APPAREL MANUFACTURING: LESSONS FROM THE PANDEMIC

An Examination of the Pandemic Impact on Apparel Production in El Salvador, Guatemala, Honduras, Dominican Republic, Haiti, and Mexico

and Recommendations for a new Post-Pandemic Supply Chain

Abstract

The opportunities to absorb additional apparel production in a post-pandemic global supply chain can be realized with collaborative and concerted efforts by the study countries with the appropriate partnerships: between governments, private sector manufacturers, banks and brands and retailers.

Inter-American Development Bank

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Executive Summary

The pandemic demonstrated that textile and apparel manufacturers in Mexico, El Salvador, Guatemala, Honduras, Haiti and the Dominican Republic can be a viable source for the Canadian and United States markets. The ability of manufacturers and governments to recognize the flexion point of possibilities in a post-pandemic environment could dictate the condition of this industry for the next decade. The pandemic illustrated several key facts that need to be addressed on an industry and regional basis.

First, the pandemic demonstrated that textile and apparel manufacturers in the study countries were flexible and quick to respond. The efforts undertaken by manufacturers to remain viable, keep operations running and shift to "immediate need" production proves that perceptions by brands and retailers that the region is not flexible or timely are not true. Companies were able to shorten the lead time for product development from months to weeks; were able to secure approvals through video conferences, were able to train workers in a matter of weeks.

> The region needs to maintain the same level of urgency exhibited during the pandemic to take advantage of the post-pandemic opportunities that have arisen not only due to the corona virus but as a result of actions taken by the United States and Canada on key apparel producing countries such as China.

Second, the pandemic demonstrated that governments need to develop strategies and plans for the future. Confused direction from federal, state and local officials as to essential operations, or protocols for production, unclear timeframes for closures, no alternative transportation plans, uncoordinated border procedures for persons and goods, slow responses to requests for exceptional policies to move samples quickly or obtain tariff preference level allocation, restrictions on workforce limits without removals of restrictions on hourly work limits, etc. combined to inhibit the private sector from pivoting to meet the new market demands.

Third, the pandemic demonstrated the vulnerabilities in brands' and retailers' supply chains. Most companies are reassessing and restructuring their global supply chain. The economic costs to retailers are resulting in physical presence reductions and closures of stores. The reduction of stores means a reduction in inventory. Brands are looking at rebalancing their sourcing to ensure they are not "overexposed" in one geographical area; are considering a "hub and spoke" sourcing model to manufacture in geographical proximity to the target market; are looking at vertical manufacturing locations either as an individual country or as a close geographical region of countries; are looking at sustainable production to meet growing consumer demands; and are looking at nearshoring suppliers as it helps to meet several of the sourcing restructuring objectives.

Fourth, we have witnessed a transformational shift in consumer shopping behaviors. Online shopping is dominating consumption patterns. Retailers and brands noted exponential increases in their ecommerce sales and forecasters are predicting much of the shopping will remain online as younger consumers prefer the option and older consumers learned to use this mode when previously resistant. Closures of stores are expected to keep online sales as a significant portion of total sales.

Fifth we note that the target markets of the United States and Canada have changed due to the economic impact of the pandemic and an increased focus on targeting suppliers that use forced labor. Domestic actions by these governments targeted at major apparel suppliers such as China present unique opportunities for the study countries to capture some of this market share. Further, civil and governmental pressures for "near shoring" and more domestic purchases will impact how goods are sourced.

All of these observations, however, can be turned to advantages for Mexico, Guatemala, Honduras, El Salvador, Dominican Republic and Haiti if assessed and addressed in their entirety and with a comprehensive approach. The textile and apparel industry can thrive is they continue

1. Demonstrating flexibility and quick response to market approaches;
2. Maintain versatility in production and supply chains for ecommerce and drop shipment supplies;
3. Develop verticality in the supply chain for yarns, fabrics and apparel by working as a regional coordinated supplier;
4. Capitalize on being "near shore" and maintain inventory for brands; and
5. Provide complete visibility to the entire supply chain for brands offering security that no forced labor is used even at the cotton farming level.

This paper examines the impact of the pandemic on the following:

1. Manufacturers in each country
2. Brands and retailers
3. Consumers

The methodology included personal interviews with manufacturers in each country and with major brands/retailers. It also examined existing synergies and levels of integration among the countries. The paper sets forth recommendations on actions that could help address barriers to achieving higher levels of investment for each country as well as the region.

A collaborative effort by the region could result in a resurgence of investment. This paper seeks to identify areas where countries can take advantage of the free trade agreement or preferential programs providing duty free access to the U.S. and Canada as well as leveraging their geographic proximity.

The effort cannot be undertaken solely by either the investors/manufacturers or the government but must be a joint effort. A commitment at the highest governmental levels to the industry must be made to establish a stable business environment that is not disrupted when there is a change in government. Political stability is desirable but more importantly is a stable investment and business environment.

Predictability is essential to planning and investment. These countries have the opportunity now to become a post-pandemic manufacturing destination in apparel and textiles if specific issues as identified in this paper are addressed.

Historical Background: Impacts on Global Sourcing Decisions

Textile and apparel manufacturing began moving out of the United States in the 1960's with Japan being the first country to export significant quantities of apparel to the United States. This influx of apparel alerted the U.S. domestic manufacturing industry and eventually resulted in the "Short Term Arrangement" (STA) followed by the "Long Term Arrangement" (LTA) and eventually the "Multifiber Fiber Agreement" (MFA) under the General Agreement on Tariffs and Trade (GATT). The STA, LTA and the MFA were trade management systems using quotas. This system witnessed a slow expansion around the globe of apparel manufacturing. As a new exporter began shipping in significant quantities into the U.S. and eventually the Canadian market, the countries moved to impose quotas which in turn forced manufacturers to expand into a different country. Some analysts have argued that the quota system was a great development tool allowing countries to enter into a manufacturing industry segment that would not have otherwise manifested in that country absent quotas that restricted the larger countries such as China, India, Brazil and Bangladesh. Mexico, Guatemala, Honduras, El Salvador, Haiti and the Dominican Republic were beneficiaries of this quota system and entered into apparel production as a result.

Eventually, these restrictions were seen by the developing countries as ceilings that prevented manufacturing expansion. During the World Trade Organization (WTO) negotiations, removing the quota system became a focus of the agreement. As a result, in the shift from GATT to WTO, a new agreement, the "Agreement on Textiles and Clothing" (ATC) was reached which implemented a ten-year phase out of the quota system. On January 1, 2005, quotas for most WTO members were removed although some quotas remained in place for China through 2008.

Several countries used the ten-year quota phase-out to negotiate unilateral or fully reciprocal trade agreements with the United States in an attempt to gain duty free access to the U.S. market and remain competitive with the Asian apparel powerhouses; however, most of the preferential programs for the countries in this study were slow to conclude and implement such agreements. Mexico had an advantage as its FTA was implemented in 1995, ten years before quotas were phased out.

The United States free trade agreement with the Central American countries and the Dominican Republic entered into effect on a rolling basis, first with El Salvador on March 1, 2006; Honduras on April 1, 2006; Guatemala on July 1, 2006 and with the Dominican Republic on March 1, 2007. The expanded preferential apparel program for Haiti, the Haiti HOPE legislation became effective on March 19, 2007 and was expanded in May 2008.

The implementation of the FTA and the Haitian preferential program although worthy, were too little too late. Global sourcing managers for brands/retailers looked at the possibility of the unrestrained low-cost goods they could source from China by 2008, thus production did not shift as had been hoped to these new free trade countries, but rather importers bided their time until quotas were removed from China.

As China's labor rates began to rise, neighboring countries became the new global producers, namely Cambodia and Vietnam. Ready access to innovative textile inputs in neighboring China made these countries in particular, and other ASEAN countries, attractive locations for cut, make and trim operations. The lack of a diverse and innovative vertical supply of inputs in the study countries has hampered production and investment.

Duty Free and Geographical Proximity: Limited Factors Considered in Sourcing Decisions

The subject countries have long relied on geographical proximity to the North American market and status a free trade partners or beneficiaries of unilateral preference programs as the incentive that will drive investment. As the data demonstrates, in image 1 below, duty free access and geographic proximity to the US market alone is not a significant enough factor to shift investment and production from Asia. Mexico is the highest-ranking free trade partner in market access to the U.S. at number seven with Honduras ranked number eight. Jordan and Nicaragua are also free trade partner countries and rank nine and ten.

In addition, the advantage of proximity to market has also not been a major contributing factor in making sourcing decisions, as the top five apparel providers are oceans away from the US, taking at least three weeks by ocean or more costly shipments by air.

Table: Major Shippers Report

MAJOR SHIPPERS REPORT
U.S. General Imports
By Category, 8/2020 Data

October 5, 2020

Category 0: TOTAL TEXTILE AND APPAREL IMPORTS (MFA)
Data in Million $$$

Country	Calendar Years 2018	2019	Year-to-Date 8/2019	8/2020	% Change	Year-Endings 8/2019	6/2020	7/2020	8/2020	YE 8/2020 % Change	% Share
WORLD	110939.53	111186.04	75737.368	55704.691	-26.45	114062.98	96317.565	93080.888	91153.368	-20.09	100.00
CHINA P	40563.951	36471.285	25402.429	15004.574	-40.93	40344.504	29183.039	27394.952	26073.430	-35.37	28.60
VIETNAM	12933.567	14435.294	9668.150	8709.029	-9.92	14009.914	13678.011	13500.046	13476.173	-3.81	14.78
INDIA	7669.834	8049.665	5579.547	4158.429	-25.47	8009.234	6901.398	6672.720	6628.547	-17.24	7.27
BNGLDSH	5606.698	6121.283	4227.427	3603.408	-14.76	6023.618	5482.569	5414.741	5497.264	-8.74	6.03
INDNSIA	4705.931	4714.078	3220.687	2589.565	-19.60	4758.075	4258.168	4195.828	4082.956	-14.19	4.48
MEXICO	4562.782	4365.622	3001.544	2149.883	-28.37	4498.643	3685.765	3598.876	3513.961	-21.89	3.85
CAMBOD	2556.190	3065.662	1980.982	2136.604	7.86	2847.115	3183.074	3232.092	3221.284	13.14	3.53
PAKISTN	2856.707	3046.329	2045.455	1747.593	-14.56	2989.627	2788.131	2739.397	2748.468	-8.07	3.02
HONDURA	2583.596	2825.553	1833.091	1044.448	-43.02	2762.463	2203.347	2091.984	2036.910	-26.26	2.23
TURKEY	1697.372	1848.994	1187.744	1161.722	-2.19	1755.821	1783.249	1803.220	1822.972	3.82	2.00
ITALY	1955.720	2006.020	1335.118	953.751	-28.56	1999.169	1688.343	1648.310	1624.653	-18.73	1.78
JORDAN	1488.262	1790.794	1179.705	1013.129	-14.12	1676.289	1742.668	1663.426	1624.218	-3.11	1.78
SRI LKA	1739.508	1805.325	1232.556	948.695	-23.03	1824.262	1590.125	1527.081	1521.464	-16.60	1.67
NICARAG	1630.649	1798.577	1166.294	850.813	-27.05	1750.463	1574.136	1517.133	1483.096	-15.27	1.63
SALVADR	1957.460	1917.354	1279.179	731.966	-42.78	1954.805	1480.291	1399.550	1370.141	-29.91	1.50
GUATMAL	1477.485	1427.976	984.783	758.397	-22.99	1460.730	1244.376	1218.247	1201.591	-17.74	1.32
CANADA	1356.943	1252.505	813.928	631.673	-22.39	1256.607	1107.841	1087.776	1070.250	-14.83	1.17
THAILND	1044.928	1139.504	758.543	665.280	-12.30	1109.980	1079.619	1059.963	1046.241	-5.74	1.15
EGYPT	1009.156	1134.026	763.752	616.463	-19.28	1093.611	1041.376	1012.254	986.737	-9.77	1.08
KOR REP	923.094	981.958	670.213	546.697	-18.43	983.908	889.960	869.477	858.442	-12.75	0.94
HAITI	926.349	998.839	682.578	450.924	-33.94	1015.621	832.979	787.583	767.185	-24.46	0.84
PHIL R	853.635	890.697	614.922	394.075	-35.91	892.318	734.720	694.692	669.850	-24.93	0.73
CHINA T	652.257	651.239	438.521	372.881	-14.97	656.026	603.812	593.555	585.599	-10.74	0.64
PERU	695.867	705.236	490.454	328.732	-32.97	719.485	567.975	551.000	543.514	-24.46	0.60
DOM REP	780.169	740.176	509.091	267.161	-47.52	779.098	539.911	508.732	498.246	-36.05	0.55

Historically, for many apparel brands such as PVH Corp., the "main investment drivers have traditionally been: access to quality materials at a reasonable cost, a labor market with relevant skills, access to ports, and assurance that laws that apply to investors and workers will be enforced"[1]. The dynamics impacting sourcing decisions have been changing over the past decade however, as the consumer has become more involved in "how" their goods are made. Exposés on working conditions, fires, building collapses etc. have impacted brands forcing them to become more diligent in sourcing and to consider more than just the lowest cost option. Environmental concerns and growing climate change rhetoric have influenced the need to minimize carbon footprints and have many corporations looking for alternatives.

Factor impacting sourcing decisions beginning to change.

Before the coronavirus pandemic, brands were already beginning to use new criteria to shape their sourcing decisions. As stated above, shareholders, consumers and other stakeholders are pressuring brands to source ethically. Not only from a corporate social responsibility perspective but to also examine if workers have safe workspaces, access to food and health, and the manufacturing process itself was not degrading the environment. This shift in focus is reflected through a recent study on sourcing decisions.

In the World Bank study "Looking Beyond the Horizon: A Case study of PVH's commitment to Ethiopia's Hawassa Industrial Park" an examination of the factors global sourcing brands consider when making new investment or sourcing decisions was undertaken. As noted above, historically brands like PVH Corp. focused on costs, labor force and shipping. But PVH undertook a bold new approach to making sourcing decisions in 2017 when it decided to find alternatives to China and traditional apparel makers.

Specifically, the report identified eight key parameters that the company used to guide them in their investment/sourcing decision:

- local cotton availability,
- Power cost and quality,
- wage cost,
- port connectivity,
- general infrastructure,
- government proactivity to attract textile investment,
- political stability and
- law and order.

These criteria resulted in three countries on the African continent for investment consideration: Ethiopia, Kenya and Ghana.

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[1] "Looking Beyond the Horizon: A Case study of PVH's commitment to Ethiopia's Hawassa Industrial Park" June 2017, Mamo Mihretu and Gabriela Llobet, World Bank Group.

Because the highest-level government officials of Ethiopia followed through on their commitments in building trust with the company as well as establishing a direct channel of communication with senior government officials, PVH Corp. determined to locate investment in Ethiopia.

Thus, brands had already begun reevaluating their historical approach to sourcing before the pandemic.

Pandemic impacts on sourcing.

The full extent of the corona virus' impact on sourcing is not yet known. However, we can draw some inferences from changes that have already taken place with respect to sourcing from El Salvador, Guatemala, Honduras, Mexico, Dominican Republic and Haiti.

Many manufacturers realized that with the closure of the U.S. retail juggernaut, they had to find an alternative to making shirts, skirts and shorts. The apparel industry in each of the subject countries quickly jumped into a "fight for your life" mentality and began identifying alternatives for production to keep their factories running. Each country in this study reacted differently, with those that limited factory shutdowns able to minimize negative economic impacts.

