WERNER INTERNATIONAL

MANAGEMENT CONSULTANTS

REPORT

The Economic and Societal Impact of the Yarn Forward Rule on CAFTA-DR Signatories

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EXECUTIVE SUMMARY

Werner International, which has provided management and strategic consulting services exclusively to fiber, textile, apparel, and retail customers on a worldwide basis for over 80 years, has conducted a third-party independent review of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR).

This report examines the economic and societal impact of the CAFTA-DR agreement and provides findings highlighting: the current benefits of the strong coproduction chain under the trade deal; the adverse impact associated with any proposals by retailers and apparel brands to weaken the rules of origin, such as changing the short supply mechanism and/or instituting other "flexibilities" in the agreement such as cumulation; and the role of China in the region and global textile and apparel supply chain.

Lastly, the study provides recommendations to the Biden administration, which is currently conducting a comprehensive review of root causes of migration issues associated with three Northern Triangle countries within the CAFTA-DR region.

In late October, officials from the U.S. Trade Representative's Office and Vice President Kamala Harris's office held an industry roundtable and *voiced support* for the current CAFTA-DR rules of origin and short supply mechanisms, , as well as the importance of the investments in the U.S. and the region by the U.S. textile industry. Further, the roundtable reaffirmed the need to onshore and nearshore these critical production chains in light of supply chain crises exacerbated by COVID-19 and other significant concerns associated with the use of forced labor in China. This signaled that the administration does not support re-opening or changing the CAFTA-DR textile rules of origin or other mechanisms, such as short supply and cumulation rules, which are among initiatives proposed by certain importers that would be detrimental to the U.S. and Western Hemisphere. In a letter to Congress dated December 15, 2021, CECATEC-RD, the CAFTA-DR regional textile and apparel trade association, noted: "the strong 'yarn forward' rule of origin brought trade and investment to our region and allowed us to make the necessary changes in order to compete against these highly subsidized economic agents, and capacity and significant investment are ramping up substantially as a result of onshoring and nearshoring efforts as global supply chains have broken down."

This report illustrates the wisdom of the administration's positioning on this critical issue and the importance of maintaining the current textile rule of origin, known as the "yarn forward rule," in the CAFTA-DR agreement. Under the yarn forward rule, most inputs used in apparel and other finished textiles traded under the agreement must be produced in the United States or CAFTA-DR countries for the finished goods to qualify for duty-free benefits. The agreement already contains sufficient flexibilities, such as a short supply list and process that allows fibers, yarns, or fabrics deemed not commercially available in the U.S. or Central America to be sourced from third parties. The existing CAFTA-DR terms have created a careful, transparent balanced agreement and have fundamentally supported billions of dollars of textile and apparel investment in both the U.S. and the CAFTA-DR region. Furthermore, continued, substantial investments are expected to be announced soon. Opportunities for this critical supply chain are further enhanced as Asian supply chains are facing enormous challenges, presenting an incredible moment to onshore and nearshore more of the value-added production through vertically integrated coproduction chains.

The report also demonstrates, through various test case scenarios, the devastation that weakened rules would have in the United States and the region: a total of almost one million jobs are at stake. Expanding any of the CAFTA-DR "flexibilities" (as proposed by certain retailers and brands) would undermine the yarn forward rule of origin and the critical investments made in this strong, essential coproduction chain. These proposed flexibilities include altering the short supply mechanism and adding cumulation provisions which provide a backdoor to Chinese inputs and Xinjiang cotton. These proposals would undermine the yarn forward rule of origin and further destabilize the U.S. industry and the region.

Specifically, key report findings associated with a scenario in which an elimination or weakening of the CAFTA-DR yarn forward rule through new proposed “flexibilities” has been instituted, are as follows:

- → U.S. textile manufacturing and employment will be devastated through the loss of billions of dollars in exports to the CAFTA-DR region, and the loss of over 307,000 jobs in the short to medium term.
- → The CAFTA-DR region will be damaged through the de-verticalization of the textile production chain and the loss of over 247,000 jobs in their countries’ textile and apparel production chain.
- → Hemispheric players, such as Haiti and Mexico, will suffer catastrophic losses in terms of sales to the U.S. market as they will be forced to compete with CAFTA-DR apparel made with subsidized, low-cost textile inputs from China and/or from other third-country suppliers not party to the agreement. Jobs at risk here, including indirect jobs through a multiplier effect, amount to over 373,000.
- → China and other third parties will capture billions of dollars in textile exports to CAFTA-DR countries that will swiftly displace U.S. and regional yarn and fabric sales.
- → China and other third parties will monopolize yarn and fabric sales to the CAFTA-DR region, contradicting critical goals associated with nearshoring supply lines, greater environmental sustainability, and ensuring that goods produced under abhorrent labor practices do not enter the U.S.

The cumulation and short supply changes certain importers are seeking, would provide a backdoor to Xinjiang cotton and Chinese inputs, thereby severely undermining U.S. jobs and those in the Hemisphere while also running counter to recent U.S. government efforts to block goods made with forced labor, including the Withhold Release Orders and the Uyghur Forced Labor Prevention Act. **Finally, elimination or weakening of yarn forward would not help resolve the current migration flow; instead, it would exacerbate the problem by eliminating jobs in the region. It would have substantial and severe consequences in Central America and disrupt the textile and apparel sectors in Haiti, Mexico, and throughout the hemisphere.**

The CAFTA-DR agreement creates jobs and value through preferential market access for a completely vertical regional production chain from base fibers through finished apparel and other textile goods. The agreement nurtures nearshore coproduction partnerships that directly employ hundreds of thousands of workers in the U.S. and its Central American neighbors Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, as well as the Dominican Republic. A fundamental part of this win-win arrangement is the yarn forward rule of origin that requires all operations, from yarn production through final assembly to be done within the bloc. This rules-based agreement ensures the parties of the agreement reap the benefits of investment. It ensures the benefits of the preferential structure are reserved for those parties who make investment and helps to verticalize the entire production chain – from yarns and fabrics, to finished apparel and other textile goods. Vertical integration is critical to the success of this sector because it ensures a stronger, more resilient industry, and any erosion of this important rule would de-industrialize the sector, resulting in enormous job losses. Further, offshoring textile production would also destabilize cut and sew operations throughout the region and make these jobs significantly more vulnerable to offshoring.

Proof of CAFTA-DR’s success is apparent in export levels from the region that remained stable even as major policy shifts in the early 2000’s diverted tremendous U.S. market share to Asian textile and apparel suppliers. These policy changes included China’s accession to the World Trade Organization (WTO) and the end of the quota system known as the Multi-Fiber Arrangement (MFA), which for 40 years had generally restricted exports to the U.S. from China and other low-cost Asian suppliers. These actions, coupled with China's predatory trade practices, have had an enormous impact on this sector in the U.S. and in the CAFTA-DR region.

The CAFTA-DR agreement's accomplishments are further demonstrated by the fact that 25% of U.S. cotton (raw material) is being consumed within the regional supply chain.

The agreement also fully integrates the primary textile industries of the U.S. (e.g., spinning, weaving) with the apparel industry in the CAFTA-DR region and gives direct jobs to over 463,000 people in CAFTA-DR countries, while indirectly supporting at least another one million people in the region. The CAFTA-DR pact also helps to support over 530,000 workers directly employed in the U.S. textile and apparel production chain.

Lastly, it drives $9 billion in textile and apparel exports to the U.S. market, while facilitating $3.5 billion in U.S. textile and apparel exports.

The severely elongated Asian textile supply chain is experiencing a series of extreme disruptions and challenges, including: the COVID-19 pandemic, soaring energy prices, logistics backlogs, unfair Chinese competition, and strong consumer demand for apparel that is produced in an environmentally friendly and ethical manner. This present time serves as a critical opportunity to bolster existing onshore and nearshore supply chains and to draw further critical investments and long-term commitments to the U.S. and CAFTA-DR region. American consumers want to see evidence of circularity, sustainability, social compliance, transparency, traceability, and enforcement. CAFTA-DR allows for full transparency as to where and how product is made, which is essential in meeting growing consumer demands for ethical environmental and labor production standards.

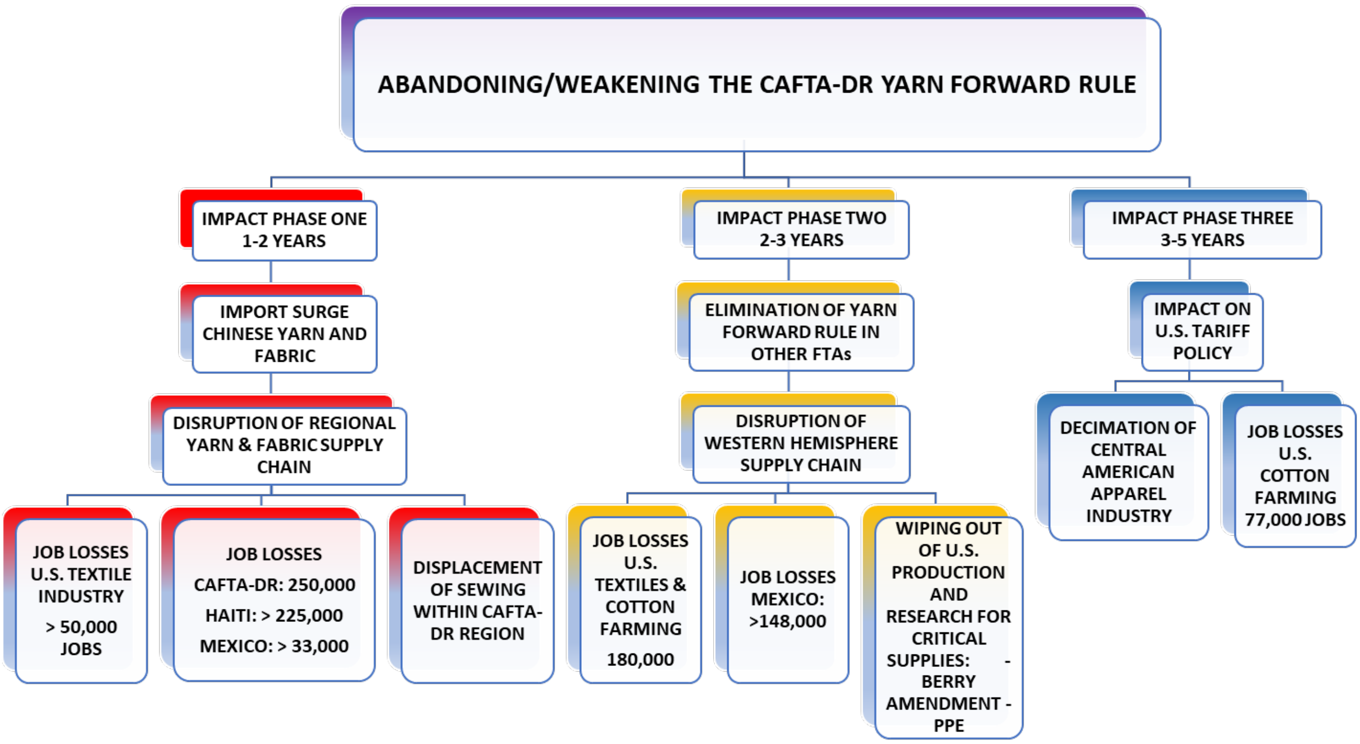
If the yarn forward rule were to be weakened or more "flexibilities" added to CAFTA-DR, the impact would send shockwaves across the regional and hemispheric textile supply chain, allowing China and other countries who are not party to the free trade agreement to make substantial gains at the expense of manufacturers in the CAFTA-DR and the U.S. Specifically, we would see the following:

- → A huge influx into the CAFTA-DR bloc of undervalued Chinese cotton, yarn, and fabric either directly or indirectly through third countries not party to the agreement, severely impacting U.S. manufacturers and farmers employing over half a million people and hundreds of thousands of textile jobs in the region.
- → An intensification of China's dominance in terms of global textile exports, an increased dependence on China as a supplier to the region and additional Chinese employment, at the cost of U.S. and CAFTA-DR jobs.
- → Disinvestment and cancelled future investment in upstream fiber, yarn, and fabric sectors for both the U.S. and the CAFTA-DR region.
- → Undermining of enforcement of the U.S. ban on cotton and cotton products made by forced labor in the Xinjiang region of China, as it would be virtually impossible to determine whether yarns and fabrics processed in the CAFTA-DR originated in Xinjiang.
- → Increased reliance on distant and potentially hostile countries for critical U.S. military procurement of domestically produced textiles and apparel under the Berry Amendment, along with medical PPE supply, as American textile mills are forced to shut down.

