

# CRS Report for Congress

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## DR-CAFTA, Textiles, and Apparel

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### Summary

The Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA), signed on August 5, 2004, by the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic is a comprehensive and reciprocal trade agreement that, if ratified by all parties, would govern market access of goods, services trade, investment, government procurement, intellectual property, labor, and the environment. With respect to textiles and apparel, DR-CAFTA is comparatively less restrictive than most other trade agreements and trade preference programs regarding what qualifies for duty-free access to the United States. On the whole, U.S. apparel manufacturers favor approval of the agreement; textile manufacturers appear to have differing opinions; most textile and apparel importers support approval. Apparel makers in the Dominican Republic and Central America see it as helpful in their competition with Chinese-made goods. This report will not be updated.

### The Agreement

On August 5, 2004, the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic signed the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA). It is a comprehensive and reciprocal trade agreement, which distinguishes it from the unilateral preferential trade program enacted by Congress as part of the Caribbean Basin Initiative (CBI), as amended. It provides detailed rules that would govern market access of goods, services trade, government procurement, intellectual property, investment, labor, and environment.<sup>1</sup>

Enacting DR-CAFTA requires legislative action in all signatory countries. To date, El Salvador, Honduras, and Guatemala have ratified the agreement. The U.S. Congress is debating it, but implementing legislation has yet to be introduced.

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<sup>1</sup> For more details on and analysis of the agreement, see CRS Report RL31970, *The Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA)*, by J. F. Hornbeck.

## Background

To avoid confusion over the meaning of the words textiles and apparel, it may be helpful to note that “textiles” can include apparel in some contexts, but more technically it refers to yarn and/or fabric, and sometimes end-products such as bed linen, towels, window curtains, tarpaulin, tents, etc. “Apparel” means clothing, and usually excludes footwear, as will be the case in this report. Also, the terms “region” and “regional” used in this report refers to the Central American countries and the Dominican Republic.

The current trade preference program for Caribbean countries, begun as the Caribbean Basin Initiative (CBI), is one of three regional programs that Congress has enacted to ease U.S. trade terms on imports of goods — especially apparel and other textile end-products — to spur economic growth in poorer regions of the world.<sup>2</sup> Textile and apparel production usually play a large role in early industrial development. U.S. textile and apparel manufacturers have been losing U.S. market share to developing countries at least since the 1960s. To provide markets for U.S. yarn and fabric producers, the trade preference programs for the most part require U.S.-made yarn and/or fabric to be used as inputs for textile and apparel end-products made in designated beneficiary countries for them to qualify for trade preference.

The Caribbean Basin Trade Partnership Act (CBTPA),<sup>3</sup> as amended, is the main legislation for the Caribbean program with respect to textiles and apparel. CBTPA expanded the CBI preferential arrangements and, as later amended, extended through FY2008 preferential treatment for imports of selected apparel items.

The U.S.-Central American/Dominican Republic economic relationship changed dramatically under CBTPA, creating an environment in which businesses forged strategic partnerships in the increasingly complex regimen of textile and apparel manufacturing. In a paradigm of coordination, components are routinely produced in countries other than where the end-product is assembled, end-products are produced mainly for export, and all are in close touch with each other.

With respect to U.S. yarn and fabric producers, the CBTPA appears to have been successful. U.S. domestic exports of fiber, yarn, and fabric to CBTPA countries, which had been rising at least since the mid-1990s, increased sharply in 2001 and have risen further since then, although not as rapidly. Such exports jumped 80% between 2000 and 2001, and rose 68% between 2001 and 2004. A roughly similar pattern holds for most of the individual major fiber, yarn, and fabric categories, as defined in the Harmonized Tariff Schedule (HTS), exported to CBTPA countries, with cotton fiber and cotton woven fabric and knitted and crocheted fabrics recording the steepest gains. In 2004, these two categories combined accounted for two thirds of U.S. fiber, yarn, and fabric exports to CBTPA countries. Exports of special woven, tufted, and other products in HTS Chapter 58 doubled between 2000 and 2002, but have since declined (**Table 1**).<sup>4</sup>

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<sup>2</sup> The other two regions receiving such trade preference are Andean and Sub-Saharan countries.

<sup>3</sup> Title II of P.L. 106-200.

<sup>4</sup> For more on trends in U.S. exports of fiber, yarn, and fabric to trade preference regions, see CRS Report RL32895, *Textile Exports to Trade Preference Regions*, by Bernard A. Gelb.