The dire immediate need in the U.S. and Canadian markets was for personal protective equipment (PPE) which the apparel industry was appropriately situated to meet. At the time of the pandemic, approximately ninety-five percent of all PPE was produced in China. However, apparel factories could quickly convert to making face coverings, patient gowns, head coverings, shoe coverings, sheets for hospital beds, etc. All of these products require limited sewing training, and the experienced hand of the apparel makers made the transition easy and quick.

While approval for patterns and fabrics traditionally could take weeks if not months, the extreme and immediate need forced all parties to act quickly. Approvals were granted rapidly, and sources were identified in a matter of days for the relevant fabrics, yarns, threads and trims needed to make the PPE.

The timeframe for conception to production transformed from months to days. The proximity of these countries to the U.S. and Canadian markets to make the PPE provided an advantage if the countries themselves did not close their manufacturing but worked with factories to implement the necessary health protocols enabling factories to remain operational.

Options for Sourcing in a Post Pandemic World.

Brands/retailers are also reexamining their dispersed sourcing schemes in the context of another pandemic. For supply chains that rely on cotton from one country, spinning in another, weaving in a third country, then cut, make and trim in a fourth country, the potential to be impacted multiple time by the virus exponentially increases. At each juncture of the supply chain, the possibility for work stoppage exists.

There is a desire by the government and many brands and retailers to produce closer to home through either "on shoring" or "near shoring" production. Another possible evolution in sourcing may be that brands/retailers begin to expand into more vertically integrated countries or regions as their sourcing for regional markets. They may move to a more 'hub and spoke' arrangement. For example, they may begin to produce in the Western Hemisphere (from dirt to shirt) for the Western Hemisphere market. They may produce in Africa for the European market and may produce in Asia for the Asian market. At each hub, they will look to developing a vertical production line so that all inputs are available for each target retail market.

Another approach is a rebalancing of sourcing options. Some brands found that while they produced in multiple countries, they had an overreliance on certain countries which did not allow them to shift production to a non-covid impacted supplier. For example, some brands found they had sixty percent of their supply in China, twenty percent in Bangladesh, fifteen percent in Central America and five percent in the United States. Because their sourcing was so heavily weighted in China, they are reexamining sourcing to balance the supply chain more effectively throughout the globe.

> In Central America and the Caribbean, the most connected ports in 2019 are Cartagena, Colombia; Manzanillo, Mexico; and Balboa, Panama; none in Central America.

Near Shoring/On Shoring.

At the same time, the United States especially, and North America in general, is reexamining global sourcing for many products and seeking a more contained value chain to be either domestic or "near" the market. Mexico has a land border and could service the needs for near shoring quickly, but El Salvador, Guatemala and Honduras countries and Dominican Republic and Haiti. also have the advantage of proximity. However, limitations exist with respect to frequency and availability of sailings to North America. The limitations for shipments and sailings can only be addressed if volumes increase in trade between the countries however[2]. In Central America and the Caribbean, the most connected ports in 2019 were Cartagena, Colombia; Manzanillo, Mexico; and Balboa, Panama,[3] none in Central America. Countries need to explore options to use the most connected ports in the short term through co-loading while efforts to increase port traffic in Honduras and the DR are put in place in the long term.

The near shoring approach can be a focus for both the North American Market and the South American markets. Mexico, Honduras, Guatemala, El Salvador, Haiti and Dominican Republic are poised to benefit in this scenario if they can integrate their supply chains with that of the U.S. industry sufficiently to tie them to supplying the North American Market.

Sustainability and Verticality.

The use of a hub and spoke or more vertical regional sourcing also meets the needs and demands of corporations seeking to become more sustainable and in reducing their carbon footprint. Legislation in

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[2] UNCTAD Review of Maritime Transport 2019. P. 32.

[3] Ibid. P 81.

the U.S. has repeatedly surfaced that would tax retailers based on the size of their carbon footprint. Brands are looking long term and see a growing trend towards a "green deal" that may force certain environmental reforms and/or taxes upon them. The EU has several member states that currently impose some form of carbon tax[4] and the EU as a whole is looking at a border carbon tax likely in 2021. Canada is not far behind the EU and due to the outcome of the U.S. Presidential elections and the Congressional elections, the Democrats will hold the White House and both chambers of Congress. As a result, the U.S. is expected to look at the possibility of a carbon border tax on imports.

U.S. brands that had sensed this impending pressure may not have been able to secure the support at the highest levels of the corporation to shift to more expensive suppliers that would reduce their carbon footprint, but with the advent of the coronavirus and the need for more verticality in the supply chain, corporations see an opportunity to address the issues simultaneously. In other words, they can justify the additional costs of shifting production to more expensive locations to demonstrate that it will protect investment and supply chains in the event of another pandemic and that it will help meet their corporate sustainability and environmental goals at the same time.

Retail impact on manufacturing:

An essential element to the productivity of El Salvador, Guatemala, Honduras, Mexico and Dominican Republic and Haiti. is to examine the impact of the pandemic on consumers. The pandemic has dramatically changed shopping experiences in North America, and it is possible that such changes will remain in effect for the foreseeable future. As a result, some companies were nimble and quick, making changes to address the shift from in person shopping experiences to on-line shopping.

Online shopping

According to Digital Commerce[5], "in August, online sales reached $63 billion, and the first eight months of 2020 generated $497 billion in online sales, according to Adobe. Since March, Adobe attributes the pandemic to an extra $107 billion spent online. As of August, 130 days in 2020 exceeded $2 billion in online sales, compared with 2019, when only two days exceeded $2 billion in online sales outside of the

[4] Carbon Taxes in Europe. Tax Foundation. https://taxfoundation.org/carbon-taxes-in-europe-2020/

[5] Digital Commerce, September 14, 2020. *"Online merchants gain an extra $107 billion in 2020 thanks to pandemic"*

holiday season.[6]" The data showed that daily apparel sales fell 3% in August compared with online daily sales in July according to Adobe. The data also showed that the average order value in August was $153.10 compared to $151.00 in July.

The countries in our paper have benefited from having free trade with the United States provided the goods meet the country of origin requirements. This advantage is disappearing with the advent of extensive on-line shopping and use of the section 321 *de minimis* provision.

Section 321 *De Minimis* Provision

The section 321 or *de minimis* provision, is a U.S. statute that allows an importer to import each day a certain value of merchandise that is duty/tax free. The United States amended its monetary ceiling to $800 from $200 under the 2015 Trade Facilitation and Trade Enforcement Act (TFTEA). To add more injury, currently, if a product is also subject to section 301 tariffs (China), using the section 321 *de minimis* provision will exempt the product from those additional tariffs too.[7]

Before the pandemic, Customs and Border Protection realized that increasing the *de minimis* ceiling would result in an increase in the number of entries made under this provision versus the traditional entry filing system with large volume cargo. The ability for a retailer to locate its e-commerce fulfilment center in a neighboring country and use a foreign warehouse as a "pick-and-pack" for e-commerce orders meant that importing the containers into the U.S. would no longer be required for this portion of a retailer's trade.

Due to the pandemic, companies had to reconfigure their sales strategies to shift more sales to an online platform and as a result, the additional costs associated with setting up a warehouse in Mexico or Canada to serve as the ecommerce fulfillment center became a justifiable expense as more sales moved online.

CBP had begun conducting two pilot programs to determine how frequently the *de minimis* entry process was being used after the limit was increased to $800[8]. Anecdotally, CBP saw that companies were moving warehousing for ecommerce to Mexico and Canada, but they had no data to support the shift because there was no "entry" type used for the *de minimis* entry; no classification, no duties paid, no documents filed.

To determine if the anecdotal evidence was supported, CBP set up two types of pilot projects on such. The first pilot program is a voluntary test of the utility of accepting advance data from e-commerce

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[6] Data is based on 18 product categories including apparel, electronics, home, grocery, appliance, person care, office supplies, books, jewelry, furniture and toys among others.

[7] CBP is currently preparing a Notice of Proposed Rule Making that will address section 321 de minimis entries which may alter this program; however, it cannot reduce the $800 ceiling; that can only be done by Congress. At the same time, the Office of Management and Budget is exploring whether it can mandate that CBP collect section 301 duties on *de minimis* entries. The current situation is undetermined and the outcome unknow as of the writing of this paper.

[8] CBP Section 321 Programs.

supply chain partners, including online marketplaces, for risk segmentation purposes. The data is being collected by the Automated Targeting System. The purpose of this pilot is to more clearly and accurately identify the entity causing the section 321 shipment to move, the final recipient and the contents of the package. This pilot is designed to ensure that the data transmitted in advance of the shipment arrival in the U.S. will help CBP target high-risk shipments for inspection as well as expedited the clearance of low-risk shipments[9].

The second pilot is a voluntary test of the commercial entry process through the creation of a new entry type "86". The entry type 86 will allow customs brokers and self-filers to electronically submit de minimis entries through the Automated Broker Interface (ABI) system including any shipments that may be subject to other government agency requirements. The purpose of the test is to provide greater visibility into the de minimis universe for both the CBP and other government agencies while ensuring that the regulatory requirements are met. These new type 86 entries allow for customs brokers and self-filers to electronically submit entries with a limited data set that is exempt from duty, taxes and fees[10].

CBP reported earlier in June of 2020 that from the time they began the pilot program through the end of February 2020, they had 6 million type 86 entries. For the month of March 2020 alone, over 6 million type 86 entries were filed and for the month of April, there were 11 million type 86 entries filed. CBP predicts that the type 86 entries will exceed the number of normal cargo entries in 2020. It is clear the number of *de minimis* entries were on the rise before the pandemic, but by March and April the sheer magnitude of these types of entries and the extensive use to which retailers were employing this technique to help avoid paying duties became more evident. The desire to save money, coupled with loss in sales, layered with additional duties if the goods were from China drove retailers to use this method of entry. Once ecommerce fulfillment centers are relocated, it will be difficult to reverse. One brand noted that they realized the same level of ecommerce shipments in the past six months as they had over the past six years. Many brands and retailers knew that shopping would shift to an online format, but the pandemic has exponentially increased the shift from in store experiences to online shipping and accelerated the process by as much as ten years.

Consumer Shopping Shifts

Prior to the pandemic, 84% of sales were in-store with 16% being online according to the Department of Commerce. When the global pandemic hit, retailers began to refocus their sales strategies to online sales to address this gross disparity in transactions.

According the U.S. Department of Commerce data and as reported in Digital Commerce 360 on November 19, 2020, nearly $1 in every $5 spent during Q3 of 2020 in the United States was from online orders.[11] Overall growth of ecommerce during this quarter was 37.1% or $199.44 billion up from $145.47

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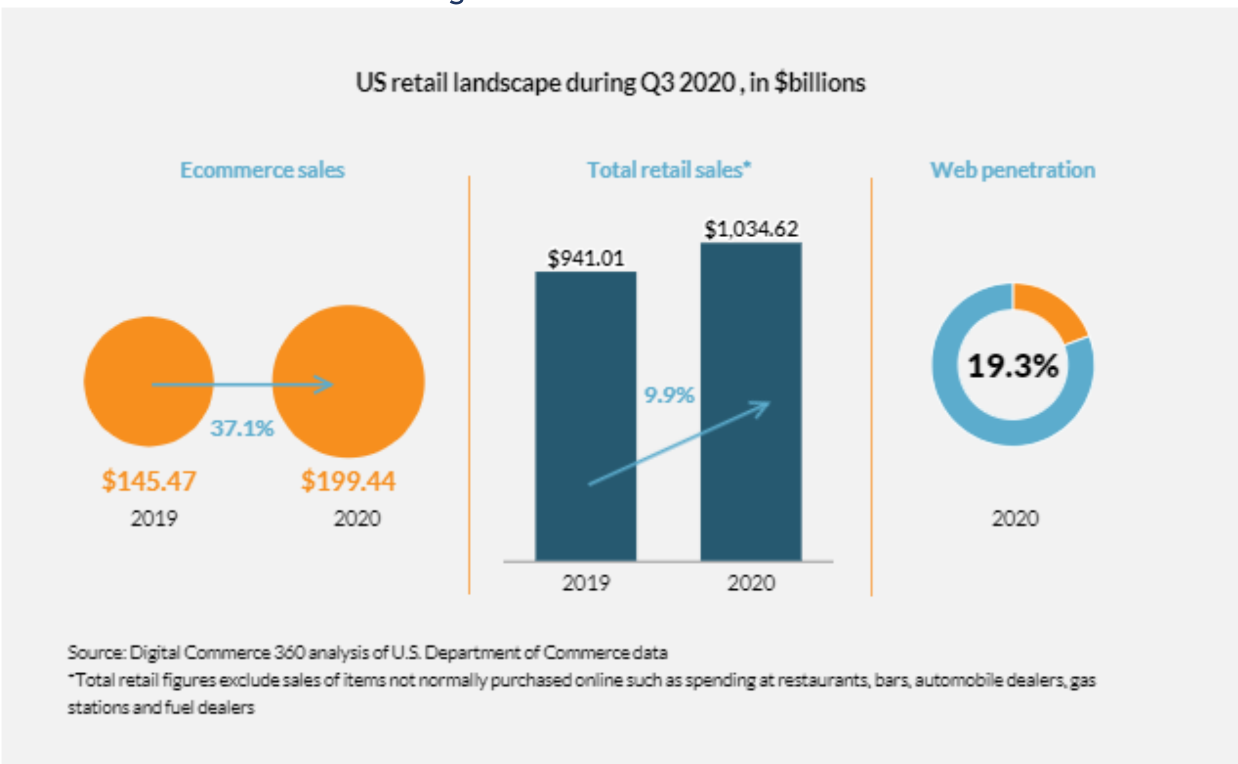
[9] Ibid.

[10] Ibid.

[11] US ecommerce sales jump 37% in Q3. Digital commerce 360, November 19, 2020.

billion spent in the same time frame in 2019. This growth was slower than the record-breaking 44.4% growth in Q2 due in part to the reopening of many retail operations. The image below demonstrates the growth.

Image 2: Growth in Online Sales



As stated previously, the data highlights the quick shift. Obviously, some retailers and brands have been more successful and transitioning to online sales than others. Because some brands and retailers were not positioned to move to online shopping, we are witnessing a number of apparel brands and retailers now facing bankruptcy and a need to reorganize. Many retailers are currently in discussions on restructuring to avoid bankruptcy. The study countries need to carefully watch the brands and retailers that enter into bankruptcy or other reorganization discussions to prepare for potential residual impact.

The result has been 610 bankruptcies as of Dec. 13[12], according to S&P Global Market Intelligence. That statistic is the highest it's been since 2012, according to the ratings agency and compares to 552 bankruptcies over the same period last year. (S&P tracks companies, private or publicly traded, with debt traded on the markets.)

[12] *U.S. Bankruptcies Surpass 600 in 2020 as coronavirus-era filings keep climbing.* S&P Global Market Intelligence. Dec. 15, 2020 https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-bankruptcies-surpass-600-in-2020-as-coronavirus-era-filings-keep-climbing-61734090

Table: Retail Bankruptcies

Top apparel brands and retailers that have filed for bankruptcy in 2020 (as of December 6, 2020) include:

At least 24 major apparel retailers filed for bankruptcy protection in the United States in 2020

Francesca's
Arcadia Group
Furla USA
G Star Raw
Aldo Group
John Varvatos
J. Hilburn
True Religion
Neiman-Marcus Group
J.C. Penney
Lucky Brand Dungarees
DVF Studio U.K.
Lulu Guinness
Brooks Brothers
RTW Retailwinds
Ascena
J. Crew
Rubies Costume Company
Stage Stores
Muji
Lord & Taylor
Tailored Brands
Steinmart
Century 21 Department Stores

Meanwhile, ecommerce has kept many companies alive and may yield flat growth for sales which is extremely impressive given the pandemic for the majority of 2020. As reported in Department of Commerce data and analyzed by ecommerce 360[13], online sales for Target increased 153% year over year for Q3 2020. The online purchases for Q3 more than doubled those of 2019 accounting for 15.7% of total sales during the period. This growth is an unprecedented advancement of online penetration in such a short timeframe.