Finally, beyond the job losses described for both the U.S. and the countries of the CAFTA-DR region, this major policy change would disrupt the stable regional supply chain between the U.S. and other hemispheric partners. The cascading negative impact would result in massive job losses in the textile and apparel sectors of Mexico, and the apparel industry in Haiti. The aggregate job displacement in Central

America and among other hemispheric trading partners will result in further intense waves of migration from those countries.

The following flow chart gives a graphical overview of the phased impact of the weakening or removal of the yarn forward rule on the U.S. and CAFTA-DR industries.



RECOMMENDATIONS

Noting the critical nature of the coproduction chain between the U.S. and CAFTA-DR trading partners, there are various policy recommendations that would significantly enhance the region, including:

- → Providing certainty and stability by rejecting efforts to weaken the CAFTA-DR rules of origin, such as through changing the short supply mechanism, cumulation, or other “flexibilities.”
- → Continued and full application of the yarn forward rule in all future FTAs.
- → Upgrading of Central American infrastructure, especially in terms of port connectivity and power supply and providing additional U.S. government support for U.S.-based industrial expansion projects to help further facilitate coproduction chains.
- → Cracking down on illegal textile and apparel transshipment through customs enforcement.
- → Applying maximum pressure on China’s predatory trade practices and increased enforcement of the Xinjiang cotton ban.
- → Precluding the granting of duty-free and other trade preference benefits to countries outside of the Western Hemisphere.
- → Considering incentives for the U.S. coproduction chain for carbon emission reduction and environmentally friendly products and/or applying penalty tariffs on countries that gain an unfair trade advantage through lax or nonexistent environmental standards.
- → Facilitating no- or low-interest loans and loan guarantees for strategic, high impact textile and apparel investment along with increased coordination among lending agencies of the U.S. government.

→ Closing the “de minimis” tariff loophole for imports that allows goods valued at $800 or less to enter duty free without being subject to rules of origin or labor and environmental standards.

Through a thorough analysis of CAFTA-DR historical and existing trade flows, labor statistics, product pricing models, and China’s disruptive role in the twenty-first century global textile and apparel industry, the following report provides detailed substantiation for the key findings and recommendations listed above.

1. IMPACT OF ELIMINATING OR WEAKENING THE YARN FORWARD RULE

Abolishing or weakening the yarn forward rule through “flexibilities” for CAFTA-DR countries would not occur in isolation. The impact will have a snowball effect across the entire supply chain in the Western Hemisphere, from cotton growing, man-made fiber production, yarn, and fabric manufacturing to apparel production.

Geographically, there are three main areas of impact:

- → The immediate impact on U.S. jobs
- → The impact on CAFTA-DR and Haiti
- → The impact on other Western Hemisphere countries

From a **supply chain** point of view there are also three levels of impact:

- → Cut and Sew
- → Primary textiles (yarns and fabrics)
- → Cotton and man-made fiber production

Under this scenario, the impact of the abolition or weakening of the yarn forward rule will occur in three consecutive phases:

<u>Phase One:</u>
The initial phase will review the immediate impact of the decision to dispense with yarn forward on the CAFTA-DR signatories. The direct impact will be experienced in the U.S. yarn and fabric industries, the primary textile industries in CAFTA-DR, and the cut and sew sector in the region, including Haiti. The result is a massive disruption of the regional supply chain with vast job losses including loss of textile investment in the region and the redistribution of cut and sew jobs within the region.

<u>Phase Two:</u>
The second phase details the snowball effect the elimination of the yarn forward rule will have on other trading partners of the U.S. in the Western Hemisphere. The disruption of the regional CAFTA-DR supply chain will have impact on the supply chain of other countries in the Western Hemisphere, with similar effects on employment.

<u>Phase Three:</u>
The third phase analyzes the escalating disruption of the textile supply chain in the Western Hemisphere through the loss of regional demand for U.S. cotton, now estimated at 25% of the total cotton crop, severely impacting cotton farmers, along with the negative impact on U.S. producers of man-made fibers.

All three phases are characterized by significant divestment, as the vertical and regional supply chain will be disrupted by enormous imports of subsidized Chinese yarn and fabric. The vertical integration will be dismantled as extruding, spinning, weaving, knitting, and dyeing and finishing mills will be displaced by Chinese textile exports to the region. Any short-term benefit for cut and sew jobs will be eroded substantially over a condensed timeframe. All future investments in primary textile production will not only be put on hold but likely entirely cancelled. Past investments by U.S. companies in the primary textile industries in the entire Latin America area are at high risk of being wiped out by Chinese and other third-country imports. The Chinese textile industry has a substantial overcapacity, and the Chinese government will take the necessary steps to support those industries, not the least by subsidizing manufacturing and exports to the rest of the world, as shown later in the report.

1.1 Impact on trade and employment

1.1.1 Impact on the U.S. textile & apparel industry

Key data on the U.S. textile and apparel industry (table below) showed a pre-COVID-19 direct employment level of just over 357,000 direct jobs in 2019. This excludes over 115,000 jobs in cotton farming and those in the wool fiber production sector. U.S. exports to CAFTA-DR countries have remained stable over the last decade and account now for about 15.4% of all U.S. textile and apparel exports. Exports to the Western Hemisphere account for almost 70%. Further, U.S. imports from CAFTA-DR are up substantially so far in 2021. By way of example, U.S. apparel imports from Honduras are up 56%, El Salvador has experienced a 55% increase, and Guatemala is up by 39% – all outpacing various key Asian suppliers, including China.[1]

KEY DATA U.S. TEXTILE AND APPAREL INDUSTRIES					
	OUTPUT	**EXPORTS**	**U.S. EXPORTS TO CAFTA-DR**	**U.S. EXPORTS TO WESTERN HEMISPHERE**	**EMPLOYMENT**
	BILLION US$	BILLION US$	BILLION US$	BILLION US$	THOUSAND
2018	76.8	23.47	3.50	16.22	366.4
2019	75.8	22.90	3.53	15.84	357.1
2020	64.4	19.33	2.52	13.29	313.6
Source	BEA	OTEXA	OTEXA	OTEXA	BLS

Abolishing/weakening the CAFTA-DR yarn forward rule will have an immediate impact on U.S. exports to CAFTA-DR (Phase One) and the Western Hemisphere (Phase Two) as Chinese and other third-party imports of yarn and fabric in the region will replace U.S. yarn and fabric. In a later phase (Phase Three) U.S. cotton farmers will be affected as the loss of the domestic and Western Hemisphere markets will have severe ramifications for this segment that spans 18 U.S. states and 115,000 direct jobs. Weakening the yarn forward rule would have a devastating impact on the domestic and Western Hemisphere markets for cotton growers, resulting in a 30% drop in their sales. U.S. cotton farmers would lose their most valuable customer, along with the value add and employment that gives cotton its greatest influence at USDA and farm programming.

In terms of jobs lost by the U.S. textile industry, we estimate that nearly 105,000 direct jobs will be lost over the three phases. Using the multiplier effect to calculate the indirect impact on jobs indicates that a total of over 307,000 U.S. jobs will be lost.[2]

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[1] U.S. Department of Commerce; OTEXA Major Shippers Report, YTD Sept 2021 compared to YTD Sept 2020

[2] As a measure for calculation, the methodology of the International Trade Administration U.S. DOC has been applied (https://www.trade.gov/jobs-supported-exports-home-page). For the multiplier effect, calculations are based on the Economic Policy Institute in Washington (https://www.epi.org/publication/updated-employment-multipliers-for-the-u-s-economy/).

ABANDONING OR WEAKENING THE YARN FORWARD RULE CAFTA-DR				
IMPACT ON U.S. JOBS LOST				
	PHASE ONE	PHASE TWO	PHASE THREE	ALL PHASES
	U.S. JOBS LOST ON CAFTA-DR EXPORTS	U.S. JOBS LOST ON EXPORTS TO WESTERN HEMISPHERE	U.S. JOBS LOST IN COTTON GROWING	
DIRECT JOBS	16,686	59,143	28,800	**104,629**
INDIRECT JOBS	34,057	120,711	48,023	**202,791**
TOTAL JOB LOSS	50,743	179,854	76,823	**307,420**

These jobs are not complemented by new job creation in the CAFTA-DR region. Instead, job loss in this sector in the U.S. and region will further grow the Asia/Chinese textile and apparel sectors.

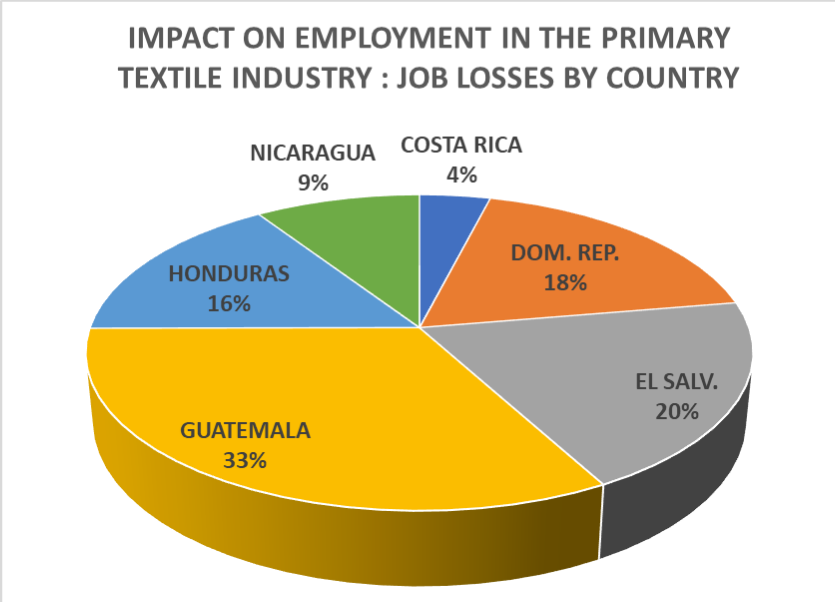
1.1.2 Impact on the CAFTA-DR textile & apparel industry

In 2019, the last pre-pandemic year with full data, total employment in the textile and garment industries of CAFTA-DR combined was estimated at almost half a million direct jobs. To measure the impact of a departure from the yarn forward rule on the CAFTA-DR industries, we have split the employment data into primary textiles and cut and sew jobs. Most jobs in the primary textile industry will be lost over time when having to compete with cheap imported yarn and fabric from China. The total employment in the primary textile industries is over 100,000, and these jobs are at risk in the short term. Applying the job multiplier effect for Central American countries, a total of almost 250,000 direct jobs are under threat.

CAFTA-DR: MULTIPLIER EFFECT PRIMARY TEXTILE INDUSTRY - 2019							
Number							
	COSTA RICA	DOM. REP.	EL SALVADOR	GUATEMALA	HONDURAS	NICARAGUA	TOTAL
DIRECT JOBS	5,799	15,031	27,484	25,588	22,250	9,363	105,515
MULTIPLIER EFFECT	1.70	3.02	1.77	3.18	1.75	2.46	
LABOR SUPPORTED	9,858	45,394	48,647	81,370	38,938	23,033	247,239
Sources: USAID 2017; Werner International							

The impact will be the highest in the Northern Triangle of Central America, which under this analysis experiences losses equating to 70% of all jobs lost in CAFTA-DR or a total of 170,000 jobs. The impact on the Dominican Republic is equally substantial with over 45,000 jobs lost. The multiplier effect of job creation in the apparel industries in Guatemala and the Dominican Republic are substantially higher when compared to other Central American countries, hence a more severe impact.[3]

[3] USAID 2017, multipliers are calculated based on the GTAP 9 database (Global Trade Analysis Project)



Since U.S. apparel demand is mature and stable, it cannot be assumed that additional sewing jobs will be created in Central America and the Caribbean. Any potential short-term gain in cut and sew jobs would be very temporary, and these jobs would be put at substantial risk. Dismantling yarn and fabric production would quickly destabilize cut and sew jobs. Instead, changing or undermining the CAFTA-DR rules through "flexibilities" will simply re-slice the same cake since CAFTA-DR and Haiti are directly competing for market share within the same product range of T-shirts, underwear, sweaters, and other products. Destabilizing the current regional supply chain would result in a relocation of sewing capacities within the region and almost certainly make the issues of migration worse, especially from Haiti as it is likely that any increase in cut and sew jobs will come at the cost of jobs displaced in other sewing-forward origins.

1.1.3 Impact on the Haitian apparel industry

The apparel industry in Haiti would similarly be severely impacted through the revocation or weakening of the yarn forward rule under CAFTA-DR. This shift in policy would force their apparel industry to directly compete with a Chinese and other third-party supplied CAFTA-DR apparel sector. The direct apparel jobs lost in Haiti would relocate to other Central American countries as Haiti will have lost its competitive advantage vis-à-vis other Central American countries, potentially creating a new wave of immigration from Haiti.