**Table 1. U.S. Exports of Fiber, Yarn, and Fabric to CBTPA Countries: Selected Major Categories and Total, 1996-2004**  
(millions of dollars)

Year	Cotton <sup>a</sup>	Manmade Filaments <sup>b</sup>	Manmade Staple <sup>c</sup>	Special Woven, Tufted, Etc. <sup>e</sup>	Knitted or Crocheted Fabrics <sup>e</sup>	TOTAL <sup>f</sup>
1996	250.9	57.2	56.6	84.2	128.0	658.0
1997	276.8	78.6	62.0	120.9	136.1	771.7
1998	351.3	95.1	68.0	126.8	98.9	851.8
1999	181.4	78.0	62.5	140.4	90.6	672.5
2000	295.3	117.9	71.7	191.8	104.0	931.2
2001	607.5	139.2	176.4	337.7	270.0	1,676.8
2002	779.2	148.5	246.8	409.2	525.2	2,275.7
2003	820.1	175.7	292.4	220.4	799.4	2,462.3
2004	1,083.3	168.1	287.2	256.4	863.4	2,823.4

Note: Data are for domestic exports. All categories except “Knitted and Crocheted Fabrics” include fiber, yarn, and fabric.

- a. HTS Chapter 52. Excludes knitted and crocheted cotton fabric.
- b. HTS Chapter 54.
- c. HTS Chapters 55.
- d. HTS Chapter 58.
- e. HTS Chapter 60.
- f. Includes HTS Chapters not shown separately.

Source: U.S. International Trade Commission (ITC), Trade Database, compiled from tariff and trade data from the Department of Commerce, Department of the Treasury, and the ITC.

**Table 2. U.S. Imports of Apparel from DR-CAFTA Countries**

Year	Millions of \$	Year	Millions of \$
1997	6,982	2001	9,141
1998	7,641	2002	9,190
1999	8,229	2003	9,274
2000	9,122	2004	9,603

Note: Data are imports for consumption:

Source: U.S. International Trade Commission (ITC), Trade Database, compiled from tariff and trade data from the Department of Commerce, Department of the Treasury, and the ITC.

On the other hand, even though Caribbean producers' exports of apparel to the United States have been rising (**Table 2**), those producers have been losing share of the U.S. apparel market *in percentage terms* to Asian countries, because U.S. imports of apparel from there have risen even faster.

## DR-CAFTA Provisions and Objections

DR-CAFTA would eliminate duties on nearly all “originating” textiles and apparel retroactive to January 2004. In general, to qualify as “originating,” all processing after fiber formation (e.g., yarn spinning, fabric production, and assembly) would have to occur in a signatory country, or be specified in the agreement in the section setting out the rules of origin, through a change in tariff classification. The rules of origin for apparel generally apply only to the component that provides the garment its “essential character.”<sup>5</sup>

Thus, a major difference between the general criterion for originating in DR-CAFTA and the one in CBTPA is that components of a textile or apparel product under DR-CAFTA could be made in the region as well as in the United States, whereas, for the most part, they have to be made in the United States under CBTPA.

Also, there are a number of qualifications and exceptions to the DR-CAFTA general criterion, including the following. While generally requiring that inputs from “yarn forward” be made in signatory countries, fiber forward is required in some cases. The origin of collars, cuffs, and invisible linings would not be considered in determining whether an item of apparel qualifies as originating. Woven goods made in Canada or Mexico would qualify as originating, subject to quantity limitations and with a two-part proviso.<sup>6</sup> In the cases of a few quantitatively important products, only one “transformation” (e.g., from yarn to fabric) would be needed to qualify as originating. A textile or apparel good containing one or more of a lengthy list of fibers, yarns, and fabrics considered to be in short supply in the United States would be treated as originating regardless of the origin of such components. For the first 10 years of the agreement, the United States would give preferential tariff treatment to a limited quantity of cotton and manmade fiber apparel assembled in Nicaragua that do not qualify as originating. And, for the first two years, the United States would provide preferential tariff treatment to a limited quantity of tailored wool apparel assembled in Costa Rica that is not originating.

Consequently, there have been objections — to a great extent, owing to concern about China, which has increased its share of the world and the U.S. apparel markets greatly in recent years. For example, U.S. companies and workers see the allowance for DR-CAFTA countries to use regionally-made components as directly and indirectly damaging to U.S. textile producers — indirectly, because they fear lax enforcement that will allow Chinese-made components to effectively enter the United States duty free (illegal trans-shipment). Similarly, critics assert that the special provisions for Nicaragua

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<sup>5</sup> For a discussion of rules of origin in international trade and a comparison of such rules in U.S. free trade agreements and trade preference programs, see CRS Report RL31934, *Textile and Apparel Rules of Origin in International Trade*, by Bernard A. Gelb.

<sup>6</sup> Those countries must (a) provide reciprocal treatment for U.S.-produced inputs under their free trade agreements with other DR-CAFTA countries, and (b) agree to certain textile verification procedures.

and Costa Rica, and the leeway to use Mexican or Canadian components, will result in Chinese-made materials entering the United States duty free. Critics say many Chinese-made goods already are smuggled into Mexico. It is obvious why the exceptions for collars, cuffs, and invisible linings in determining whether an item of apparel would be originating is meeting objections.

On the other hand, DR-CAFTA contains a safeguard provision specifically for textile and apparel goods applicable during a transition period. If, as a result of the reduction or elimination of a duty, imports of a good from another signatory country increase to the extent that there is serious damage or a threat thereof to the domestic industry, the importing party may increase or reimpose the duty to a specified level.