Walmart ecommerce sales jumped 79% year on year in Q3 while Home Depot saw an increase of 80% in the same period. Amazon has seen growth as well up 42.6% over Q3 in 2019. Members of Amazon's popular Prime membership program that offers free two-day shipping and other perks are still shopping with greater frequency and across more categories than pre-pandemic.

[13] Ibid.

Erosion of Proximity to Market

The countries of El Salvador, Guatemala, Honduras, Mexico, Haiti and the DR have long relied on their close proximity to the United States as a strong selling point justifying investment in manufacturing. They further highlighted the duty-free access provided either under the free trade agreements or other preferential programs into the U.S. and Canadian markets.

As stated previously, the duty-free status as a benefit is dwindling as a result of increased imports using the *de minimis* provision to allow goods **of any origin** to enter the U.S. duty free provided they are shipped direct to the consumer and are less than $800 per day.

The geographic proximity has diminished in value as these countries variously imposed restrictions on internal manufacturing operations slowing down the supply chain. Further, sailings and frequencies have been reduced to the United States. In fact, there is an 8% projected drop in global container volume representing a revenue reduction of approximately US$18 billion for the container carrier sector. The impact of the COVID-19 pandemic on port performance in 2020 requires that all forecasts regarding stability and future growth be revised. While a projection made in the last quarter of 2019 foresaw 3.6% growth in container trade worldwide, the most recent estimate published in July points to a -7.2% drop.

Among all the ports selected in ECLAC's analysis of the January-June 2020 period, in Central America, the West Coast of South America (WCSA) and Mexico, activity levels fell on average in comparison with the same period of 2019. The WCSA showed the steepest decline, with a -15.0% year-on-year drop during that six-month time span. Mexico's Gulf and Pacific coasts suffered similar declines of -14.1% and -14.0%, respectively[14].

> Several brands noted that they believe one of the problems with development of apparel manufacturing in these countries is because they have had duty free access and close proximity to the North American market.

The average decline in selected Central American ports was -7.0% from January through June 2020, while the Caribbean ports under study marked an average decrease of -4.8% in the same period.

Several other issues are threatening to seriously disrupt container shipping including the challenge of repatriating seafarers whose employment contracts with ships have expired but cannot return to their home bases because of international travel restrictions.

If those crew members or their unions do not agree to contract extensions, ships will be under-manned and considered unseaworthy. That action will force more cancelled sailings and further disrupt global trade and supply chain.

The pandemic has made the distance between the U.S. and the study countries greater.

[14] Economic Commission for Latin America and the Caribbean. https://www.cepal.org/en/pressreleases/container-throughput-regions-ports-held-steady-2019-and-contracted-first-half-2020-due

Several brands noted that they believe one of the problems with development of apparel manufacturing in these countries is due to the fact that they have had duty free access and close proximity. They noted that the countries and the factories are not "hungry" for the market. Their perception is that the governments and the investors believe that the orders "should" come to them because of these benefits rather than seeking innovation, development and collaboration in the region as the investment attraction and becoming a manufacturing powerhouse. The fact that the benefits are in place have made the companies and countries "lazy and outdated". Several interviewed entities noted that the difference between visiting a factory in the study countries versus visiting a factory in Cambodia or Vietnam are the difference between "night and day". The investment is seeking innovation, driving production and expanding capacity and skills. Asian countries have a coordinated government approach to developing an education stream for management, technology, engineers and workers that does not exist to the scale or is coordinated in any significant manner in the study countries.

A recurring complaint among brands was that the governments in these countries viewed apparel manufacturers as a source of income rather than a source of employment and growth in the countries' GDP. They especially noted that the countries' governments vacillated wildly when a change in leadership occurred resulting in the investors feeling they were being "gouged" for more money and being used to resolve domestic revenue distress for the governments rather than being viewed as a partner that could help the governments address deficiencies. The lack of consultation and cooperation with investors and factories was raised frequently as an issue by brands and retailers.

Other issues raised were that the region has not "collaborated" but has "competed" against each other and against the region's best interests. The brands noted that while the countries at issue, with the exception of Mexico, do not have the ability to be individually vertically integrated, they are not using the resources they do have among each other and with the U.S. industry and Mexican industry to develop a vertically integrated bloc that could take advantage of the domestic actions on China, and the desire for near shoring of supply chains. But these actions require the governments and industry to collaborate not compete.

Taking Advantage of U.S. Policy Objectives

President Biden, former President Trump and many members of Congress have focused on the U.S. becoming more independent in its production of medical devices, medical equipment, PPE, drugs and therapeutics. Former president Trump issued Executive Order 13938, July 24, 2020, that specifically states the U.S. supports the "goal of safe importation of prescription drugs." Additionally, there is a strong focus on buying and using American products or near shoring the supply of goods especially in alliances with partner countries. Mexico, Guatemala, Honduras, El Salvador, Haiti and the Dominican Republic, as free trade partners or preferential access beneficiaries, are poised to benefit from the federal policies focusing on sourcing goods to the U.S. Given the apparel industry's long relationship with the U.S. yarn and fabric makers, it is easy to see how these countries could use their imports of fibers, yarns, fabrics, machinery etc. from the United States, the proximity to market and the existing relationships with U.S. companies to create a near shoring operation as an alternative to sourcing from China.

The Trump Administration also issued an executive order 13944 on August 6, 2020 regarding ensuring essential medicines, medical countermeasures, and critical inputs are made in the United States. The emphasis on the U.S. notwithstanding, the order recognizes that exceptions to the rule are necessary when such inputs are not made in the United States. As free trade allies, these countries can work with the U.S. government to become exceptions to the rule allowing participation in this market into the U.S.

U.S. Policy action on competitor nations.

In addition, the U.S. is targeting certain countries for trade transgressions. Most well-known are the actions taken under Section 232 of the Trade Expansion Act of 1962 and Section 301 of the Trade Act of 1974 against China and potentially other countries. The modus operandi of this former Trump Administration was to take action regardless of statutory limitations and maintain the action until such time as the courts rule against the President. In the interim, the actions remain in place and dissuade companies from sourcing in the targeted countries, especially China.

If the study countries wanted to take advantage of the more than $550 billion in additional duties being levied on Chinese goods, they need to offer a secure advantage to brands and retailers to get them to look again sourcing from the region.

On July 20, the Department of Commerce added eleven new entities to its entity list which restricts the export of U.S. technology and other goods to those on the list[15]. This list included apparel supply chain companies. On July 31, the Department of Treasury's Office of Foreign Assets Control named the Xinjiang Production and Construction Corporation (XPCC) as a "specially designated national" making it illegal to undertake any action that results in a financial benefit directly or indirectly to the XPCC or to any entities control singly or collective by entities with 50% or more XPCC involvement[16]. This listing on the sanctions list is a severe blow to trade from the Xinjiang Uyghur Autonomous Region (XUAR) region.

The XUAR region is responsible for more than 80% of all the cotton grown in China. The raw fibers, or yarns or fabrics made using cotton that may have been grown in Xinjiang will represent a violation of the OFAC sanctions. Apparel companies are fleeing China in record numbers to avoid violating U.S. sanctions law.

On November 30, the Department of Homeland Security's Customs and Border Protection issued a withhold release order[17] on cotton from XPCC and its subordinate and affiliated entities. This action differs from the OFAC action because it addresses the "goods" not the transactions. As a result, goods that may contain XPCC cotton will be detained at the border and until such time as importers can demonstrate that such goods do not have XPCC cotton in their supply chain, they will not be allowed into the country. Importers will have the option to export the alleged offending goods or to prove that there is no XPCC cotton in the good.

[15] Bureau of Industry and Security, Federal Register, Vol. 85, No. 141, Wednesday July 22, 2020, p. 44159 – 44170.

[16] Office of Foreign Assets Control, Federal Register, Vol 85, No. 152, Thursday August 6, 2020, p. 47838 – 47840.

[17] CBP Detention Orders (Withhold Release Orders).

But it is not just the administration that is targeting China. On September 22, the House of Representatives passed the Uyghur Forced labor Prevention Act[18] which states that all goods, wares, articles and merchandise mined, produced, or manufactured wholly or in part in the Xinjian Uyghur Autonomous Region of China, or by persons working with the XUAR government for purposes of the "poverty alleviation" program or the "pairing assistance" program which subsidizes the establishment of manufacturing facilities in the XUAR shall be deemed to be made with forced labor and therefore banned from import under section 1307 of the tariff Act of 1930. While this bill died in the 116th Congress, its sponsors have already indicated their intent to reintroduce the measure. The bill is before the Senate pending action.

This legislation is even more impactful than the CBP WRO on XPCC cotton as it will pertain to any goods that were made/grown in XUAR and not just if they were affiliated with an XPCC entity. If this act becomes law, the subject countries will have an even greater opportunity to attract investment in this hemisphere vs. sourcing from China in large part because the source of the cotton yarns is traceable. In this instance, the free trade rules of origin will provide clear benefits to apparel brands seeking to ensure that from "dirt to shirt" they have visibility into the supply chain.

Regardless of the fact that the legislation did not pass Congress, CBP took additional steps on January 13, 2021 to ban imports of all cotton and cotton containing products produced in China's XUAR[19] based on information that reasonably indicates the use of detainee or prison labor and situations of forced labor.

Canada too, has undertaken action to prevent the importation of goods made using forced labor. On July 1, 2020, amendments to Canada's Customs Tariff officially prohibited the importation of goods that are mined, manufactured or produced wholly or in part by forced labor.

On January 12, 2021, Canada announced a seven-pronged approach to address such goods including:

1. The Prohibition of imports of goods produced wholly or in part by forced labor;
2. A Xinjiang Integrity Declaration for Canadian companies;
3. A Business Advisory on Xinjiang-related entities;
4. Enhanced advice to Canadian businesses;
5. Export controls;
6. Increasing awareness for Responsible Business Conduct linked to Xinjiang; and
7. A Study on forced labor and supply chain risks.

[18] H.R. 6210

[19] https://www.cbp.gov/newsroom/national-media-release/cbp-issues-region-wide-withhold-release-order-products-made-slave

Additional information as to how Canadian Customs will implement the ban are expected in early 2021. Further, Canada's Parliament is, similar to the U.S. Congress, attempting to implement a law that will impose reporting obligations on entities involved in the production of goods in Canada or elsewhere or in the importation of goods produced outside Canada including a requirement to make the report available to the public on its website, requires supply chain transparency and would impose fines of up to $250,000 per instance of non-compliance.

Further, the U.S. launched a section 301 investigation on Vietnam into the acts policies and practices related to currency valuation[20] and into the act, policies and practices related to the import and use of illegal timber[21]. The USTR determined that Vietnam did indeed undervalue its currency and that such undervaluation damaged U.S. interests, but it deferred taking any action given the transition in the Presidency[22]. The investigation on illegally harvested timber will be concluded by the Biden Administration. If the Biden Administration decides to take action it could impose section 301 tariffs on Vietnam's exports which could include apparel. Vietnam is the second largest supplier of apparel to the United States.

China has been the dominating global player in the production of Personal Protective Equipment (PPE). PPE includes not only masks, but medical scrubs, sheets, gloves, foot covers, headcovers, etc. With respect to other products required to fight a pandemic, the U.S. is focused on removing over reliance on external providers.

The actions taken by the US government to remove China from the supply chain, to reduce over reliance on foreign producers, to have traceability into the fully supply chain and to near shore production with allies, opens opportunities for the study countries, provided they approach the opportunity with a comprehensive and collaborative approach.

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[20] Federal Register, Vol. 85, No. 196, Thursday, October 8, 2020 pp. 63637-63638.

[21] Federal Register, Vol. 85, No. 196, Thursday, October 8, 2020 pp. 63639-63640.

[22] Federal Register, Vol. 86, No. 13, Friday, January 22, 2021 pp. 6732 – 6733.

USMCA – Changes from the NAFTA

The USMCA made some significant changes to the NAFTA in the textile and apparel sector, but these changes aligned it with the rules of origin in place with the Central American- Dominican Republic Free Trade Agreement rules. Specifically, the following rules were added:

1. Pocket bag fabric must originate in a Party;
2. Sewing Thread must originate in a Party;
3. Narrow elastic fabrics must originate in a Party;
4. Coated fabrics must originate in a Party;
5. Tariff Preference Levels were decreased and adjusted;
6. New Customs Enforcement provisions;
7. TSA uniforms moved to the non-conforming measures;
8. Increased the de minims provision to 10%;
9. Removed the requirement for non-visible lining fabric to originate; and
10. Allow non-originating rayon fibers to be used.

Each of these changes was already a part of the CAFTA-DR. These changes were in large part more restrictive. The increase to 10% (from 7% de minimis) offers the ability to use non-U.S., Mexico or Canadian inputs and lifting the restriction on originating for non-visible linings will allow opportunities for such products made globally.

One significant change to the UMCA that may have repercussions in the textile and apparel sector is the requirement for a "labor value" content rule for autos. That rule requires that certain autos be made using 40-45% auto content that was made by workers earning at least $16 per hour. Some analysts predict that the increased wage will attract more workers to the auto industry making the retention of trained and qualified workers more competitive. It could mean that apparel workers are attracted to jobs in the automotive sector. This pull in the labor force could then result in the need to increase wages in the textile and apparel sector to retain workers.

If the wages in Mexico increase in areas outside the automotive sector, it is possible the pressure for increased wages will radiate to other manufacturers in the region, in particular, El Salvador, Guatemala and Honduras. The other indication from the USMCA changes that may impact the study countries is that if the U.S. were to "update" the CAFTA-DR, it is very likely that USMCA similar provisions will be inserted into a new agreement.

Part II: Current State of Regional Integration in the Textile and Apparel Sector

Overview

Import and export data for El Salvador, Guatemala, Honduras, Dominican Republic, Haiti and Mexico show:

1. relatively high degrees of integration[23] between the textile and apparel sectors of El Salvador, Guatemala and Honduras, and particularly between the textile and apparel sectors of the Dominican Republic and Haiti;

2. a low degree of integration between the textile and apparel sectors of El Salvador, Guatemala, Honduras, and Mexico; and

[23] For purposes of this paper, integration is defined as the level of trade between and among the study countries in the textile and apparel sector.

3. a very low degree of integration between the textile and apparel sectors of Dominican Republic, Haiti and El Salvador, Guatemala and Honduras as well as between the textile and apparel sectors of Mexico, Dominican Republic and Haiti.

Additionally, there is a high degree of integration between Mexico and the U.S., both in imports and exports, as well as high integration on the import side between the Dominican Republic / El Salvador and the U.S.

The two tables immediately below show, for each country under consideration, the share of their textile input exports that are shipped to regional[24] markets including the U.S., and the share of their textile input imports that come from regional suppliers as well as the U.S.