Haiti's apparel industry directly employed 54,882 workers in March 2021[4] based on an intense coproduction relationship with the Dominican Republic. These apparel jobs support another 450,000 indirect jobs in Haiti,[5] based on a multiplier effect of 8.2 as estimated by the International Finance Corporation (IFC).

Increased competition as a result of moving existing capacity from Haiti into other Central America and Caribbean countries is estimated to impact apparel exports from Haiti to the U.S. by at least 50%. In 2019, Haiti exported almost $1 billion in apparel to the U.S., so an impact equating to 50% on the country's output and employment will put over 27,000 direct jobs, half of Haiti's current employment, at risk. In

[4] ADIH Association des Industries d'Haïti
[5] IFC, 2020

addition, 225,016 indirect jobs supporting the Haitian apparel sector would be at risk. Once this starts happening, the entire apparel industry in Haiti is on a slippery slope to complete implosion.

HAITI: JOBS AT RISK IN THE APPAREL SECTOR	
DIRECT JOBS AT RISK	27,441
MULTIPLIER	8.20
TOTAL JOBS AT RISK	225,016

1.1.4 Impact on the Mexican textile industry

With a total employment of over 80,000 people in the Mexican textile industry, fundamentally weakening the yarn forward rule for CAFTA-DR and direct competition with Chinese and other third-party imports, would, over a two-to-three-year period, result in the estimated elimination of over 60,000 direct jobs in the Mexican textile industry. With the job multiplier, more than 180,000 jobs would be lost.

MEXICO: JOBS LOST IN THE TEXTILE INDUSTRY	
DIRECT JOBS AT RISK	60,733
MULTIPLIER	3.00
TOTAL JOBS AT RISK	182,199

1.2 Short Supply Mechanism

The U.S.-CAFTA-DR agreement contains a streamlined commercial availability, or short supply, determination process that allows fibers, yarns, or fabrics that are determined to be not commercially available in the U.S. and/or Central America-DR to be sourced from third parties. The process is both transparent and efficient and results in a determination within a month and a half when all potential U.S. and regional suppliers inform requestors and the U.S. government that they cannot supply the requested article.

Under CAFTA-DR, there are currently 152 products that have been granted short supply designation, by far the highest number for all comparative trade agreements. The last two requests were granted in December 2021 and due diligence inquiries have been ongoing. The short supply mechanism is providing CAFTA-DR with substantial product sourcing flexibility and inherently makes the agreement dynamic in nature.

Short supply imports represented 4% of total U.S. imports from CAFTA-DR in 2019 and has been stable for several years now. The relative stability since 2017 is likely a reflection that the list is now in a mostly mature state, with the preponderance of inputs unavailable in the region having already worked their way through the process and been added to the list. However, activity is still ongoing as previously noted.

Importantly, the CAFTA-DR short supply mechanism precludes the need for renegotiating or amending the CAFTA-DR rules to introduce other flexibilities, as it identifies and grants flexibility to products based on actual availability in the U.S. and region.

Further, given that the CAFTA-DR countries already have a far more extensive short supply list compared with other Western Hemisphere free trade agreement (FTA) regions, any efforts to weaken, bypass, or rewrite the short supply process to allow in third-party inputs that displace products available in the signatory countries, should be rejected. Such a move would undermine the rules of the agreement and adversely impact jobs in the region and in the U.S.

1.3 De Minimis Rule

The United States provides a duty exemption for goods valued at less than $800 in retail value if imported by one person on one day. De Minimis exemptions have had a significant negative impact in terms of undermining carefully constructed textile and apparel rules of origin in CAFTA-DR and other FTA and trade preference partners.

Of note, the de minimis exemption was raised from $200 to $800 in 2016 under the U.S. Customs reauthorization legislation. The current application of de minimis provides exemptions on base MFN tariffs, as well as Section 301 tariffs, such as those currently in place against imports from mainland China. Use of this exemption has skyrocketed alongside the growth of direct-to-consumer e-commerce, which has further accelerated due to the COVID-19 pandemic.

U.S. Customs & Border Protection (CBP) reports over 2 million individual de minimis shipments a day enter the U.S., and preliminary analysis indicates most of these shipments are apparel. De minimis imports qualify for unilateral duty-free treatment despite not being subject to rules of origin, or to labor and environmental standards, as opposed to products manufactured in an FTA partner country, which are subject to strong rules and standards. This has become a significant legal loophole that is clearly undermining trade preferences with CAFTA-DR, and other countries that have negotiated reciprocal duty-free preferences with the U.S.

1.4 Impact on Investment

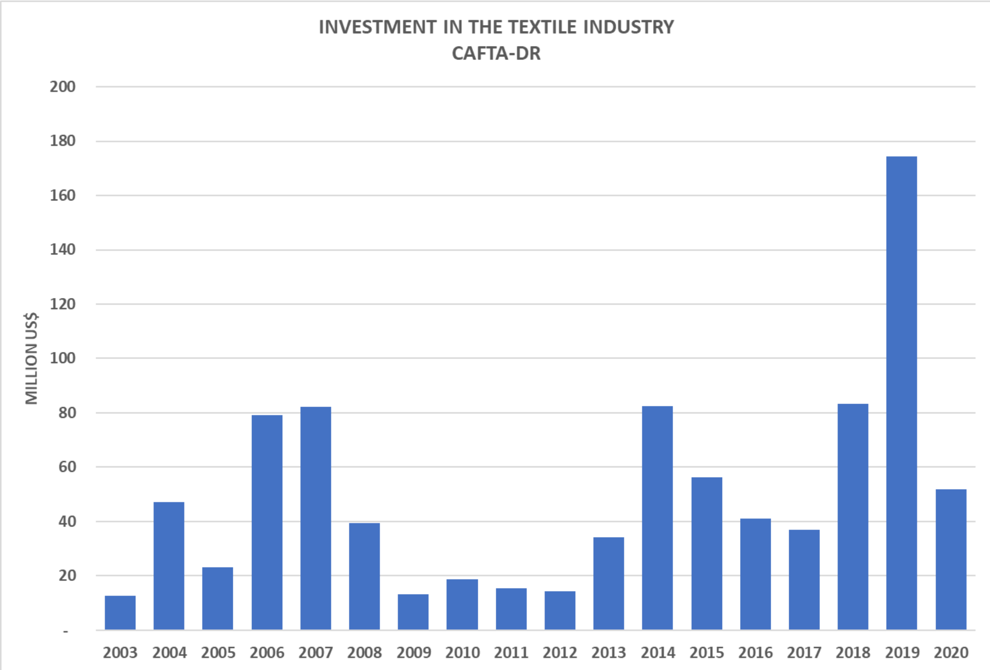
A vertically integrated supply chain is a requirement for sustainable future competitiveness in the textile and apparel industries. In the last 5 years, investments in the U.S. spinning industry to supply the CAFTA-DR market with yarn have also been significant. Notably, Parkdale Mills, the largest U.S producer of spun yarn, recently announced a $150 million dollar investment in a new yarn spinning facility in Honduras and a substantial investment to support existing operations in Hillsville, Virginia, which will create hundreds of jobs in Honduras and further support hundreds of employees in Parkdale's Hillsville operations. Parkdale has also invested $145 million to add ring spinning capacities at its Mountain City, Tennessee yarn plant.

Over the last ten years, Gildan has invested more than $500 million in yarn spinning operations in the United States including both greenfield projects and the acquisition of yarn spinning facilities that were subsequently modernized by the company. Furthermore, Gildan recently announced the acquisition of Frontier Yarns for $168 million. In total, Gildan now operates 10 yarn spinning facilities in the United States representing employment of approximately 2,100 people. The yarn produced in the United States supplies knitting, dyeing, cutting and sewing facilities, as well as garment dyeing and hosiery manufacturing plants that Gildan operates in the CAFTA-DR region. The facilities are located in Honduras, Nicaragua, and the Dominican Republic and represent total employment of close to 40,000 people.

In the last five years, investments in the U.S. and CAFTA-DR synthetic filament industry to supply the CAFTA-DR market have been significant as well. Unifi, the largest synthetics (polyester and nylon) textured yarn producer in the U.S.-CAFTA-DR region, has invested over $70 million in capital expenditures to upgrade, modernize, and expand their facilities in North Carolina coupled with substantial investments in its El Salvador operations. Unifi is currently expanding and upgrading their polyester textured yarn facilities in North Carolina and El Salvador; with $80 million of new capital expenditure between 2021 and 2023. Honduras-based UTEXA spent $73 million to build a brand-new synthetics polyester filament and textured yarn facility during 2018 and 2019.

As can be seen from some of the private sector investments listed above, abolishing, or weakening the yarn forward rule will have a detrimental effect on the viability of companies that have made major investments.

The following table provides an overview of investments in the textile industry within CAFTA-DR. It should be noted that within the region, the Northern Triangle countries have seen the largest investment.



Since the agreement was signed into law in 2005, the CAFTA-DR countries (minus the U.S.) have benefited from over $1 billion in direct textile and apparel sector investment that has helped to construct a truly vertical production chain in the region.

As a result, U.S. investments are mostly at stake if the agreement's rules are weakened. Long-term stability is an absolute requirement with certain, established rules and regulatory framework for attracting investments.

Just recently, the yarn forward rule was reconfirmed and strengthened in the updated NAFTA, otherwise known as the United States-Mexico-Canada Agreement (USMCA), which was negotiated and signed in September 2018. Considering that is has been just over a year since USMCA went into effect in July 2020, any changes in rules and regulations in other FTAs of that same yarn forward rule can hardly be seen as sustained regulatory stability.

1.5 Impact on the Berry Amendment and PPE Supply

The Berry Amendment

The Berry Amendment requires 100% U.S. content for textile and clothing products sourced for the U.S. armed forces. It is aimed at ensuring that a U.S. production base exists for critical supply to the U.S. armed forces. As demonstrated in the previous chapters, eliminating the yarn forward rule for CAFTA-DR would immediately and directly impact U.S. manufacturers of intermediate and final products listed under the Berry Amendment. With the cascading effect that the elimination or weakening of the yarn forward rule will have in the short- to medium- term on other trade agreements, major U.S. players will be further affected and forced to close. Consequently, the U.S. armed forces will not be able to source reliable and top-quality products from within the United States. With the elimination of the yarn forward rule for CAFTA-DR, textile and apparel companies in the U.S. will not have the ability and capacity to meet surge production requirements in times of military mobilization.

In the short term, about a quarter of U.S. textile industry output will be lost, and, within a few years' time, more than two-thirds of the industry will be wiped out. The vast majority of U.S. textile and apparel manufacturing firms involved in supplying defense materials are also heavily dependent on supplying the commercial (non-military) market. If a company involved in U.S. military textile production loses a significant component of its commercial business, it could lead to bankruptcy or, at a minimum, a severely impaired ability to supply the U.S. armed forces. Destabilizing the domestic textile military industrial base in this manner will make the U.S. dependent on offshore suppliers, such as China for these strategically critical materials. Additionally, cutting-edge research that has resulted in innovative products enhancing operational capabilities and protecting U.S. soldiers would be wiped out.

The removal of the yarn forward rule for CAFTA-DR will cause a cascading effect resulting in the undermining of onshoring efforts and the integrity of critical supply chains. This will start from the capital-intensive upstream processes of fiber, yarn, and fabric production as they will be impacted first.

PPE Supply

Many U.S. yarn spinners, fabric producers, and apparel manufacturers pivoted their resources to personal protective equipment (PPE) production to assist health care workers and the general public in the fight against COVID-19.

According to a study published by the U.S. International Trade Commission (USITC) in December 2020, the U.S. market relies heavily on PPE from non-domestic suppliers and this import reliance has continued during the pandemic.[6] It is estimated that up to 90% of essential PPE materials are being supplied by foreign companies, the vast majority from China. This includes surgical masks, surgical and isolation gowns, and medical gloves.

Global production of PPE for healthcare use is characterized by high volumes and low profit margins for PPE producers. The fact that pricing is such a significant factor in PPE sourcing decisions has helped non-market countries, especially China, dominate global production and markets in this strategically important sector. However, during the pandemic China implemented new rules that slowed or delayed the export of PPE, which was also impacted by transportation bottlenecks due to elongated supply lines.

As with military textiles, a destabilization of the U.S. textile industry through an undermining of the yarn forward rule will have substantial, negative ramifications for the effort to construct a viable domestic supply chain for PPE that can meet national needs in a future pandemic.

