated Assembly Operations

By Ralph Watkins

NAFTA Article 303 and Restrictions on Duty Drawback

On October 30 and December 31, 2000, the Government of Mexico issued changes to the decrees governing the Maquiladora and PITEX programs (published in the Diario Oficial),[27] bringing Mexico into compliance with Article 303 of NAFTA, which restricted duty drawback[28] for goods traded between Mexico and its NAFTA partners effective January 1, 2001. As a result, companies importing machinery and components originating from outside North America for use in assembly plants in Mexico began paying duties on such imports.

In compliance with Article 303, Mexico will reduce the duty owed to it on the importation of non-North American inputs by the lower amount collected by either Mexico or the other NAFTA party (table 1). That is, if the assembled product is exported to the United States and U.S. duties are higher than those calculated when the inputs entered Mexico, no duty will be owed to Mexico on the non-North American inputs. However, if the duties on the inputs in Mexico are higher, Mexico may or may not exempt any duties of its own, depending on the amount of duties collected by U.S. Customs on the assembled product. Duties owed to Mexico must be paid to Mexican Customs (Aduanas) within 60 days of export to the United States.[29] Mexican duties on non-North American inputs imported by companies not registered under either the Maquiladora or PITEX Programs are collected by Aduanas at the time of entry into Mexico.[30]

[27] For additional information on changes to the Maquiladora Decree, see Charles Bliel, “Main Reforms to Sector Promotion, PITEX and Maquiladora Programs,” in North American Free Trade & Investment Report, vol. 10, no. 21, Nov. 30, 2000, p. 7ff and Baker & McKenzie, “Latest Amendments to the Maquiladora and PITEX Decrees,” Client Bulletin 09/00. For example, terms for registering under the Maquiladora Program were liberalized to include companies whose annual export sales are greater than $500,000 or whose exports equal 10 percent or more of its annual production. By 2000, the share of a company’s annual production that had to be exported to maintain eligibility to operate under the Maquiladora Program was reduced to 15 percent, from 100 percent prior to NAFTA. However, there were no value threshold requirements. In order to import machinery and equipment temporarily under the Maquiladora and PITEX Programs in 2001, a company must invoice exports equal to at least 10 percent of its total invoicing (maquiladoras) or make annual sales abroad equal to a minimum value of 30 percent of its annual sales (PITEX).

[28] Under drawback, duties on imported components used in the manufacture of products that are eventually exported could either be waived or refunded. The NAFTA parties restricted duty drawback to reduce the likelihood that one NAFTA party would be used by non-North American companies as an export platform for duty-free assess to other NAFTA parties.

[29] Julia S. Padierna-Peralta, Changes in Mexico’s Maquiladora Industry 2001: Sectoral Development Programs, Neville, Peterson & Williams, panel presentation at the U.S.-Mexico Chamber of Commerce, Nov. 14, 2000.

[30] Julia S. Padierna-Peralta and George W. Thompson, “Maquiladoras and Mexico’s Sectoral Programs in 2001,” Neville, Peterson & Williams memorandum dated Dec. 2000.

Table 1
Illustrations of duty payment on non-North American inputs under NAFTA duty drawback restrictions
(U.S. dollars)

Case	Import duties payable to Mexico on "X" inputs from Taiwan	Import duties payable to U.S. or Canada on "Y" end product	Duties exempted by Mexico: the lesser of the two values	Final duties payable to Mexico (within 60 days)	Total amount of duties paid by exporter
A	11	2	2	9	11
B	5	6	5	0	6
C	5	0	0	5	5

Source: Prepared by Julia Padierna-Peralta, Neville Peterson LLP (formerly Neville, Peterson & Williams) and reprinted with permission.

The new regulations governing the Maquiladora and PITEX Programs allow companies registered under these programs to continue to import inputs for their assembly plants originating in the United States or Canada free of duty, even if the staged NAFTA rates for these inputs are not yet "free." Inputs originating outside North America that are imported into Mexico's Maquiladora and PITEX sectors are not subject to duty on entry into Mexico because these imported components are eligible for duty-free treatment if the assembled product is exported to a country other than the United States or Canada. If the assembled good is exported to the United States, the higher of the U.S. or Mexican duty would apply.

Mexico's Sectoral Promotion Programs

In anticipation of the restrictions on duty drawback, a number of companies with Maquiladora and PITEX operations have convinced suppliers in Asia and Europe to establish parts production facilities in North America to replace imports from non-NAFTA sources. Some have found or developed alternative suppliers in North America. Nonetheless, non-North American sources supplied 18 percent ($17.3 billion) of the imported inputs used by Maquiladora and PITEX companies in 2000, led by Japan (4 percent), Germany (3 percent), and Korea (3 percent) (table C-4).

