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# COMMON MYTHS

## ABOUT THE TRANS-PACIFIC PARTNERSHIP AND THE YARN FORWARD RULE OF ORIGIN

### U.S. FREE TRADE AGREEMENTS AND THE YARN FORWARD RULE

**Myth:** *The textile and apparel sector has always been treated as a separate chapter under U.S. free trade agreements.*

**Fact:** The Panama, Israel, and Jordan FTA contain no separate textile and apparel chapters. Further, the concept of a separate textile chapter was introduced to trade agreements during a time when U.S. textile and apparel trade was highly regulated and dependent on a quota system. Since the end of 2008, textiles and apparel have been fully integrated into the global trading system, with no special rules or protections. The regulatory system that led to the need for a separate chapter for textiles and apparel no longer exists today. The World Trade Organization reflects this change and there no longer is a separate textile and apparel agreement, or even a separate chapter, in the Doha Round negotiations.

**Myth:** *The yarn-forward rule of origin is the accepted rule for the industry.*

**Fact:** The yarn-forward rule is advocated only by portions of the U.S. textile industry. The National Textile Association, for example, regularly advocates for less restrictive fabric-forward rule of origin provisions. INDA, the association representing Non-Woven textile companies does not support a yarn-forward approach either. Apparel and travel goods companies regularly ask for simplified and more flexible rules of origin than yarn-forward. Negotiating partners, in both the TPP and in other contexts, often advocate for different approaches that create more flexibility and more opportunity to grow trade and investment.

**Myth:** *The yarn-forward rule is incorporated into all U.S. free trade agreements dating back to NAFTA.*

**Fact:** No two yarn forward rules in U.S. FTAs are alike. The Jordan FTA, negotiated more than 5 years after NAFTA, does not contain yarn forward rules of origin. Moreover, just about every FTA negotiated after NAFTA contain alternative rules of origin and significant exemptions to the yarn forward rule of origin.

**Myth:** *A non-yarn forward rule in the TPP would damage the competitiveness of existing agreements and destroys U.S. export markets.*

**Fact:** U.S. export markets for textiles and apparel exist around the world. Flexible rules in a TPP will encourage the development of growing U.S. export markets in Asia and Latin America. The TPP Apparel Coalition supports broad cumulation to create business opportunities for partnership with existing free trade agreement partners, as their inputs, some of which contain U.S. content, will be able to be used under the TPP.

**Myth:** *Yarn-forward is the most logical rule because it reserves the benefits for the signatories to the agreement.*

**Fact:** Because it very narrowly restricts the ability to source inputs from only those produced by parties of an agreement, and because it creates an enormous administrative burden for companies to prove they comply, a yarn-forward style rule actually creates incentives for companies to avoid using Free Trade Agreements (FTAs) or preferential arrangements that contain such restrictions. Instead successful companies build trade and investment relationships outside the agreements, relationships that are based on the realities of today's global supply chain, and simply pay the duties. The garment industry depends on a constantly evolving global value chain, with inputs coming from ever changing sources from all over the world. Companies have great difficulty creating fashionable and affordable garments when they are forced to rely on a narrow list of acceptable countries for inputs year in and year out for all styles. Moreover, because yarn-forward is an "all or nothing" approach, it creates disincentives for the use of U.S. inputs because those inputs rarely line up with other textile inputs in an FTA. For example the yarn forward rule of origin would mean that suits sewn and tailored in the U.S. using Italian fabric could not qualify for duty-free sales to TPP countries.

**Myth:** *Yarn forward is a logical rule because the vast majority of the value of a finished textile or apparel product comes from its components rather than final assembly.*

**Fact:** In general, only about 25 percent of the retail value of a garment comes from the value of the materials and the direct manufacturing processes. In contrast, on average, 75 percent of the value of the garment is attributed to research and development,

design, compliance, marketing, merchandising, and retailing. Not only are such functions critical to the end product, but almost all of these high-paying jobs occur in the United States. Yarn forward does not promote or sustain these jobs or value-additions. Moreover, the amount of value-added in a garment from material components is no different than other consumer goods, and in some cases is even less. For example, a University of California, Irvine study shows that material inputs account for 31 percent of the value of an iPad.

**Myth:** *A weak textile text could lead to an increase in the U.S. trade deficit and cause the loss of significant textile and apparel jobs in the United States.*

**Fact:** More than 3 million Americans are employed in the United States in the design, production, distribution, and sale of clothing today. Their jobs depend on the ability of U.S. apparel and retail companies to make efficient use of global supply chains to create garments that can sell. Restrictive and onerous rules, such as those found in a yarn-forward approach, create costs and burdens that limit the ability of U.S. companies to bring affordable and fashionable clothing to market. New markets created by a robust and commercially meaningful TPP will create opportunities for those companies, as well as their U.S. textile suppliers, to maintain and grow well-paying U.S. jobs.