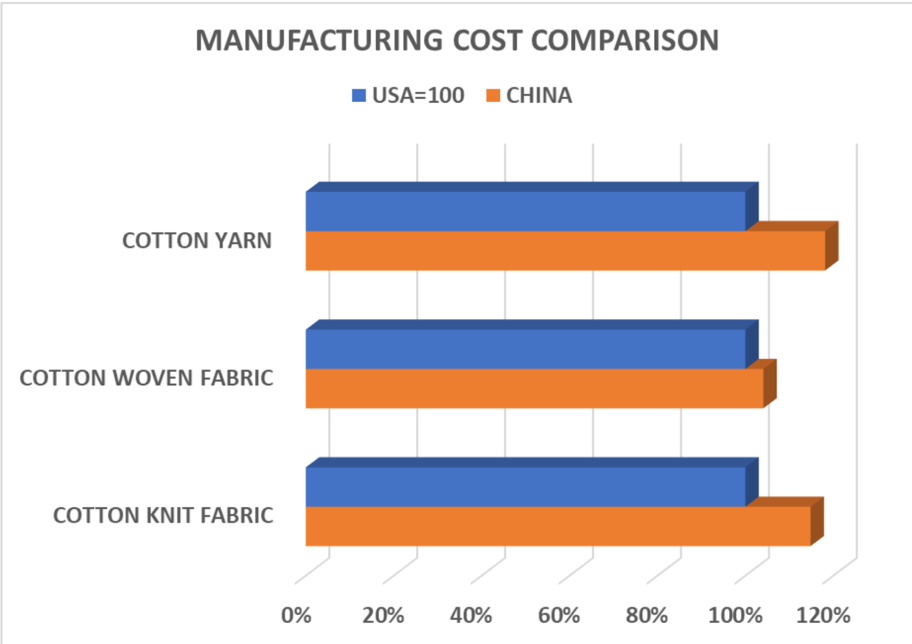
[6] https://www.usitc.gov/publications/332/pub5145.pdf

2. COMPETITIVE BENCHMARKING

2.1 Yarn and Fabric Manufacturing Cost

This chapter deals with the comparison of manufacturing cost factors for global competitors in the primary textile industry. The comparison assumes that manufacturing conditions are similar in each country and is calculated on the application of the latest new processing technologies. This provides a realistic analysis that considers the local raw material prices, labor costs, power costs, operating efficiencies, etc. Subsidies are not assumed in this assessment. The range of processes covered includes ring spinning, open-end spinning, texturing, weaving, knitting, and dyeing and finishing. It should be noted that cost reflects only one element of the final sales price, with other factors being overhead, incentive schemes, freight and shipping, insurance, import duties, and export fees. Quality and style, reliability, speed to market, and flexibility are additional factors that will have an impact on price.

The obtained results are given in the graph below,[7] comparing manufacturing cost in the U.S. (Index 100 in all cases) and the Chinese textile industry.



This data comparison clearly demonstrates that China has lost its competitive advantage in the cotton textile sector, compared to the United States. Contrary to popular belief, China is not the lowest cost producer for many textile inputs and finished products. Obviously, China mitigates its production cost disadvantage through massive state subsidies, substandard, and in some cases forced, labor practices, and the dumping of product at artificially low prices, all of which allow China to overwhelm competitors and unfairly dominate global markets in this sector.

[7] The data used in the comparison are for 2018 and based on information collected by the International Textile Machinery Federation. Every year, textile machinery manufacturers conduct numerous cost calculations for prospective clients around the world. Based on factors supplied by these clients, manufacturing costs are measured and used in the evaluation of investment projects. Cost factors are supplied by individual companies, consultants, and textile trade associations.

2.2 Product Cost Benchmarking

An additional benchmarking exercise has been executed for the following four apparel products:

- Men's 100% cotton basic T-shirt
- Men's 100% polyester active T-shirt Polyester
- Men's five pocket cotton jeans
- Women's trouser, 96% polyester, 4% Lycra

The evaluation compares Chinese products versus the same apparel items manufactured in Honduras. The following table shows the outcome in terms of the ex-factory price for each garment produced, the import duties paid into the U.S., and the final price, including duties paid, freight, and insurance costs.

MANUFACTURING COST COMPARISON					
US$ PER ITEM					
		T-SHIRT COTTON	T-SHIRT POLYESTER	MEN'S COTTON JEANS	WOMEN'S POLYESTER TROUSERS
EX FACTORY PRICE	CHINA	1.61	1.19	8.32	6.41
	HONDURAS	1.73	1.57	8.45	8.02
DUTIES PAID	CHINA	24%	39.5%	24.1%	36.1%
	HONDURAS	0%	0%	0%	0%
LANDED DUTY PAID U.S.	CHINA	2.34	1.99	10.76	9.17
	HONDURAS	1.98	1.85	8.82	9.14
Note: Landed Duty Paid includes duties, freight and insurance fees					

As the table above demonstrates, duty-free access to the U.S. market makes CAFTA-DR countries globally competitive for the U.S. market across the spectrum of apparel products. The duty-free access and close proximity to the U.S. market along with a strong, integrated coproduction chain are the inherent advantages of the US-CAFTA-DR trade relationship. The region is competitive on pricing because of this combination of factors.

As the table above shows, China has a significant advantage in terms of raw material costs, particularly in synthetics. But the data also demonstrate that China's pervasive price manipulation can be offset by the application of duty-free benefits for qualifying goods under the CAFTA-DR agreement. According to a major U.S. textile producer, the U.S. and Central American polyester yarn industry has invested millions of dollars in the last two years and is projected to invest more in the next two to three years, which will improve the region's competitiveness in regard to labor, energy, speed, and flexibility. These technology investments in polyester yarn production will yield significant cost improvements related to labor and energy and narrow the gap compared to China's synthetic yarn costs. Given the substantial duty savings associated with synthetic products from the region, it provides a sourcing advantage for these product categories.

Weakening the yarn forward rule would needlessly allow Chinese yarns and fabrics to displace U.S. and regional textile production. Other hemispheric partners would also suffer significant losses. The benefits associated with the yarn forward rule create a careful balance between Western Hemisphere competitors, while simultaneously providing lucrative duty preferences that allow regional partners to compete with Asia.

3. DEPENDENCE ON CHINA

3.1 China: The Dominant Factor

China is the dominant force in the global textile and apparel market. China's mill consumption of cotton is 33% of the total world consumption and its synthetic fiber production accounts for two-thirds of the global production. Its predominance is particularly impressive in the synthetic fiber business. For example, China's draw texturing capacity is at 68% of global production capacity. In waterjet looms for weaving of synthetic fibers and yarns, China holds an astonishing 84% of world capacity. Also, in knitting China is by far the largest producer with almost 60% of global capacity in circular knitting and 69% in flat knitting. To put this into perspective, the Chinese population is 18% of world population.

CHINA AS % OF WORLD TOTAL 2020		
	CHINA	
RING SPINNING	37.4%	Finer cotton yarns
OE SPINNING	34.9%	Coarser cotton yarns
DRAWTEXTURING	68.0%	Synthetic yarn
WEAVING	53.8%	Woven fabrics for trousers, shirts, …
of which synthetic weaving	84.0%	Synthetic woven fabrics
CIRCULAR KNITTING	58.3%	Fabric for T-shirts, underwear, hosiery,…
FLAT KNITTING	69.0%	Fabric for sweaters, …

It is clear from the above statistics that China has built up a massive overcapacity in the textile industry. This excessive capacity can only be sustained through the dumping of product at artificially low prices on the world market.

The USITC report to Congress on China's WTO Compliance, published in March 2020, confirms this point and states that:

- → China continues to provide substantial subsidies to its domestic industries.
- → China is the world's leading offender in creating non-economic capacity, as evidenced by the severe and persistent excess capacity situations in several industries.
- → China is attempting to manage the export of goods by raising or lowering the VAT rebate available upon export. It sometimes reinforces its objectives by imposing or retracting export duties, causing tremendous disruption, uncertainty, and unfairness in the global markets particularly downstream products where China is a leading world producer or exporter.[8]

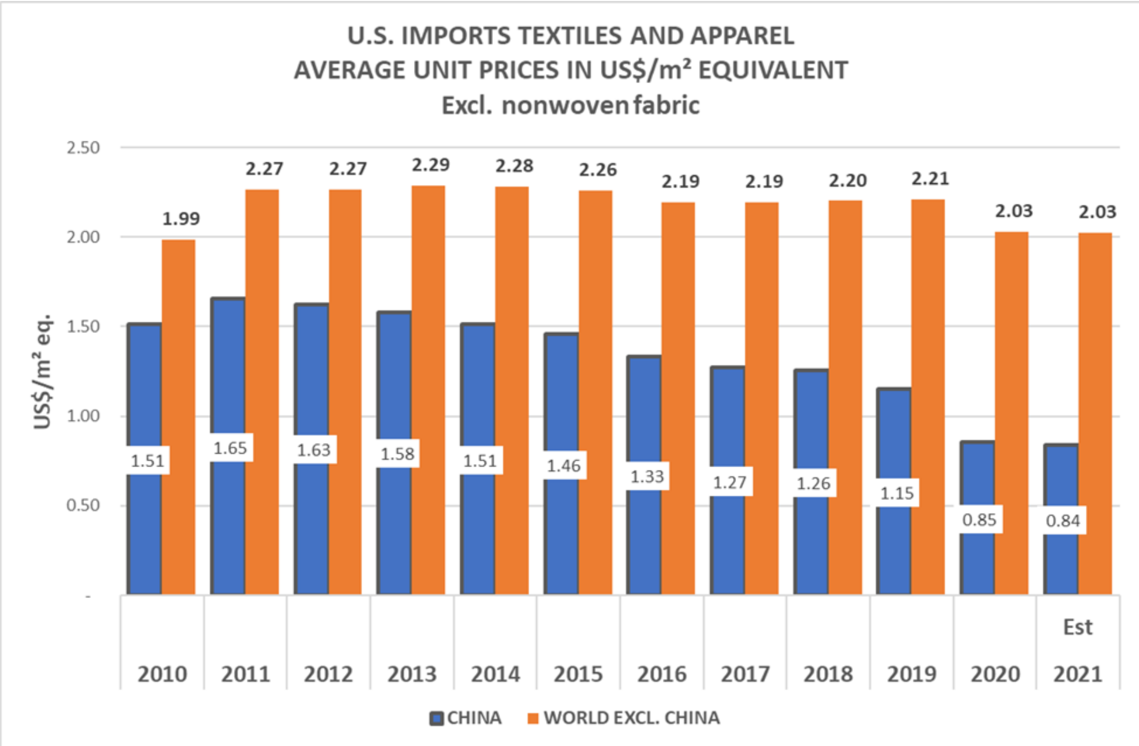
These unfair trade practices have had detrimental effects on domestic and regional textile and apparel supply chains in North America. As detailed in this report, the U.S. / CAFTA-DR supply chain is under great pressure from unfair competition. To eliminate or weaken the yarn forward rule in CAFTA-DR would reward China for its predatory activities and make any enforcement of unfair Chinese trade practices virtually impossible. It would also give backdoor access to other countries not party to the agreement to gain the benefits of the agreement without the obligations. Without a doubt, this major policy shift would also cripple the U.S. textile industry's ability to provide lifesaving PPE and military equipment.

The following section will provide evidence of China's manipulation of prices, both in direct exports to the U.S., and through intermediate processing in third countries.

[8] https://ustr.gov/sites/default/files/2019_Report_on_China%E2%80%99s_WTO_Compliance.pdf

3.2 China and Artificial Pricing

The main driver behind China's dominance of U.S. imports of textiles and apparel is pervasive price manipulation. This is evidenced by the dramatic decrease in unit price of Chinese textile and apparel products compared to prices for products imported into the U.S. from other countries. The graph below shows that unit prices (measured in US$ per square meter equivalent to account for different product categories and units) from China have been dropping steadily since 2011 and have now reached a level far below prices from other countries.