Maquiladora and PITEX operations that continued to rely on non-North American inputs expressed concern to the Ministry of the Economy [31]that Article 303 of NAFTA would increase their costs to the point of making their goods noncompetitive in the North American market relative to finished goods imported directly into the United States and Canada from sources other than Mexico. Many also claimed that they could not find North American producers of certain parts required in their assembly operations.

To ease the burden emanating from the effects of Article 303 of NAFTA, the Ministry of the Economy established the Sectoral Promotion Programs (PPS), effective November 20, 2000, for

[31] The Ministry of Trade and Industrial Development (SECOFI) was renamed the Ministry of the Economy in December 2000.

Commented [BH1]: For these companies, the intent of NAFTA in limiting duty drawback in order to "help guard against the establishment of export platforms in Mexico by companies seeking to take advantage of NAFTA tariff preferences" has not been realized. In fact, the limitation on duty drawback has been shown to be not a *cause* detriment, but rather a *cause* of export platforms being established in Mexico.

Commented [BH2]: This is exactly the opposite result as that anticipated by the Senate Finance Committee when they stated that the limitations on duty drawback "will help ensure that North American producers whose goods are not eligible for NAFTA preferences…will not be disadvantaged when they compete with non-North American producers…".

exports from companies registered under the Maquiladora and PITEX Programs, and effective January 1, 2001, for products exported from all other companies.[32] The PPS unilaterally reduced Mexico's General Import Tariff (GIT) rate of duty for thousands of tariff rate lines in 22 industrial sectors. Import duty rates under the PPS on most qualifying inputs and capital equipment are either free or 5 percent, although a number of products have duty rates of 3, 7, or 25 percent.[33] Most of the product categories for which rates were reduced under the PPS had previously been dutiable at rates that varied between 13 percent and 23 percent. Each “Program” sector lists certain qualifying end-products and inputs by tariff number. If the non-North American inputs are used to manufacture any of the end-products listed, the non-North American inputs may be imported at the import duty rate specified in the particular Program.[34]

The Mexican Ministry of the Economy based its list of articles eligible for reduced duties under the PPS on requests from the assembly industry and reaction from the domestic industry in Mexico.[35] Critics of the PPS have expressed concern that it mitigates the impact of the restrictions on NAFTA duty drawback and may reduce the incentive for maquiladoras still importing parts from suppliers in Asia to find alternative sources in North America.

Despite the reduction or elimination of Mexican tariffs under the PPS, maquiladoras using parts that are not of North American origin will be subject to the U.S. duty on the value of those imported parts contained in the assembled article when it enters the United States. If the U.S. rate of duty is lower than the PPS rate, the maquiladora must pay duties to Mexico’s Aduanas calculated at the PPS rate minus duties paid to U.S. Customs.[36] In addition, because a country’s temporary duty relief, including the new PPS tariff reductions, are not bound at the World Trade Organization (WTO), the Government of Mexico can again raise duties (to the higher bound or intermediate rate) without violating WTO rules.[37] According to an industry observer, a key feature of Mexico’s Sectoral Promotion Programs is that they are policy instruments often subject to change; frequent revisions of existing programs should be expected.[38] Domestic producers in Mexico can ask the Government to remove specific articles from the PPS, and industry observers suggest that the Ministry of the Economy is likely to remove articles from the PPS list if a request is made by a company that initiates production anywhere in North

[32] 32 For an overview of the Sectoral Promotion Programs, see David Bond and Esther Moreno, “SECOFI Publishes Automotive Sectoral Program and Modifies Electric and Electronic Program,” North American Free Trade & Investment Report, Nov. 15, 2000, p. 8ff.
[33] Mexico has 10 free-trade agreements. Most components used by the maquiladora industry that are imported from Israel and 30 countries in Europe and the Western Hemisphere subject to these agreements currently are eligible to enter Mexico free of duty or at reduced tariffs. The temporary reduction or elimination of tariffs under the PPS primarily affects imports from Asia. See “New Maquiladora Rules Leave Asia Out in the Cold, but Asian Firms Pin Hopes on Fox Administration,” in Mexico Watch, Dec. 1, 2000, p. 9. Also, Padierna-Peralta, Neville Peterson LLP, telephone interview with USITC staff, July 11, 2001.
[34] Padierna-Peralta and Thompson, “Maquiladoras.”
[35] For a brief overview of the operation of the PPS, see “Sectoral Promotion Programs: Frequently Asked Questions,” in Trade Commission of Mexico Newsletter, Mar. 2001, available at http://www.mexico-trade.com.
[36] For many goods in the electronic and electrical products sector, which accounts for the majority of imports from Asia by companies operating under the Maquiladora and PITEX programs, the U.S. rates of duty were reduced to free under the multilateral Information Technology Agreement (ITA). Mexico is not a signatory to that agreement.
[37] David Bond and Esther Moreno, “New Versions of the Electric, Electronic and Automotive Sectoral Promotion Programs Published,” North American Free Trade & Investment Report, Jan. 31, 2001, p. 4.
[38] Padierna-Peralta, Neville Peterson LLP, telephone interview with USITC staff, July 11, 2001.

