

**Expand U.S. Apparel Sourcing from CAFTA-DR
Members and Solve the Root Causes of Migration:
Perspectives from U.S. Apparel Companies**

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Abbreviations

AGOA	African Growth and Opportunity Act
CAFTA-DR	Dominican Republic-Central America Free Trade Agreement
CRS	Congressional Research Service
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
COVID	Coronavirus
FTA	Free trade agreement
HTS	Harmonized Tariff System
ILO	International Labor Organization
MFN	Most Favored Nation
MMF	Manmade fiber
MTB	Miscellaneous Tariff Bills
NAFTA	North American Free Trade Agreement
NAICS	North American Industry Classification System
OTEXA	Office of Textiles and Apparel
ROO	Rules of Origin
SITC	Standard International Trade Classification
SME	Square meter equivalent
USITC	U.S. International Trade Commission
USTR	Office of the U.S. Trade Representative
WTO	World Trade Organization

Executive summary

For decades, U.S. fashion brands and retailers have seen Central America as an emerging apparel sourcing base with great interest. This is particularly the case since the implementation of the **Dominican-Republic Central America Free Trade Agreement (CAFTA-DR)** in 2006, a trade deal between the United States, El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic (joined in 2007), and Costa Rica (joined in 2009).

U.S. apparel sourcing from CAFTA-DR has played a critical role in supporting the region's economic growth and job creation. A billion dollars of apparel exports to the U.S. could support about 75,919-- 84,646 apparel jobs for CAFTA-DR members.

However, U.S. apparel sourcing from CAFTA-DR has yet to achieve its full potential. Notably, CAFTA-DR countries' market shares in the U.S. apparel import market barely increased over the past 15 years. It is also concerning that CAFTA-DR's utilization rate for U.S. apparel sourcing fell to a record low of only 73.7 percent in 2021, meaning 26 percent of U.S. apparel imports from CAFTA-DR members did NOT claim preferential duty benefits.

This study offers valuable input and practical policy recommendations from U.S. apparel companies' perspectives regarding expanding U.S. apparel sourcing from CAFTA-DR members. Unlike existing studies that only look at macro-trade data, we consulted executives at 27 leading U.S.-based apparel companies to gain their first-hand insights from the forefront. Notably, 85 percent of respondents report having annual revenues exceeding \$500 million, and over 95 percent have been sourcing apparel from the CAFTA-DR region for more than ten years.

The results confirm that expanding U.S. apparel sourcing from CAFTA-DR could be the best chance to effectively create more jobs in Central America and solve the root causes of migration there. To achieve this goal, we need to focus on four areas:

First, improve CAFTA-DR's apparel production capacity and diversify its product offers.

- **As many as 92 percent of respondents report currently sourcing apparel from CAFTA-DR members.**
- Highly consistent with the macro trade statistics, the vast majority of respondents (i.e., 60 percent) place **less than 10 percent** of their company's total sourcing orders with CAFTA-DR members.
- Whereas respondents rate CAFTA-DR members overall competitive in terms of "speed to market," **they express concerns about CAFTA-DR countries' limited production capacity in making various products.** As a result, U.S. companies primarily source basic fashion items like T-shirts and sweaters from the region. These products also face growing price competition with many alternative sourcing destinations.
- Improving CAFTA-DR's production capacity and diversifying product offers would encourage U.S. apparel companies to move more sourcing orders from Asia to the region permanently.

Second, practically solve the bottleneck of limited textile raw material supply within CAFTA-DR and do NOT worsen the problem.

- **The limited textile raw material supply within CAFTA-DR** is a primary contributing factor behind the region’s stagnated apparel export volume and a lack of product diversification.
- Notably, respondents say for their apparel imports from CAFTA-DR members, only **42.9% of fabrics, 40.0% of sewing threads, and 23.8% of accessories** (such as trims and labels) can be sourced from within the CAFTA-DR area (including the United States). CAFTA-DR’s textile raw material supply problem could worsen as the U.S. textile industry switches to making more technical textiles and less so for apparel-related fabrics and textile accessories.
- Maintaining the status quo or simply calling for making the CAFTA-DR apparel supply chain more “vertical” will NOT automatically increase the sourcing volume. Instead, allowing CAFTA-DR garment producers to access needed textile raw materials at a competitive price will be essential to encourage more U.S. apparel sourcing from the region.

Third, encourage more utilization of CAFTA-DR for apparel sourcing.

- **CAFTA-DR plays a critical role in promoting U.S. apparel sourcing from the region.** Nearly 90 percent of respondents say the duty-free benefits provided by CAFTA-DR encourage their apparel sourcing from the region.
- **The limited textile supply within CAFTA-DR, especially fabrics and textile accessories, often makes it impossible for U.S. companies to source apparel from the region while fully complying with the strict “yarn-forward” rules of origin.** As a result, consistent with the official trade statistics, around 31 percent of respondents say they sometimes have to forgo the CAFTA-DR duty-free benefits when sourcing from the region.
- Respondents say the exceptions to the “yarn-forward” rules of origin, including “short supply,” “cumulation,” and “cut and assemble” rules, provide necessary flexibilities supporting respondents’ apparel sourcing from CAFTA-DR members. **Around one-third of respondents utilize at least one of these three exceptions when sourcing from CAFTA-DR members when the products are short of meeting the strict “yarn-forward” rules of origin.** It is misleading to call these exceptions “loopholes.”

Fourth, leverage expanded apparel sourcing to incentivize more investments in the CAFTA-DR region’s production and infrastructure.

- U.S. apparel companies are interested in investing in CAFTA-DR to strengthen the region’s sourcing and production capacity. Nearly half of respondents explicitly say they will make investments, including “building factories or expanding sourcing or manufacturing capacities” in the CAFTA-DR region through 2026.
- CAFTA-DR will be better positioned to attract long-term investments in its textile and apparel industry with a sound and expanded apparel sourcing volume.

I. U.S. Apparel Sourcing from CAFTA-DR and Its Economic Impacts: An Overview

For decades, U.S. fashion brands and retailers have seen Central America as an emerging apparel sourcing base with great interest. Especially since the implementation of the Dominican-Republic Central America Free Trade Agreement (CAFTA-DR) in 2006, a trade deal among the United States, El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic (joined in 2007), and Costa Rica (joined in 2009), sourcing from the region gained consistent interest among U.S. companies.¹

Data from the Office of Textiles and Apparel (OTEXA) at the U.S. Department of Commerce shows that **U.S. apparel sourcing from CAFTA-DR members reached \$8.6 billion in 2019 and stayed at the same level in 2021 despite COVID-19.**²

Further, about 92 percent of U.S. apparel imports from the CAFTA-DR region come from its four top suppliers, namely Honduras (30 percent), Nicaragua (22 percent), El Salvador (21 percent), and Guatemala (19 percent).³

Table 1-1 U.S. apparel sourcing from CAFTA-DR supports the regional supply chain

Items	2010	2015	2018	2019	2020	2021
% of CAFTA-DR apparel exports to the U.S.	89.3%	87.5%	86.0%	87.5%	85.6%	86.0%
% of CAFTA-DR textile* imports from the U.S.	51.0%	47.0%	41.8%	41.4%	38.2%	N/A
% of U.S. yarn exports to CAFTA-DR	34.1%	34.6%	37.9%	40.8%	35.5%	42.3%

Data source: UNComtrade (2022); OTEXA (2022); Note: “Textile” refers to SITC codes 651-656.

U.S. apparel imports from CAFTA-DR also support the regional textile and apparel supply chain, particularly U.S. yarn exports to the region. Thanks to CAFTA-DR’s duty-free benefits, garment producers in Central American countries tend to import textile raw materials (such as yarns) from the United States and then export the finished garments back to the U.S. for consumption.⁴ Reflecting the close supply chain collaboration, data from UNComtrade⁵ shows that **CAFTA-DR members stably serve as the single largest export market of U.S.-made yarns** (see Table 1-1).

¹ Congressional Research Service (2019). Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR). Retrieved from <https://crsreports.congress.gov/product/pdf/IF/IF10394>

² Office of Textiles and Apparel, OTEXA (2022). Total U.S. textile and apparel imports. Retrieved from <https://otexa.trade.gov/msr/catV0.htm>

³ Office of Textiles and Apparel, OTEXA (2022). Total U.S. textile and apparel imports. Retrieved from <https://otexa.trade.gov/msr/catV0.htm>

⁴ Keough, K., & Lu, S. (2021). Explore the export performance of textiles and apparel “Made in the USA”: A firm-level analysis. *Journal of the Textile Institute*, 112(4), 610-619.