In addition, for purposes of this analysis the term "textile inputs" comprises goods classified under HS Chapter 50 through 56 and 58 through 60. These chapters include almost exclusively raw materials and intermediate goods, although a very small share of goods intended for final sale to the consumer (e.g., sewing thread put up for retail sale) does fall within these chapters. The term "textile inputs" does not include apparel parts of subheadings 6117.90 or 6217.90 or semi-finished apparel of HS Chapters 61 or 62.

Table One: Exports of Textile Inputs in 2019 – % Share Held by Regional Markets and the U.S.

Export Market

Exporter	Mexico	El Salvador	Honduras	Guatemala	DR	Haiti	Northern Triangle	U.S.
Mexico		1.5	1.9	2.3	0.4	0.8	4.1	41.2
El Salvador	3.0		54.4	23.8	0.9	0.2	78.2	4.1
Honduras	n/a	n/a		n/a	n/a	n/a	n/a	n/a
Guatemala	5.7	33.9	24.6		2.4	1.8	58.5	2.2
DR	0.3	0.4	1.6	0.0		83.4	2.0	8.2
Haiti	n/a	n/a	n/a	n/a	n/a		n/a	n/a

Note: Available trade data for Honduras does not include trade by free zone companies, greatly diminishing its usefulness. Accordingly, those statistics are not being considered in this analysis.

Source: Calculated from UN Comtrade and DR Customs data.

[24] For purposes of this analysis, the terms "region" and "regional" encompass El Salvador, Guatemala, Honduras,, Dominican Republic, Haiti and Mexico, but do not include other Central American countries or the U.S. Given the importance of the U.S. as a textile input supplier, however, supplementary tables are provided adding the U.S. to the regional grouping.

Table Two: Imports of Textile Inputs in 2019 – % Share Held by Regional Suppliers and the U.S.

	Supplier							
Importer	**Mexico**	**El Salvador**	**Honduras**	**Guatemala**	**DR**	**Haiti**	**Northern Triangle**	**U.S.**
Mexico		0.2	0.6	0.3	0.1	0.0	0.9	51.7
El Salvador	1.7		6.3	10.3	0.0	0.0	16.7	56.6
Honduras	n/a	n/a		n/a	n/a	n/a	n/a	n/a
Guatemala	5.6	10.7	5.8		0.0	0.2	16.5	24.7
DR	1.1	0.5	1.2	0.9		0.1	2.5	68.4
Haiti	n/a	n/a	n/a	n/a	n/a		n/a	n/a

Note: Available trade data for Honduras does not include trade by free zone companies, greatly diminishing its usefulness. Accordingly, those statistics are not being considered in this analysis.

Source: Calculated from UN Comtrade and DR Customs data.

The two tables immediately below show the share of textile input imports supplied by regional partners as well as regional partners plus the U.S. Table Three clearly shows that textile input imports from regional partners are moderate at best and that most inputs continue to be sourced from non-regional suppliers. Regional integration on the import side has increased in Guatemala, with the share of textile inputs supplied by regional partners growing from 16.7 percent in 2015 to 22.3 percent in 2019. In the case of El Salvador, that share grew from 17.1 percent in 2015 to 18.3 percent in 2019. On the other hand, the shares of textile input imports accounted by regional suppliers in Mexico and the DR are very low and either stable or falling.

Table Three: Total Imports of Textile Inputs as % Share of Total – Regional vs. Non-Regional

Country	2015	2017	2019	% Change 2015/19
Imports from Regional Partners 1/				
Guatemala	16.7	18.8	22.3	5.6
El Salvador	17.1	18.5	18.3	1.2
DR	7.7	4.5	3.7	-4.0
Mexico	1.1	1.1	1.2	0.1
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a
Imports from Non-Regional Partners				
Mexico	98.9	98.9	98.8	-5.6
DR	92.3	95.5	96.3	4.0
El Salvador	82.9	81.5	81.7	-1.2
Guatemala	83.3	81.2	77.7	-0.1
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a

1/ This includes imports from El Salvador, Guatemala, Honduras,, Dominican Republic, Haiti and Mexico, but does not include other Central American countries or the U.S.

Source: Calculated from UN Comtrade and DR Customs data.

As shown in Table Four below, the share of textile input imports supplied by regional partners increases substantially if the U.S. is included in that calculation, highlighting the historical and continuing importance of the U.S. as a textile input supplier to Mexico, Central America and the Caribbean Basin. In the case of El Salvador, that share jumps from 18.3 percent without the U.S. to 75.0 percent with the U.S., in the case of the DR it soars from 3.7 percent to 72.1 percent, in the case of Mexico it increases from 1.2 percent to 52.9 percent, and in the case of Guatemala it increases by a more moderate margin, from 22.3 percent to 46.9 percent.

Table Four: Total Imports of Textile Inputs as % Share of Total – Regional Plus USA vs. Non-Regional

Country	2015	2017	2019	% Change 2015/19
Imports from Regional Partners Plus USA				
El Salvador	77.0	75.0	75.0	-2.0
DR	66.0	71.3	72.1	6.1
Mexico	60.0	57.2	52.9	-7.2
Guatemala	43.6	46.9	46.9	3.3
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a
Imports from Non-Regional Partners Less USA				
Guatemala	56.4	53.1	53.1	-3.3
Mexico	40.0	42.8	47.1	7.2
DR	34.0	28.7	27.9	-6.1
El Salvador	23.0	25.0	25.0	2.0
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a

Source: Calculated from UN Comtrade and DR Customs data.

2. Dominican Republic-Haiti

The highest degree of integration is found in Dominican Republic and Haiti, with Haiti accounting for an estimated 83.4 percent of the DR's total exports of textile inputs in 2019. This share stood at 72.4 percent in 2017 and 92.2 percent in 2015. These textile materials include fabric produced at Hanesbrands' mill in Bonao as well as various inputs produced by Grupo M in Santiago's Caribbean Industrial Park free zone. DR imports of textile raw materials from Haiti are negligible, accounting for 0.1 percent of total DR imports in both 2015 and 2019 as well as 0.3 percent of such imports in 2017. This marginal share is not surprising, as Haiti is not – and is not expected to be – a significant producer of textile inputs and any such inputs produced domestically are primarily consumed by its apparel exporting sector.

While it is not always obvious from the data, there is also a substantial amount of bi-national trade in semi-finished apparel and apparel components as part of well-established co-production activities that involve cutting, sewing and finishing operations in both the DR and Haiti, where capital-intensive activities as well as activities requiring more skilled labor take place in the DR and labor-intensive operations take place in Haiti.

For example, the data show that 84.5 percent of the US$9.4 million worth of woven apparel that the DR exported to Haiti in 2019 were woven apparel parts of subheading 6217.90 used in assembly operations. And in the case of knitted apparel, the vast majority of the US$103.2 million worth of such apparel that the DR exported to Haiti in 2019 is believed to be semi-finished apparel or apparel components ready for assembly.

DR-Haiti integration is expected to remain robust following the current model. Of particular importance in this regard is Haiti's ability to continue to increase – or at least preserve – its share of U.S. apparel imports (that share stood at 1.5 percent in quantity terms and 1.2 percent in value terms in 2019, up from 1.2 percent in quantity terms and 1.1 percent in value terms in 2015), as well as the preservation of the HOPE and CBTPA trade preference programs in place in the U.S. for Haiti.

3. Northern Triangle

Integration between the textile and apparel sectors of El Salvador, Guatemala and Honduras countries is also relatively high, with exports playing a much more significant role than imports. The data show that El Salvador and Honduras combined accounted for 58.5 percent of Guatemala's total exports of textile inputs in 2019, down somewhat from 61.5 percent in 2017 and 61.1 percent in 2015. In the case of El Salvador, Guatemala and Honduras represented 78.2 percent of its exports of textile inputs in 2019, up from 76.4 percent in 2017 and 73.7 percent in 2015.

By contrast, imports of textile inputs from other Northern Triangle countries accounted for just 16.5 percent of Guatemala's total imports of textile inputs in 2019, up from 13.8 percent in 2017 and 11.6 percent in 2015, while such imports accounted for 16.7 percent of El Salvador's total imports of textile inputs in 2019, down slightly from 16.8 percent in 2017 but up from 14.8 percent in 2015.

Looking at individual Northern Triangle countries, Guatemala is currently significantly more integrated with El Salvador than with Honduras. Specifically, El Salvador represented 33.9 percent of Guatemala's exports of textile inputs in 2019, compared to Honduras' 24.6 percent. Then again, El Salvador's share has declined from 43.0 percent in 2017 and 40.1 percent in 2015, while Honduras' share has increased from 18.5 percent in 2017 and 21.0 percent in 2015. El Salvador also accounted for 10.7 percent of Guatemala's total imports of textile inputs in 2019, compared to Honduras' 5.8 percent, although Honduras' share rose from 2.1 percent in 2015 and 3.1 percent in 2017 while El Salvador's share has seen more modest growth, from 9.5 percent in 2015 and 10.6 percent in 2017.

El Salvador, meanwhile, relies more heavily on Honduras as a destination of domestically produced textile inputs but has a greater dependence on Guatemala for imported textile inputs. Specifically, Honduras accounted for 54.4 percent of El Salvador's total exports of textile inputs in 2019, up from 52.8 percent in 2017 and 44.7 percent in 2015, while Guatemala held shares of 28.9 percent in 2015, 23.6 percent in 2017 and 23.8 percent in 2019. On the other hand, Guatemala accounted for 10.3 percent of El Salvador's total imports of textile inputs in 2019 (up from 7.0 percent in 2015 and 10.1 percent in 2017), compared to Honduras' 6.3 percent (down from 7.8 percent in 2015 and 6.7 percent in 2017).

In general, the data suggest that, while the Northern Triangle is a key market for regional producers of textile inputs, those inputs still account for a relatively modest share of the textile inputs needed by regional textile and clothing producers for their export-oriented production operations, including apparel exports to the U.S. There is therefore considerable room to ramp up sourcing of textile inputs from the region while further reducing the Northern Triangle's reliance on non-regional inputs. In this regard, there could be opportunities to reduce the share of imported textile inputs held by China (15.8 percent in El Salvador and 29.0 percent in Guatemala in 2019) and/or the U.S. (56.6 percent in El Salvador and 24.7 percent in Guatemala in 2019).

Increased collaboration between El Salvador, Guatemala and Honduras countries to determine the availability of specific textile inputs in the region that could potentially be used in regional textile and apparel production, including current and projected production capacities by yarn spinners and fabric mills (especially knitted fabric mills) and information regarding product specifications and pricing, would be desirable in this regard, in addition to any efforts designed to attract domestic and foreign investment to the textile and apparel sectors across El Salvador, Guatemala and Honduras.

4. Northern Triangle and Mexico

The free trade agreement between El Salvador, Guatemala and Honduras and Mexico does not appear to have had a significant effect on textile and apparel integration. Mexico's exports of textile inputs to El Salvador, Guatemala and Honduras accounted for a relatively modest 4.1 percent of total exports of such inputs in 2019, down from 5.6 percent in 2017 and 5.3 percent in 2015. And Mexico's imports of textile inputs from the Northern Triangle region accounted for an even lower 0.9 percent of total imports of such inputs, compared to 0.8 percent in 2017 and 0.9 percent in 2015.

The textile and apparel sectors of Mexico and Guatemala are somewhat more integrated than those of Mexico and El Salvador. In the case of Guatemala, Mexico accounted for 5.7 percent of total exports of textile inputs by that country in 2019, down from 8.5 percent in 2017 and 10.1 percent in 2015, and held a 5.6 percent share of total imports of textile inputs by Guatemala in 2019, up from 5.0 percent in both 2017 and 2015. In the case of El Salvador, Mexico accounted for 3.0 percent of total exports of textile inputs by that country in 2019, down from 3.8 percent in 2017 and 3.6 percent in 2015, and held a 1.7 percent share of total imports of textile inputs by El Salvador in 2019, compared to 1.7 percent in 2017 and 2.3 percent in 2015.

While the primary focus of Mexico's textile and apparel sector currently is and is expected to remain the U.S., efforts could be undertaken by both Mexican and Northern Triangle stakeholders to ascertain whether there could be opportunities to enhance regional integration at least to some degree. Mexico specializes in denim fabric production and while the Northern Triangle has a relatively small denim apparel segment, it may be possible to, for example, increase shipments of such fabric for denim trouser production in Guatemala. Mexico, a relatively large producer of nonwoven fabric, could also be a source of such fabric for Northern Triangle production of face masks and medical/hospital clothing.

5. Dominican Republic, Haiti and Northern Triangle

There is a very low degree of integration between the textile and apparel sectors of Dominican Republic, Haiti and El Salvador, Guatemala and Honduras. DR exports of textile inputs to El Salvador, Guatemala and Honduras accounted for just 2.0 percent of total exports of such inputs in 2019, up from 1.8 percent in 2017 and 0.9 percent in 2015. And in the case of DR imports, the Northern Triangle's share stood at 2.5 percent in 2019, unchanged from 2017 and down from 3.7 percent in 2015.

Data for Guatemala show that exports of textile inputs to the DR and Haiti accounted for 2.4 percent and 1.8 percent, respectively, of that country's total exports of such inputs in 2019, compared to 3.1 percent (DR) and 1.0 percent (Haiti) in 2017 and 2.3 percent (DR) and 0.6 percent (Haiti) in 2015, while imports from the DR held negligible shares of 0.03 percent or less during those three periods and imports from Haiti held shares of 0.03 percent to 0.2 percent.

In the case of El Salvador, exports of textile inputs to the DR and Haiti represented 0.9 percent and 0.2 percent, respectively, of total textile input exports by El Salvador in 2019, compared to 1.2 percent (DR) and 0.1 percent (Haiti) in 2017 as well as 1.3 percent (DR) and 0.2 percent (Haiti) in 2015. El Salvador's imports of textile inputs from the DR and Haiti combined accounted for 0.02 percent or less of total imports of textile inputs during those three periods.

These shares are low despite the fact that Central America and the DR have two free trade agreements in place: CAFTA-DR and the Central America-Dominican Republic Free Trade Agreement. With substantial room to grow in the coming years, these agreements should be used as a basis to foster increased co-production activities between these two sub-regional groups. In addition, Haiti's continuing relevance as a low-cost supplier to the U.S. combined with its lack of a developed textile sector offer significant opportunities to the textile sectors of Northern Triangle countries, particularly producers of knitted fabrics, narrow fabrics and trim.

6. Dominican Republic, Haiti and Mexico

The degree of integration is also very low in the case of Dominican Republic and Haiti and Mexico, which is not surprising given the already low level of integration between Mexico and the neighboring Northern Triangle countries as well as the lack of a free trade agreement or partial trade arrangement between Mexico and both the DR and Haiti. Only 0.4 percent of Mexico's exports of textile inputs in 2019 went to the DR, down from 1.3 percent in 2017 and 2.8 percent in 2015, while 0.8 percent of Mexico's exports of textile inputs in 2019 went to Haiti, up from 0.2 percent in both 2017 and 2015. Similarly, only 0.3 percent of the DR's exports of textile inputs went to Mexico in 2019, compared to 0.4 percent in 2017 and 0.02 percent in 2015.

In the case of imports, a meager 0.1 percent of Mexico's total imports of textile inputs originated in the DR 2019, up from 0.02 percent in 2017 and 0.01 percent in 2015, and zero percent of such inputs originated in Haiti during 2015-2019. Additionally, 1.1 percent of the DR's imports of textile inputs came from Mexico in 2019, down from 1.7 percent in 2017 and 3.9 percent in 2015.