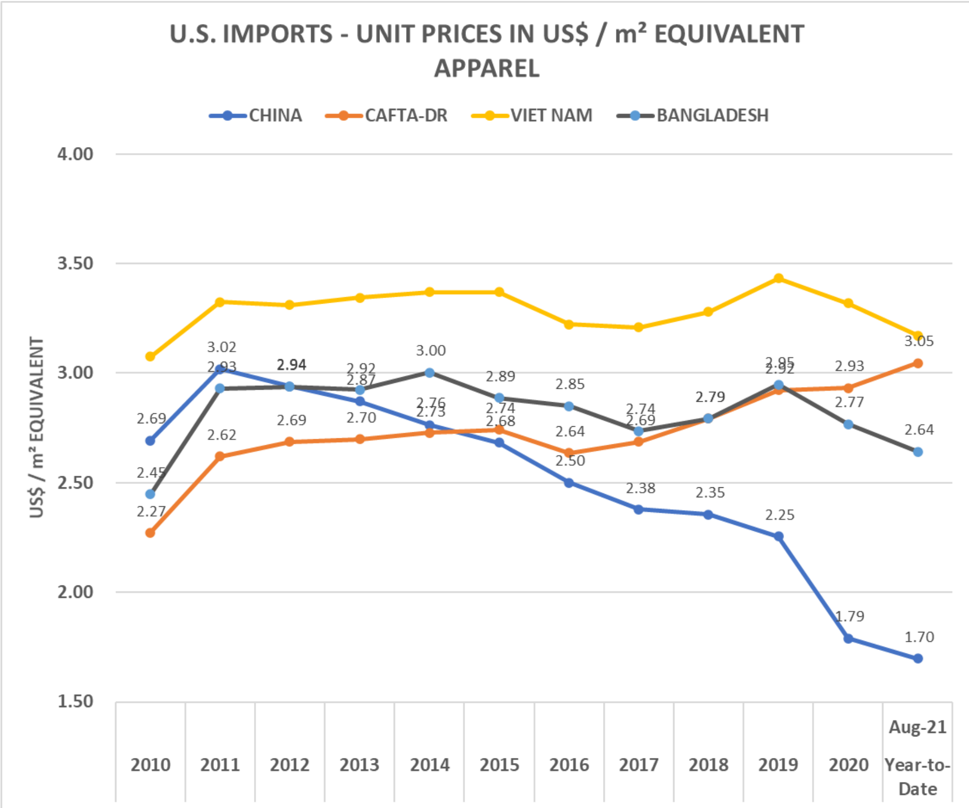


The above graph is for all textiles and apparel combined. It clearly demonstrates that massive overcapacity and state sponsored subsidies have allowed China to defy normal market forces and artificially lower their offerings in this sector. Looking at total apparel, average U.S. import prices from China have dropped over 25% since 2019. Since 2011, average import prices of apparel products from China have dropped over 50%.

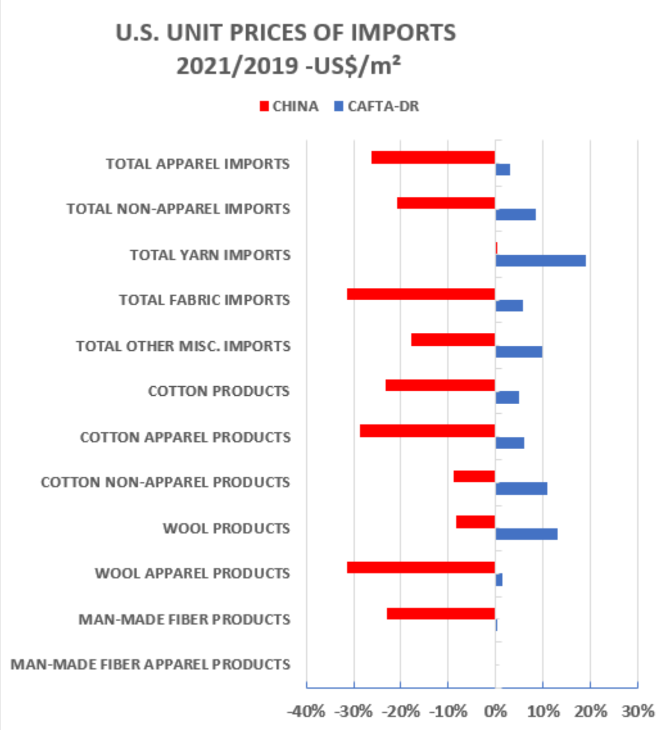
In addition, unit prices for apparel and textile imports into the U.S., measured in US$ per equivalent m2, have been analysed to compare CAFTA-DR competitiveness versus major suppliers from China, Vietnam, and Bangladesh. Our findings show that the difference between import prices of Chinese product compared to other countries is completely out of proportion and inexplicable from an economic perspective.

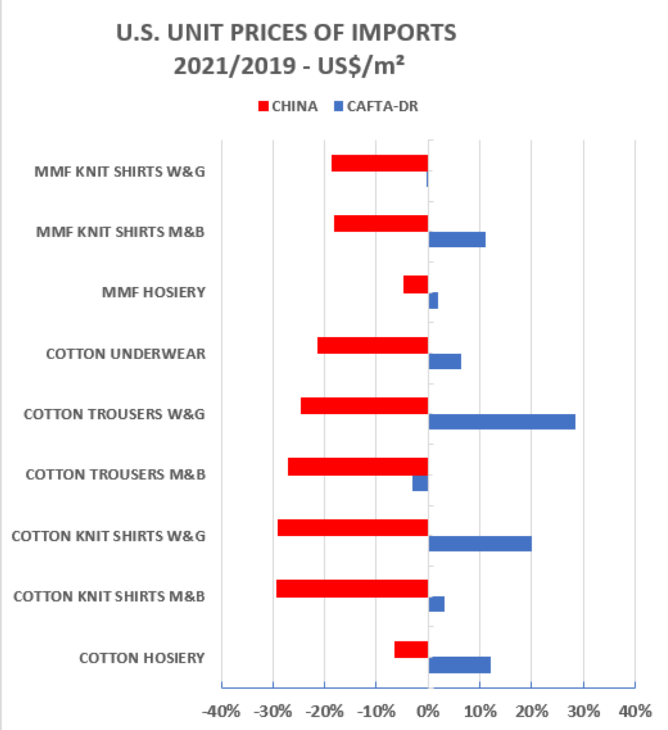
As opposed to China, apparel exports from the CAFTA-DR region to the U.S. have been increasing in FOB price since 2010, reaching their highest point last year (2021), based on average price for the January-August period. While experiencing a drop in 2020 and 2021 due to the pandemic, apparel unit import prices from countries like Vietnam and Bangladesh have remained stable over time. Again, China's sharp decline in pricing is inexplicable from a pure market standpoint, even relative to major Asian competitors.

Further, there is little doubt that Vietnam, Bangladesh, and other major Asian suppliers of apparel have been able to keep apparel prices from rising, utilizing heavily subsidized Chinese yarns and fabrics. The chart below shows China's precipitous drop in apparel pricing over the past decade compared to the CAFTA-DR and key Asian suppliers.



Exploring in further detail, one can see that the drastic drop in import prices from China is happening across all apparel categories. The following two graphs provide a detailed pricing comparison of various product categories and single apparel items from 2019-2021.

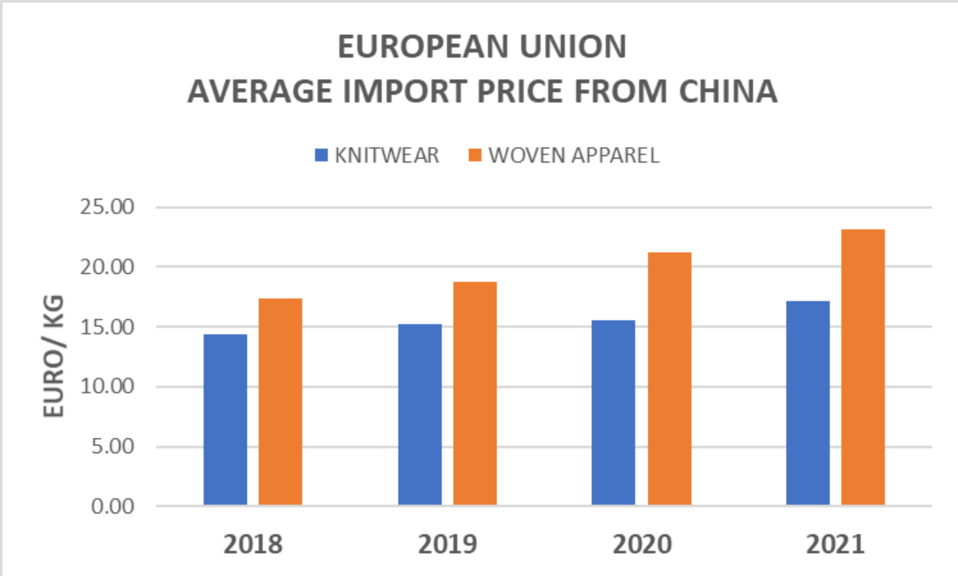




Remarkably, every product category from China has dropped in price since 2011. In comparison, an analysis of import unit prices from China into the European Union shows that prices have been increasing in recent years, not decreasing. This could be attributed to the fact that EU tariffs are lower, noting that Europe has not replicated U.S. penalty tariffs on China. It is possible that China is lowering prices to U.S. brands in an effort to offset Section 301 penalty tariffs. Further, the Chinese could be lowering prices to convince U.S. brands not to shift sourcing over fears that they may have shipments seized as part of the U.S. ban on Xinjiang cotton and cotton products.

Undoubtedly, a closer examination of the data showcases that these heavy subsidies have created a distorted import market with the Chinese continuing to dominate production chains based on this manipulation. To date, the EU has not been as forceful as the U.S. on the Xinjiang cotton forced labor issue. Regardless, the data demonstrate that China can manipulate pricing according to circumstances within specific markets to unfairly secure and maintain a position of global dominance within this sector.

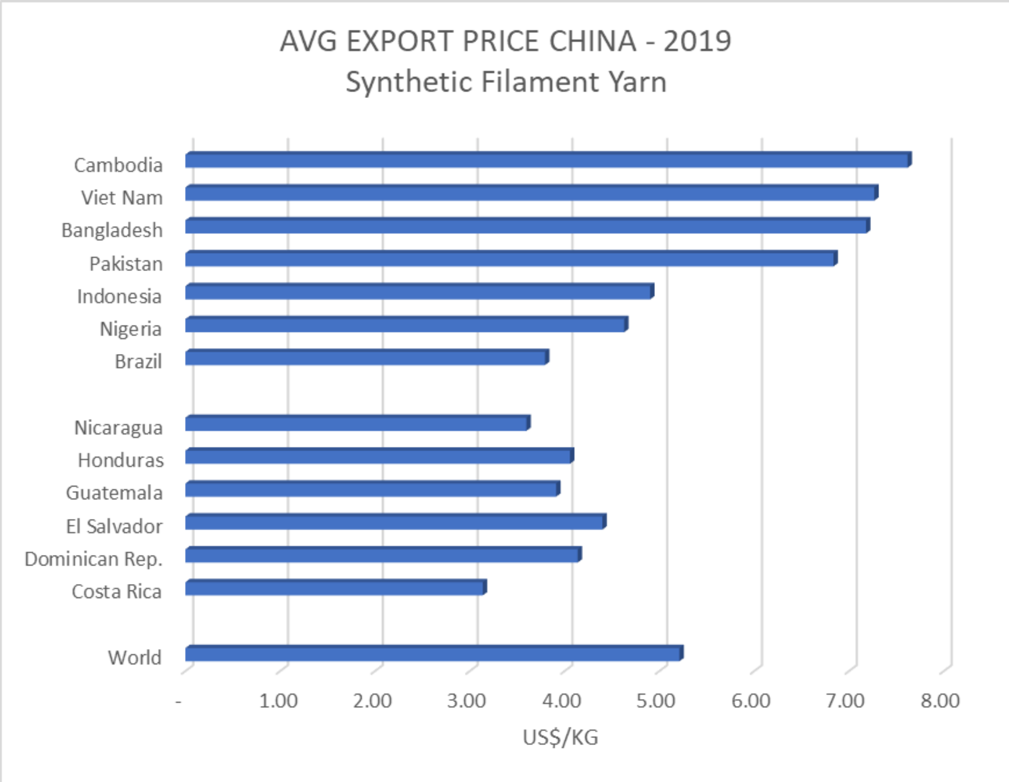
As an illustration, the chart below shows a consistent climb in the price of Chinese apparel items exported to the EU since 2018.



As one can see in the above chart, China's apparel pricing in Europe is directly and inexplicably converse to their price offerings to brands, retailers and importers servicing the U.S. market. If the yarn forward rule is weakened, there is no doubt that China will utilize this extraordinary pricing power to undercut U.S. and regional yarn and fabric suppliers to rapidly seize billions of dollars in market share in the CAFTA-DR region.

The CAFTA-DR region is also a victim of Chinese dumping of yarn and fabric – thereby undermining both the region's industry and that of the US. Import data analysis from products originating from CAFTA-DR into the U.S. in 2020 show that dutiable imports from Guatemala (19.3% of the total exports to the U.S) and particularly Nicaragua (37.8% of the total exports to the U.S.) have grown in importance in recent years when compared to duty-free imports. The only reasonable explanation is that China is keeping the prices for yarn and fabric artificially low through rampant subsidies for CAFTA-DR countries, in order to be able to compete with duty-free items, from local or U.S. and regional yarn and fabric suppliers.