**Myth:** *Textile and Apparel Trade Grows Under a Yarn Forward Rule*

**Fact:** Yarn-forward creates a very high hurdle to be overcome in order to export or import textiles and apparel. In the case of apparel, yarn-forward limits the availability of inputs to just a few countries or producers, driving up costs (by creating artificial monopolies) and strangling the ability of apparel companies to respond to ever changing fashions. Documentation requirements that accompany yarn forward – each input must be tracked to each final garment – impose additional burdens, costs, and liabilities. Textile exporters lose under yarn forward because it discourages the development of a robust apparel industry – i.e., it scares away customers. Moreover, because yarn-forward is an “all or nothing” approach, requiring all inputs to be produced in the region or nothing qualifies, there is less incentive for companies to invest in new apparel production since they cannot guarantee the availability of FTA-qualifying inputs. Individual exporters are disincentivized because their products will be useful in a final product only if combined with other qualifying inputs. Finally, despite the proliferation of FTAs containing yarn forward rules, the percent of apparel imports that are entered pursuant to FTAs (and other preference programs) is declining.

**Myth:** *CAFTA-DR is a Yarn-Forward Success Story.*

**Fact:** Yarn forward has had a mixed record in CAFTA-DR. From 2007 to 2010, U.S. apparel imports from the CAFTA-DR region dropped by 9.35 percent. It is also important to note that some of these imports reflect rules of origin that are NOT yarn forward, such as the Nicaragua Tariff Preference Level (TPL) or the CAFTA single transformation provisions. Although U.S. exports of yarns and fabrics to CAFTA have increased slightly during that period, that increase is a fraction of the growth of U.S. textile exports to other regions. While, U.S. yarn exports to the CAFTA-DR region have seen significant growth during this period, it has come almost entirely at the expense of U.S. fabric exports to the CAFTA-DR region, which have dropped by more than half a billion U.S. dollars during that time. The healthiest growth in U.S. fabric exports is to Nicaragua because the U.S. fabrics can be cost-averaged with non-CAFTA fabrics using the TPL.

**Myth:** *A Yarn-Forward rule is necessary to grow U.S. textile exports.*

**Fact:** The fastest growing significant market of U.S. textiles over the last five years hasn't been CAFTA-DR, Peru, Colombia, Chile, Singapore or Australia. The fastest growing significant market for U.S. textile exports has been China, where U.S. exports of yarn and fabric have almost doubled over the last five years. In fact, for the year ending July 2011, China bought 8.6% of all exports U.S. yarns and fabrics, or over \$1.1 billion. As a result, China is now the 2nd largest market for U.S. yarns and the 3rd largest market for U.S. fabrics. There are no yarn forward rules governing U.S.-China textile and apparel export trade.

## YARN FORWARD AND THE TPP

**Myth:** *Yarn forward will lead to trade and investment in TPP member countries*

**Fact:** A yarn forward rule, particularly the restrictive version proposed by the United States, appears designed to discourage trade and investment in the textile and apparel sector, as the history of prior FTAs subject to this rule demonstrates. There is no evidence to support the conclusion that the yarn-forward rule would work any differently under the TPP. While some vertical supply chains may be able to use yarn forward in limited circumstances, taking advantage of narrow product lines that use dedicated suppliers, the vast majority of companies will find the rules too burdensome and restrictive. The experience to date is that trade flows away from yarn forward FTAs, rather than to them. The four FTA partners that the U.S. already has in the TPP region have experienced trade and investment declines. The only growth that has occurred has centered on either flexibilities built into the agreements (such as tariff preference levels) or narrow vertical supply chains for specialized garments and textile inputs. Likewise, the CAFTA-DR has witnessed stagnation under its yarn forward rules except when it has been able to complement yarn forward with the numerous flexibilities built into that agreement.

**Myth:** *TPP does not need to apply exceptions to yarn forward to be workable.*

**Fact:** While yarn forward is difficult under any circumstances, it is impossible without viable exceptions that incentivize trade and investment and recognize realities of a global supply chain. In the CAFTA-DR, one of the biggest success stories is Nicaragua, where both U.S. apparel imports and U.S. fabric exports have surged in recent years. The foundation of this success is an exception to the yarn-forward rule called a tariff preference level (TPL). The Nicaragua TPL permits the use of up to 100 million square meter equivalents (SME) of third-country yarns and fabrics in qualifying, duty-free apparel production, which accounts for about one-third of all U.S. apparel imports from that country.