To be sure, the prospects for increased integration between Dominican Republic and Haiti and Mexico are likely to remain low until a comprehensive trade arrangement is negotiated and implemented. Then again, Mexico's well-developed and diversified textile sector could take advantage of Haiti's continuing need for textile inputs for its apparel production operations to further strengthen export flows to that country in the years ahead. Additionally, the Dominican Republic – already a significant producer and exporter of a broad range of medical supplies – could take advantage of the nonwoven fabric capabilities of Mexico to import that fabric for production of face masks and medical/hospital clothing and supplies. Moreover, there is some denim apparel production in the DR that could potentially look into increasing imports of Mexican denim fabric.

Verticalization Trends in the Textile and Apparel Sector and Future Opportunities

Overview

While verticalization in the textile and apparel sector has continued to grow at a steady pace at both the regional and sub-regional levels over the past decade, imported textile inputs – including inputs from CAFTA-DR / USMCA partners the U.S. – still account for a substantial share of the value of regional textile and apparel exports. In El Salvador, Guatemala, Honduras, Dominican Republic and Haiti,, verticalization has mainly focused on the production of fabric – particularly knitted fabric – as well as various trim and related accessories. This has been the case, in particular, in Honduras, the DR and El Salvador. Mexico has a larger, more consolidated textile manufacturing sector but still counts on the U.S. for over US$500 worth of yarn imports and over US$3,700 million worth of fabric imports each year.

As shown in Table Five, Mexico imported an estimated US$5,659.0 million worth of textile inputs from "non-regional partners"[25] in 2019, making it by far the largest importer of such inputs in the region. However, such imports fell by 8.7 percent from 2015 to 2019. Imports of textile inputs from non-regional partners by El Salvador totaled US$830.0 million in 2019, down by 6.6 percent from US$888.3 million in 2015, while imports of textile inputs from non-regional partners by Guatemala totaled US$704.3 million

[25] As previously noted, for purposes of this analysis regional partners comprise Mexico, El Salvador, Guatemala and Honduras, Dominican Republic, Haiti while non-regional partners comprise all other countries.

in 2019, down by 15.0 percent from US$828.2 million in 2015. In the case of the DR, imports of textile inputs from non-regional partners declined from US$802.2 million in 2015 to US$689.9 million in 2019.

Table Five: Total Imports of Textile Inputs in US$ – Regional vs. Non-Regional

Country	2015	2017	2019	% Change 2015/19
Imports from Regional Partners 1/				
Guatemala	165,764,614	161,996,607	201,586,662	21.6
El Salvador	183,471,213	185,239,540	186,434,245	1.6
Mexico	69,124,928	64,122,863	69,436,883	0.5
DR	66,876,580	33,413,049	26,392,019	-60.5
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a
Imports from Non-Regional Partners				
Mexico	6,197,086,095	5,990,224,929	5,658,955,531	-8.7
El Salvador	888,317,926	814,175,591	830,002,277	-6.6
Guatemala	828,242,668	699,322,043	704,266,834	-15.0
DR	802,179,869	714,909,661	689,910,072	-14.0
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a

1/ This includes imports from El Salvador, Guatemala and Honduras, Dominican Republic, Haiti and Mexico, but does not include other Central American countries or the U.S.

Source: Calculated from UN Comtrade and DR Customs data.

Not surprisingly, imports of textile inputs from non-regional suppliers would be substantially lower if the U.S. were considered a regional supplier, as shown in Table Six. Then again, there would still be over US$3.6 billion worth of textile inputs imported by the region from Asian and other non-regional suppliers, including US$2,699.5 million by Mexico, US$480.6 million by Guatemala, US$254.4 million by El Salvador and US$199.7 million by the DR.

Table Six: Total Imports of Textile Inputs in US$ – Regional Plus USA vs. Non-Regional

Country	2015	2017	2019	% Change 2015/19
Imports from Regional Partners Plus USA				
Mexico	3,761,683,327	3,460,368,633	3,028,891,157	-19.5
El Salvador	825,276,422	750,039,350	762,005,953	-7.7
DR	573,690,295	533,354,288	516,624,330	-9.9
Guatemala	433,883,589	403,608,887	425,220,255	-2.0
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a
Imports from Non-Regional Partners Less USA				
Mexico	2,504,527,696	2,593,979,159	2,699,501,257	7.8
Guatemala	560,123,693	457,709,763	480,633,241	-14.2
El Salvador	246,512,717	249,375,781	254,430,569	3.2
DR	295,366,154	214,968,423	199,677,761	-32.4
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a

Source: Calculated from UN Comtrade and DR Customs data.

The declines in imports of non-regional textile inputs are attributable to a combination of factors, including growing textile and apparel industry verticalization within certain individual countries, increased integration with regional partners, and, in the case of the DR, falling textile and apparel exports which lessen the need for textile inputs in general.

In the case of Guatemala and El Salvador, which registered textile and apparel export growth of 8.9 percent and 2.4 percent, respectively, during 2015-2019, the driving factors appear to be increased industry verticalization as well as increased regional integration. In the case of Mexico, meanwhile, its 8.8 percent growth in textile and apparel exports from 2015 to 2019 has seemingly come hand-in-hand with increased verticalization, while progress in regional integration efforts has been limited.

Table Seven: Total Exports of Textiles and Apparel (HS Chapters 50-63) in US$

Country	2015	2017	2019	% Change 2015/19
Mexico	6,785,466,549	6,433,122,280	7,380,537,258	8.8
El Salvador	2,552,403,226	2,617,132,136	2,612,470,896	2.4
Guatemala	1,611,690,393	1,634,844,112	1,754,746,198	8.9
DR	1,090,750,062	888,177,945	835,973,202	-23.4
Honduras	n/a	n/a	n/a	n/a
Haiti	n/a	n/a	n/a	n/a

Source: UN Comtrade and DR Customs data.

In the context of textile and apparel verticalization and regional integration, the still substantial magnitude of imports of textile inputs from non-regional partners may be viewed as opportunities for further verticalization and regional integration. Such opportunities appear more feasible in fabrics and trim and are likely more challenging in the case of yarn, raw cotton and manmade staple fibers. A critical factor to consider in this regard is that various large apparel manufacturers in the region – such as Hanesbrands and Gildan – already make fabric in the region but source their yarn from facilities in the U.S., which have access to an ample supply of U.S. raw cotton, while other regional producers have longstanding business relationships with U.S. yarn spinners that are likely to persevere in the years ahead.

Accordingly, while this analysis may identify various textile product categories where there may be opportunities for increased verticalization and regional integration, the production and sourcing matrices of every major apparel manufacturer in the region need to be considered individually in order to determine which specific inputs may be feasibly produced regionally in either the short, medium or long terms, both by taking advantage of existing production capacity, expanding capacity at existing facilities, and attracting investment to develop additional textile input capacity.

An important aspect to consider relates to the fact that a significant share of U.S. apparel imports from the region do not currently benefit from duty-free treatment under either the CAFTA-DR or USMCA because they do not meet the applicable origin rules. Assuming the apparel complies with all other applicable requirements, use of domestic or CAFTA-DR inputs (domestic or USMCA inputs in the case of Mexico) in lieu of non-qualifying foreign inputs would qualify these products for such duty-free treatment.

Table Eight: Amount and Share of U.S. Apparel Imports that Do Not Qualify for Duty-Free Treatment

Country	2018		2019	
	Million US$	% Share of Total	Million US$	% Share of Total
Guatemala	329.7	22.5	315.5	22.2
DR	125.4	16.4	126.1	17.4
Honduras	557.0	21.0	462.3	16.0
Mexico	516.1	14.3	399.2	11.4
El Salvador	131.6	6.9	131.7	7.1
Haiti	27.7	3.0	24.8	2.5

Source: UN Comtrade and DR Customs data.

Northern Triangle

The reliance of Northern Triangle countries on non-regional textile inputs varies somewhat from country to country, as summarized below.

Honduras

Honduras is the largest producer of textile inputs in the Northern Triangle region. The Honduran Manufacturers Association (Asociación Hondureña de Maquiladores, or AHM)'s sourcing directory shows that the association has 21 textile mill members, with about three-quarters of those companies specializing in fabric production. The association highlights on its website that Honduras "has achieved a vertical integration of its textile industry, becoming a world textile and apparel manufacturing power, and creating conditions for competitiveness along the supply chain." The association further states that "this vertical development of the Honduran textile and apparel industry using American yarn has integrated it to the U.S. milling and cotton industry, which is an important part of the trading and strategic relationship between Honduras and the United States."

Table Nine: AHM's Textile Mill Members

Company	Product(s)	Location
AKH, S. de R.L.	Fabric	Quimistan
Caracol Knits, S.A. de C.V.	Fabric	Potrerillos
Ceiba Textiles, S. de R.L.	Fabric	Quimistan
Central America Spinning Works, S.A.	Textile mill	Choloma
Coats Honduras, S.A.	Thread	Choloma
Coral Knits, S.A. de C.V.	Fabric	Potrerillos
Cottonwise Textiles (Honduras), S.A.	Textile mill	San Pedro Sula
Elcatex, S. de R.L. de C.V.	Fabric	Choloma
Gildan Activewear Honduras Textile Company, S. de R.L.	Fabric	Choloma
Gildan Choloma Textiles, S. de R.L.	Fabric	Choloma
Gildan Mayan Textiles, S. de R.L.	Fabric	Choloma
Gildan Textiles de Sula, S. de R.L.	Fabric	Choloma
Hilos y Mechas, S.A. de C.V.	Production of mops, mop yarn, brooms, recycled yarns, woven textile products (canvas, sheeting and diapers)	San Pedro Sula
Honduras Spinning Mills, S.A. de C.V. (Grupo Karim's)	Combed and carded ring spun yarns, 100% cotton, tri-blends cotton/viscose/polyester, heathers and charcoals 100% natural cotton/black cotton and heathers natural cotton/black polyester from 99/1 to 50/50	San Pedro Sula
Pride Performance Fabrics, S.A. de C.V.	Textile-cotton (tubular and open width) and synthetic (single knit, double knit, warp, knit and fleece) fabrics	Quimistan
RLA Manufacturing, S. de R.L.	Fabric	Choloma
Roman Knit Honduras, S.A.	Fabric	Quimistan
Savitex, S.A. de C.V.	Texturized thread	Choloma
Simtex International, S. de R.L. de C.V.	Fabric	Quimistan

Terrapolyester, S.A. de C.V.	Textile and plastic industry, recycling of plastic for production of plastic flakes, brooms, plastic parts and polyester fiber	Choloma
United Textile of America, S. de R.L. de C.V.	Filament yarn	Choloma

Source: AHM's sourcing directory.

Honduras is the largest foreign market for U.S. yarn largely as a result of its strong focus on fabric production. U.S. yarn and thread exports to Honduras totaled $1,034.9 million 2019, accounting for 24.2 percent of total U.S. yarn exports, although shipments fell slightly by 0.3 percent from US$1,038.2 million in 2017. Of the yarn total, U.S. cotton yarn and sewing thread shipments accounted for 64.8 percent or US$670.6 million in 2019, filament yarn held a 3.6 percent share or US$37.6 million, while other yarn and thread held a 31.6 percent share or US$326.7 million.

In fabrics, Honduras is the fourth largest market for U.S. exporters with a 3.5 percent of total U.S. fabric exports and shipments growing by 12.0 percent from US$277.3 million in 2017 to US$310.5 million in 2019. Of that total, manmade fiber broadwoven fabrics accounted for 36.2 percent or US$112.4 million in 2019, knitted and knitted pile fabrics accounted for 29.8 percent or US$92.6 million, felts and other nonwovens accounted for 14.0 percent or US$43.4 million, and cotton broadwoven fabrics accounted for 9.3 percent or US$28.7 million.

As the largest fabric producer in the Northern Triangle, Honduras may consider the possibility of further increasing its domestic production capacity in order to serve as a regional fabric manufacturing hub to service neighboring countries as well as Dominican Republic and Haiti. Yarn production in Honduras is also significant, and such production – especially cotton and synthetic yarn and thread production – could also be increased to service a growing domestic fabric manufacturing sector as well as fabric producers in the Northern Triangle, Dominican Republic and Haiti. Use of Honduran fabric made with domestic or regional/U.S. yarn, as well as Honduran yarns and sewing thread, would ensure that the resulting apparel would qualify for duty-free treatment in the U.S. under the CAFTA-DR.

As shown previously, 16.0 percent of all Honduran apparel exported to the U.S. in 2019 did not qualify for duty-free treatment under the CAFTA-DR, most likely due to non-compliance with the relevant origin rules. This issue would normally be resolved through the use of domestic and/or regional textile inputs in lieu of non-originating foreign inputs.

Guatemala

Vertical integration in Guatemala's textile and apparel sector is also significant but the country remains dependent on a broad range of imported textile inputs. Key textile manufacturers in Guatemala include, among others: Liztex, Guatemala's leading textile producer specializing in yarn and woven and knitted fabric production (as well as various other textile products); Textiles Gran Fe – Grupo Young Shin, which specializes in knitted fabric production; Faxel Textiles, which specializes in eco-friendly yarn and fabric production (as well as personal protective equipment and certain other products); and Grupo Eltitex, which specializes in narrow elastics.

Guatemala imported an estimated US$905.9 million worth of textile inputs in 2019, down by 8.9 percent from US$994.0 million in 2017. Of the 2019 total, US$201.6 million or 22.3 percent came from regional partners while the remaining US$704.3 million or 77.7 percent came from non-regional partners. As shown in Table Ten, US$262.6 million or 29.0 percent of total imports came from China, US$223.6 million or 24.7 percent came from the U.S., US$97.0 million or 10.7 percent came from El Salvador, and US$52.2 million or 5.8 percent came from Honduras.

Table Ten: Guatemala's Top Ten Foreign Suppliers of Textile Inputs in 2019 - in US$

Country	2017	2019	% Change 2017/19	% Share of 2019 Total
China	257,405,533	262,598,252	2.0	29.0
U.S.	268,118,975	223,633,593	-16.6	24.7
El Salvador	94,039,495	97,022,300	3.2	10.7
Honduras	21,239,326	52,160,355	145.6	5.8
Mexico	49,945,321	50,603,790	1.3	5.6
South Korea	53,407,110	41,077,757	-23.1	4.5
India	34,294,857	35,284,430	2.9	3.9
Costa Rica	28,181,519	32,552,742	15.5	3.6
Vietnam	10,898,457	29,510,863	170.8	3.3
Hong Kong	20,334,222	27,359,231	34.5	3.0
Other	156,142,467	54,050,183	-65.4	6.0
TOTAL	994,007,282	905,853,496	-8.9	100.0

Source: Calculated from UN Comtrade data.

Guatemala is especially dependent on non-regional textile inputs in the case of carded and uncarded cotton (headings 5201-5203), with 99.5 percent of the total value imported in 2019 coming from non-regional suppliers. The U.S. supplied 99.2 percent of such cotton inputs to Guatemala in 2019 and that share is expected to remain at or near that very high level for the foreseeable future. Non-regional suppliers accounted for 93.4 percent of all manmade filament fabric, 92.3 percent of all manmade staple fibers and 90.7 percent of all manmade staple fiber fabric imported by Guatemala in 2019. Key foreign suppliers of those products included the U.S. (US$27.1 million or 41.8 percent) and China (US$26.0 million or 40.1 percent) in the case of manmade filament fabric, China (US$16.0 million or 65.9 percent) in the case of manmade staple fibers, and China (US$65.5 million or 72.8 percent) in the case of manmade staple fiber fabric.

