



## TRANS-PACIFIC PARTNERSHIP APPAREL COALITION

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# COMMON MYTHS

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

### 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 10 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 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 has a large state-owned and subsidized textile sector.*

**Fact:** Over 90% of textile and apparel companies in Vietnam are either privately owned or contain minority public sector ownership. About 60 percent of textile and apparel export transactions by value are made by foreign owned companies.

**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. In 2009, about 34% of spun fibers used in Vietnam came from Taiwan, compared to 20% from China. The rest came from other countries, including Korea (16%) and Indonesia (6%). Taiwan is also the top supplier of unspun fibers, accounting for about 40 percent of all such imports. About 48 percent of Vietnam's cotton imports come from the United States, with India accounting for another 10 percent. Although China is the source of 38 percent of fabric, other top suppliers include Korea (20%) and Taiwan (18%).

**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 2012 (by value) are about 13 times greater than they were in 2001, and the Commerce Department identifies Vietnam as one of the fastest growing export markets for U.S. yarns and fabrics. According to the Congressional Research Service (CRS), cotton, including yarn and fabric, is the third largest U.S. export to Vietnam, accounting for about 9 percent of all exports. 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 now ranks as the second most important export market for U.S. yarns and the third most important export market for U.S. fabrics.

**Myth:** *Vietnam can benefit from a yarn forward rule of origin.*

**Fact:** Although Vietnam does present enormous export opportunities for yarns and fabrics from other TPP countries, including the United States, it is currently not well positioned to trade under a rule that restricts inputs to the TPP countries. In 2009, only about 2 percent of Vietnam's yarn, fiber, and fabric needs came from TPP countries (and it is unclear if those inputs would meet a yarn forward rule of origin). Forcing Vietnam to adhere to a yarn forward rule of origin would be tantamount to excluding the Vietnamese apparel sector from the TPP.

**Myth:** *Apparel is not important to the overall agreement.*

**Fact:** Apparel is one of the top export priorities for Vietnam in the TPP, and, as such, it is key to opening up market access in Vietnam for a range of other U.S. export priorities. In 2012, about 73 percent of all duties collected by U.S. Customs on imports from Vietnam were collected on apparel. Moreover, more than 50 percent of all duties collected by U.S. Customs on all imports of all products from TPP countries were collected on Vietnamese apparel.

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

**Fact:** No complaint or formal allegation has ever been filed, much less adjudicated, regarding textile-sector subsidies in Vietnam. This is true despite many years of vigilant surveillance by the U.S. industry and a period, after Vietnam joined the WTO in 2006, of intensive U.S. government monitoring as well.

Furthermore, there are longstanding remedies available for U.S. companies and industries negatively affected by illegal and trade-distorting subsidies. These remedies include countervailing duty actions and recourse to WTO disciplines. The TPP will not dilute, in any way, the availability and effectiveness of these anti-subsidy remedies. On the contrary, TPP negotiators are pursuing new disciplines that could address one of the root causes of improper subsidization – under the heading of “State-Owned Enterprises” or “SOEs.”

Even without new SOE-specific disciplines, the possibility that a trading partner might bestow subsidies in a particular sector is not a reason to write restrictive rules of origin or make extended tariff phase outs in that sector, especially in the context of an FTA. If it were, then the United States could never expect to receive any trade concessions boosting export opportunities for U.S.-origin yarns and fabrics. This is because the U.S. textile industry receives substantial government support in numerous forms, including:

- **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.
- **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.

The U.S. textile industry also benefits from a wealth of other government measures, not technically classifiable as “subsidies” but similar in their economic effect, including: Buy American restrictions; statutory exemptions from paying import taxes on foreign-made production machinery and other inputs; access to cheap, government-subsidized U.S. cotton; and of course very high duties on imported textiles and apparel.

## US 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 FTAs 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. For example, there was no separate textile and apparel agreement, or even a separate textile 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 strongly opposed by the U.S. apparel industry, and is advocated only by portions of the U.S. textile

industry. Some textile groups have advocated for fabric forward approaches, while, INDA, the association representing Non-Woven textile companies does not support a yarn-forward approach at all. 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:** The Jordan FTA, negotiated more than 5 years after NAFTA, does not contain yarn forward rules of origin. Even in those U.S. FTAs with a yarn forward rule, no two yarn forward rules in those FTAs are alike. Moreover, just about every FTA negotiated after NAFTA contain significant exemptions to the yarn forward rule of origin in the form of cut and sew rules, tariff preference levels (TPLs), and short supply provisions.