⁵ UNComtrade (2022). International Trade Statistics Database. <https://comtrade.un.org/>

Likewise, nearly 40 percent of CAFTA-DR members’ textile imports come from the United States. As high as 86-88 percent of CAFTA-DR members’ apparel exports also target the U.S. market (see Table 1-1).

Additionally, U.S. apparel sourcing from CAFTA-DR supports economic growth and job creation in Central America and the United States. Data from the International Labor Organization (ILO)⁶ and Office of Textiles and Apparel (OTEXA) suggest a strong correlation between CAFTA-DR members’ employment in the apparel sector and the value of their apparel exports to the United States.⁷ For example, **as estimated, a billion dollars of apparel exports to the U.S. could support about 75,919-- 84,646 apparel jobs for CAFTA-DR members (See Figure 1-1).**

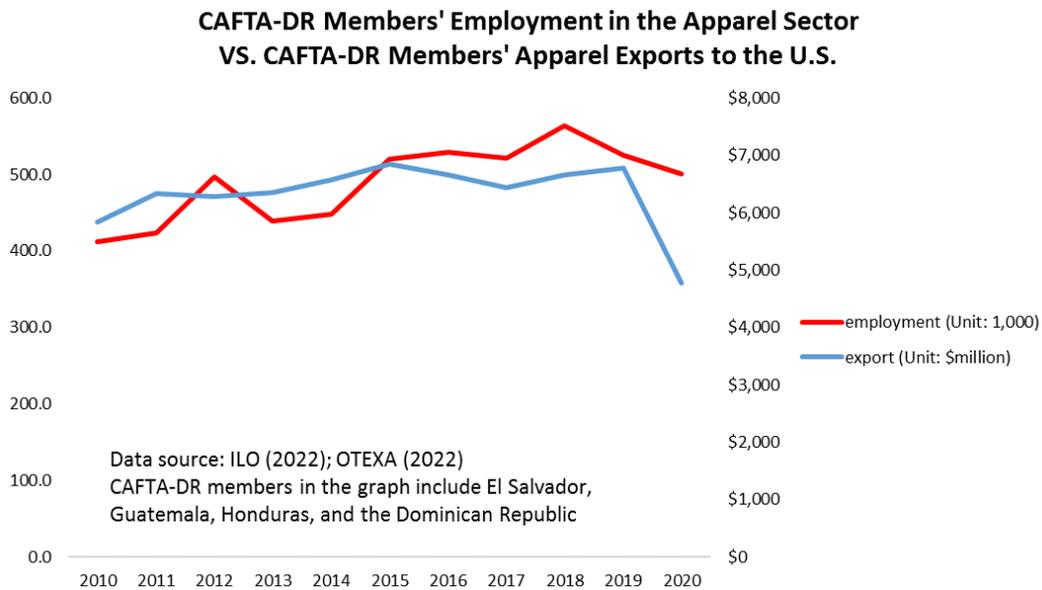


Figure 1-1 Apparel exports to the U.S. support millions of jobs in CAFTA-DR members

However, U.S. apparel sourcing from CAFTA-DR is NOT without challenges. **Notably, CAFTA-DR countries’ market shares in the U.S. apparel import market barely increased over the past decade (see Figure 1-2).** Instead, measured in quantity, only 9.4% of U.S. apparel imports came from CAFTA-DR members in 2021, a substantial drop from 15.1% in 2006 when the trade agreement entered into force.

⁶ International Labor Organization, ILO (2022). ILO Stat. <https://ilostat ilo.org/data/>

⁷ Correlation =0.73 (p-value=0.017<0.05)

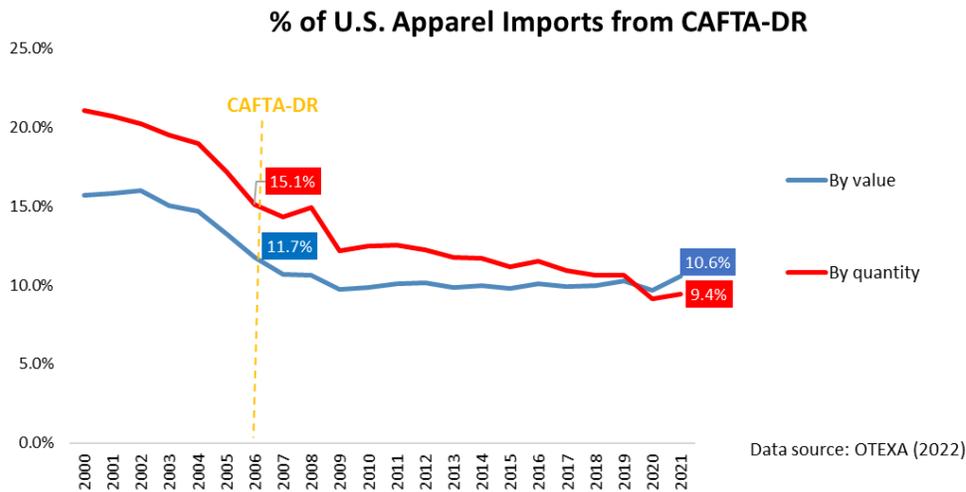


Figure 1-2 CAFTA-DR countries’ market shares in the U.S. apparel import market enjoyed NO growth over the past decade, but why?

So why hasn’t U.S. apparel sourcing from CAFTA-DR members enjoyed growth? What can be done further to improve the competitiveness of the CAFTA-DR region as an apparel sourcing base?

To answer these critical questions, we recently consulted executives from 27 leading U.S.-based apparel companies. These respondents:

- Represent apparel companies of different kinds. Approximately 72 percent of respondents are self-identified brands, 55 percent self-identified retailers, 67 percent self-identified importers/wholesalers, and 33 percent of self-identified manufacturers.
- Over 95 percent report having more than 1,000 employees, and 85 percent with annual revenues exceeding \$500 million
- Over 95 percent have sourced or made apparel from the CAFTA-DR region for more than ten years

We hope the findings will enhance our understanding of U.S. apparel companies’ CAFTA-DR sourcing strategies, outlook, and challenges and inspire new thinking about promoting more U.S. apparel sourcing from the CAFTA-DR region. The results will also offer valuable inputs for policymakers regarding improving CAFTA-DR and leveraging the trade agreement as a critical economic tool to solve the root causes of migration⁸.

⁸ National Security Council (2021). U.S. strategy for addressing the root causes of migration in Central America. Retrieved from <https://www.whitehouse.gov/wp-content/uploads/2021/07/Root-Causes-Strategy.pdf>

II. U.S. Apparel Companies' Sourcing and Manufacturing Strategies from CAFTA-DR

U.S. apparel companies' sourcing and manufacturing strategies from CAFTA-DR members have several unique features.

First, U.S. apparel companies treat sourcing from CAFTA-DR as part of their sourcing diversification strategy.

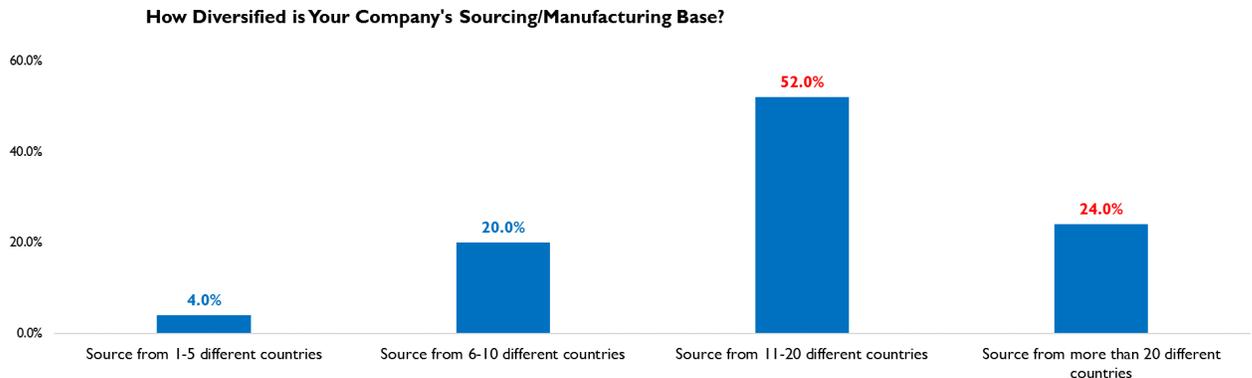


Figure 2-1 U.S. apparel companies adopt an overall diversified sourcing base

U.S. fashion companies typically source from multiple countries to balance sourcing costs, speed to market, reliability, flexibility, and various compliance risks.⁹ Figure 2-1 shows that **sourcing or manufacturing from 11-20 countries** is the most popular practice among respondents. Another 24 percent of respondents report sourcing or manufacturing from more than 20 countries.

