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Textile and Apparel Sectors Disagree on Certain Provisions of the Proposed U.S.-Mexico-Canada (USMCA) Agreement

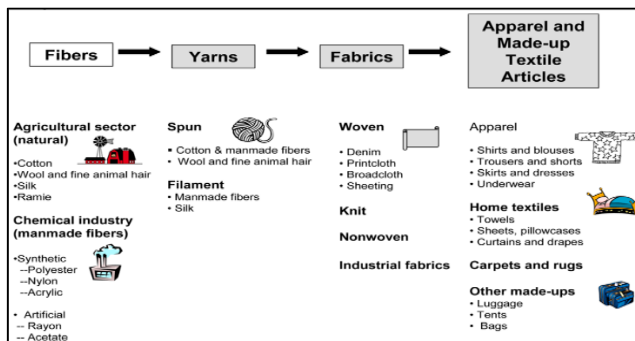
Introduction

The U.S.-Mexico-Canada Agreement (USMCA) is the proposed replacement of the North American Free Trade Agreement (NAFTA), which entered into force in 1994 and gradually eliminated tariffs and quotas on regionally made textile and apparel products. The proposed agreement would make several changes in rules affecting textiles and apparel among the three countries. U.S. textile manufacturers and the apparel and retail industries have expressed overall support for the USMCA. Still, certain provisions have been controversial, and textile producers and the apparel sector hold divergent views. If Congress considers the USMCA, its textile and apparel provisions may draw particular scrutiny.

U.S. Textile and Apparel Manufacturing

Textile and apparel manufacturing covers several different industrial processes (Figure 1). Textiles are made with fibers harvested from natural sources (such as cotton or silk), manufactured from cellulosic materials (such as rayon or acetate), or made of man-made synthetic materials (such as polyester, nylon, or acrylic). The raw fibers pass through four main stages of processing: yarn production, fabric production, finishing, and fabrication.

Figure 1. The Fiber, Textile, and Apparel Industries



Source: U.S. International Trade Commission (USITC).

Both the textile and apparel sectors have undergone extensive structural changes. U.S. production at textile mills in 2018 was 60% below the 1994 level, and U.S. production at apparel plants was 88% less in 2018 than in 1994, according to the Federal Reserve Board.

Still, significant textile production remains in the United States largely owing to automation, which has helped reduce operating costs for U.S. producers. Textile production is also capital- and scale-intensive, making U.S.-based textile manufacturing less prone to relocation to lower-wage countries. However, demand for U.S.-made textile products has fallen as the industry that was formerly the main consumer, apparel manufacturing, has reduced

domestic production. U.S. manufacturers of textiles employed 229,000 workers in 2018.

Many U.S.-headquartered apparel companies, which increasingly focus on product design and marketing, have transferred much of their production to third-party manufacturers in non-U.S. locations. In 2018, employment was 113,000. Apparel production in the United States is generally restricted to high-quality niche products and U.S. government defense contracts. The Berry (10 U.S.C. §2533a) and Kissell (6 U.S.C. §435b) Amendments require 100% U.S. content for textiles and garments purchased by the Departments of Defense (DOD) and Homeland Security (DHS) for certain military and nonmilitary purposes.

Textile and Apparel Trade

U.S. textile manufacturers have arranged their production with Canada and Mexico around the NAFTA provisions. Half of all U.S.-made yarns, fabrics, made-up articles (such as towels and bedsheets), and apparel are sold to Canada or Mexico. U.S.-made technical fabrics, which make up more than half of all fabrics exported to those two countries, are used in industrial applications such as automobile seats. More than three-fourths of all clothing imported into the United States from Mexico is made from U.S.-produced yarn or fabric.

Domestic textile mill producers also are affected by other trade arrangements in the Western Hemisphere. For example, under the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) regional producers from six partner countries are allowed to ship apparel products to the United States duty-free as long as the yarn and fabrics used for these manufactures originate in the region, with some exceptions. Most CAFTA-DR apparel shipped to the United States is made from U.S. textiles. In 2017, the United States exported \$2.5 billion worth of textiles to the region, making it the second-largest U.S. textile export market in the world (NAFTA is first).

The most significant competitive challenge for textile and apparel production in the Western Hemisphere comes from outside the region, specifically China and Vietnam. China is the world's largest manufacturer of man-made fibers, a large producer of cotton, and a major supplier of yarns, fabrics, and trims. China has become the leading exporter of textiles and apparel to the U.S. market, supplying 38% of imports in 2017. Vietnam is the second-largest source of apparel for the United States. Neither has a preferential trading relationship with the United States, suggesting lower production costs have offset tariff incentives offered by NAFTA. Asian apparel uses little or no U.S.-made yarn and fabric, but Asian countries rank as top markets for U.S. cotton exports.