*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 nearly all 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 unilateral preferential arrangements that contain such restrictions. In fact, despite the growth of preference arrangements and FTAs, about 80 percent of apparel imports enter the United States without using these programs. 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 suppliers 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 (or U.S. exports) 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 exports 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 30 percent of the retail value of a garment comes from the value of the materials and the direct manufacturing processes. In contrast, on average, 70 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 hire more U.S. workers or 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 rules – 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 2005 (the year before CAFTA-DR took effect) to 2012, U.S. apparel imports from the CAFTA-DR region dropped by more than 20 percent. Although U.S. exports of yarns and fabrics to CAFTA have increased slightly during that period, this increase is exceeded by the growth of U.S. textile exports to other regions, including China. Moreover, any analysis of CAFTA-DR needs to understand the impact of the many flexibilities – such as the Nicaragua TPL (which allows the use of third country fabrics and yarns), cut and sew provisions, and the fabric forward rule that applies to apparel – that are embedded throughout the agreement. Were it not for these far more flexible provisions, all of which have shown growth, trade under CAFTA-DR would have been even lower.

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

**Fact:** The fastest growing significant market for U.S. textiles over the last five years hasn't been FTA partners like 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, in 2012, China bought about 10% of all exports U.S. yarns and fabrics, or over \$1.3 billion. Roughly 25 percent of the growth of U.S. yarn and fabric exports during the 2007 to 2011 period went to China. 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 US-China textile and apparel export trade.

## CUSTOMS

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

**Fact:** A yarn-forward rule creates extensive documentation requirements and relies on confusing and complex requirements 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 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 products face such procedures for preferential 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 important for all products. 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 in the post quota world to apply special rules to textile and apparel shipments.

A more simple Rule of Origin actually would make it easier for Customs authorities to enforce the TPP rules. For example, a cut and sew Rule of Origin would be easier to verify since the manufacturing operations would be required to be done in a TPP Party and could easily be tracked. Or a Regional Value Content Rule of Origin would link enforcement to the reporting of the value of the various inputs and manufacturing operations - which is the standard rules for most manufactured products.

## 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. In fact, preventing the creation of apparel trade and investment in the TPP appears to be the primary goal of apparel producers in CAFTA or Africa who are concerned that a robust TPP will lead to more competition.

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 data and experience to date is that trade flows away from yarn forward FTAs, rather than to them. The four FTA partners that the United States 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:** US 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 meaningful 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:** *A non-yarn forward rule in the TPP would damage the competitiveness of existing agreements and destroys U.S. export markets.*

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

**Fact:** The TPP is a very complicated negotiation, involving many stakeholders. Many of the most politically sensitive issues, such as labor, have not yet been resolved. Negotiators are working on 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. To the contrary, given the importance of apparel to Vietnam, and that country's opposition to restrictive rules, continued insistence on a restrictive approach for apparel will prevent forward movement in the negotiations.

**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. Of the 76 House members who signed a letter supporting yarn forward rules, 33 voted against all three of the most recent FTAs – Korea, Colombia and Panama -- which contain yarn forward rules. Many of the other signatories to that letter have a history of opposing other free trade agreements. At the same time, in a series of letters and statements since 2011, dozens of Members of Congress from both chambers and both parties have been urging the Obama Administration to ensure that the rules of origin for apparel are flexible and simple. This strong level of support for a fresh approach for the apparel provisions is unprecedented in any prior FTA.

**Myth:** *Short supply provides sufficient flexibility for a yarn forward rule.*

**Fact:** While the record on short supply provisions in previous FTAs is mixed, at best, the industry consensus is that short supply provisions by themselves cannot provide needed flexibility to satisfy the demands of a robust 21st century agreement. In CAFTA-DR, which has a process that enable companies to petition to add or remove yarns and fabrics from a list of items designated not commercially available, short supply entries account for less than 5 percent of total trade. In other FTAs, the short supply process has failed to work at all.