Reflecting the CAFTA-DR region's role as an essential sourcing and production base for U.S. apparel companies, 92 percent of respondents report sourcing apparel from there. However, mirroring trade statistics, the vast majority of respondents (i.e., 60 percent) treat CAFTA-DR as part of their company's sourcing diversification strategy, **placing less than 10 percent of their company's total sourcing orders with the region** (Table 2-1). In comparison, it is much more common to see respondents source than 10 percent of their total value or volume from Asian countries, such as China, Vietnam, and Bangladesh.

⁹ Emma Davis and Sheng Lu (2021). Which apparel sourcing factors matter the most?. *Just-Style*. Retrieved from <https://shenglufashion.files.wordpress.com/2021/06/which-apparel-sourcing-factors-matter-the-most.pdf>

Table 2-1 Most respondents place less than 10 percent of their company’s total sourcing orders with CAFTA-DR members

Sourcing Destinations	>50% of Total Sourcing Quantity/Value	31-50% of Total Sourcing Quantity/Value	11-30% of Total Sourcing Quantity/Value	1-10% of Total Sourcing Quantity/Value	Do Not Source There
China	4%	4%	39%	52%	0%
Vietnam	4%	22%	35%	39%	0%
Bangladesh	0%	0%	39%	61%	0%
Elsewhere in Asia (excluding China, Vietn	0%	4%	39%	57%	0%
USMCA (NAFTA) members	0%	0%	0%	68%	32%
CAFTA-DR members	8%	13%	13%	58%	8%
United States	0%	4%	0%	57%	39%
Turkey	0%	0%	5%	27%	68%
Europe	0%	0%	4%	39%	57%
Africa	0%	0%	13%	48%	39%

Second, respondents commit to expanding apparel sourcing from CAFTA-DR in the long run

Respondents overall expressed a strong interest in expanding apparel sourcing from CAFTA-DR members through 2023. However, their ambition is severely restricted by the region’s production capacity limitations. As Figure 2-2 shows, as high as 76 percent of respondents say, they plan to increase their apparel sourcing value or volume from the CAFTA-DR region, including 11 percent that hope to “substantially increase.” Among CAFTA-DR members, Guatemala and El Salvador are the most popular.

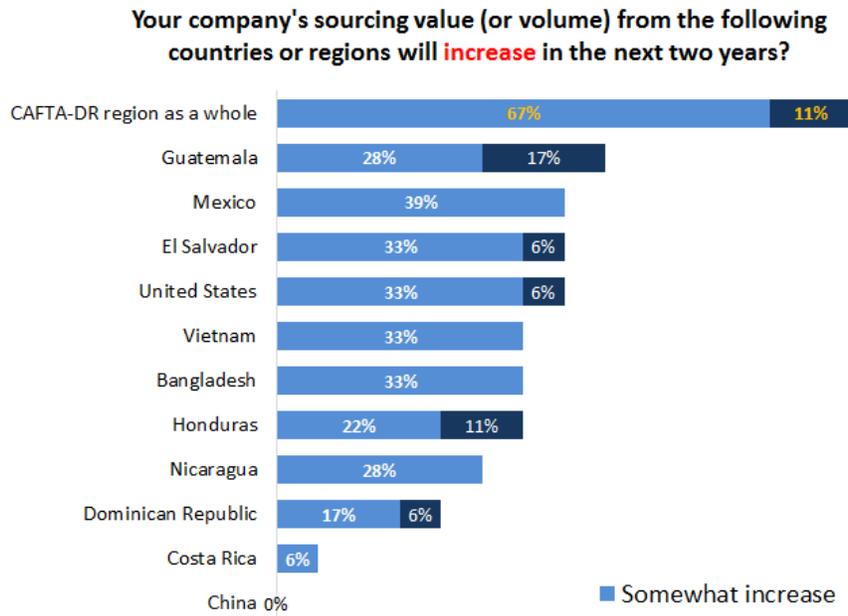


Figure 2-2 Respondents expressed a strong interest in expanding apparel sourcing from CAFTA-DR members over the next two years

Few respondents plan to cut back sourcing from the CAFTA-DR region, except for Nicaragua, due to social compliance concerns (see Figure 2-3). The results echo the findings of other recent studies, also suggesting the growing popularity of near-sourcing from the Western Hemisphere among U.S. fashion companies.¹⁰

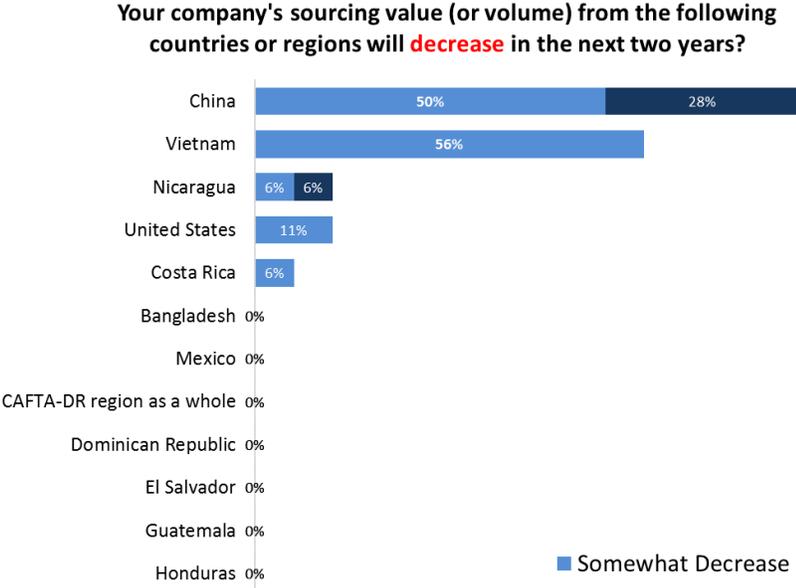


Figure 2-3 Few respondents plan to reduce apparel sourcing from CAFTA-DR members over the next two years

Consistent with Table 2-1, most respondents say expanding more apparel sourcing from CAFTA-DR members is part of their overall sourcing diversification strategy, especially to reduce “China exposure” against the current business environment. For example, as many as 78 percent of respondents plan to reduce apparel sourcing or production in China through 2023. Among these respondents, nearly 60 percent plan to increase sourcing from other Asian countries as well as CAFTA-DR members. **However, reflecting the region’s production capacity limitation concerns, only around 20 percent of respondents plan to move sourcing orders solely to CAFTA-DR members.**

¹⁰ McKinsey & Co and Business of Fashion (2021). The State of Fashion 2022. <https://www.mckinsey.com/industries/retail/our-insights/state-of-fashion>

What are your company's sourcing/manufacturing and investment strategies for the CAFTA-DR region over the next five years?

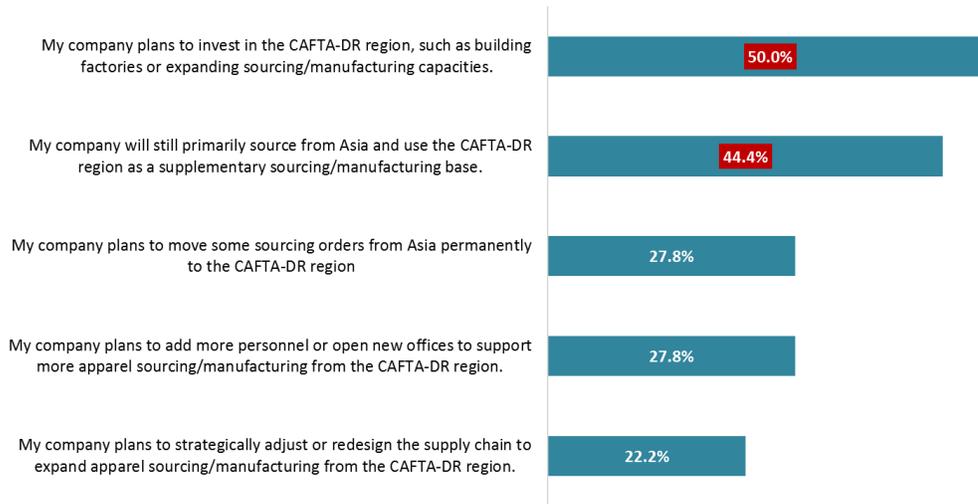


Figure 2-4 Respondents commit to making investments in the CAFTA-DR region over the next five years

As another encouraging sign, **respondents commit to making investments to strengthen the apparel sourcing and production capacity in the CAFTA-DR region over the next five years.** Figure 2-4 shows that nearly half of respondents explicitly say they will make investments, including “building factories or expanding sourcing or manufacturing capacities” in the CAFTA-DR region through 2026. Another 28 percent of respondents plan to “add more personnel or open new offices to support more apparel sourcing or manufacturing from the CAFTA-DR region.”