America.[39] At the same time, manufacturing companies can seek the inclusion of their critical inputs in the Programs.[40]

Many maquiladora representatives from Japan, Korea, Taiwan, the United States, and Mexico reportedly have been unable to locate suitable component suppliers in North America. These officials claim that the PPS as currently constituted is inadequate to meet their competitive needs, and have requested Mexican officials to consider additional financial incentives. Without incentives to compensate for increased costs due to NAFTA Article 303, some companies currently using maquiladora operations reportedly will start searching for opportunities in other countries. For example, industry observers point to an assertion by the president of the Korean Maquiladoras of Baja California that Article 303 forces some maquiladoras to purchase raw materials from suppliers that do not meet required quality standards. However, Mexico's Economy Minister reportedly has encouraged the maquiladora industry and members of the Industry Chambers Confederation to design a program to develop suppliers for the industry.[41]

Maquiladora Taxation

U.S. companies operating under Mexico's Maquiladora Program have expressed concerns about changes to Mexico's tax laws that went into effect on January 1, 2000, that reclassified many maquiladora operations as permanent establishments and could have resulted in double taxation.[42] Mexican and U.S. tax authorities reached agreement on an "Addendum to the United States-Mexico Competent Authority Agreement on the Maquiladora Industry" that entered into force on August 3, 2000. The addendum provides for an indefinite extension of the previously agreed exemptions from Mexican asset tax and permanent establishment exposure for U.S. companies that use the processing services of a maquiladora. The initial agreement, signed in October 1999, had established new standards for Mexico to impose in determining the income tax liability of a Mexican maquiladora company as a condition for maintaining the Mexican tax exemptions for the U.S. company.[43] That agreement only provided for application of the specific standards through taxable year 2002, and created uncertainty for maquiladora operations which the Addendum announced in August 2000 was intended to address. Some experts on Mexican tax law note that significant uncertainty still remains regarding the manner in which Mexico will implement the terms of the mutual agreement for 2000 and later years, and the industry awaits the outcome of talks between the United States and Mexico on this subject.[44]

---

[39] Bond and Moreno, "SECOFI," p. 10.
[40] Padierna-Peralta, Neville Peterson LLP, telephone interview with USITC staff, July 11, 2001.
[41] David Bond and Paola Santos, "Ministry of Finance Extends Rectification of Import Duties for PPS; Ministry of Economy Refuses to Modify NAFTA Article 303," North American Free Trade and Investment Report, June 15, 2001.
[42] For background on U.S. industry concerns about maquiladora tax issues, see Larry Brookhart and Ralph Watkins, "Production-Sharing Update: Developments in 1999," Industry Trade and Technology Review, USITC Publication 3335, July 2000, posted on USITC Internet server at www.usitc.gov ("publications").
[43] For information on the addendum and remaining concerns, see John A. McLees and Jaime Gonzalez-Bendiksen, "Maquiladora Tax Issues Need Careful Attention as Mexico Extends the Current Maquiladora Tax Regime Beyond 2002," Tax Notes International, Sept. 11, 2000, p. 1189.
[44] John A. McLees and Jaime Gonzalez-Bendiksen, "Mexico Lags in Implementing Mutual Agreement on Maquiladora Taxation," Tax Notes International, May 7, 2001, p. 2371.

Phase-In of Domestic Market Access for the Maquiladora Industry

Mexico committed in NAFTA (Annex I for Mexico, p. I-M-34) to "phase out" the Maquiladora Program by each year increasing the share of its production that a maquiladora operation could sell to the domestic market in Mexico, until a maquiladora could sell 100 percent of its production domestically on January 1, 2001. Instead of being a "phase out" of the Maquiladora Program, the NAFTA provision appears to have resulted in further evolution of the maquiladora industry's access to the Mexican market. This provision facilitated intramaquiladora sales, which were not allowed prior to NAFTA. Further, the ability to sell to both the U.S. and Mexican markets attracted additional investment in the industry, particularly among parts producers and companies in the durable goods sector. Instead of the Maquiladora Program being phased out, employment in the maquiladora industry grew from 468,000 at the end of 1993 to 1.3 million in December 2000.[45]