Guatemala's reliance on non-regional inputs is also high in the two largest product categories: knitted fabric with an 81.3 percent penetration by non-regional suppliers, and cotton yarn and sewing thread with a 77.8 percent penetration by non-regional suppliers. In the case of knitted fabric, China held a 32.9 percent share of all imports in 2019 (US$69.0 million), the U.S. held a 20.9 percent share (US$43.8 million), South Korea held a 10.3 percent share (US$21.6 million), and Hong Kong held a 7.6 percent share (US$16.0 million). In the case of cotton yarn and sewing thread, the U.S. held a 25.6 percent share of total imports in 2019 (US$48.4 million), Costa Rica held a 15.8 percent share (US$29.8 million), India held a 12.6 percent share (US$23.8 million), China held an 8.7 percent share (US$16.4 million), and Vietnam held a 7.0 percent share (US$13.2 million).

Table Eleven: Guatemala's Reliance on Regional vs. Non-Regional Textile Inputs by Category – 2019

Selected Product Categories	Imports of Regional Inputs		Imports of Non-Regional Inputs	
	US$	**% Share of Total**	**US$**	**% Share of Total**
Carded & uncarded cotton	340,052	0.5	61,630,811	99.5
Manmade filament fabric	4,261,373	6.6	60,648,071	93.4
Manmade staple fibers	1,862,302	7.7	22,388,624	92.3
Manmade staple fiber fabric	8,361,100	9.3	81,702,029	90.7
Knitted fabric	39,276,978	18.7	170,627,002	81.3
Cotton yarn & thread	41,848,437	22.2	147,047,063	77.8
Cotton woven fabric	19,754,726	48.0	21,381,169	52.0
MMF staple/filament yarn & thread	57,549,596	48.3	61,707,405	51.7

Source: Calculated from UN Comtrade data.

It is worth mentioning that Guatemala's level of reliance on non-regional inputs would be significantly lower if inputs from the U.S. as well as Central American partners (especially Costa Rica) were considered to be regional inputs for purposes of this analysis. This is particularly true in the case of carded and uncarded cotton, cotton yarn and sewing thread, manmade fiber staple and filament yarn and sewing thread, manmade filament fabric and knitted fabric. If only other Central American partners (i.e., Costa Rica, Nicaragua and Panama) were added to the mix of regional partners, Guatemala's reliance on non-regional inputs would only drop noticeably in the case of cotton yarn and sewing thread.

Generally speaking, there may be significant opportunities to lessen Guatemala's reliance on Chinese, South Korean, Indian and other Asian textile inputs – and possibly also U.S. textile inputs – while continuing to promote the use of regional inputs in supply chains. Of the countries under examination, Guatemala already has the highest rate of usage of regional inputs and that rate could be gradually increased by further incorporating yarns and knitted fabric from Honduras and El Salvador, as well as, potentially, denim and other woven fabrics, and nonwoven fabrics for masks and medical supplies, from Mexico.

For example, knitted fabric made in Guatemala or other Northern Triangle partners could replace at least some of the US$69.0 million worth of Chinese fabric, US$21.6 million worth of South Korean fabric, US$16.0 million worth of Hong Kong fabric and US$13.2 million worth of Vietnamese fabric that was imported in 2019 (that year, Guatemala imported US$122.8 million worth of knitted fabric from Asia). Domestic, U.S. and/or Costa Rican cotton yarn and sewing thread could also replace some of the yarn that is currently being imported from India (US$23.8 million in 2019), China (US$16.4 million) and Vietnam (US$13.2 million). In 2019, cotton yarn and sewing thread imports from Asia totaled US$62.8 million. Additionally, Guatemala should consider building on its existing yarn and fabric capabilities to service textile and apparel manufacturers in the region, with a focus on its Northern Triangle partners and possibly Haiti.

An important dilemma facing Guatemala is that while its textile and apparel sector is characterized by a comparatively high degree of regional integration, its comparatively low usage of U.S. textile inputs in apparel production means that, at the end of the day, a substantial amount of its apparel exports to the U.S. (22.2 percent or US$315.5 million in 2019) does not comply with the CAFTA-DR origin rules and those products are therefore precluded from claiming duty-free treatment under that agreement.

El Salvador

As in the case of Honduras and Guatemala, verticalization has increased in El Salvador's textile and apparel sector over the past ten years. Similarly, however, El Salvador continues to rely on a range of textile inputs from non-regional suppliers, mainly from the U.S. and China. A review of the Chamber of the Textile, Clothing and Free Zone Industry of El Salvador (Cámara de la Industria Textil, Confección y Zonas Francas de El Salvador, or CAMTEX)'s directory of members shows that it includes approximately 17 manufacturers of textile inputs focusing, for the most part, on yarn, sewing thread, knitted fabric and elastics production.

Table Eleven: CAMTEX's Textile Mill Members

Company	Product(s)
Asheboro Elastics Central America, Ltda. de CV.	Elastics
Confecciones Gama, S.A. de C.V.	Knitted fabric
CS Central America, S.A. de C.V.	Polyester and nylon yarn
Etiquetas y Cintas Bordadas, S.A. de C.V.	Yarn, fabric and textile finishing
George C. Moore El Salvador Ltda. de C.V.	Narrow elastics
Grace Ribbon Limited, S.A. de C.V.	Textile tapes for labels
Hanesbrands El Salvador, Ltda. de C.V.	Knitted fabric
Industria de Hilos, S.A. de C.V.	Yarn and sewing thread
Industria Sintéticas de Centro America, S.A.	Fabric
Industrias Unidas, S.A.	Yarn and fabric
Inmobiliaria Apopa S.A. de C.V.	Yarn, fabric and textile finishing
Nemtex, S.A. de C.V.	Fabric
Pettenati Centro América, S.A. de C.V.	Knitted fabric
Swisstex El Salvador, S.A. de C.V.	Knitted fabric
Textiles Giulianna, S.A. de C.V.	Elastics, sewing thread, elastic yarn
Textufil, S.A. de C.V.	Yarn, polyester filament, sewing thread, knitted fabrics
Unifi Central América, Ltda.. de C.V.	Yarn

Source: CAMTEX's member directory and additional research.

El Salvador imported an estimated US$1,016.4 million worth of textile inputs in 2019, up by 1.7 percent from US$999.4 million in 2017. Of the 2019 total, US$186.4 million or 18.3 percent came from regional partners while the remaining US$830.0 million or 81.7 percent came from non-regional partners. As shown in Table Thirteen, US$575.6 million or 56.6 percent came from the U.S., US$161.0 million or 15.8 percent came from China, US$105.0 million or 10.3 percent came from Guatemala, and US$64.5 million or 6.3 percent came from Honduras.

Table Thirteen: El Salvador's Top Ten Foreign Suppliers of Textile Inputs in 2019 - in US$

Country	2017	2019	% Change 2017/19	% Share of 2019 Total
USA	564,799,810	575,571,708	1.9	56.6
China	149,617,665	160,988,056	7.6	15.8
Guatemala	100,538,442	104,954,209	4.4	10.3
Honduras	67,054,562	64,461,731	-3.9	6.3
Mexico	17,432,415	16,950,950	-2.8	1.7
India	15,701,168	15,859,899	1.0	1.6
Portugal	10,854,476	8,561,032	-21.1	0.8
Thailand	8,831,515	7,083,107	-19.8	0.7
South Korea	13,879,252	6,089,908	-56.1	0.6
Vietnam	6,261,753	5,393,547	-13.9	0.5
Other	44,444,073	50,522,375	13.7	5.0
TOTAL	999,415,131	1,016,436,522	1.7	100.0

Source: Calculated from UN Comtrade data.

Similar to Guatemala, El Salvador is especially dependent on non-regional textile inputs in the case of carded and uncarded cotton, with 99.7 percent of the total value imported in 2019 coming from non-regional suppliers. The U.S. supplied 99.4 percent of such cotton inputs to El Salvador in 2019 and that share is expected to remain at or near that very high level for the foreseeable future. El Salvador is more reliant than Guatemala on non-regional cotton yarn and sewing thread, with such suppliers accounting for 95.7 percent of the total value imported in 2019. The U.S. is also by far the most dominant supplier in that segment with a 91.5 percent share of total imports in 2019.

Non-regional suppliers also accounted for 93.8 percent of all manmade staple fiber fabric, 92.0 percent of all cotton woven fabric, 91.6 percent of all manmade staple fibers and 89.7 percent of all manmade fiber staple/filament yarn and sewing thread imported by El Salvador in 2019. Key foreign suppliers of those products included China (US$17.7 million or 60.6 percent) and the U.S. (US$7.2 million or 24.6 percent) in the case of manmade staple fiber fabric, China (US$10.7 million or 35.7 percent) and Portugal (US$8.5 million or 28.1 percent) in the case of cotton woven fabric, China (US$14.6 million or 61.4 percent) in the case of manmade staple fibers, and the U.S. (US$216.2 million or 81.0 percent) in the case of manmade fiber staple/filament yarn and sewing thread.

El Salvador's reliance on non-regional inputs is also fairly high in knitted fabric, where non-regional suppliers accounted for 59.9 percent or US$163.8 million of total imports by El Salvador in 2019. The U.S. accounted for 30.6 percent or US$83.7 million of total shipments of knitted fabric in 2019, followed by Guatemala with a 27.4 percent share or US$75.0 million, China with a 21.5 percent share or US$58.8 million and Honduras with an 11.7 percent share or US$31.9 million.

Table Fourteen: El Salvador's Reliance on Regional vs. Non-Regional Textile Inputs by Category – 2019

Selected Product Categories	Imports of Regional Inputs		Imports of Non-Regional Inputs	
	US$	% Share of Total	US$	% Share of Total
Carded & uncarded cotton	222,158	0.3	71,723,414	99.7
Cotton yarn & thread	7,326,248	4.3	161,332,737	95.7
Manmade staple fiber fabric	1,809,136	6.2	27,406,323	93.8
Cotton woven fabric	2,398,688	8.0	27,667,101	92.0
Manmade staple fibers	1,996,564	8.4	21,804,565	91.6
MMF staple/filament yarn & thread	27,485,263	10.3	239,455,515	89.7
Manmade filament fabric	14,925,153	33.2	30,067,904	66.8
Knitted fabric	109,537,163	40.1	163,792,317	59.9

Source: Calculated from UN Comtrade data.

Even much more markedly than in Guatemala's case, El Salvador's level of reliance on foreign non-regional inputs would be substantially lower if inputs from the U.S. were considered to be regional inputs for purposes of this analysis.

El Salvador is more reliant on U.S. textile inputs and less reliant on Asian textile inputs than Guatemala. For example, El Salvador was the fifth largest foreign market for U.S. yarn in 2019 with total shipments of US$244.5 million, while Guatemala was only the 18th largest market for U.S. yarn that year with total shipments of US$42.7 million. In fabrics, El Salvador was the 14th largest foreign market for U.S. fabrics in 2019 with total shipments of US$98.6 million, while Guatemala was the 16th largest market with total shipments of US$95.9 million. Plausibly, it may be more difficult for El Salvador to reduce its yarn purchases from the U.S. than for Guatemala to do the same with respect to Asian suppliers, given the generally more longstanding and durable business relationships that regional fabric mills have with U.S. yarn spinners. That said, there may be opportunities for El Salvador to shift some of its yarn and fabric purchases from Asian and even U.S. suppliers to domestic and regional suppliers.

Such opportunities may be most evident in the case of knitted fabric, where El Salvador could favor domestic and Northern Triangle suppliers in lieu of China (which had US$58.8 million worth of shipments in 2019), India (US$9.6 million) and South Korea (US$3.1 million). In all, El Salvador imported US$76.1 million worth of knitted fabric from Asia in 2019. Some cotton yarn and sewing thread purchases may also be shifted from the U.S. to regional suppliers, including Guatemala, as well as Costa Rica. In manmade fiber staple/filament yarn and sewing thread, there is some production in El Salvador, and it may be possible to replace at least some of those inputs that are currently being imported from the U.S., as well as some of the US$21.7 million worth of shipments from Asia in 2019. There may also be opportunities to increase regional sourcing of specific manmade fiber woven fabrics, both from domestic sources as well as Northern Triangle and Mexican sources, while reducing shipments from Asia (which totaled US$19.8 million in 2019 in the case of manmade staple fiber fabric, as well as US$20.6 million in 2019 in the case of manmade filament fabric).

As in the case of Guatemala, El Salvador should consider building on its existing yarn and fabric capabilities to service textile and apparel manufacturers in the region, with a focus on its Northern Triangle partners and possibly Haiti. Increased purchases of Mexican nonwoven fabric for masks and medical supplies are yet another possibility.

Dominican Republic and Haiti

Regional integration and verticalization have come hand-in-hand in both Haiti and Dominican Republic, with lower-cost Haiti attracting a steadily growing share of Dominican Republic and Haiti labor-intensive apparel sewing operations – especially those involving simpler garments – and the Dominican Republic generally focusing on more capital and skilled labor-intensive activities such as fabric production as well as research and development, design, marketing, sales and managerial activities. A very substantial number of sewing operations remain in the DR, clearly outstripping textile production there, but apparel production is certainly less relevant than five years ago.[26]

In 2019, there were 103 free zone companies operating in the textile and apparel sector in the DR, up from 102 companies a year earlier. While the vast majority of these companies are apparel manufacturers, the domestic production of textile inputs has continued to grow over the past

[26] To illustrate this point, the DR exported US$722.1 million worth of apparel to the U.S. in 2019, down 9.0 percent from a high of US$793.7 million in 2015. During that period, Haiti's apparel exports to the U.S. rose 9.7 percent from US$895.0 million to US$981.9 million. And Haiti's apparel exports to the U.S. have soared by 91.3 percent from 2009.

decade. Hanesbrands' Dos Ríos fabric mill currently leads the way as the main supplier of textile inputs for apparel production in Dominican Republic and Haiti. Grupo M is a vertically integrated textile and apparel producer with extensive operations in both the DR and Haiti. Other producers of textile inputs in the DR include, among others, Puntex (knitted fabric), Hilos A & E Dominicana (sewing thread) and Notions Dominicana (trim).

Haiti has approximately 41 export-oriented apparel manufacturers that participate in the International Labour Organization/International Finance Corporation's BetterWork program. In Haiti, membership in this program is mandatory for all apparel producers exporting their products to the U.S. market under the HOPE II program. Textile input production in Haiti is believed to be marginal, however, with most inputs imported from the DR, China and various other countries. Cotton fabrics are typically sourced from the DR and synthetic fabrics from China. For example, according to DR Customs statistics the DR exported US$114.3 million worth of cotton woven fabric to Haiti in 2019, while according to UN Comtrade data China exported US$95.2 million worth of knitted fabric as well as US$28.7 million worth of manmade staple fiber fabric to Haiti that year. South Korea, for its part, shipped US$35.9 million worth of knitted fabric to Haiti in 2019.

The DR imported an estimated US$716.3 million worth of textile inputs in 2019, down by 4.3 percent from US$748.3 million in 2017. Of the 2019 total, only US$26.4 million or 3.7 percent came from regional partners while the remaining US$689.9 million or 96.3 percent came from non-regional partners. If the U.S. were considered a regional partner, the share held by regional partners would jump to 72.1 percent while the share held by non-regional partners would plummet to 27.9 percent, highlighting the importance of the U.S. for the Dominican textile and apparel sector.

As shown in Table Fifteen, US$490.2 million or 68.4 percent of total imports of textile inputs by the DR in 2019 came from the U.S., US$109.2 million or 15.2 percent of such imports came from China, US$18.5 million or 2.6 percent came from India, US$8.4 million or 1.2 percent came from South Korea, and US$8.3 million or 1.2 percent came from Honduras.