Furthermore, building a new sourcing and production capacity seems to be the primary motivation for U.S. apparel companies to invest in the CAFTA-DR region. Notably, 80 percent of respondents planning to invest in the CAFTA-DR region currently source from more than 20 countries. However, as few as 20 percent of these companies intend to “permanently move sourcing orders from Asia to CAFTA-DR members.”

Third, whereas respondents see CAFTA-DR members overall competitive in terms of “speed to market,” they express concerns about CAFTA-DR countries’ limited production capacity in making various products.

Table 2-2 (A) strengths and weaknesses of CAFTA-DR as an apparel sourcing base

	Sourcing destination	Speed to market	Sourcing cost	Flexibility	Production capacity
Asia	China	◆ 2.5	▲ 3.5	● 4.0	● 5.0
	Vietnam	◆ 2.5	● 4.0	▲ 3.5	● 4.5
	Bangladesh	◆ 2.0	● 4.5	▲ 3.0	▲ 3.5
CAFTA-DR	CAFTA-DR region as a whole	● 4.0	▲ 3.0	▲ 3.0	◆ 2.5
	Costa Rica	▲ 3.5	◆ 2.0	◆ 2.5	◆ 2.0
	Dominican Republic	● 4.0	◆ 2.5	▲ 3.0	◆ 2.5
	El Salvador	● 4.0	▲ 3.0	▲ 3.5	▲ 3.0
	Guatemala	● 4.0	▲ 3.0	▲ 3.0	◆ 2.0
	Honduras	▲ 3.5	▲ 3.0	▲ 3.5	◆ 2.5
	Nicaragua	● 4.0	▲ 3.0	▲ 3.0	◆ 2.5
	United States	● 4.0	◆ 1.5	◆ 2.5	◆ 2.0
USMCA	Mexico	● 4.0	▲ 3.0	▲ 3.0	◆ 2.5

Note: The results are based on respondents’ average rating for each country on a scale of 1 (much lower performance than the average) to 5 (much higher performance than the average). In the table, ● means strength as a sourcing base (rating score between 5.0-4.0); ▲ means average performance (rating score between 3.0-3.9); ◆ means weakness as a sourcing base (rating score between 1.0-2.9). However, the results do NOT reflect the author’s evaluation of each country.

Table 2-2 (B) strengths and weaknesses of CAFTA-DR as an apparel sourcing base

Region	Speed to market	Sourcing cost	Flexibility	Production capacity
Asia	◆ 2.3	● 4.0	▲ 3.5	● 4.3
CAFTA-DR	● 4.0	▲ 3.0	▲ 3.0	◆ 2.5

To understand the strengths and weaknesses of CAFTA-DR as an apparel sourcing destination, especially compared with its competitors in Asia, we asked respondents to rate them against four key sourcing performance indicators. As Table 2-2 (A) and (B) shows:

- Thanks to their geographic proximity to the U.S. market, respondents say sourcing from CAFTA-DR members can offer a competitive “**speed to market**” than most Asian countries.
- Respondents say the CAFTA-DR region has an average performance in **sourcing costs and flexibility**; However, the competitiveness of particular CAFTA-DR members varies. Specifically, respondents rate El Salvador, Guatemala, Honduras, and Nicaragua outperforming the Dominican Republic and Costa Rica regarding sourcing costs and flexibility (i.e., quickly adjusting the delivery method, delivery time, sourcing volume,

and product of the order upon requests of customers). Nevertheless, respondents say Asian apparel suppliers could offer a more competitive price (such as Bangladesh) and more flexibility (such as China) than those in the CAFTA-DR region.

- **Respondents expressed top concerns about CAFTA-DR countries’ limited production capacity in making various products.** For example, except for El Salvador, all other CAFTA-DR members receive a below-average rate.
- Consistent with the findings, trade data also show **that U.S. apparel imports from CAFTA-DR members become increasingly concentrated on basic fashion items like T-shirts and sweaters**¹¹ (see Table 2-3). This is concerning as basic fashion items typically face intense competition with many alternative sourcing destinations.

Table 2-3 Product Export Diversification Index (Apparel, HTS Chapters 61-62)

Exporters	2010	2015	2018	2019	2020	2021	Export Product Diversification
China	3.2	2.7	2.6	2.4	4.9	2.4	Highly diverse
Vietnam	4.9	3.4	3.5	3.5	3.4	3.6	Diverse
Bangladesh	10.7	10.7	11.2	10.7	8.7	8.3	Concentrated
Mexico	12.5	13.2	11.0	11.9	9.5	10.9	Highly concentrated
CAFTA-DR	9.7	8.8	9.8	10.6	11.3	12.7	More highly concentrated

Data source: U.S. International Trade Commission, USITC (2022)¹²; A Higher value means more product concentration.

Fourth, the limited textile raw material supply within CAFTA-DR is a significant bottleneck preventing more U.S. apparel sourcing from the region.

Previous studies suggest that a lack of sufficient supply of textile raw materials within CAFTA-DR significantly limits the scale of U.S. apparel sourcing from the region.¹³ Echoing the findings, trade data from the UNComtrade also suggests that **whereas CAFTA-DR members can get most textile yarns from the United States, garment factories have to import half of their needed woven fabrics, knitted fabrics, and textile accessories from outside the region because of limited supply within CAFTA-DR (see Table 2-4).**

¹¹ United States International Trade Commission, USITC (2022). Dataweb. Retrieved from <https://dataweb.usitc.gov/>

¹² The same as above.

¹³ Lu, Sheng (2021). U.S. Fashion Industry Benchmarking Study. United States Fashion Industry Association. Washington, D.C. https://www.usfashionindustry.com/pdf_files/20210715-fashion-industry-benchmarking-survey.pdf

Table 2-4 CAFTA-DR members have to import half of their needed woven fabrics, knitted fabrics, and textile accessories from outside the region

Year 2010				
Source of imports	Textile yarns	Woven fabrics	Knitted fabrics	Textile accessories
United States	58.7%	42.8%	53.8%	48.5%
CAFTA-DR members	7.7%	7.7%	9.8%	17.8%
United States + CAFTA-DR	66.4%	50.5%	63.5%	66.3%
Asia	19.0%	37.9%	34.4%	21.4%
CPTPP	3.2%	3.0%	0.8%	2.9%
Year 2015				
Source of imports	Textile yarns	Woven fabrics	Knitted fabrics	Textile accessories
United States	64.9%	37.2%	33.5%	29.8%
CAFTA-DR members	10.3%	7.1%	25.2%	23.4%
United States + CAFTA-DR	75.2%	44.3%	58.7%	53.3%
Asia	14.2%	42.4%	36.7%	38.6%
CPTPP	9.6%	5.6%	3.2%	4.6%
Year 2020				
Source of imports	Textile yarns	Woven fabrics	Knitted fabrics	Textile accessories
United States	56.1%	41.0%	20.6%	23.0%
CAFTA-DR members	20.9%	5.7%	33.1%	28.9%
United States + CAFTA-DR	77.0%	46.7%	53.8%	51.9%
Asia	19.8%	34.6%	43.6%	40.7%
CPTPP	6.6%	12.7%	3.3%	4.2%

Data source: UNcomtrade (2022); In the table, “Textile yarns” refer to SITC code 651; “Woven fabrics” refer to SITC codes 652, 653, and 654; “Knitted fabrics” refer to SITC code 655; “Textile accessories,” which include tulle, lace, embroidery, ribbons, trimmings, and other small wares refer to SITC code 656.