To comply with NAFTA, the Maquiladora Decree published in 1998 ordered the termination of all restrictions regarding maquiladora sales to the domestic market as of January 1, 2001.[46] In order to maintain certification as a maquiladora operation and, therefore, be eligible for exemption from the value-added tax,[47] a company's exports in the current year must be equivalent to at least 10 percent of the value of its previous year's production.[48] If a maquiladora is not involved in the manufacture of goods for export markets, then a U.S. company that owns machinery and equipment used in the maquiladora operation cannot claim eligibility for exemption from Mexican asset tax and from Mexican income tax applicable to permanent establishments; moreover, value-added tax applies on sales of finished products into the domestic market.[49]

[45] "Maquiladora Scoreboard" in Twin Plant News, June 1994 and July 2001.
[46] See article 16 of "Mexico's Decree for the Development and Operation of the Maquiladora Industry for Exports," Diario Oficial, June 1, 1998.
[47] According to Padierna-Peralta (Neville Peterson LLP) and John McLees (Baker & McKenzie) in telephone interviews with USITC staff, July 11 and July 23, 2001, imports of components and materials entered under Mexico's Temporary Import Programs (Maquiladora and PITEX) are not subject to the value-added tax, but there are requirements for imposition of value-added tax on temporarily imported machinery and equipment if it is later determined to be a definitive import.
[48] Based upon an amendment to the Maquiladora Decree issued December 31, 2000. Bliel, "Main Reforms," p. 7.
[49] John McLees, Baker & McKenzie, telephone interview with USITC staff, July 23, 2001.

Exhibit 11

UNITED STATES-SINGAPORE FREE TRADE AGREEMENT IMPLEMENTATION ACT AND THE UNITED STATES-CHILE FREE TRADE AGREEMENT IMPLEMENTATION ACT -- (Senate - July 31, 2003)

[Page: S10586]

Mr. BREAUX. Mr. President, I strongly support the Singapore and Chile Free Trade Agreements and believe they will promote domestic growth in manufacturing and exports. I look forward to seeing these agreements enacted into law. However, I am concerned about the current U.S. negotiating objective of restricting, limiting or otherwise eliminating drawback and duty deferral rights for U.S. manufacturers and exporters in free trade agreements, FTA. The administration's current policy places U.S. companies at a significant competitive disadvantage in the global market.

Free trade agreements should include no language that eliminates or otherwise restricts the application of duty drawback and duty deferral programs to U.S. manufacturers and exporters. The language in the United States-Singapore and United States-Israel FTAs, for example, have no such restrictive language and we should model future agreements after these FTAs. This issue is of significant importance to many U.S. manufacturers and exporters, including those in my home state of Louisiana.

Duty drawback and duty deferral programs reduce production and operating costs by allowing our manufacturers and exporters to recover duties that were paid on imported materials when the same or similar materials are exported either whole or as a component part of a finished product. Duty drawback positively affects nearly $16 billion of U.S. exports each year. Additionally, nearly 300,000 U.S. jobs are directly related to exported goods that benefit from drawback, and these high quality jobs could be adversely affected by eliminating or restricting drawback. In my own home state of Louisiana, drawback and duty deferral programs provide substantial benefits to local industries, allowing them to compete on a level playing field in the global market.

Drawback makes a significant difference to U.S. companies at the margin when exporting to our FTA partners where they compete against foreign producers that either have substantially lower costs of production or enjoy low or zero import duty rates. This export promotion program is one of the last WTO-sanctioned programs' which provides a substantial advantage to U.S. companies participating in the export market. The application of these programs to U.S. manufactures and exporters should not be restricted in future free trade agreements that we negotiate with our trading partners.

We need to work hard to complete free trade agreements that provide as many competitive advantages as we can to U.S. manufacturers competing in the global market, encourage growth in U.S. exports, and create U.S. jobs.