Data show that average export prices from China to CAFTA-DR countries are equally well below their exports to other major countries. Using the example of synthetic filament yarns, the chart below demonstrates that China's export prices are relatively high when shipping to countries like Vietnam, Cambodia, and Bangladesh where China is the dominant textile supplier. In markets, such as Central America, Chinese prices for the same yarns are significantly lower despite greater shipping and delivery costs. China is obviously offering textile inputs at a substantial discount in Central America in an attempt to undercut U.S. and regional yarn manufacturers.



It is evident that, from both the dramatic drop in prices of imports from China and the price setting of yarn and fabric delivered to CAFTA-DR for dutiable exports to the U.S., prices are being manipulated by China.

Whenever there is an opportunity for a country to have preferred access to the U.S. market, China is focusing on how to supply these intermediary markets.

3.3 Cotton and Forced Labor

In addition to price manipulation, China heavily subsidizes its cotton production and utilizes other illegal trade practices such as the pervasive use of forced labor in Xinjiang, as evidenced by well documented reports.

The ICAC, International Cotton Advisory Committee in Washington,[9] has identified multiple cotton subsidies provided by the Chinese government, including:

- → the government border protection program for cotton
- → direct subsidy payments to cotton producers in Xinjiang
- → a subsidy for using high quality seeds
- → subsidies for the transportation of cotton from Xinjiang to mills in eastern and southern China, where most of China's textile industry is located.

The sum of all cotton subsidies provided by the Chinese government are estimated at $4.7 billion (37 cents/pound) in 2019/20, up from $3.8 billion in 2018/19 (29 cents/pound).

[9] https://www.icac.org/Content/PublicationsPdf%20Files/d77a4022_9008_40f6_a972_c8c8e5d43d2f/Cotton_subsidies2020.pdf.pdf

These state-sponsored cotton subsidies contribute to China’s overall ability to artificially reduce their pricing on yarns, fabrics, and apparel globally.

Additionally, China has a long track record of failing to adequately enforce its laws and regulations concerning labor rights and social welfare. Forced labor in cotton farming in the Xinjiang province has been evidenced by many sources and condemned by the U.S and other countries. The Xinjiang region accounts for over 80% of China’s cotton production and 20% of the world’s cotton production. More than half a million Uyghur and other ethnic minority workers are being ordered into seasonal cotton picking under forced labor conditions. As a result, in January 2021 the U.S. banned the import of cotton and cotton products produced in Xinjiang in a move aimed at pressuring the Chinese Government to end the illegal use of forced labor in cotton production and halt the suppression of Uyghur and other minorities. In addition, Congress and the Administration enacted the Uyghur Forced Labor Prevention Act to ensure further accountability and enforcement related to imports of Xinjiang cotton and other products.

The U.S. Department of Commerce’s (DOC) Bureau of Industry and Security has published a list of 11 Chinese entities allegedly implicated in human rights abuses in Xinjiang, three of which are textile and garment factories. The textile mills included are: Changji Esquel Textile Co Ltd, Hetian Taida Apparel Co., and Yangtze River Delta-based exporter Nanjing Synergy Textiles Co. Ltd. Changji Esquel supplies major brands including Nike, GAP, Tommy Hilfiger, and Patagonia.

The strict enforcement of the U.S. import ban is necessary to ensure products are being imported into the U.S. market tied to forced labor. It also serves as a critical opportunity to divert apparel sourcing out of China to the CAFTA-DR region, where higher labor standards are in place and is traceability in the supply chain.

4. NEARSHORING, SUSTAINABILITY, AND CAFTA-DR

As stated in the Biden administration's National Strategy for a Resilient Public Health Supply Chain report published in July 2021, U.S. access to reliable supply chains both onshore and nearshore will increase the robustness and resilience of the U.S. economy and eliminate the potential for 'single source of failure'. Robustness also involves supplier diversity. This is equally true for the supply of textiles and apparel in terms of products under the Berry Amendment and PPE products and extends into the wider production base of companies in the textile industry. The U.S. government is committed to growing and sustaining this industrial base for the supply of critical textile and apparel products and to supporting its manufacturing base.

Another fundamental objective is to enhance supply chain transparency. Within the textile and apparel industries, *transparency* can only be achieved by *traceability* at every step of the chain, from raw material to finished product:

- → Raw Material: to expose and end forced labor as cotton farming and other production processes in China are dependent on the use of forced labor of the Uyghurs and other ethnic minorities in the Xinjiang area, producing over 80% of Chinese cotton
- → Processing: to support sustainable processing, especially in dyeing and finishing, printing
- → Cut and Sew: to source from socially responsible manufacturers

The domestic and regional supply chain of CAFTA-DR is a critical building block in this respect as it reduces the dependence on China, while emphasizing a nearshore regional supply chain that is based on strong U.S./CAFTA-DR coproduction partnerships. In addition to the USMCA, it is the base for nearshoring and home to many U.S. companies that are at the forefront of traceability through the production chain - from cotton and man-made fibers to final products.

The pandemic exposed significant fragilities in existing global sourcing practices, underscored by the failure of the predominant supplier, China, to provide lifesaving supplies at the height of the pandemic. It would be a fallacy to believe that removing the coproduction benefits that CAFTA-DR brings (i.e., eliminating or crippling the yarn forward rule or replacing it with a watered-down rule through other measures) will help. To the contrary, it will increase the dependence of the U.S. on Asian supply chains. It is the exact opposite of the objectives for nearshoring as stipulated in the administration's National Strategy for a Resilient Public Health Supply Chain.

4.1 Nearshoring Provides Proximity to Market

The U.S.-CAFTA-DR coproduction chain has many benefits that help brands and retailers respond to fast fashion demands. First, the close proximity to market allows the Western Hemisphere to respond more quickly to changing fashion trends and replenish inventories more quickly.

The closer the factories are to final market – the less "dead-time" on the water and the greater ability of supply chains to respond quickly as demonstrated by transit times:
→ 9 to 10 weeks for onshore in the U.S., or nearshore from Mexico or CAFTA-DR
→ 14 to 15 weeks for offshore from China.

Since much of the production chain has yarn and fabric mills and apparel sewers co-located or nearby, CAFTA-DR countries can get products out five weeks faster. This is a huge advantage over Asian suppliers. If the region were substantially dependent on Asia for raw material production- versus the regional or the U.S. industry- this time production and delivery advantage the region currently has compared to Asia would completely evaporate. The vertical coproduction between the U.S. and CAFTA-DR offers the following:

- → Flexibility and quick response to market demand

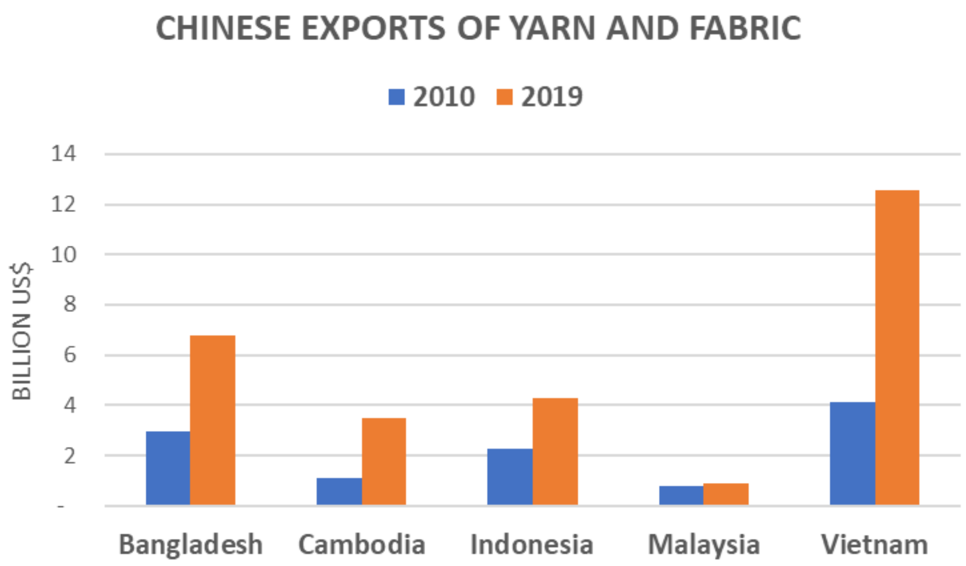
→ Versatility in production and supply chains for e-commerce
→ Shorter inventory hold times for brands
→ Considerably shorter shipping routes, and
→ Traceability throughout the supply chain.

Allowing for imported fabric from Asia into CAFTA-DR for assembly and subsequent export to the U.S. market can hardly be called nearshoring.

4.2 Nearshoring Reduces Dependence on China and Other Asian Producers

As abundantly demonstrated in the previous chapters of the report, China is dominating the world's textile and apparel industries and global trade in these sectors.

In the U.S. alone, China continues to be the dominant supplier of apparel and textiles, accounting for a 28 percent share of the market in the latest U.S. government trade data. Still, the geographical patterns of sourcing have been changing over the past 10 years, with Cambodia, Bangladesh, Indonesia, and Vietnam gaining some market share from China. Since labor costs in the Chinese sewing industry have been rising, China is shipping increasing amounts of yarn and fabric to nearby countries with lower wages for sewing. The following graph shows that in 2010 Chinese textile exports to other Asian countries amounted to just over $8 billion, and by 2019 these exports had grown to over $28 billion.



China has consistently taken advantage of sourcing shifts, as evidenced above. Changing the FTA rules by removing or undermining the yarn forward rule for CAFTA-DR will only serve to make the Central American countries much more reliant on Chinese and other third-country inputs, at the expense of existing U.S. and regional production of yarns and fabrics.

Furthermore, granting duty-free and other trade preference benefits to entities outside of the Western Hemisphere – such as by expanding the Generalized System of Preferences (GSP) to include textiles and apparel or negotiating FTAs with major Asian suppliers – would equally increase dependence on China, as it is the major supplier to these countries of intermediate textiles like yarn and fabric. Any measures that directly or indirectly undermine the CAFTA-DR yarn forward rule will destabilize the U.S.-CAFTA-DR supply chain while boosting the competitive advantage of China and other Asian producers.

As the Chinese textile sector, subsidized by the Chinese government, continues to dominate world production of textile fiber, yarn, and fabric inputs, supply chain transparency issues have intensified. As stated earlier, it is well known that over 80% of Chinese cotton comes from the Xinjiang Uyghur Autonomous Region (XUAR) region. Nearly all that output is further processed within China and often blended with fibers of other origins making it very difficult to trace. Much of that processed output, yarn, and fabric is then shipped all over the world to downstream manufacturers for either fabric formation or sewing, making it almost impossible to track. This paradigm provides a backdoor to third markets to transport the Xinjiang cotton issues associated with the use of forced labor.

Consequently, it is likely that anything made in many of the main Asian origins could contain Xinjiang cotton. For example, Cambodia, Bangladesh, Vietnam are not significant cotton producers and therefore import cotton, cotton yarns and cotton fabrics from China. As the longer-term trend of moving cut and sew operations from China to poorer countries, or to those with duty-free option continues, it becomes all the more important to maintain a strong rule of origin in the CAFTA-DR region.

While DNA tracing and rigorous analysis of shipment records will improve traceability, such mechanisms are also dependant on being able to genetically map cotton in remote regions as well as the cooperation of governments in countries that produce goods and raw materials. To date, the Chinese government has been resistant to allowing traceability mechanisms associated with cotton grown in the XUAR. In fact, China has threatened retaliatory actions toward companies and organizations that have attempted to effectively trace the origin of cotton products back to Xinjiang. This likely means that unless there are significant breakthroughs in cotton tracing technology in the near-term, it will be difficult at best to effectively address the forced labor issues in Western China.

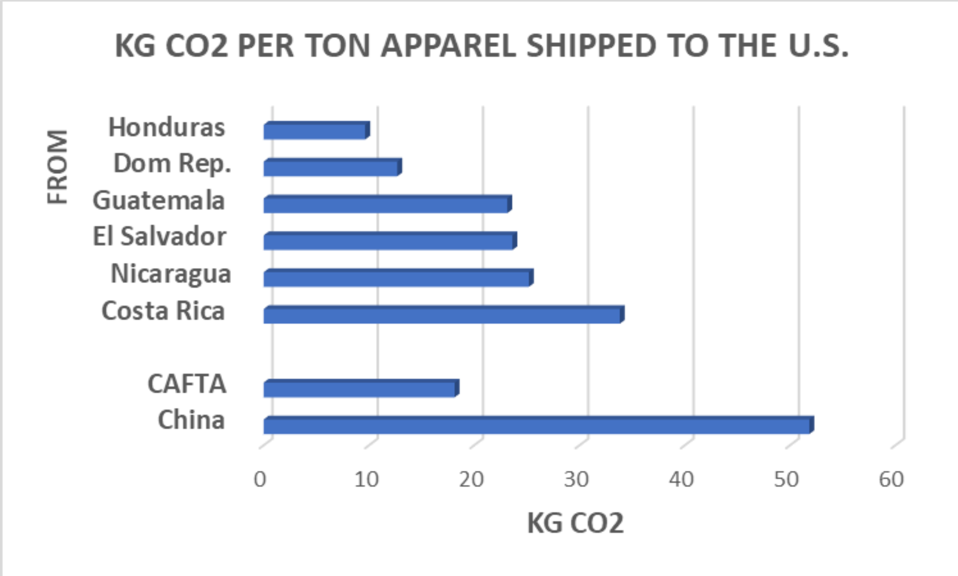
The CAFTA-DR supply chain does not have this issue, since the U.S. and the region produce most of the raw cotton and cotton yarns and fabrics processed in the CAFTA-DR. However, removing or tampering with the rules of origin would certainly import the China slave labor problem into Central America.