Notably, reflecting the demand for more diversified textile inputs, besides Asia, CAFTA-DR members’ textile imports from elsewhere in the world, such as members of the Comprehensive and Progressive Agreement for Trans-Pacific (CPTPP)¹⁴, also enjoyed a fast growth. For example, more than 12% of CAFTA-DR members’ woven fabrics came from CPTPP members in 2020, a substantial increase from only 3.0% in 2010 (see Table 2-4).

Respondents say the supply chain of their apparel imports from CAFTA-DR members echoes the same trends reflected in the macro trade statistics. Two trends are noteworthy:

On the one hand, apparel produced by CAFTA-DR members primarily uses U.S.-made yarns or those locally made in the CAFTA-DR region (Figure 2-5). As many as 64

¹⁴ CPTPP members include Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.

percent of respondents say their company’s apparel imports from CAFTA-DR members contain BOTH U.S.-made yarns and those locally made in the CAFTA-DR region (such as Guatemala). Some respondents also use yarns made in Mexico. In comparison, few respondents say their apparel sourced or produced by CAFTA-DR members contain yarns made by an Asian country.

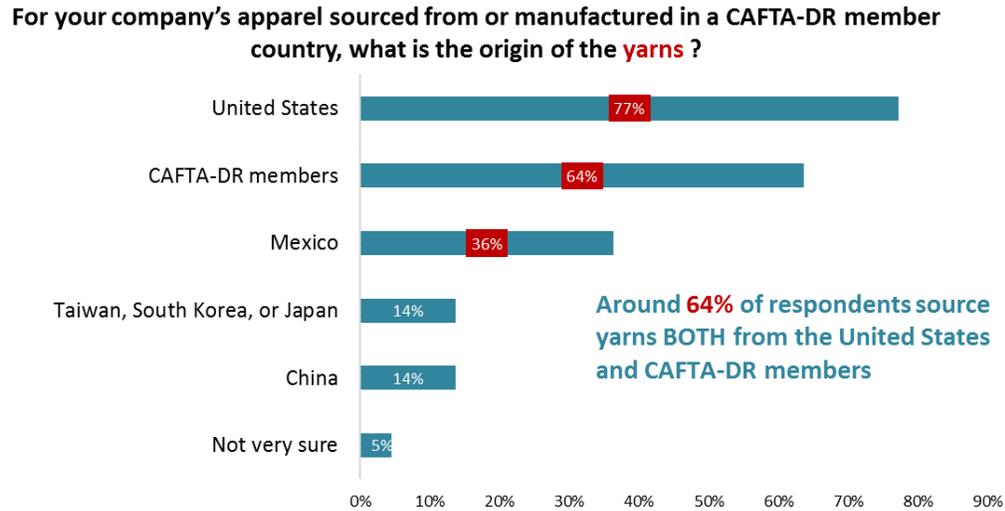


Figure 2-5 Apparel made by CAFTA-DR members primarily uses U.S.-made yarns or those locally made in the CAFTA-DR region.

On the other hand, due to more limited supply within CAFTA-DR, apparel made by CAFTA-DR members often need to use inputs from outside the region for fabrics, sewing threads, and accessories (such as buttons, zippers, trims, and labels). For example, as Table 2-5 shows, only about 42.9% of respondents say they can entirely rely on the supply from within CAFTA-DR (including from the United States) for fabrics. This percentage is even lower for sewing thread (40.0%) and accessories (23.8%).

Table 2-5 Apparel made by CAFTA-DR members often need to use textile inputs from outside the region, particularly fabrics, sewing threads, and accessories

Sources/Raw materials	Yarns	Fabrics	Sewing threads	Accessories
CAFTA-DR + U.S.	63.6%	42.9%	40.0%	23.8%
CAFTA-DR	0.0%	23.8%	20.0%	0.0%
CAFTA-DR + Mexico	36.4%	28.6%	30.0%	23.8%
CAFTA-DR + Asia	22.7%	14.3%	20.0%	61.9%

Data further shows that **CAFTA-DR’s textile raw material supply problem could become even worse as the U.S. textile industry switches to making more technical textiles and less so for apparel-related fabrics and textile accessories.** As Table 2-6 shows, from 2015 to 2019, the value of U.S. broadwoven fabric manufacturing (NAICS code 31321) and knit fabric (NAICS code 31324) continued to shrink. **As of 2019, broadwoven fabric and knit fabric accounted only for 13.2% and 5.3% of the U.S. textile industry’s**

total output. In contrast, U.S. non-woven fabric (NAICS code 31323) manufacturing surged by 11.0% in value from 2015 to 2019 and accounted for nearly one-third of the industry’s total output today.

Table 2-6 Structure of US Textile Mills Output by Value (NAICS 313)

NAICS	Product description	Growth of output 2015-2019	Share in textile output in 2015	Share in textile output in 2019
31311	Fiber, yarn, and thread	-16.8%	21.4%	17.9%
31321	Broadwoven fabric	-2.0%	13.4%	13.2%
31322	Narrow fabric	-0.8%	4.9%	4.9%
31323	Nonwoven fabric	11.0%	28.6%	32.0%
31324	Knit fabric	-2.7%	5.4%	5.3%
31331	Textile and fabric finishing	-2.5%	18.6%	18.3%
31332	Fabric coating	9.2%	7.6%	8.4%

Data source: U.S. Census Bureau (2022)¹⁵

Note: “**Broadwoven fabrics**” refer to woven fabrics more than 12 inches (30.48 centimeters) in width. Such fabrics are typically used to make woven apparel products or home furnishings. “**Narrow fabrics**” are typically used for decorative purposes (e.g., tapes, braids, and webbings). “**Knit fabrics**” are typically used to make knit apparel items.

Table 2-7 US Textile Exports (by value)

NAICS Number	Description	2019 vs. 2010	2021 vs. 2019	Share of exports in 2010	Share of exports in 2021	Share 2021 vs. 2010*
31311	Fiber, yarn, and thread	25.0%	-11.4%	21.0%	23.3%	2.30
31321	Broadwoven fabric	2.1%	-20.4%	21.9%	17.9%	-4.08
31322	Narrow fabric	8.1%	-1.5%	9.0%	9.6%	0.61
31323	Nonwoven fabric	15.2%	10.7%	21.2%	27.1%	5.89
31324	Knit fabric	-26.6%	-1.6%	13.6%	9.8%	-3.75
31332	Fabric coating	19.0%	-14.3%	12.1%	12.3%	0.27

Data source: USITC (2022)¹⁶; *: percentage point

Corresponding to the decline in manufacturing, US broadwoven fabric (NAICS 31321) and knit fabric (NAICS 31324) exports decreased substantially (see Table 2-7). In 2021, broadwoven fabrics accounted for 17.9% of US textile exports, lower than 21.9% in 2010. Over the same period, knit fabrics also dropped from 13.6% of US textile exports to only 9.8%. In comparison, the export of US nonwoven fabric (NAICS 31323)

¹⁵ U.S. Census Bureau (2022). Annual Survey of Manufactures. Retrieved from <https://www.census.gov/programs-surveys/asm/data/tables.html>

¹⁶ United States International Trade Commission, USITC (2022). Dataweb. Retrieved from <https://dataweb.usitc.gov/>

enjoyed a 15.2% growth from 2010 to 2019 and another 10.7% growth from 2019 to 2021. As of 2021, more than 27.1% of US textile exports were nonwoven fabrics, up 5.89 percentage points from ten years ago. ¹⁷

The gradual shrinkage of U.S. fabric manufacturing and export is not necessarily surprising, given its relatively more labor-intensity nature. ¹⁸ However, the results again remind us that **there is a legitimate need for garment producers in CAFTA-DR to import essential textile raw materials from outside the region. Improving access to needed textile raw materials will be the best chance for CAFTA-DR garment producers to expand their export volume, diversify product offers, improve production flexibility and compete with Asian suppliers in the U.S. market.**

¹⁷ Lu, Sheng & Matteson, Anna. (2022). How can the 'Made in the USA' apparel market reach its full potential? Just-Style. <https://www.just-style.com/features/how-can-the-made-in-the-usa-apparel-market-reach-its-full-potential>

¹⁸ For example, according the U.S. Census Bureau, from 2015 to 2019, labor cost accounted for 16.8% of broadwoven fabric manufacturing's shipment value, 18.4% for knit fabric manufacturing, but only 12.2% for non-woven fabric manufacturing.