Exhibit 12

Loss of Duty Drawback in NAFTA and Impact on Textile and Apparel Industry

September 2003

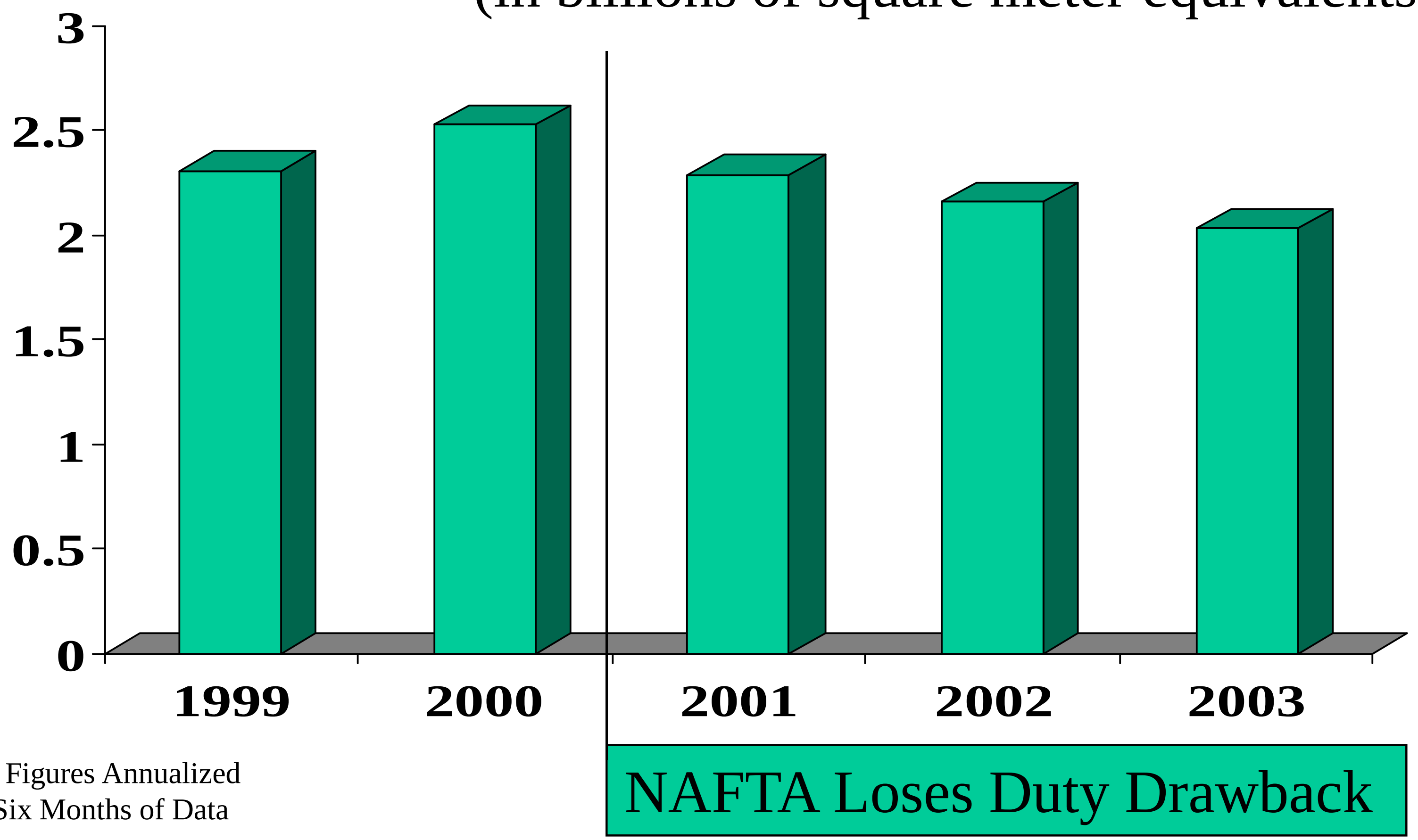
Article 303 of the NAFTA eliminates duty drawback for inputs of non-NAFTA origin as of January 1, 2001.

Loss of duty drawback raises costs for garments imported from Mexico because duties on non-Mexican inputs now have to be factored into final garment costs.

As a result…..