**Myth:** *A TPP yarn forward rule of origin will prevent further consolidation of the industry towards China.*

**Fact:** U.S. apparel brand and retailers maintain balanced sourcing strategies. China currently is the largest supplier of apparel to the U.S. market, supplying 40 percent of these imports. A flexible rule of origin in the TPP will provide incentives for companies to expand sourcing from many TPP countries. Conversely, a yarn forward rule of origin in the TPP, particularly the restrictive version proposed by the United States, will provide no incentive for the development

of new trade and investment in textiles and apparel in the TPP countries. Ironically, if TPP features a yarn forward rule of origin, the biggest beneficiary may be China since the rule actually discourages companies from moving their sourcing to some of China's main competitors. Although companies have to pay high U.S. duties when sourcing apparel from China, they are not saddled with the expense and burden of the yarn-forward rule, can use inputs from anywhere, and can manage their sourcing operations and supply chains more efficiently.

*Myth: Opposing a yarn forward rule of origin will delay the TPP agreement.*

**Fact:** The TPP is a very complicated negotiation, involving many stakeholders. Some of the most politically sensitive issues, such as labor, have not yet been discussed. Negotiators are just now beginning to review the various offers that have been made in a wide variety of areas. It is wrong to believe that textile and apparel negotiations – which have barely begun - are “holding up” the agreement. Moreover, textile and apparel talks in previous FTAs are often among the last issues to be resolved.

*Myth: Congress will only pass a TPP that contains tough yarn forward rules.*

**Fact:** Congress will vote for an agreement that advances U.S. interests. Whether an agreement is seen as beneficial for the United States is a balancing act among all parts of the agreement. Therefore, if yarn forward provisions result in a less-beneficial agreement for U.S. companies in sectors other than just textiles, then many Members may in fact oppose the resulting agreement. Moreover, many Members of Congress who identify themselves as supporting textile interests will not necessarily vote for the agreement because it has yarn forward or even support the views of textile trade associations. Of the 52 House members who recently signed a letter supporting yarn forward rules, only 15 supported all three recent FTAs that contain yarn forward rules. Moreover, 20 of those signatories voted against all 3 FTAs despite their inclusion of yarn forward rules. Further, 27 voted against the Colombia FTA, even though textile groups supported it while 17 voted to support the Korea FTA, even though textile groups opposed it.

## CUSTOMS

*Myth: Yarn-forward is the most logical rule because it aids in Customs enforcement.*

**Fact:** A yarn-forward style rule creates extensive documentation requirements and relies on confusing and complex rules that even the most sophisticated customs compliance professionals, Customs agents and port officials find difficult to understand. Enforcement of these rules requires Customs to expend scarce resources – in budget and personnel – on education, paperwork checks, and exhaustive and detailed verification visits – to make sure that each garment contains the proper inputs, right down to the elastic strips and sewing thread. Moreover, this paperwork burden is so great that it alone acts as a disincentive to use FTAs whose tariff benefits are limited by yarn-forward. No other countries face such procedures on entry to the U.S.

*Myth: Given Vietnam's heavy reliance on China for yarns and fabrics, strong customs rules are mandatory if fraudulent activity is to be contained.*

**Fact:** Strong customs rules are always important. But equally important are customs rules that allow Customs officials to accurately and efficiently do their job, and to build trusted partners in the trade. A 21st century trade agreement needs to incorporate account management and other risk mitigation tools to enable Customs and buyers to focus their energies on those intent on perpetrating Customs fraud – be they in China or elsewhere. Finally, strong Customs rules should be applied equally to all sectors. There is no valid reason to apply special rules to textile and apparel shipments.

## THE U.S. DOMESTIC TEXTILE INDUSTRY

*Myth: The U.S. domestic industry needs protection from all apparel imports.*

**Fact:** The U.S. domestic textile industry needs apparel imports to survive. With 98 percent import penetration, the customers of the domestic textile industry are largely overseas. As is the case for all globalized industries, the customers of the textile industry are located all over the world, including Asia. Restrictive rules will merely act as a disincentive for the use of U.S. content – by embracing a failed all or nothing approach – cutting off U.S. textile companies with many of their customers.