III. CAFTA-DR Rules of Origin and U.S. Apparel Sourcing from the Region

Like other free trade agreements, only apparel products that meet CAFTA-DR's rules of origin (ROO) requirements can enjoy duty-free benefits.¹⁹ CAFTA-DR generally adopts the so-called "yarn-forward" tariff shift rule for cotton and manmade fiber (MMF) apparel products. This means that for cotton and MMF apparel to qualify for the preferential duty treatment, the formation of yarn, fabric making, cutting of fabric, sewing, and finishing of the final garment ALL need to happen in one or more CAFTA-DR member countries.²⁰ However, CAFTA-DR's ROO for wool products is relatively more liberal, allowing yarn to come from anywhere in the world in addition to fiber.²¹

Further, recognizing the reality that not all needed textile inputs are available in the region, CAFTA-DR includes three major exceptions to the "yarn-forward" tariff shift rule to provide flexibility for apparel sourcing. Specifically:

- **Short supply (or commercial availability):** Fibers, yarns, and fabrics determined not to be available in commercial quantities in a timely manner from CAFTA-DR members may be sourced from outside the region for use in qualifying textile and apparel products.
- **Cumulation:** CAFTA-DR allows specific woven apparel, cut-and-sewn in the CAFTA-DR region, may use Mexican yarns and fabric. The provision is limited to 100 million square meter equivalent units (SME) of imported apparel annually.
- **Cut and assemble rule:** certain yarns and fabrics for the apparel products may come from countries outside the CAFTA-DR region. However, the fabric must be cut, and the garment must be assembled in one or more of the CAFTA-DR countries.

Respondents say CAFTA-DR and its rules of origin significantly impact U.S. apparel companies' sourcing strategies from the region. Specifically:

First, CAFTA-DR's duty-saving benefits encourage U.S. apparel sourcing from the region.

As Figure 3-1 shows, nearly 90 percent of respondents say they use CAFTA-DR primarily for apparel sourcing purposes. In comparison, it is less common to see respondents leverage CAFTA-DR to import or export textile raw materials.

Consistent with the finding, trade statistics show that from 2015 to 2021, approximately 75-80 percent of U.S. apparel imports from CAFTA-DR members claimed preferential duty

¹⁹ Congressional Research Service, CRS (2020). International Trade: Rules of Origin. Washington, D.C.. Retrieved from <https://sgp.fas.org/crs/row/RL34524.pdf>

²⁰ U.S. International Trade Commission, USITC (2021). Economic Impact of Trade Agreements Implemented under Trade Authorities Procedures, 2021 Report. Retrieved from <https://www.usitc.gov/publications/332/pub5199.pdf>

²¹ Office of Textiles and Apparel, OTEXA (2022). Free Trade Agreements Summary of the U.S. - Dominican Republic-Central America Free Trade Agreement. Retrieved from https://otexa.trade.gov/fta/CAFTA_DR.pdf

benefits.²² As estimated, every year, sourcing from CAFTA-DR members helps U.S. apparel companies save around \$1,100 million—\$1,200 million in import duties.²³

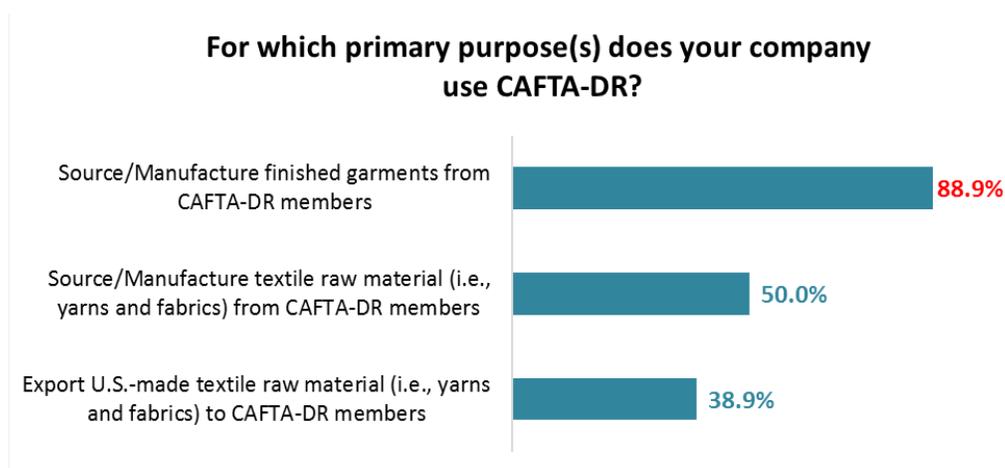


Figure 3-1 CAFTA-DR supports U.S. apparel sourcing from its members

However, there are also missed duty-saving opportunities. As Table 3-1 shows, **U.S. apparel imports from CAFTA-DR members do NOT necessarily focus on items subject to a high tariff rate.** Measured at the 6-digit H.S. code level, apparel items subject to a high tariff rate (i.e., applied MFN tariff rate >17%) only accounted for about 7% of U.S. apparel imports from CAFTA-DR members in 2021 (Jan-Nov). In comparison, even having to pay a significant amount of import duties, about 17% of U.S. apparel imports from Vietnam and 11% of imports from China were subject to a high tariff rate.

This phenomenon again reflects CAFTA-DR’s limited production capacity for man-made fibers clothing categories (such as jackets, swimwear, dresses, and suits), typically facing a higher tariff rate. **This result also implies that expanding production capacity and diversifying the export product structure will be critical to making CAFTA-DR a more attractive sourcing destination.**

Table 3-1 Percentage of apparel imports with a high MFN tariff rate (HTS code 6-digit level, by value)

Regions	2015	2018	2019	2020	2021
China	9.4%	10.3%	10.4%	8.8%	10.6%
Vietnam	16.9%	17.3%	17.1%	15.7%	16.2%
CAFTA-DR	9.1%	8.5%	7.2%	7.8%	7.0%

Data source: USITC (2022); WTO (2022)

Note: “high MFN tariff rate” refers to a rate >17.0%

²² Office of Textiles and Apparel (2022). U.S. Imports under Free Trade Agreements. Retrieved from <https://otexa.trade.gov/fta/catv1.htm>

²³ Lu, Sheng (2021). US apparel sourcing: Understanding import duty savings. *Just-Style*. <https://www.just-style.com/features/us-apparel-sourcing-understanding-import-duty-savings/>

Second, the limited textile supply within CAFTA-DR, especially fabrics and textile accessories, often makes it impossible for U.S. companies to source apparel from the region while complying with the strict “yarn-forward” rules of origin.

How does your company use CAFTA-DR for apparel sourcing/manufacturing?

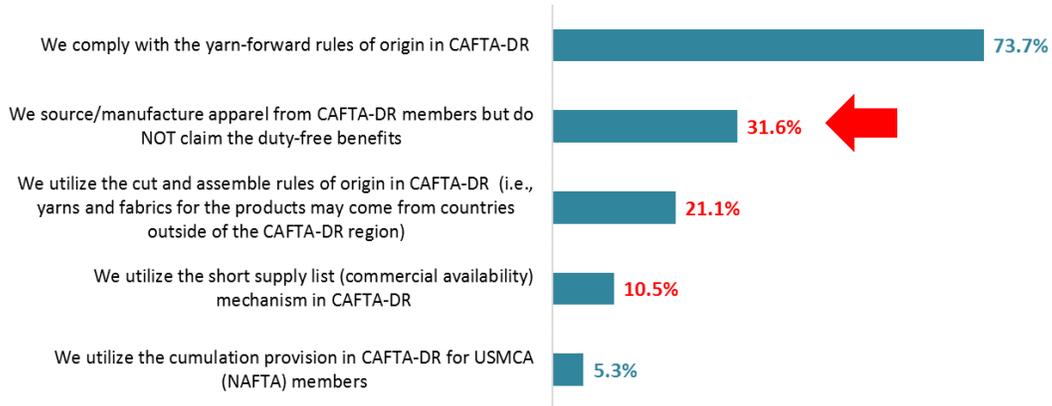


Figure 3-2 One-third of respondents sometimes have to forgo the duty-saving benefits while sourcing apparel from CAFTA-DR

Figure 3-2 shows that around 73 percent of respondents say they comply with the “yarn forward” rules of origin when sourcing apparel under CAFTA-DR. **However, it is concerning to see as many as one-third of respondents sometimes have to forgo the duty-saving benefits when sourcing apparel from CAFTA-DR members.**