Table Fifteen: DR's Top Ten Foreign Suppliers of Textile Inputs in 2019 - in US$

Country	2017	2019	% Change 2017/19	% Share of 2019 Total
USA	499,941,238	490,232,311	-1.9	68.4
China	93,477,746	109,157,985	16.8	15.2
India	18,264,869	18,450,906	1.0	2.6
South Korea	4,730,581	8,353,472	76.6	1.2
Honduras	11,457,573	8,270,541	-27.8	1.2
Mexico	12,577,210	7,775,828	-38.2	1.1
Taiwan	11,041,610	7,206,228	-34.7	1.0
Germany	11,689,412	6,484,641	-44.5	0.9
Guatemala	6,025,712	6,288,103	4.4	0.9
Indonesia	3,260,331	6,038,156	85.2	0.8
Other	75,856,429	48,043,920	-36.7	6.7
TOTAL	748,322,711	716,302,091	-4.3	100.0

Source: Calculated from DR Customs data.

The DR is generally more dependent on non-regional inputs than its Northern Triangle partners. This dependence is particularly high in the case of cotton woven fabric (97.5 percent of total imports in 2019 came from non-regional suppliers), manmade staple fiber fabric (97.4 percent), cotton yarn and sewing thread (97.1 percent), manmade fiber staple/filament yarn and sewing thread (95.9 percent) and knitted fabric (90.0 percent). Then again, this dependence is primarily attributable to the DR's heavy reliance on U.S. textile inputs: US$256.2 million or 90.0 percent of total textile inputs imported in 2019 in the case of cotton yarn and sewing thread, US$23.3 million or 66.6 percent in the case of knitted fabric, US$81.2 million or 66.6 percent in the case of manmade staple fiber fabric, US$40.3 million or 65.1 percent in the case of manmade fiber staple/filament yarn and sewing thread, US$39.4 million or 50.2 percent in the case of cotton woven fabric, US$2.0 million or 47.9 percent in the case of manmade staple fibers, and US$7.8 million or only 28.9 percent in the case of manmade filament fabric.

Other important non-regional suppliers include, among others, China in the case of manmade filament fabric (US$11.7 million or 43.4 percent), cotton woven fabric (US$18.6 million or 23.8 percent), manmade staple fiber fabric (US$25.5 million or 20.9 percent), knitted fabric (US$5.1 million or US$14.7 percent), and manmade fiber staple/filament yarn and sewing thread (US$7.4 million or 11.9 percent); and India (US$9.1 million or 3.2 percent) and Indonesia (US$4.7 million or 1.6 percent) in the case of cotton yarn and sewing thread.

Table Sixteen: DR's Reliance on Regional vs. Non-Regional Textile Inputs by Category – 2019

Selected Product Categories	Imports of Regional Inputs		Imports of Non-Regional Inputs	
	Million US$	% Share of Total	Million US$	% Share of Total
Cotton woven fabric	1,952,762	2.5	76,423,676	97.5
Manmade staple fiber fabric	3,198,047	2.6	118,685,205	97.4
Cotton yarn & thread	8,185,024	2.9	276,451,871	97.1
MMF staple/filament yarn & thread	2,557,906	4.1	59,447,596	95.9
Knitted fabric	3,506,064	10.0	31,468,718	90.0
Manmade staple fibers	474,775	11.5	3,659,674	88.5
Manmade filament fabric	3,085,749	11.5	23,767,922	88.5
Carded & uncarded cotton	269,469	24.8	817,434	75.2

Source: Calculated from DR Customs data.

In all, there are ample opportunities for the DR to reduce its dependence on non-regional textile inputs. While a substantial share of inputs – such as cotton yarn – are expected to continue to come from the U.S. because they are produced there by manufacturers with operations in both the DR and the U.S., there are still opportunities to lessen that dependence on certain specific inputs and increasingly shift certain Chinese, Indian and other Asian inputs to domestic or regional facilities. For example, Asian imports could be reduced in the case of manmade staple fiber fabric (US$31.0 million in 2019), cotton yarn and sewing thread (US$19.4 million), manmade fiber staple/filament yarn & thread (US$16.2 million) and manmade filament fabric (US$13.0 million).

Importantly, given that US$126.1 million or 17.4 percent of all U.S. apparel imports from the DR in 2019 did not qualify for duty-free treatment under the CAFTA-DR, a targeted assessment should be made as to whether increased use of domestic and/or Northern Triangle yarns and fabric would qualify most or some of these shipments for CAFTA-DR treatment.

In the case of Haiti, a feasible objective would be to continue to strengthen apparel cutting, sewing and finishing operations there while at the same time further increasing the DR's textile input capabilities in order to service that growth. Additional fabric exports to Haiti by the Northern Triangle and Mexico could be explored, although the fact that Haiti is able to use fabrics from anywhere in the world in its apparel production and still qualify for duty-free treatment in the U.S. makes this a complex proposition unless such fabrics can be sold at competitive prices.

4. Mexico

Mexico has a large, well-diversified and vertically integrated textile and apparel sector, with an extensive presence in all aspects of textile production – including yarn spinning, fabric knitting and weaving, nonwoven and industrial fabric production, and textile finishing. Textile input production in Mexico totaled MX$59,735 million in 2019 (approximately US$3,103 million), down by 6.2 percent from MX$63,663 million in 2018 but up by 15.4 percent from MX$51,783 million in 2015. The vast majority of that production – MX$39,595 million in 2019 (approximately US$2,057 million) – focuses on fabric manufacturing, while MX$9,783 million (approximately US$508 million) focuses on fiber preparation and yarn production and MX$6,756 million (approximately US$351 million) focuses on coated fabric production.

Table Seventeen: Mexico's Production of Textile Inputs – Value of Production in Million MX$

Product	2015	2016	2017	2018	2019	% Change 2015/19
TOTAL	51,783	56,609	58,336	63,663	59,735	15.4
Fiber preparation and yarn production	7,784	8,048	8,979	9,814	9,783	25.7
Fabric production	35,886	39,438	39,817	43,022	39,595	10.3
Coated fabric production	4,863	5,522	5,930	6,811	6,756	38.9

Source: INEGI.

Mexico's textile input production focuses primarily on denim fabric, followed by blended soft fiber fabrics primarily of manmade fibers, blended soft fiber yarn primarily of manmade fibers, nonwoven fabrics for industrial applications, coated fabrics, manmade fiber knitted fabric and cotton knitted fabric. Denim fabric production has remained relatively unchanged from 2015 to 2019, while production of blended soft fiber yarn primarily of manmade fibers has fallen somewhat. A March 2020 report by Mexico's National Institute of Statistics and Geography (INEGI) and the National Chamber of the Textile Industry (CANAINTEX) estimates that 58.9 percent of the main inputs used by the textile and apparel sector in Mexico are domestically produced, while 41.4 percent are imported.

Mexico imported an estimated US$5,728.4 million worth of textile inputs in 2019, down by 5.4 percent from US$6,054.3 million in 2017. Of the 2019 total, a meager US$69.4 million or 1.2 percent came from regional partners while the remaining US$5,659.0 million or 98.8 percent came from non-regional partners. If the U.S. were considered a regional partner, the share held by regional partners would be much greater, jumping to 52.9 percent, while the share held by non-regional partners would fall to 47.1 percent, underlining the importance of the U.S. for the Mexican textile and apparel sector.

As shown in Table Eighteen, US$2,959.5 million or 51.7 percent of total imports of textile inputs by Mexico in 2019 came from the U.S., US1,289.3 million or 22.5 percent of such imports came from China, US$163.6 million or 2.9 percent came from Canada, US$161.0 million or 2.8 percent came from Germany, and US$119.3 million or 2.1 percent came from Italy.

Table Eighteen: Mexico's Top Ten Foreign Suppliers of Textile Inputs in 2019 - in US$

Country	2017	2019	% Change 2017/19	% Share of 2019 Total
USA	3,396,245,770	2,959,454,274	-12.9	51.7
China	1,287,466,818	1,289,339,212	0.1	22.5
Canada	150,308,581	163,620,778	8.9	2.9
Germany	141,671,646	160,987,008	13.6	2.8
Italy	108,739,929	119,254,159	9.7	2.1
India	98,989,638	116,795,311	18.0	2.0
South Korea	121,295,515	104,891,979	-13.5	1.8
Spain	77,840,507	74,822,515	-3.9	1.3
Japan	57,697,455	71,584,735	24.1	1.2
Vietnam	16,415,046	44,267,696	169.7	0.8
Colombia	32,989,571	41,148,884	24.7	0.7
TOTAL	6,054,347,792	5,728,392,414	-5.4	100.0

Source: Calculated from UN Comtrade data.

Mexico relies heavily on non-regional textile inputs across major product categories. This includes cotton yarn and sewing thread (US$63.2 million, or 100 percent of total imports in 2019), carded and uncarded cotton (US$318.1 million or 100 percent), manmade fiber staple/filament yarn and sewing thread (US$693.4 million or 99.9 percent), manmade staple fibers (US$201.0 million or 99.6 percent), manmade filament fabric (US$474.7 million or 99.3 percent), manmade staple fiber fabric (US$342.1 million or 99.0 percent), cotton woven fabric (US$454.6 million or 97.9 percent) and knitted fabric (US$645.3 million or 95.0 percent).

Similarly to El Salvador, Honduras or the DR, Mexico relies heavily on U.S. textile inputs: US$318.1 million or 100 percent of total textile inputs imported in 2019 in the case of carded and uncarded cotton, US$50.7 million or 80.2 percent in the case of cotton yarn and sewing thread, US$225.9

million or 65.4 percent in the case of manmade staple fiber fabric, US$254.9 million or 54.9 percent in the case of cotton woven fabric, US$268.8 million or 38.7 percent in the case of manmade fiber staple/filament yarn and sewing thread, US$66.4 million or 32.9 percent in the case of manmade staple fibers, US$143.5 million or 30.0 percent in the case of manmade filament fabric, and US$194.7 million or 28.7 percent in the case of knitted fabric.

Other important non-regional suppliers include, among others, China in the case of knitted fabric (US$360.4 million or 53.1 percent), manmade filament fabric (US$211.8 million or 44.3 percent), cotton woven fabric (US$123.5 million or 26.6 percent), manmade fiber staple/filament yarn and sewing thread (US$175.1 million or 25.2 percent), manmade staple fiber fabric (US$71.5 million or 20.7 percent) and manmade staple fibers (US$39.1 million or 19.4 percent); India in the case of manmade staple fibers (US$19.9 million or 9.9 percent), cotton yarn and sewing thread (US$4.0 million or 6.3 percent) and manmade fiber staple/filament yarn and sewing thread (US$33.3 million or 4.8 percent); South Korea in the case of manmade staple fibers (US$18.2 million or 9.0 percent); and Spain in the case of cotton yarn and sewing thread (US$4.7 million or 7.5 percent).

Table Nineteen: Mexico's Reliance on Regional vs. Non-Regional Textile Inputs by Category – 2019

Selected Product Categories	Imports of Regional Inputs		Imports of Non-Regional Inputs	
	Million US$	% Share of Total	Million US$	% Share of Total
Cotton yarn & thread	0	0.0	63,233,839	100.0
Carded & uncarded cotton	0	0.0	318,126,601	100.0
MMF staple/filament yarn & thread	849,388	0.1	693,418,728	99.9
Manmade staple fibers	792,549	0.4	201,007,810	99.6
Manmade filament fabric	3,499,600	0.7	474,744,708	99.3
Manmade staple fiber fabric	3,325,609	1.0	342,091,062	99.0
Cotton woven fabric	9,545,233	2.1	454,644,709	97.9
Knitted fabric	33,891,425	5.0	645,299,653	95.0

Source: Calculated from UN Comtrade data.

Generally speaking, while it may be undesirable or disadvantageous for Mexico to weaken its upstream textile links with the U.S., especially as goods made in Mexico from U.S. inputs normally benefit from duty-free treatment under the USMCA and given Mexico's geographical proximity to the U.S. market and longstanding business relationships with U.S. textile manufacturers, there may be opportunities to reduce Mexico's reliance on textile inputs from other suppliers, including China, India and other Asian producers. That said, it is to Mexico's advantage to continue to import non-USMCA yarns and fabrics for textile and apparel production to be exported under one of several USMCA trade preference levels, including in particular the 45 million square meters equivalent TPL for cotton and manmade fiber apparel cut and sewn in Mexico from non-originating yarns and/or fabrics.

Mexico should find ways to further reduce the share of shipments to the U.S. that do not qualify for duty-free treatment under the USMCA due to their use of non-originating inputs (that share stood at 11.4 percent or US$399.2 million in 2019). There may also be opportunities for Mexico to become a nonwoven fabric hub for the region as textile and apparel producers in El Salvador, Guatemala and Honduras, Dominican Republic and Haiti consider ramping up production of face masks and medical/hospital clothing and other supplies, as well as for Mexico to increase its exports of denim fabric to Guatemala and other woven fabrics to the Northern Triangle, Dominican Republic and Haiti.

Part III: Greater Integration for Increased Market Access and Changes to Preference/Free Trade Programs.

As illustrated in this report, each country has specific advantages and disadvantages. However, as regional groupings they have opportunities to succeed together for greater market access into each other's markets as well as into the United States and Canada.

Dominican Republic and Haiti

It is critical for Haiti to at least preserve or, ideally, continue to increase its share of the U.S. apparel import market. Haiti could achieve that goal both by further increasing its market share of low-cost, relatively simple garments that are imported into the U.S. (such as t-shirts and underwear), as well as by further diversifying into more complex, higher value-added garments. At the same time, Dominican Republic and Haiti, could push for the establishment of a HOPE-like program in Mexico as well as the relaxation of Canada's rules of origin under its least-developed country tariff program (LDCT).

A key to this strategy lays in the continued participation of Haiti's apparel sector in the International Labor Organization/International Finance Corporation's BetterWork program, as well as in continued improvement by program participants in areas where additional progress is required, such as on matters related to compensation, working time, contracts and human resources, and particularly occupational safety and health. Also of critical importance is the restoration of political, institutional and economic stability to Haiti, in order to allow domestic and foreign investment to continue to flow to the apparel sector. Furthermore, efforts must be undertaken in the U.S. by all relevant stakeholders to ensure a timely extension of the HOPE program, which is currently scheduled to expire on September 30, 2025. The CBTPA program, for its part, was extended in 2020 through September 30, 2030.

For Haiti to be able to take advantage of additional opportunities in the U.S. and other markets, it will likely be necessary for the country to further strengthen apparel cutting, sewing and finishing operations as well as for Haiti and the DR to work together to increase and diversify fabric production in the DR. Additionally, stakeholders in Haiti and both the Northern Triangle and Mexico should explore opportunities to strengthen integration between Haitian apparel producers and fabric producers in both the Northern Triangle and Mexico.

Paradoxically, the origin rules that have enabled Haiti to become a large U.S. apparel supplier present a roadblock to regional integration. Specifically, the HOPE program has very flexible origin rules that allow Haiti, for example, to use fabric from anywhere in the world – including Chinese or South Korean fabric – to make most duty-free-qualifying apparel as long as such apparel is wholly assembled in Haiti. Most shipments from Haiti are subject to trade preference levels (i.e., tariff-rate quotas) under either HOPE or the CBTPA, whereby duty-free treatment is provided only up to certain specified levels, none of these TPLs are heavily utilized and do not represent a hindrance on Haiti's exports to the U.S.