*Myth: High tariffs protect the domestic industry.*

**Fact:** High tariffs add costs to consumers. U.S. tariffs result in thousands of dollars of costs to U.S. consumers. Moreover, the persistence of high U.S. tariffs encourages foreign countries to maintain high apparel tariffs themselves, constituting a trade barrier to U.S. exports. Indeed if the objective of high tariffs is to protect jobs in this sector and help make U.S. companies more competitive, it has been an abject failure in achieving these goals.

## VIETNAM

*Myth: The TPP agreement poses unique challenges for the U.S. textile and apparel industry, especially with the inclusion of Vietnam.*

**Fact:** Beginning with 8 Pacific Rim countries, the TPP will stimulate tremendous new investment and export opportunities for U.S. companies with some of the world's most dynamic economies. U.S. textile companies, whose customers are almost entirely offshore and predominately located in Asia, stand to benefit greatly through increased export opportunities. Apparel manufacturers, brands, and retailers can develop new markets and investment opportunities as well as diversified sourcing opportunities throughout Asia. This agreement, if it is robust and commercially meaningful, will lead to the creation of thousands of U.S. jobs.

**Myth:** Vietnam depends on China for most of its yarns and fabrics.

**Fact:** Vietnam depends on a lot of countries, including the United States, for its yarn and fabric inputs. About 38 percent of yarn used in Vietnam comes from Taiwan, compared to 21 percent from China. The rest comes from other countries, including Korea (9%), Thailand (8%), Indonesia (3%), and Malaysia (4%). Taiwan is also the top supplier for fiber, accounting for 42 percent. Other top fiber suppliers are Thailand (19%), China (18%), and Korea (12%). About 60 percent of Vietnam's cotton comes from the United States, with India accounting for another 18 percent. Although China is the source of 40 percent of fabric, other top suppliers include Taiwan (18%), Korea (16%), and Japan (7%).

**Myth:** Due to the fact that China is the dominant source of Vietnam's textile and apparel inputs, their market does not offer significant export opportunities for U.S. yarn and fabric producers.

**Fact:** Vietnam offers enormous export opportunities for U.S. yarn and fabric producers. As a major producer of garments for sale in the U.S., Europe, and Asia, Vietnam offers a rich natural market for any globally competitive textile company. U.S. textile companies, in

fact, are well-positioned to take advantage of Vietnam's market. U.S. fabric exports for 2011 are about nine times greater than they were in 2002, and the Commerce Department identifies Vietnam as one of the fastest growing export markets for U.S. yarns and fabrics. In fact, U.S. yarn and fabric exports to Vietnam have almost tripled in just the last few years alone. As the TPP eliminates barriers to U.S. textile exports, such as Vietnam's 12% tariff on imported fabrics, U.S. fabric exporters can enjoy a competitive advantage over other competitors in this important market and U.S. textile exports should grow even stronger. Moreover, China itself has emerged as one of the fastest growing export market for U.S. textiles. China is now ranks as the second most important export market for U.S. yarns and the fourth most important export market for U.S. fabrics.

**Myth:** The government of Vietnam provides significant subsidies to its textile sector, including preferential loans, preferential access to capital, free or subsidized land, duty-free imports, worker training subsidies and rebates on import duties.

**Fact:** Upon joining the WTO in 2006 Vietnam was under a U.S. monitoring system where no complaints of illegal subsidies in Vietnam were made. If any company or country has evidence that the Vietnamese textile industry or indeed any importing country receives illegal subsidies, there is effective remedy available under U.S. law to challenge them. There has not been such a case or complaint filed against Vietnam.

Additionally, the U.S. textile industry receives substantial government support in the form of access to cheap, government-subsidized U.S. cotton; a system of government-managed trade in textiles and apparel and "Buy America"; and duties on imported textiles and apparel that are an extremely high protective barrier when compared to the low average U.S. tariff on other goods.

Trade rules are clear about the types of government support to an industry – [1] prohibited subsidies ("red light"); [2] subsidies subject to offsetting import duties ("yellow light"); and [3] those that are permitted ("green light").

The list of government supports that the U.S. textile industry receives from federal, state and local government includes:

- **Preferential Access to Capital.** U.S. textile companies have received millions of dollars in targeted preferential loans and grants from many state and local governments including North Carolina, New York, Pennsylvania, Texas, and Virginia.
- **Duty-Free Imports.** U.S. textile companies have long received statutory exemptions from paying import taxes on their foreign-made production machinery and other inputs.
- **Worker training subsidies.** The U.S. textile industry is one of the main beneficiaries of Trade Adjustment Assistance (TAA), one of the largest government-sponsored worker training programs.
- **Other Subsidies.** Other government support to the U.S. textile industry includes millions of dollars in federal government research and development subsidies and state tax breaks.