…U.S. Apparel Imports from Mexico Lose Competitive Advantage and Decline…

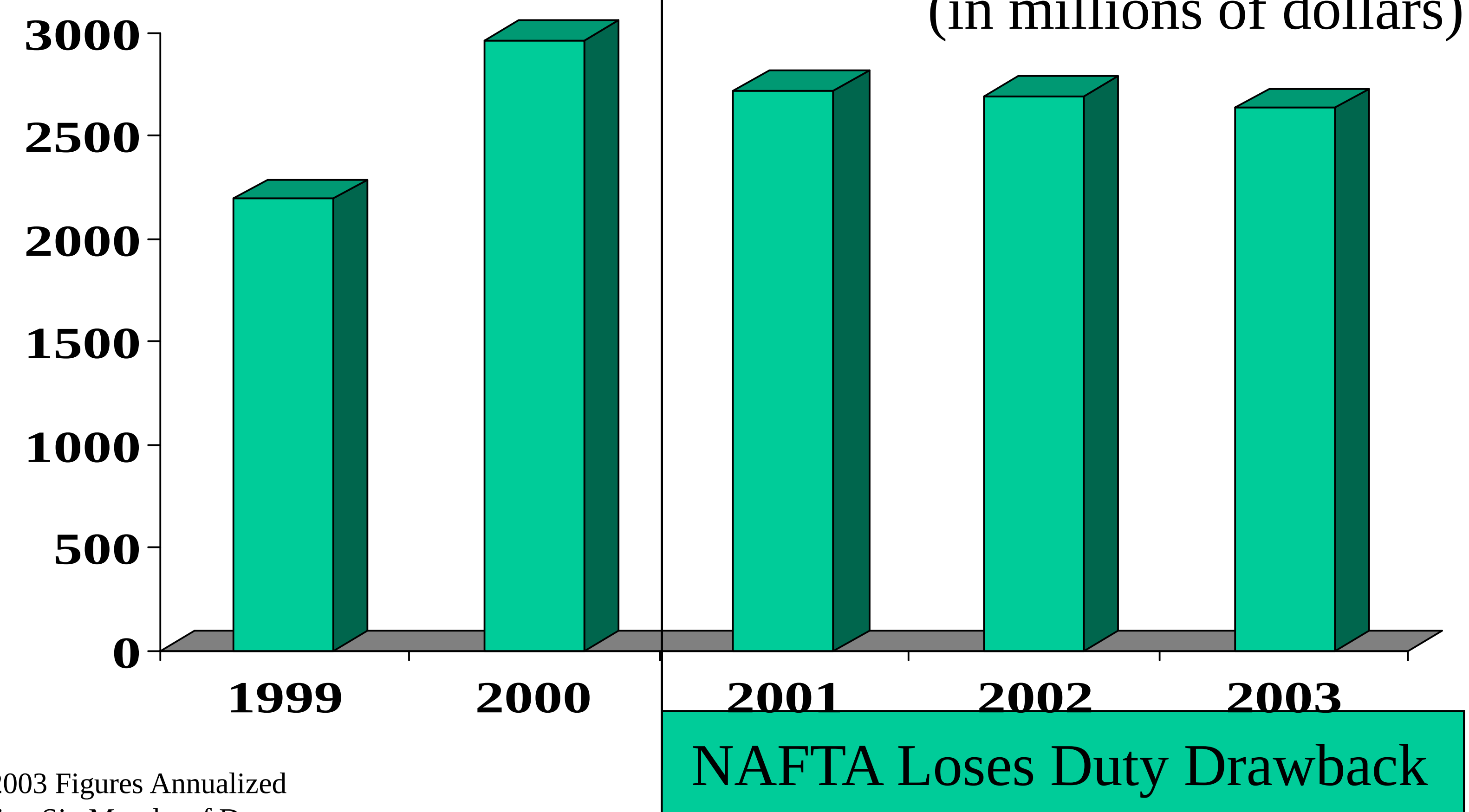
(in billions of square meter equivalents)