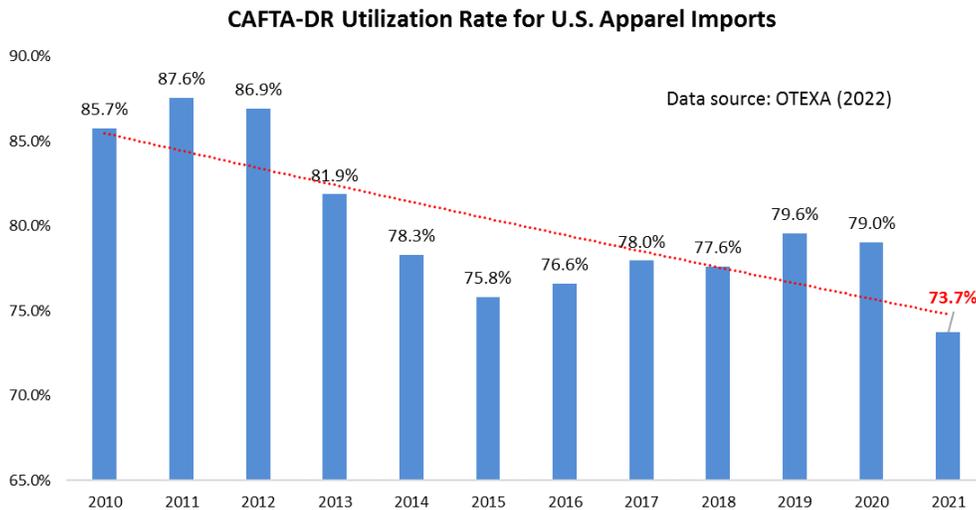


Figure 3-3 Approximately 20-26 percent of U.S. apparel imports from CAFTA-DR members did NOT claim preferential duty benefits since 2015

Consistent with the result, nationwide, the CAFTA-DR utilization rate for apparel imports was stagnant at about 75%-80% since 2015, meaning **20-26 percent of U.S. apparel imports from CAFTA-DR members did NOT claim preferential duty benefits every year** (see Figure 3-3).

The lower free trade agreement (FTA) utilization rate became a bigger problem in 2021, particularly among CAFTA-DR members with fast export growth to the U.S. market. For example, whereas U.S. apparel imports from Honduras enjoyed an impressive 45.6% growth in 2021, only 72.6% of these imports claimed the CAFTA-DR duty benefits, down from 82.3% a year ago. We can observe a similar pattern in El Salvador, Nicaragua, and the Dominican Republic²⁴ (Table 3-2).

Table 3-2 Utilization of CAFTA-DR for U.S. apparel sourcing significantly dropped in 2021, particularly among CAFTA-DR members with fast export growth to the U.S.

Source of imports	% of apparel imports under CAFTA-DR			Growth of U.S. apparel imports in 2021 vs. 2020
	2020	2021	2021 vs. 2020*	
CAFTA-DR	79.0%	73.7%	-5.29	39.9%
Guatemala	80.1%	82.9%	2.84	36.8%
El Salvador	91.9%	84.0%	-7.89	36.4%
Nicaragua	60.9%	57.3%	-3.59	42.9%
Costa Rica	34.4%	36.0%	1.66	0.8%
Dominican Republic	84.0%	80.2%	-3.84	26.1%
Honduras	82.3%	72.6%	-9.67	45.6%

Data source: OTEXA (2022) *: Percentage point

According to respondents, **the limited textile supply within CAFTA-DR, especially fabrics and textile accessories, often creates a dilemma: either source from Asia entirely or source from CAFTA-DR but forgo the duty-saving benefits.** As one respondent put it, *“We would like to be able to get a wider variety of fabrics (besides basic constructions), so we can produce more garments in the region”* Another added, *“Really, it’s about what is available. In order to increase (sourcing) business in CAFTA-DR, we need a larger volume and wider variety of yarns and materials, which currently do not exist in this hemisphere or the U.S., making it impossible to move more product there.”*

Third, respondents say the exceptions to the “yarn-forward” rules of origin provide essential flexibility to source apparel from CAFTA-DR members.

As Figure 3-2 shows, the exceptions to the “yarn-forward” rules of origin, including “short supply,” “cumulation,” and “cut and assemble,” provide necessary flexibilities supporting respondents’ apparel sourcing from CAFTA-DR members. **Around one-third of respondents say they utilize at least one of these three exceptions when sourcing from CAFTA-DR members.** Notably, all but one of these respondents also use the “yarn-

²⁴ Lu, Sheng (2022). US apparel imports patterns: Trends and critical issues to watch in 2022. Just-Style. Retrieved from <https://www.just-style.com/features/us-apparel-imports-patterns-trends-and-critical-issues-to-watch-in-2022/>

forward” rules of origin to enjoy the duty-free benefits under CAFTA-DR. In other words, **given the limited textile raw material supply within CAFTA-DR, these exceptions allow U.S. apparel companies to continue to source from CAFTA-DR members when the products are short of meeting the strict “yarn-forward” rules of origin.**

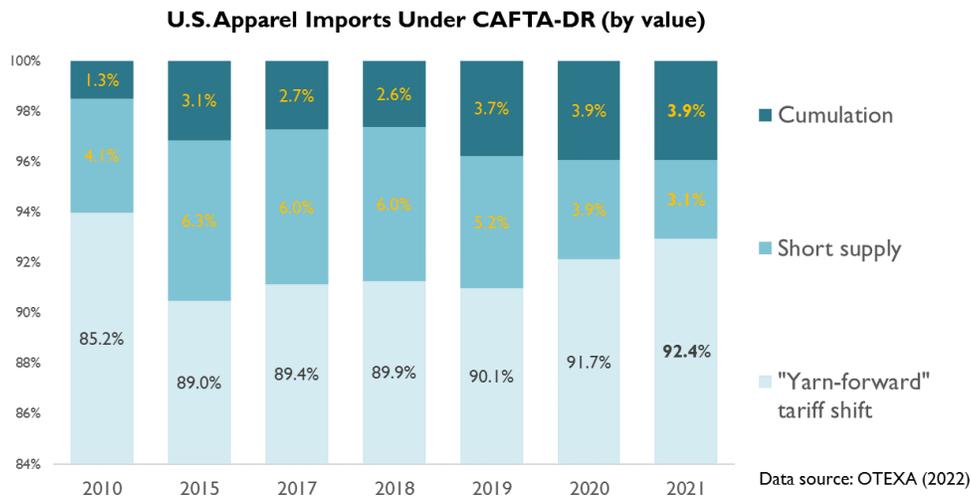


Figure 3-4 Exceptions to the “yarn-forward” rules provide necessary flexibilities supporting U.S. companies’ apparel sourcing from CAFTA-DR members

Reflecting U.S. apparel companies’ practical needs for rules of origin flexibility, nationwide, consistently, about 8-9 percent of U.S. apparel imports under CAFTA-DR utilize the “short supply,” “cumulation,” or “cut and assemble” to claim the duty-free benefits every year (Figure 3-4).

On the other hand, **respondents explicitly say that providing more meaningful flexibility in rules of origin will encourage MORE apparel sourcing from CAFTA-DR.** As one respondent put it, *“In the absence of the capability that exists in Asia / Southeast Asia, there needs to be more flexibility in CAFTA-DR rules of origin.”* Another added, *“allowing imported textile materials from Asia would hugely expand my companies’ ability to source more apparel from the CAFTA-DR region.”*

IV. Conclusions and Policy Recommendations

This study provides valuable insights from U.S. apparel companies' perspectives regarding the opportunities and challenges facing U.S. apparel sourcing from CAFTA-DR members. The results show that thanks to CAFTA-DR, Central America has become one of the emerging sourcing bases for U.S. apparel companies. In particular, U.S. apparel sourcing from CAFTA-DR plays a critical role in supporting the region's economic growth and job creation.

However, the study's findings also indicate that U.S. apparel sourcing from CAFTA-DR has yet to achieve its full potential. For example:

- U.S. apparel imports from CAFTA-DR have been stagnant in sourcing volume over the past 15 years
- CAFTA-DR garment production lacks product diversification, production flexibility, and price competitiveness
- U.S. apparel companies cannot substantially move sourcing orders from China and Asia to CAFTA-DR due to limited production capacity in the region
- U.S. apparel companies often have to forgo the duty-saving benefits when sourcing from CAFTA-DR members

As expanding U.S. apparel sourcing from CAFTA-DR could be the best chance to effectively create more jobs in Central America and solve the root causes of migration there, we propose the following four practical policy recommendations:

First, improve CAFTA-DR's apparel production capacity and diversify its product offers. In particular, we should enhance CAFTA-DR's production capacity beyond basic apparel items. These basic apparel items also face growing price competition with many alternative sourcing destinations and do not necessarily require "speed to market." Instead, with an improved production capacity for various apparel products, U.S. apparel companies would be more likely to move more sourcing orders from Asia to the CAFTA-DR region.