## **Impact Assessments and Industry Positions**

Perhaps most important to U.S., Dominican Republic, and Central American textile and apparel producers in assessing the potential impact of DR-CAFTA is how great any alleged potential illegal Chinese inroads in legitimate DR-CAFTA trade would be. However, at this point, it is unknown.

With respect to legitimate trade, while it is widely believed that Chinese producers generally have a cost advantage over DR-CAFTA producers, the latter have the advantage of geographical proximity that confers lower transportation costs and faster turnaround at least with respect to shipping time. And given that Chinese-made goods still are subject to tariffs, the expanded duty-free access to the U.S. market that DR-CAFTA would provide would help DR-CAFTA producers. Thus, apparel makers in the Dominican Republic and Central America see DR-CAFTA as a potential help in their competition with Chinese-made goods.

Given the option in the agreement for components to be made in non-U.S. signatory countries, the option to use Mexican and Canadian components, and other provisions, U.S. yarn and fabric producers would tend to benefit less than DR-CAFTA producers from the advantages cited above.

Abstracting from the China issue, the National Council of Textile Organizations estimated that DR-CAFTA would incur annual losses to the U.S. industry of \$1.0 — \$1.8 billion.<sup>7</sup> The U.S. International Trade Commission (ITC) said that DR-CAFTA “is likely to result in a moderate increase in U.S. imports of textiles, apparel, and footwear from the CA/DR region,” but the increase in U.S. imports of these goods from all sources is likely to be small as CA/DR goods are likely to displace imports from other countries. The ITC also estimated that DR-CAFTA is likely to result in a small increase in U.S. exports of textiles, apparel, and footwear to the CA/DR region, and have a negligible impact on U.S. output or jobs.<sup>8</sup>

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<sup>7</sup> Written submission to the ITC by Robert DuPree, Vice President, May 11, 2004, as reported in the U.S. International Trade Commission report cited in footnote 9.

<sup>8</sup> U.S. International Trade Commission. *U.S.-Central America-Dominican Republic Free Trade Agreement: Potential Economywide and Selected Sectoral Effects*. USITC Publication 3717, August 2004, p. 28 and 32.

On the whole, U.S. apparel manufacturing companies favor approval of DR-CAFTA. While the agreement provides regional apparel producers more flexibility in obtaining materials and other components than allowed under CBTPA, U.S. apparel makers see greater advantage in changing the present unilateral preference program to a permanent reciprocal “economic partnership” that, by strengthening the economies of the region, will maintain their stability and foster predictability for U.S. businesses. Also, they say, it “help determine whether .....imported garments are made in central America and the Dominican Republic using U.S. inputs.....or in some other area of the world using somebody else’s inputs.”<sup>9</sup>

Reflecting the portions of the industry that are more heavily represented in their memberships, U.S. textile manufacturing trade associations have differing opinions of the agreement. Thus, the National Council of Textile Organizations and the National Cotton Council support DR-CAFTA.<sup>10</sup> The yarn spinners in the former group and the various segments of the cotton industry see continued, or even expanded opportunity arising from DR-CAFTA’s provisions, given the yarn forward requirements, albeit partial, and the limited cotton producing capacity of the regional countries. The American Manufacturing Trade Action Coalition and the National Textile Association oppose DR-CAFTA.<sup>11</sup> With greater representation of fabric producers, they see the provisions of the agreement allowing apparel made from regionally-produced fabric to qualify for duty-free entry into the United States as potentially diminishing their market in the Dominican Republic and the five Central American countries.

Most U.S. textile and apparel importers, which include retailers, support approval of DR-CAFTA. They expect lower prices to result from the agreement, enabling them to compete better with goods obtained elsewhere and/or sell greater quantities to consumers as a consequence of lower prices.

UNITE HERE, a major union representing textile and apparel industry workers, among others, opposes the agreement. UNITE HERE sees DR-CAFTA as potentially costing U.S. jobs. Moreover, DR-CAFTA’s rules, UNITE says, are designed primarily to facilitate and protect foreign investment by large multinational corporations. These rules, UNITE adds, would make large corporations more mobile and less accountable to local communities and governments, “dramatically shifting the balance of power” away from democratically elected governments and towards private companies, and increasing the bargaining power of employers vis-à-vis their workers.<sup>12</sup>

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<sup>9</sup> American Apparel and Footwear Association. Letter to President George W. Bush, April 13, 2005.

<sup>10</sup> National Council of Textile Organizations. “NCTO Board Votes to Support DR-CAFTA,” Textile News and Information, May 9, 2005; National Cotton Council. “Industry Affirms Support for DR-CAFTA,” press release, May 10, 2005.

<sup>11</sup> American Manufacturing Trade Action Coalition. AMTAC Reaffirms Opposition to CAFTA, Agreement a Job Killer,” press release, May 9, 2005; National Textile Association. “NTA denounces CAFTA as a threat to U.S. textile industry, December 18, 2003.

<sup>12</sup> Statement of Mark Levinson, Chief Economist, UNITE HERE, before the Senate Finance Committee on the Dominican Republic–Central American Free Trade Agreement, April 13, 2005.