4.3 Nearshoring Increases Sustainability

Carbon emissions: Freight

A recent study by the International Labour Organization (ILO) on how to assess carbon emissions in the garment sector in Asia stated that 1% to 6% of the total energy consumption of the value chain of a garment is from transport.[10] A relaxation of the yarn forward rule would significantly increase the use of carbon simply because inputs would be shipped from farther afield – i.e., from China to the CAFTA-DR region – for assembly, rather than directly from the region or U.S. Comparing the carbon emissions of a garment shipped from China into the U.S. market with one from the CAFTA-DR region to the U.S. results in a large difference: on average apparel exported from China produces 51.8 kgs CO2 per ton, compared to 18.1 Kgs CO2 from CAFTA-DR.[11]

[10] https://www.ilo.org/asia/publications/WCMS_781938/lang--end/index.htm
[11] Calculations based on www.carboncare.org



Energy consumption in manufacturing

Globally, textile and apparel manufacturing are characterized by high energy consumption and carbon emission. As a result, low-carbon production that is less energy intensive is becoming more imperative. The textile and garment industry is the 6th largest consumer of industrial energy[12] in all of China. Moreover, the energy shortage in China has resulted recently in a higher output from Chinese coal mines to feed its industrial base. In October 2021, China ordered its two top coal regions to boost output.

China's manufacturing economy continues to be primarily fuelled by coal. From 1990 to 2019, China's coal consumption nearly quadrupled. In August 2021, coal accounted for over 62% of total power generated. Since 2011, China has consumed more coal than the rest of the world combined. China's industrial sector is by far the largest consumer of coal, accounting for over 95% of their total coal consumption. According to the International Energy Agency, 79.7% of China's emissions came from coal in 2018, compared to 25.8% in the United States. By comparison, the U.S. industry's demand for coal has been declining continuously and at present represents a mere 3.7% of total energy used by industry.

Cotton – use of pesticides

It is also known that cotton growing accounts for 30% to 40% of all pesticides used in China. Additionally, China uses four times more pesticides in crops than the U.S., with roughly half of the output of the U.S. Nearly 40% of the pesticides used by Chinese cotton farmers contain active ingredients that are classified as extremely or highly hazardous by the World Health Organization.

Genetically modified insect-resistant cotton was introduced in China in 1997. In northern China, 95% of cotton is of this variety. In theory this should require less pesticides as it produces a toxin that kills cotton's number one enemy, the bollworm. However, the practice of applying excessive amounts of highly toxic pesticides has continued even after the adoption of the genetically modified cotton. Eliminating the bollworm has also allowed other pests to thrive, and now farmers are using even more pesticides to kill other insects than they previously used.[13]

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[12] Carbon Emission Evaluation Based on Multi-Objective Balance of Sewing Assembly Line in Apparel Industry, Xujing Zhang and Yan Chen, College of Textile and Clothing Engineering, Suzhou, China, July 2019

[13] Multidecadal, county-level analysis of the effects of land use, Bt cotton, and weather on cotton pests in China, Zhang, Yanhui Lu, Wopke van der Werf, Jikun Huang, Feng Wu, Ke Zhou, Xiangzheng Deng, Yuying Jiang, Kongming Wu, and Mark W. Rosegrant, 2018

Circularity
China's business model in the textile and clothing industries is largely based on the traditional and linear 'take-make-dispose' production system, whereas circular economies are becoming more prevalent in the U.S. and Europe as global leaders strive to incorporate circularity principles into production models to meet future global climate targets. A circular production system reduces the disposal of microplastics in the environment, limits the use of hazardous substances, and recycles waste to renewable inputs. It is important to emphasize that circularity requires full transparency and traceability across the value chain, including the ability to trace products, components, and materials as well as the social and environmental conditions in which they are produced.

A closed manufacturing chain based on nearshoring, such as the CAFTA-DR supply chain, can clearly achieve the above goals easier than production from Chinese factories where transparency is lacking, and labor and environmental abuses have been pervasive.

Traceability
Traceability means the ability to track any raw material, intermediate product, and final product through all stages of production, processing, and distribution. Companies are facing global pressure to focus more resources on incorporating traceability in their supply chains to measure real impacts. For example, throughout the production process, apparel products can be dyed, printed, bleached, stone washed, degraded, shrunk, and felted, and those processes must be tracked to ensure they are made sustainably and ethically.

Shipments through third countries for further processing imposes added constraints on any traceability system aimed at recording the different stages of the supply chain. A major flaw in current tracing technologies is the lack of cooperation by supplier countries in sharing essential information. For example, China's inflexibility in this area makes it unlikely that credible traceability mechanisms for products made in China will be in place anytime soon, especially for goods and raw materials linked to labor abuse.

As explained above, the widescale use of forced labor in Xinjiang cotton and apparel production is a prime example of how traceability can contribute to more sustainability and improved human rights enforcement. The well documented abuses of Uyghur minorities in Xinjiang, China underscore the urgent need for more traceability in global supply chains. At present, the Asian supply chain is non-transparent. It is common practice for companies to blend the tainted Xinjiang cotton with other fibers (including U.S. cotton) in intermediate goods shipped out of China to other Asian countries, to mask the origin and gain credibility.

DNA testing is gaining some traction as evidenced by specific cases where companies used the testing method on Egyptian cotton contained in home textiles exports to the U.S. After reports surfaced about the misuse and mislabelling of the Egyptian cotton logo, it was discovered that there were widespread instances of fraud in which no Egyptian cotton content was found in tested home textile products.[14]

While this technology area has its challenges, traceability is becoming increasingly important. In today's global garment production chain, brands and retailers are the owners of the final products. Improving traceability and standardizing the various methods used at present will be one of the major drivers for consumer preference. Moving towards more ethical and sustainable consumer demands requires retailers and fashion brands to be more transparent about environmental impacts and human rights conditions along the global textile/garment supply chain.

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[14] See also https://adnas.com/cotton-supply-chain-protection/# and https://www.cps.bureauveritas.com/needs/dna-authenticity-confidence

China will likely continue to have major problems and resist demands for detailed information about the origins of inputs in its production chain because increased traceability in the Chinese production chain will continue to expose many unfair and harmful processes.

By contrast, it is much easier to trace inputs in the U.S./CAFTA-DR coproduction chain due to strong rules of origin in the FTA. Shifting apparel production capacity from China to CAFTA-DR would demonstrate that retailers and brands are serious about meeting their corporate sustainability and environmental goals based on well-regulated traceability.

As an essential element of the CAFTA-DR agreement, the yarn forward rule therefore cannot be corrupted, as this would make companies in Central America and the Caribbean potentially and unknowingly complicit with the Chinese use of forced labor and render thorough traceability impossible.

4.4 Test Scenario - Doubling CAFTA-DR Exports to the United States

Prior to the pandemic, the global garment industry was largely based in Asia. Years of continuous offshoring of production in a race to the bottom has led to a tipping point caused by a global pandemic that uncovered the vulnerability of this excessive reliance by the U.S. on one region with one dominant player, China.

Across the entire political spectrum and business communities, there is a call for more onshoring and nearshoring of manufacturing production. Within the textile and apparel sector, the coproduction chain between the U.S. and CAFTA-DR, and the U.S. and USMCA, as well as the entire Western Hemisphere, serves as a strong model for both onshoring and nearshoring the textile and apparel production chain.

If brands and retailers committed to doubling the exports out of CAFTA-DR to the U.S. under the current rules, it would mean an additional 180,000 jobs created in the U.S. textile industry and an additional 2.17 million jobs in CAFTA-DR. This is including direct and indirect job creation.

DOUBLING OF CAFTA-DR EXPORTS TO THE U.S.			
IMPACT ON U.S. TEXTILE & APPAREL INDUSTRY			
TOPIC	**2019**	**UNIT**	**SOURCE**
U.S. EXPORTS TO CAFTA-DR	3.53	Billion U.S. $	OTEXA
DOUBLING =	7.06	Billion U.S. $	
ADDITIONAL EXPORTS	3.53	Billion U.S. $	
U.S. DIRECT JOBS PER BILLION U.S. EXPORTS	16,686	Number	U.S. DOC ITA
ADDITIONAL U.S. JOBS ON DOUBLING EXPORTS	58,941	Number	
MULTIPLIER INDIRECT JOBS	2.04	Number	IPC Washington
U.S. INDIRECT JOBS ON DOUBLING EXPORTS	120,298	Number	
U.S. TOTAL JOBS ON DOUBLING EXPORTS TO CAFTA-DR	179,239	Number	
IMPACT ON CAFTA-DR TEXTILE & APPAREL INDUSTRY			
TOPIC	**2019**	**UNIT**	**SOURCE**
U.S. IMPORTS FROM CAFTA-DR	8.71	Billion U.S. $	OTEXA
CAFTA-DR DIRECT EMPLOYMENT	463,699	Number	WERNER
MULTIPLIER INDIRECT JOBS	2.34	Number	
CAFTA-DR TOTAL EMPLOYMENT	1,085,056	Number	
DOUBLING U.S. IMPORTS FROM CAFTA-DR TO	17.41	Billion U.S. $	
DOUBLING CAFTA-DR EMPLOYMENT TO	2,170,111	Number	

This shift would also unlock significant textile and apparel investment in the region under the existing yarn forward rule. Conservatively, $6 billion in new investment would occur in the U.S. and CAFTA-DR countries if exports were doubled from the region. New investments would occur in the spinning, weaving, and knitting industries in Central America and in the United States. There would also be benefits in reducing greenhouse gas emissions, as shipping a container to the U.S. from Central America, versus China, cuts greenhouse gases by 80%.

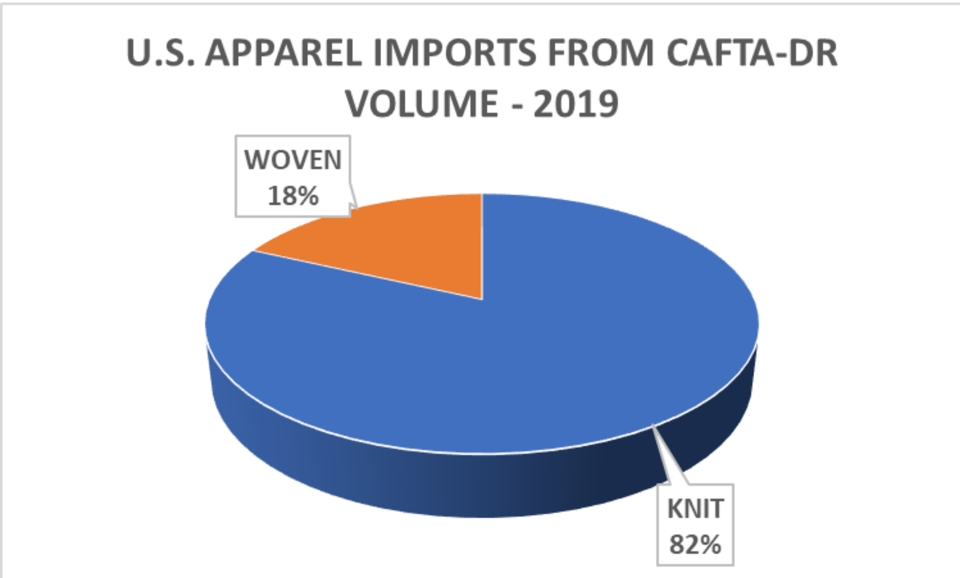
5. POLICY RECOMMENDATIONS

Upgrade Infrastructure in CAFTA-DR Region

Port connectivity, general infrastructure and the cost of power are having a major impact on investment decisions in the CAFTA-DR textile industry. Port connectivity is a key problem within CAFTA-DR as transportation through the various ports in the region are fragmented, resulting in low volumes and limited traffic frequency. In 2022, the Central American Economic Integration Board *SIECA*[15] is expected to approve a master plan to turn the region into a world-class logistics and transport hub by solving problems related to high transport costs and delays in mobility due to outdated and poor infrastructure. The plan will focus on airports, railways, ports, urban transport, highways, and border crossings.