Second, practically solve the bottleneck of limited textile raw material supply within CAFTA-DR and do NOT worsen the problem. As the study's findings repeatedly illustrate, the limited textile raw material supply within CAFTA-DR has been a significant bottleneck preventing more U.S. apparel sourcing from the region. Moreover, the limited textile raw material supply within CAFTA-DR is also a primary contributing factor behind the region's stagnated apparel export growth and a lack of product diversification.

It is critical to recognize that maintaining the status quo or simply calling for making the CAFTA-DR apparel supply chain more "vertical" miss the target and will NOT automatically increase U.S. apparel sourcing from the region. **Notably, the stagnated U.S. apparel import volume from CAFTA-DR members over the past 15 years directly results from the highly restrictive yarn-forward rules of origin, which locked the region's apparel production capacity to a few basic fashion categories.** In other words, the fundamental problem facing CAFTA-DR is NOT a lack of a vertical supply chain but the ability to make a

diverse category of products to meet U.S. apparel companies' sourcing needs. Instead, allowing CAFTA-DR garment producers to access their needed textile raw materials at a competitive price will be essential to solve the bottleneck and encourage more U.S. apparel sourcing from the region.

Third, encourage more utilization of CAFTA-DR for apparel sourcing. As the study's findings indicate, CAFTA-DR's underutilization problem for apparel sourcing has existed for years. It is also a consensus view among existing studies that utilization of a free trade agreement declines with more stringent rules of origin.²⁵

When textile raw materials like fabrics and accessories are NOT available within CAFTA-DR, policymakers should continue to offer reasonable rules of origin flexibilities that allow garment factories to import them outside the region without financial penalty. This is similar to several U.S. trade policy initiatives with widespread public support, such as the Miscellaneous Tariff Bills (MTB)²⁶ and the Section 301 exclusion process.²⁷

Additionally, we should leverage expanded apparel sourcing to incentivize more investments in the CAFTA-DR region's production and infrastructure. CAFTA-DR will be better positioned to attract new investments in its textile and apparel industry when the sourcing volume steadily expands. This is similar to the idea of launching the "third-country fabric" provision in the African Growth and Opportunity Act (AGOA).²⁸ New investments, especially those beyond yarn producers, will further strengthen CAFTA-DR's textile and apparel production capacity, creating a beneficial cycle to expand the economic impact of U.S. apparel sourcing from the region.

²⁵ Powers, William, & Ubee, Ricky (2020). A comprehensive comparison of rules of origin in U.S. trade agreements. U.S. International Trade Commission (USITC) Economic Working Paper Series. Retrieved from https://www.usitc.gov/publications/332/working_papers/powers_ubeecomprehensiveanalysisofusrulesoforigin2020-05-20_compliant.pdf

²⁶ MTBs aim to temporarily suspend or reduce tariffs on certain imported products proven to have no U.S. domestic producer and are revenue-neutral (i.e., forgone tariff revenues of no more than \$500,000 per product). See Congressional Research Service, CRS (2021). Miscellaneous Tariff Bills (MTBs). Retrieved from <https://crsreports.congress.gov/product/pdf/IF/IF10478>

²⁷ The tariff exclusion allows an exemption from the Section 301 tariff increases for specific imports from China. See Congressional Research Service, CRS (2022). Section 301 Tariff Exclusions on U.S. Imports from China. Retrieved from <https://crsreports.congress.gov/product/pdf/IF/IF11582>

²⁸ U.S. International Trade Commission, USITC (2018). U.S. Trade and Investment with Sub-Saharan Africa: Recent Developments. Washington, D.C.. Retrieved from <https://www.usitc.gov/publications/332/pub4780.pdf>

Appendix: Textile and Apparel Manufacturing Basics

While textiles and apparel are often treated as one industry, textile manufacturing and manufacturing are very different.

In general, **textile manufacturing** mainly involves the spinning, weaving, and fabric finishing processes, is primarily based on sophisticated machinery for production. In other words, **textile manufacturing is highly automated and capital-intensive**. Usually, a country won't be able to make textiles, especially man-made fiber (MMF) products, until its national economy reaches a particular development stage with sufficient cumulation of capital and technology.

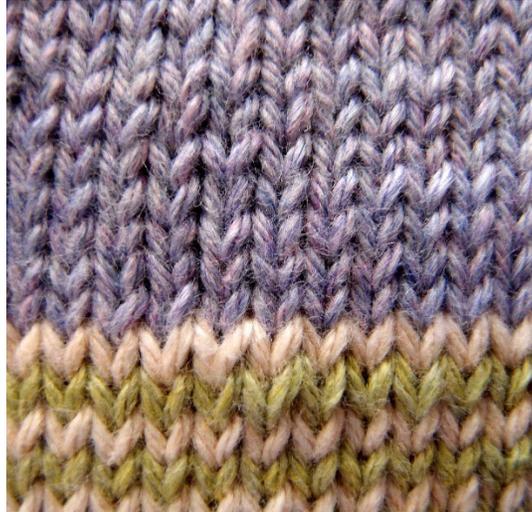
Apparel manufacturing, which includes cloth cutting and sewing operations, primarily relies on labor inputs. Even today, in the 21st century, apparel manufacturing is still highly labor-intensive with a minimum requirement for technology and capital.

Apparel products include two major categories—woven and knitted apparel, each accounting for around half of the world's total apparel production and exports. **However, the supply chains of these two types of apparel are pretty distinct.**



(picture above: Woven fabric)

Woven apparel is made from woven fabric cut into pieces and sewed together by apparel manufacturers. In most cases, the apparel assembly stage is not the same factory as the fabric weaving mill. Backward integration into weaving, dyeing, and finishing is capital intensive and uses more energy than apparel assembly processes. Labor-intensive handlooms exist to make woven fabrics, but handloom fabrics are mostly used for home textiles or traditional apparel rather than ready-made apparel for export markets.



(picture above: Knitted fabric)

Knitted apparel can be made from various knitted fabric types, or the final product can essentially be knitted from yarn into an apparel product without a distinct fabric production stage. Countries often move into knitted fabric production before woven fabric production because a knitting machine is generally less expensive and uses less energy than a weaving machine. Furthermore, products that use flat knit fabrics (sweaters, pullovers, dresses, suits, trim, and so forth) can be made with hand knitting or semiautomatic flatbed knitting machines that are labor-intensive, and they are often found in developing countries with large, low wage labor pools despite more advanced electronic versions. Thus, knit apparel lead times have declined faster as more countries have invested in backward linkages.

About Dr. Sheng Lu

Dr. Sheng Lu is an Associate Professor in the Department of Fashion and Apparel Studies at the University of Delaware. He also serves as a consultant for the International Trade Centre (ITC) co-run by the World Trade Organization (WTO) and the United Nations (UN). With over 70 publications in academic and trade journals, Dr. Lu's research focuses on the economic and business aspects of the textile and apparel industry, including international trade, trade policy, and the governance of the global apparel value chain. Dr. Lu received the 2014 Rising Star Award and 2019 Mid-Career Excellence Award from the International Textile and Apparel Association (ITAA) to recognize his research and teaching excellence. He is also the multiple-time recipient of the Paper of Distinction Award at the ITAA annual conferences for his study on the textile and apparel specific-sectoral impact of mega free trade agreements. Several of his studies were cited by government reports, such as the Congressional Research Service (CRS) studies prepared for members of U.S. Congress, U.S. International Trade Commission (USITC) official assessment on the economic impacts of free trade agreements as well as the World Bank, International Labor Organization, and the United Nations research publications. Dr. Lu's published works also have been translated into Chinese, Vietnamese, Spanish, and Thai and regularly featured by the media outlet, including the Wall Street Journal, New York Times, Financial Times (UK), BBC World News (UK), Nikkei Asian Review (Japan), Associated Press, Bloomberg, South China Morning Post (Hong Kong), Los Angeles Times, Voice of America, and Forbes.

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About the Coalition for Economic Partnerships in the Americas (CEPA)

The Coalition for Economic Partnerships in the Americas (CEPA) is a group of major American companies and manufacturers dedicated to promoting regional trade and job growth, today released the following statement reiterating its commitment to supporting and expanding trade and investment throughout the Western Hemisphere.

More Information: www.cepacoalition.com