Note: 2003 Figures Annualized
from First Six Months of Data

… Which Reduces Demand for U.S. Fabric Exports to Mexico…

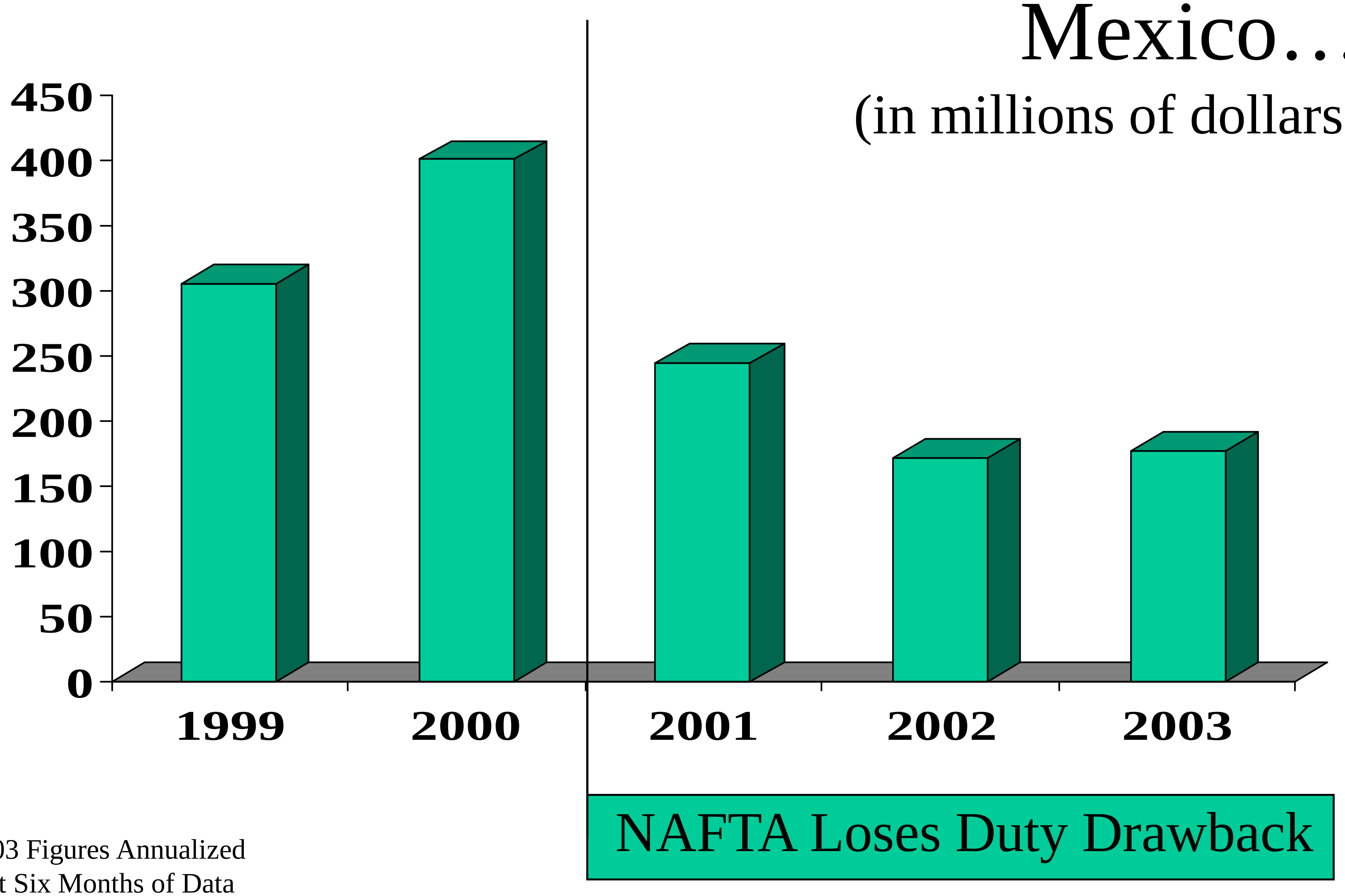
(in millions of dollars)



Note: 2003 Figures Annualized from First Six Months of Data

…and Demand for U.S. Yarn Exports to Mexico…

(in millions of dollars)



Note: 2003 Figures Annualized from First Six Months of Data

…So Number Of Mexican Apparel Maquiladoras Decline

(as of January in each year)