Increase Product Diversification and Investment Planning

At present, there is a very high predominance of knitted apparel produced in CAFTA-DR. Within the knitted apparel category, the focus is on T-shirts, sweaters/sweatshirts, and underwear. This has been influenced by the sourcing and relocation strategies of U.S. companies like Fruit of the Loom, Gildan, Hanes and others. Over 82% of all apparel exported from CAFTA-DR to the U.S. is knitted apparel, of which 80% is T-shirts, sweaters/sweatshirts, and underwear.



Redirecting product volumes from China would require a focus on other apparel products next to the traditional product lines and adding opportunities for sourcing more wovens from the U.S./region. The emphasis should be on cotton and man-made fiber blends.

Doubling CAFTA-DR exports to the U.S. would require additional supply of yarns and new spinning production capacity, in addition to the newly planned capacities. Significant investments are already announced and will be announced regarding additional capacities. A feasibility plan should be developed to calculate the expected capacities. Potentially, home textiles could also form part of this expanded capacity, as cotton usage is important in these product groupings. This feasibility study should be part of an overall strategic business plan to further develop the regional, integrated supply chain.

A direct inward investment program aimed at the primary textile industry should include product, country, and company-specific investment targets. Vertical capacity will enhance competitiveness and

[15] Secretaría de Integración Económica Centroamericana (SIECA)
https://www.sieca.int/?lang=en

provide a closed loop supply base.

In addition, access is needed to low-to-no-interest loan guarantees and competitive financing to expand investment in this important sector as well as continued assistance from the U.S. government to increase high priority industrial expansion projects.

Support the Move to Full Package

The cut, make and trim (CMT) business model is the most basic stage of the apparel industry, in which garment-sewing plants assemble products using imported inputs that belong to the buyer. The apparel manufacturer is responsible for cutting, sewing, supplying trim, and/or shipping the ready-made garment. The buyer purchases the fabric and supplies it to the apparel manufacturer, along with detailed manufacturing specifications. The required formal skill level of operators is low.

When upgrading from CMT to full package, which is often the preferred model for buyers and an area in which Asia has an advantage over CAFTA-DR, the apparel manufacturer takes responsibility for all production activities. Full package requires upstream logistic capabilities: procuring, financing, and stocking necessary raw materials such as piece goods, and trim needed for production. The buyer may identify textile firms from which the garment manufacturer must purchase materials, or the garment manufacturer may be responsible for establishing its own network of suppliers. The firm is also often responsible for downstream logistics, including packaging for delivery to the retail outlet. The buyer still provides the manufacturer with product specifications and designs, but the buyer is not involved in details of the manufacturing process. Using nearby or domestic fabric can create important logistical advantages and backward linkages to the textile industry, and thus create an integrated vertical supply structure.

Buyers must play a stronger role in shifting to full package within CAFTA-DR.

Maintain Maximum Pressure on China

As has been evidenced throughout our analysis, China is a highly disruptive factor, destabilizing the U.S. market and its industry by undermining price levels, manipulating distribution channels, and taking advantage of loopholes in trade agreements. If the U.S. industry is to have a fighting chance to turn the tide against China's dominance and illegal trading practices, all possible actions need to be considered and existing measures need to be strengthened. This includes first and foremost the continuing enforcement of the rules of origin in the existing FTAs as well as closing all loopholes potentially undermining their effectiveness.

There is a stable regional supply base with the U.S. industry at its core and now is the opportunity to capitalize and expand investment and employment. To achieve new paths to growth, existing countermeasures need to be reinforced, including:

Enforcing the Xinjiang Cotton Ban

The U.S. cotton ban needs rigorous enforcement with DNA testing and the tracking of document issues for suppliers outside of China utilizing Chinese inputs. What is clear is that the U.S. ban on cotton and cotton products from the Xinjiang region would be much more difficult to enforce if more fabric came from China via third countries' intermediate products to the CAFTA-DR region

Increase Utilization of Trade Remedies

Open trade can grow businesses and create jobs, but fair competition must be maintained between domestic and foreign producers. This is at present not the case with the Chinese textile and apparel industries dominating world markets. The U.S. government should use all trade remedies to fight unfair trade practices. The instruments include anti-dumping remedies, specific safeguards, penalty duties, and anti-subsidies.

Penalty tariffs need to be applied if China is not playing by the rules. Tariffs can be an effective tool to deter subsidized imports of finished products. Once the competition in the market is wiped out, Chinese prices will start to increase again. The consumer also has the right to know that unfair trade practices and abuse of human rights are at the root of cheap prices, and that lax and/or non-existent environmental standards have a cost.

Crackdown on Illegal Transshipment through Better Customs Enforcement
Due to the lucrative tariff-free benefits afforded under CAFTA-DR, unscrupulous importers attempt to illegally avoid duties through transshipment schemes. Non-qualifying goods are often labeled as a product of an FTA country and transshipped through the FTA region in an effort to falsely claim duty-free entry into the United States. Additional CBP resources and an intensified focus are needed to ensure that CAFTA-DR benefits are not siphoned off through illegal activity that damages legitimate textile manufacturers, both in U.S. and the CAFTA-DR countries.

Refrain from Cumulation Provisions and Short Supply Process Changes

Certain brands, retailers, and importers have consistently attempted to weaken or abandon the yarn forward rule, which is the underpinning of the U.S. FTA structure in the textile sector as detailed in this report. The latest attempt is an effort to convince the administration and Congress to weaken the yarn forward rule as part of the ongoing policy conversation regarding the Northern Triangle. Current proposals center around allowing more flexibility for third-country yarns and fabrics through cumulation and/or changes to the short supply process in CAFTA-DR.

The CAFTA-DR short supply process is functioning as intended as it both grants considerable flexibility on sourcing while giving textile producers a voice in the process to ensure products are not added that are available in the region. Removing these important safeguards in the process would be detrimental to textile producers in the U.S. and CAFTA-DR region.

The concept of "cumulation" among existing FTA partners would allow inputs, such as yarns and fabrics, to be shared among FTA partner countries without disqualifying those products from duty-free treatment under individual FTAs. The unstated purpose of promoting cumulation is to grant brands and apparel makers the option to replace U.S. and regional yarns and fabrics with inputs from outside of an existing FTA region. This would result in severe ramifications for U.S. textile manufacturers, who would certainly see significant decreases in domestic textile production, exports, and employment. It would also severely destabilize and offshore textile investment in the CAFTA-DR countries.

Further, certain apparel importers are pushing for an even broader cumulation concept that would also allow for the use of yarns and fabrics from Trade & Investment Framework Agreement (TIFA) countries in duty-free qualifying garments from CAFTA-DR. Beyond the 20 countries with which the U.S. has FTAs, there are TIFAs in place with more than 100 countries, including a number of large exporters in Asia like Vietnam, Pakistan, and Indonesia. TIFAs are very basic agreements, often spanning less than five pages, and are designed to provide a framework for dialogue as opposed to involving FTA-type commitments on market access, rules of origin, labor and environment, or customs enforcement.

Any cumulation arrangement, whether among FTA countries or FTA/TIFA countries, would be fraught with unintended consequences – harmful to the interests of the CAFTA-DR region and beneficial to China. Other FTA and TIFA producers of yarns and fabrics would be allowed to displace yarn and fabric production in Central America and the Dominican Republic and would almost certainly source upstream inputs from China, including cotton from Xinjiang. Although proponents are characterizing cumulation as a way to diversify outside of China given that China is not a U.S. FTA or TIFA partner, this argument quickly breaks down as China would undoubtedly benefit despite the FTA/TIFA country façade. China is embedded in these supply chains as the largest global textile exporter and would benefit from cumulation as the predominant supplier of upstream textile inputs to many FTA and TIFA countries.

Today, using virtually every major metric, textile cumulation breaks faith with those who have invested in yarn and fabric production in the Northern Triangle to take advantage of current CAFTA-DR rule-of-origin requirements. Existing facilities would immediately be devalued as competitors in other FTA and TIFA regions would be eligible to compete as suppliers of textile inputs throughout the CAFTA-DR region. This would also serve as a major disincentive to future investors in new textile production in the U.S. and CAFTA-DR region as brands could source textile inputs from any FTA without negative impact on their duty-free benefits.

Cumulation proposals also raise concerns from a WTO compliance perspective and would further dramatically complicate customs enforcement, including enforcement of the Xinjiang cotton ban.

Simply put, while cumulation is something that is attractive to brands and sourcing agents in order to maximize their profits, it would severely alter the current coproduction model that has proven to be extremely successful and mutually beneficial for the textile and apparel partnerships between the U.S. and the CAFTA-DR region. There would certainly be major unintended consequences for the entire region and the U.S. industry.

Oppose Granting Duty-free and other Trade Preference Benefits to Countries Outside of the Western Hemisphere (e.g., through GSP Expansion or FTAs with Major Asian Suppliers)

Duty-free and trade preference programs for imports of textiles and clothing into the U.S. offer significant advantages and opportunities for U.S. trading partners with preferred access to the largest single consumer market in the world. Both the USMCA and CAFTA-DR have proven that although the participating countries cannot be isolated from global competition, the FTA creates a climate of stability within which a country's textile and/or apparel industry can thrive.

That regional stability should not be jeopardized by providing new preferential trade access to apparel and textiles under the Generalized System of Preferences or negotiating free trade agreements with major Asian suppliers, which will only serve to undermine the Western Hemisphere.

Close the "De Minimis" Loophole

It is critical the U.S. government close the legal "de minimis" tariff loophole for imports that allows goods valued at $800 or less to enter duty free, if imported by one person on one day.

De Minimis exemptions have had a significant impact on undermining carefully constructed textile and apparel rules of origin in CAFTA-DR and with other FTA and trade preference partners.

The current application of de minimis provides exemptions on base MFN tariffs as well as Section 301 tariffs, such as those currently in place against imports from mainland China. Use of this exemption has skyrocketed alongside the growth of direct-to-consumer e-commerce, which has further accelerated due to the COVID-19 pandemic.

U.S. Customs & Border Protection (CBP) reports that over 2 million individual de minimis shipments a day enter the U.S., and preliminary analysis indicates a large percentage of these shipments are apparel. De minimis imports qualify for duty-free treatment despite not being subject to rules of origin, or to labor and environmental standards, as opposed to products produced in an FTA partner country, which are subject to strong rules of origin and standards. This has become a significant legal loophole that is clearly undermining trade preferences with CAFTA-DR and other countries that have negotiated reciprocal duty-free preferences with the U.S.

Provide Incentives to Western Hemisphere Coproduction Chain for Carbon Emission Reduction and Sustainable Products and/or Impose Penalty Tariffs on Countries for Lax Environmental Standards

The prospect of climate change and potential carbon taxes for goods crossing borders is a growing concern for importers and their suppliers.

The U.S. Congress has been examining proposals to establish a carbon tax on certain imports to fight climate change and protect domestic production. Proposals of a "Polluter Import Fee" are being drafted. While the details of the carbon tax are still unclear, it is worthwhile examining the potential impact on imports of textiles and apparel.

Underscoring the global interest in the use of a carbon tax, the European Union in July 2021 adopted a proposal for a new *Carbon Border Adjustment Mechanism,* putting a carbon price on imports of a targeted selection of products. The mechanism will equalize the price of carbon between domestic products and imports and ensure that the EU's climate objectives are not undermined by production relocating to countries with less ambitious policies. It is designed in such a way that EU importers will buy carbon certificates corresponding to the carbon price that would have been paid, had the goods been produced under the EU's carbon pricing rules. The mechanism will also help reduce the risk of carbon leakage by encouraging producers in non-EU countries to "green" their production processes.

CONCLUSION

As this report clearly demonstrates, elimination or dilution of the yarn forward rule under the CAFTA-DR would have disastrous consequences for the U.S. textile industry and its 530,000 workers. Further, it would severely damage the existing vertical nature of the Western Hemisphere textile and apparel coproduction platform, while simultaneously eliminating any incentive for future textile investment in the hemisphere. Doing so would jeopardize the employment of 1.5 million workers (not including those in the U.S.) directly employed in Western Hemisphere textile and apparel manufacturing. Millions of additional jobs in the hemisphere that are dependent on a stable textile and apparel production chain would also be placed at risk. Finally, it would be a major boon to China and its massive and highly subsidized yarn and fabric sector, as well as other countries not party to the agreement, which would move rapidly to displace U.S. and CAFTA-DR textile production in the region.

For all these reasons, it is imperative that the United States maintain a trade agreement and preference program structure based on the yarn forward rule of origin for textiles and apparel.