A short-supply concept may offer limited flexibility from a rigid yarn-forward rule of origin only if:

- (1) the list is amendable and the process is permanent,
- (2) the accepted fibers, yarns, and fabrics are sufficiently broad so as to permit meaningful investment in TPP countries,
- (3) a reasonable and fair methodology is developed to provide a realistic assessment of commercial availability,
- (4) there is a process to accept and review petitions to amend the short-supply list on an expedited manner.
- (5) there must be certainty that a fabric will remain on the list so long as it is not available in commercial quantities.

A proposal that does not incorporate these elements would be unworkable.

**Myth:** *The TPP short supply exercise will offer the flexibility needed to balance a yarn forward ROO.*

**Fact:** While any discussion of flexibilities is always welcome, nobody yet knows how much flexibility the TPP short supply exercise will ultimately yield. Discussions are on-going, between Parties and industry, which will reveal how robust the TPP short supply exercise will ultimately be. However, because the TPP short supply exercise is currently not envisioned as a process that will live with the agreement, the results of this year's exercise may result in increasingly diminishing value and relevance to the agreement over time. Moreover, the short supply exercise, even if accompanied by a robust process, cannot be viewed as a surrogate for other types of flexibilities, such as cut and sew rules, regional value content approaches, which should be considered and applied in tandem.

## 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 apparel import penetration in the U.S. market, the customers of the domestic textile industry are largely overseas, including in Asia. 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 from many of their customers. Moreover, according to a recent report by the Congressional Research Service (CRS), only about 17 percent of U.S. textile production goes into apparel. The rest goes into other products and sectors, none of which are subject to restrictive approaches in the TPP.

**Myth:** *High tariffs protect the domestic industry.*

**Fact:** High US tariffs add billions of dollars in costs for American 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.

## REGIONAL VALUE CONTENT PROVISIONS

**Myth:** *Regional value content (RVC) rules are not appropriate for apparel under the TPP.*

**Fact:** RVC rules are widely used for apparel in Asia and for non-textile products in the FTAs the U.S. has negotiated. The original P4 agreement, upon which the TPP is based, contains an RVC rule for apparel. RVC rules for apparel are widely, and successfully, used in the ASEAN Free Trade Agreements (FTAs).

**Myth:** *The United States has no experience using a regional value content (RVC) rule for textiles and apparel.*

**Fact:** Several U.S. free trade agreements – the Israel FTA and the Jordan FTA – and several unilateral preference programs – such as the Haiti HOPE Act – contain RVC rules for textiles and apparel. Moreover, the Generalized System of Preferences (GSP) program, which also covers some textile products, is built on an RVC model. In addition, the United States also has ample experience with RVC rules for most manufactured products in U.S. FTAs.

**Myth:** *Customs and Border Protection (CBP) cannot enforce a regional value content rule for textiles and apparel.*

**Fact:** CBP has considerable experience enforcing regional value content rules for textiles and apparel, and for other products. Unfortunately, some have characterized CBP as being “opposed” to such approaches because they are “different” than a yarn forward model that has been used in many other US FTAs. In December 2006, as the U.S. Congress was considering the RVC rules in the Haiti HOPE legislation, then-CBP Commissioner Basham countered these false claims about RVC enforcement:

“As the CBP official ultimately charged with our trade facilitation and enforcement efforts, including protecting U.S. industry against unfairly traded textile imports, we can and will enforce this legislation, if enacted. I was disturbed to learn that some interests are characterizing CBP’s position as opposed to the package of legislation. That is not the case.”

**Myth:** *U.S. textile and apparel companies would be harmed by a regional value content rule.*

**Fact:** To the contrary, an RVC rule would actually promote the use of U.S. yarns, fabric, and cotton while recognizing that American companies are engaged in a variety of economic activities and employ diverse supply chain models as they compete in the global textile and apparel industry. An RVC rule is one of the best ways to ensure that the many diverse supply chain and sourcing approaches are accommodated, while promoting value added in the TPP. In contrast, the “all or nothing” approach of a yarn forward rule in actuality would severely restrict the use of U.S. yarns, fabrics, and cotton because yarn forward is not equipped to handle the complex needs of modern textile and apparel global value chains.