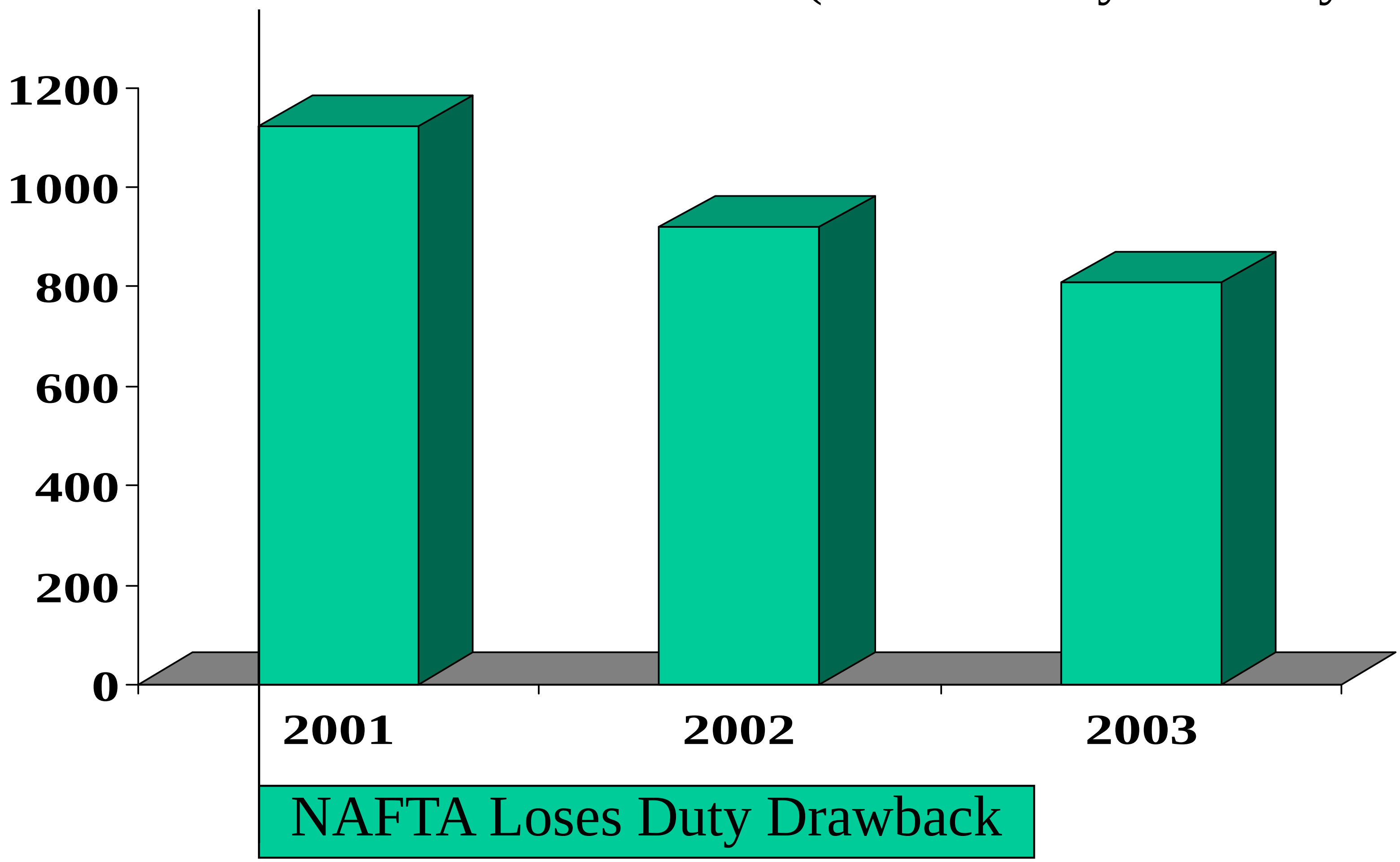


Exhibit 13

LIVE EXAMPLE OF NAFTA DRAWBACK LIMITATIONS ON A U.S. CHEMICALS MANUFACTURER

A chemicals manufacturer in the United States imports raw materials "X" and "Y" which are to be used in the manufacture of "Z", a high value agricultural product that is sold to their customers within the U.S. and in Canada. Raw material "X" qualifies for reduced tariffs under the duty suspension or reduction provision of the American Manufacturing Competitiveness Act of 2016. For a material to qualify for duty suspension or reduction, it must be a product that is not available domestically, and merchandise used in value-added manufacturing within the United States.

	RAW MATERIAL X		RAW MATERIAL Y	
YEAR	QUANTITY (IN MILLION POUNDS)	DUTY PAID (IN MILLION USD)	QUANTITY (IN MILLION POUNDS)	DUTY PAID (IN MILLION USD)
2013	5.07	$ 20.00	1.10	$ 7.50
2014	5.07	$ 20.00	0.88	$ 5.00
2015	1.98	$ 8.00	0.03	$ 0.10

***ACTUAL PRODUCT DESCRIPTIONS AND QUANTITIES AND VALUES MAY VARY SLIGHTLY TO PROTECT THE CONFIDENTIAL INFORMATION OF THE DRAWBACK CLAIMANT.

Sixteen percent (16%) of the final cost of product "Z" is composed strictly of the duty paid on the imported raw materials, which puts the U.S. chemicals manufacturer at a real disadvantage to foreign competition who can sell their product for less. Furthermore, under the current NAFTA drawback lesser-of provision, all agricultural manufacturers would not be able to recover duties on their qualifying products, as Canada allows duty free entry for these agricultural products. In a call with the chemicals manufacturer, they were discouraged by the inability to recover duties, and because of this, they are investigating the opportunities to manufacture this product in Italy instead for both the domestic and export supply of product "Z". This would mean a loss in jobs here in the United States for the chemical manufacturer and for the jobs that might be impacted with the loss of exports out of the U.S.

Beyond their agricultural business, the chemical manufacturer has not pursued NAFTA drawback due to the complexities and the limited drawback potential under the current regulatory restrictions. Product "Z" is based on a real scenario the claimant is subject to, but the impact of the NAFTA restriction goes beyond their agricultural department to their pharmaceuticals, pigments/dyes, catalysis, construction chemicals, and catalysts divisions (only to name a few).

Through this analysis, it was determined that this chemical manufacturer could increase their drawback recovery by approximately $17M annually, 75% more than they currently claim. This increase in drawback revenue would promote U.S. manufacturing and global competitiveness and could ensure that jobs stay here in the United States, instead of shifting to Canada, Mexico, Italy, or some other nation that proves to be a better business opportunity for this company.

COMSTOCK & THEAKSTON, INC. SINCE 1894
466 Kinderkamack Road Oradell, NJ 07649 | +1.201.967.1220 | www.dutydrawback.com