# Killing drawback would be a mistake

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The Office of the U.S. Trade Representative recently sought public comment on a proposal to limit duty-drawback benefits. Eliminating or severely limiting drawback opportunities in multilateral free-trade agreements is not a new position for the USTR.

The duty-drawback law, originally enacted in 1789, allows refunds of import duties on raw materials or finished goods that are subsequently exported. The law's purpose to help U.S. businesses compete globally and generate exports that produce domestic jobs and general economic expansion.

The USTR says drawback "can distort investment decisions by creating an incentive for investors to locate in the FTA (Free Trade Agreement) partner country in order to benefit from duty drawback when exporting processed goods for sale in the U.S. market." The USTR relied upon this "export platform" theory to successfully limit drawback on exports to Canada and Mexico when it negotiated the North American Free Trade Agreement.

I use the word "theory" because the USTR has yet to provide any objective economic evidence that drawback significantly influences investors' decisions on plant locations. Numerous other factors, including land and labor costs, condition of local infrastructure, available raw materials, and marketing advantages, do more to determine the location of a manufacturing plant than a refund of import duties that average only 2 to 5 percent in industrialized countries.

While a 2 to 5 percent reduction in cost is unlikely to affect a major plant-investment decision, it could mean the difference in whether a company secures a specific export sale. Recently, I spoke with a manufacturer based in rural Georgia that decided to implement a drawback program to enhance its razor-thin margin on an export order. Tough economic conditions forced the company to significantly reduce pricing, but the company pursued the order to avoid further plant layoffs. In this instance, the drawback refund represented a significant portion of the profit associated with the export sale.

While the USTR theory of "export platforms" is unproven, we can measure the impact of the Nafta drawback restrictions. U.S. exporters have lost millions of dollars worth of drawback refunds on exports to Canada and Mexico due to the additional regulatory burdens of complying with the convoluted Nafta drawback restrictions. Ironically, drawback is one of the few export incentive programs allowed by the World Trade Organization.

The trade community can no longer take advantage of drawback's substitution provision when a claim is based on "pass through" exports, or exports to Canada and Mexico of goods that are in the same condition as imports.

Nafta eliminated manufacturing drawback on exports to Canada and Mexico if the finished product receives duty-free treatment when it enters the commerce of a Nafta partner. This provision cost U.S. automakers dearly since large volumes of automobile components flow into Canadian plants for final assembly. Through successful lobbying efforts, the citrus industry managed to secure an exclusion from the Nafta drawback restrictions.

Canada and Mexico agreed to similar restrictions but avoided elimination of drawback benefits by removing or reducing tariffs for export-driven industries that relied upon imported raw materials. Because the U.S. did not implement similar measures, Nafta's drawback provisions put U.S. industry at a disadvantage against Canadian and Mexican manufacturers.

Why does the USTR stake a position on drawback that is opposed by the vast majority of the domestic trade community? In my estimation, the USTR's position reflects the opinion of Bureau of Customs and Border Protection decision-makers who consider the drawback program an inefficient use of scarce Customs resources. The program is costly to administer, with only $500 million or so a year in actual refunds to exporters.

The solution, however, is not to further discourage claimants with additional convoluted regulations or to eliminate the drawback incentive on exports to specific trade partners. Instead, we should simplify the drawback program's regulations and administrative procedures to encourage participation by exporters while reducing the burden on already overworked Customs personnel. U.S. industry and the economy as a whole will benefit from the expansion of this valuable export-incentive program.

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