Disagreements About Specific Provisions

Rules of origin, which specify how much processing must occur within a free-trade area for a product to obtain duty-free benefits, are an important aspect of any trade agreement. For textile and apparel companies, the rules determine what tariffs apply to imported textile and apparel inputs or finished products. Apparel products face normal tariff rates ranging as high as 32% of import value and textile tariffs are as high as 20%, so importers may benefit from significant duty savings if their products qualify for favored treatment under NAFTA, and this would continue under the proposed USMCA. Because rules of origin affect textile and apparel producers differently, they disagree on certain provisions.

Textile “Yarn-Forward” Rule of Origin. The USMCA generally would maintain the existing NAFTA “yarn forward” rule of origin. This is meant to ensure that primarily U.S.-made yarns and fabrics—not lower-cost Asian inputs—supply textile and apparel producers located in the region. Fibers in the yarn may generally be produced anywhere in the world.

U.S. textile manufacturers almost always support eliminating exceptions to the “yarn forward” rule. In a concession to the textile industry, the USMCA would newly require sewing thread, coated fabric, narrow elastic strips, and pocketing fabric used in apparel and other finished products to be made in a USMCA country to qualify for duty-free access to the United States. The National Council of Textile Organizations, a textile industry trade group, estimates a yearly USMCA market for sewing thread and pocketing fabric of more than \$300 million. The U.S. apparel industry opposes “yarn forward” and argues that apparel should be considered of North American origin under a more flexible regional “cut and sew” standard, which would provide maximum flexibility for sourcing, including the use of foreign-made yarns and fabrics.

Tariff Preference Levels for Textiles and Apparel. In response to concerns raised by the apparel industry, the USMCA, like NAFTA, would permit exceptions to the textile rules when certain inputs are not available in partner countries. With some adjustments, the USMCA would continue a program that allows duty-free access for limited quantities of wool, cotton, and man-made fiber apparel made with yarn or fabric produced or obtained from outside the NAFTA region, including yarns and fabrics from China and other Asian suppliers.

U.S. imports of textiles and apparel covered by the tariff preference level mechanism supply 13% of total U.S. textile and apparel imports from Canada and Mexico. Apparel producers assert that these exceptions give regional producers flexibility to use materials not widely produced in North America. The textile industry contends China is a major beneficiary of the current NAFTA tariff preference level mechanism, and it strongly pushed for its complete elimination in the USMCA.

Other Exemptions. The U.S. textile industry opposes several other exemptions, which do not encourage more use of U.S. yarn and fabric inputs. Under the USMCA, for example, visible lining fabric for tailored clothing could be sourced from China or other foreign suppliers, and it would permit up to 10% of a garment’s content, by weight, to come from outside the NAFTA region. (NAFTA’s de

minimis textile threshold is 7%). Another exemption is a “short supply process” for certain textile items deemed commercially unavailable within North America. The new agreement would incorporate the existing NAFTA short supply procedure, a process apparel importers argue will continue to make it difficult to get a new item approved and added to the list, limiting their flexibility to source apparel with inputs from outside North America.

Customs Enforcement. More than \$20 billion of imported textiles and clothing claim preferential tariff treatment annually, according to U.S. Customs and Border Protection. The USMCA would add specific textile verification and customs procedures aimed at preventing fraud and transshipment because of concerns that major textile- and apparel-producers such as China are shipping products through Canada, Mexico, and other countries that have free-trade agreements with the United States. Textile producers consider this a key improvement, whereas the apparel industry questions the need for separate enforcement provisions.

Kissell Amendment. The USMCA would end exceptions in NAFTA that allow manufacturers from Canada and Mexico to qualify as “American” sources when DHS buys textiles, clothing, and footwear using appropriated funds. DHS spent more than \$30 million on textiles, clothing, and shoes subject to the Kissell amendment in FY2018.

Additional Provisions. The USMCA includes a separate chapter for textiles and apparel, which the textile industry argues is meaningful because it highlights the importance of textile manufacturing for the North American region. In NAFTA, many specific provisions affecting textile and apparel trade appear in an annex to the broader market access chapter for goods (Annex 300-B). The USMCA would also create a Committee on Textile and Apparel Trade Matters to raise concerns regarding mutual trade in these products.

Outlook

For the proposed USMCA to enter into force, implementing legislation must be passed by Congress under the Trade Promotion Authority procedures set in 2015 by the Bipartisan Congressional Trade Priorities and Accountability Act (P.L. 114-26). The Canadian parliament and the Mexican congress must approve it as well. In general, the USMCA tightens some provisions of NAFTA and loosens others to balance the competing interests of textile and apparel producers. Regardless of whether the USMCA takes effect, the global competitiveness of U.S. textile producers and U.S.-headquartered apparel firms may depend more on their ability to compete against Asian producers than on the USMCA trade rules.

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