Table: U.S. Apparel Imports from Haiti Entered under HOPE/CBTPA – in Million US$

HOPE/CBTPA Provision	2018	2019	% of Total in 2019
HOPE – knit apparel TPL	299.2	328.1	34.4
CBTPA – knit apparel of regional fabric/U.S. yarn TPL	133.5	134.7	14.1
HOPE – earned import allowance program	71.4	127.1	13.3
HOPE – woven apparel TPL	151.7	122.4	12.8
HOPE – value added (60%) TPL	108.3	121.5	12.8
CBTPA – non-underwear t-shirts of regional fabric/U.S. yarn TPL	76.4	71.8	7.5
CBTPA – knit apparel from U.S. yarn/thread/fabric	43.7	40.9	4.3
Other provisions	1.9	6.1	0.6

Table: Approximate Year-End Utilization of HOPE/CBTPA TPLs

TPL	2017	2018	2019	2020
HOPE – knit apparel TPL	22.6%	54.1%	58.0%	44.7%
CBTPA – non-underwear t-shirts of regional fabric/U.S. yarn TPL	50.1%	50.4%	50.8%	30.2%
HOPE – woven apparel TPL	15.8%	19.3%	19.1%	16.3%
HOPE – value added TPL	14.3%	15.0%	13.4%	14.5%
CBTPA – knit apparel of regional fabric/U.S. yarn	6.1%	5.5%	7.4%	5.0%

Note: TPL period is year-ending December 19 for the HOPE value added TPL and year-ending September 30 for all other TPLs. 2020 utilization rate for HOPE value TPL is as of November 30, 2020.

A potential way to foster integration between Dominican Republic and Haiti and both the Northern Triangle and Mexico would be for Mexico to establish a HOPE-like program for apparel made in Haiti. Haitian products already benefit from duty-free treatment in various large markets across the globe under unilateral trade preference programs specifically tailored to least-developed countries (LDCs), including in the U.S., EU, Canada, Australia, Japan, New Zealand, South Korea and Switzerland. In Latin America, Chile currently provides such benefits to Haiti and other LDCs.

Given the expected opposition of the Mexican apparel industry to such a program, a HOPE-like program in Mexico would most likely have to include a global TPL and/or specific TPLs for certain apparel categories, as well as a regional value requirement. The regional value requirement could encompass, for example, Mexico, El Salvador, Guatemala and Honduras (or Central America as a whole), Dominican Republic and Haiti. This way, Haiti would be encouraged to purchase textile inputs from the region in order to qualify its apparel for duty-free or preferential duty treatment in Mexico.

Another way for Haiti to be able to increase its apparel exports, thereby increasing demand in Haiti for textile inputs made in the DR and possibly El Salvador, Guatemala and Honduras and Mexico, would be for Canada to make the rules of origin under its LDCT program more flexible. In 2019, Canada imported US$29.7 million worth of apparel from Haiti, up from US$23.1 million in 2018 and US$18.9 million in 2015. However, Haiti held a share of only 0.3 percent of Canada's total apparel imports in 2019, compared to a 1.2 percent share or US$981.6 million in the U.S. that same year.

Typically, to qualify for duty-free treatment in Canada most Haitian apparel must be both cut and sewn in Haiti from yarns and fabric made in the DR or other developing countries such as Mexico, El Salvador, Guatemala and Honduras countries or China, and at least 25 percent of the value of the garment must be added in Haiti. However, this disqualifies all apparel made from regional and other developing country fabric from U.S. yarn, as well as apparel not meeting the 25 percent value threshold.

In June 2017, Canada amended its regulations to establish more flexible origin rules for outerwear and underwear t-shirts (subheadings 6109.10 and 6109.90) as well as cotton and synthetic fiber pants of subheadings 6103.42, 6103.43, 6104.62, 6104.63, 6203.42, 6203.43, 6204.62 and 6204.63. In practical terms, these amendments allow t-shirts and cotton and synthetic fiber pants made in Haiti to incorporate U.S. textile inputs (such as yarn and fabric), and also enable manufacturers to cut the fabric into apparel components in the DR rather than in Haiti if at least 25 percent of the value of the garment is added in Haiti, Canada and/or one or more of Canada's FTA partners. Depending on the needs of the Haitian apparel sector, a push could be made to extend this flexibility to all apparel, rather than just t-shirts and pants.

Additionally, given that US$126.1 million or 17.4 percent of all U.S. apparel imports from the DR in 2019 did not qualify for duty-free treatment under the CAFTA-DR, a targeted assessment should be made as to whether increased use of domestic and/or Northern Triangle yarns and fabrics would qualify most or some of these shipments for CAFTA-DR treatment.

In addition to Mexico establishing a HOPE-like program for Haitian apparel, the DR and Mexico should consider the possibility of launching in the medium-term negotiations on a bilateral free trade agreement. Such an agreement would benefit both sides by (1) providing reciprocal preferential duty treatment to originating textile and apparel products, and (2) allowing the DR to take advantage of the Mexico cumulation mechanism under the CAFTA-DR, which would require the DR and Mexico to implement an FTA with a cumulation provision similar to those contained in the CAFTA-DR and Mexico's FTA with Central America.

Besides a bilateral FTA, the DR and Mexico could establish a bilateral forum to explore ways to enhance collaboration to potentially encourage the production and export of medical/hospital and related apparel and face masks cut and sewn in the DR from Mexican nonwoven fabric, given that the CAFTA-DR allows the unlimited duty-free importation into the U.S. of such apparel made with nonwoven fabrics of any origin as long as any sewing thread used to assemble the apparel, as well as any pocket bag fabric and narrow elastics contained therein, are made in the CAFTA-DR region. It is worth noting in this regard that the DR is already a significant U.S. supplier of medical equipment.

Northern Triangle and Mexico

As our analysis has shown, in El Salvador, Guatemala and Honduras there is considerable room to ramp up sourcing of regional textile inputs while further reducing the Northern Triangle's reliance on non-regional inputs. Perhaps the most important action that can be taken in the near term to encourage regional integration is creating a permanent, regional, public-private forum for collaboration to determine as precisely as possible:

1. the current and future textile input needs of El Salvador, Guatemala and Honduras textile and apparel sectors;

2. the availability of specific textile inputs – cotton yarns, synthetic yarns, knitted fabrics, woven fabrics, narrow elastics, apparel trim, and so forth – including current output and production capacity as well as planned textile input production capacity in the medium-term;

3. specific areas or segments where regional fabrics and other textile inputs are not currently competitive vis-a Asian or U.S. fabrics and other textile inputs, either in terms of price, quality or otherwise;

4. ways to increase the competitiveness of regional textile inputs that are currently considered to be non-competitive vis-à-vis Asian or U.S. fabrics and other textile inputs;

5. specific areas or segments where regional fabrics and other textile inputs are currently competitive vis-à-vis Asian or U.S. fabrics and other textile inputs but there is not sufficient output or production capacity; and

6. ways to promote additional investment, by providing tax incentives or other benefits, in textile production that is considered competitive.

To be successful, the forum would require the full commitment of the major textile and apparel producers in the region, as well as of all relevant trade associations and government agencies. The production and sourcing matrices of every major apparel manufacturer in the region would need to be considered individually in order to determine which specific inputs may be feasibly produced regionally in either the short, medium or long terms, both by taking advantage of existing production capacity, expanding capacity at existing facilities, and attracting investment to develop additional textile input capacity.

Concurrently, the forum would explore the reasons why a considerable share of apparel made in the Northern Triangle – 7.1 percent of total shipments in 2019 in the case of El Salvador, 16.0 percent in the case of Honduras, and 22.2 percent in the case of Guatemala – do not currently qualify for duty-free treatment in the U.S. under the CAFTA-DR. For example, is apparel not qualifying for CAFTA-DR treatment mainly because it contains non-regional yarn above the *de minimis* allowance in the component that determines the tariff classification of such apparel, or because it is not assembled with regional sewing thread? Or is there a substantial share of Northern Triangle apparel that incorporates non-regional fabrics in the component that determines the tariff classification of the apparel? Are there any other significant reasons why Northern Triangle apparel is not currently qualifying for CAFTA-DR treatment?

Once these reasons are identified, the forum would seek to determine whether it may be feasible, in terms of price, quality, availability, etc., for apparel manufacturers to replace non-regional with regional inputs in the short and medium terms, or whether investment in additional facilities and/or production capacity would be needed to achieve this shift.

Other matters that could be explored in a regional or bilateral collaboration mechanism with Mexico, which may possibly stem from the aforementioned forum, would include ways to increase purchases by El Salvador, Guatemala and Honduras of Mexican textile inputs as well as exports of Northern Triangle apparel to Mexico. For example, forum participants should assess ways to encourage a more active use of the existing cumulation mechanism in the CAFTA-DR that allows Mexican yarns, fabrics and sewing thread to be used in woven apparel production in El Salvador, Guatemala and Honduras. Such production qualifies for duty-free treatment in the U.S. under the CAFTA-DR subject to a 100 million square meters equivalent (SME) annual limit, which may be increased to up to 200 million SME (although each percentage increase must correspond to the percentage increase in imports of CAFTA-DR-originating woven apparel).

As shown below, cumulation sub-limits apply in the case of cotton and manmade fiber trousers and skirts, other than of cotton blue denim (45 million SME, which may be increased to up to 90 million SME), cotton blue denim trousers and skirts (20 million SME, which may be increased to up to 40 million SME) and certain tailored apparel of wool (1 million SME, which may be increased to up to 2 million SME). These potential increases are also subject to the "1-to-1" clause outlined for the parent TPL.

Table: Approximate Year-End Utilization of Mexico Cumulation TPL under CAFTA-DR

TPL	2017	2018	2019	2020 1/
Cumulation TPL – Total	20.6%	27.1%	38.2%	27.2%
Sublimit for cotton and manmade fiber trousers and skirts	45.4%	57.6%	83.8%	59.9%
Sublimit for cotton blue denim trousers and skirts	0.2%	0.8%	0.5%	0.2%
Sublimit for tailored apparel of wool	10.2%	37.9%	38.6%	22.5%

1/ 2020 utilization rate is as of November 30, 2020.

In addition to assessing ways to encourage further utilization of these TPLs, El Salvador, Guatemala and Honduras should consider the desirability and feasibility of approaching the U.S. to discuss a potential increase to the CAFTA-DR sublimit for cotton and manmade fiber trousers and skirts, given its rapid increase in utilization from 45.4 percent in 2017 to 57.6 percent in 2018 and 83.8 percent in 2019. The objective would be to increase this sublimit outright, without tying such an increase to an equivalent increase in shipments of CAFTA-DR-originating woven apparel (i.e., apparel made with CAFTA-DR textile inputs).

In exchange for an increase to this sublimit under the CAFTA-DR, which would partly benefit Mexico, Mexico, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua would concurrently agree to amend Annex 3.16 of their FTA to increase by the same percentage amount the sublimit for cotton and manmade fiber trousers and skirts made with U.S. inputs that are exported from Central America to Mexico (that sublimit currently totals 31.5 million SME).[27] At the same time, El Salvador, Guatemala and Honduras and Mexico should review the current and historical use of the Annex 3.16 cumulation TPLs to determine whether any further amendments to that annex may be warranted.

These matters could be raised, respectively, within the framework of the CAFTA-DR Free Trade Commission and the Administrative Commission of the Free Trade Agreement between Mexico and Central America.

Other matters that may be considered as part of a Northern Triangle-Mexico or Central America-Mexico collaboration mechanism, which could be an offshoot or integral component of the aforementioned Northern Triangle regional integration forum, would include:

- ways to enhance collaboration to potentially encourage the production and export of medical/hospital and related apparel and face masks cut and sewn in the Northern Triangle / Central America with Mexican nonwoven fabric, given that the CAFTA-DR allows the unlimited duty-free importation into the U.S. of such apparel made with nonwoven fabrics of any origin as long as any sewing thread used to assemble the apparel, as well as any pocket bag fabric and narrow elastics contained therein, are made in the CAFTA-DR region (the sewing thread, pocket bag fabric and narrow elastics could also be made in Mexico and the apparel entered under the cumulation TPL); and

- ways to promote the production and export to the U.S. of denim trousers and other apparel made in the Northern Triangle / Central America from Mexican denim fabric and Mexican and/or U.S. yarn.

Similar matters could be explored by El Salvador, Guatemala and Honduras in a separate collaboration mechanism also possibly stemming from the aforementioned forum with the DR and Haiti, including ways to utilize the two FTAs in place between the DR and El Salvador, Guatemala and Honduras to foster increased trade and co-production activities between these countries.

As regards exports to Canada, it is not surprising that Mexico and Honduras are by far the largest regional exporters of apparel to that country, as they both have an FTA in place with Canada (the USMCA in the case of Mexico, and the Canada-Honduras FTA in the case of Honduras). Canada's apparel imports from Mexico were relatively stable during 2016-2019, totaling US$245.4 million

[27] For additional information on Mexico's cumulation limit and sublimits for CAFTA-DR apparel made with U.S. inputs, see Annex 3.16 and the Acuerdo issued August 31, 2012.

in 2019 compared to US$252.0 million in 2016, while Canada's apparel imports from Honduras have risen markedly since the entry into force of the Canada-Honduras FTA on October 1, 2014, from US$96.3 million in 2015 to US$149.8 million in 2019.

Canada's apparel imports from El Salvador (US$53.2 million in 2019) and Guatemala (US$43.0 million in 2019) have grown at a much slower pace, as they generally do not benefit from preferential duty treatment. The only feasible way for these two countries to substantially increase their apparel exports to Canada would be through the negotiation and implementation on an FTA. FTA negotiations between Canada and the Northern Triangle plus Nicaragua took place more than a decade ago but only Canada and Honduras were ultimately able to reach a deal. It appears, however, that Canada remains willing to re-engage with El Salvador and Guatemala should they be interested in rekindling FTA talks.

The FTAs with Canada should be reviewed to see if it is possible to accumulate inputs from mutual FTA partners. For example, goods made in Honduras that have Mexican or US inputs would be given duty free access to Canada and vice versa. This change would be a first step to perhaps entice the United States to allow reciprocal free trade partner inputs to be used in making apparel to create a bloc that includes El Salvador, Guatemala, Honduras, Dominican Republic, Mexico and Canada. Such a bloc could be viewed as a possible counterweight to the Comprehensive and Progressive Agreement for Transpacific Partnership (CPTPP - among Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam) and the Regional Comprehensive Economic Partnership (RCEP – among Australia, Brunei, Cambodia, China, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, S. Korea, Thailand and Vietnam).

Part IV: Brands/Retailers and Manufacturers' Reaction to the Pandemic and Barriers that Should be Addressed?

As the pandemic drifted across continents, countries were impacted at different times and at different severity levels. Each country responded to the pandemic differently. The responses impacted global supply chains and revealed problems as well as opportunities for brands and manufacturers to help them determine new strategies for sourcing and production in a post pandemic environment. A factor that cannot be overlooked as well, is the impact of the pandemic on the consumer. Shopping behaviors have changed significantly as the majority of goods being purchased has shifted to an "online" experience; either in total or part, rather than an "in store" event.

Brands'/Retailers' Sourcing Reactions to the Pandemic

The leading apparel brands in the United States were interviewed for this study, assessing the region as a supply source as well as how the pandemic may impact global sourcing decisions going forward. In summary, most brands are looking at some changes to prior global value chains.

Regionalization

Several brands noted that they are moving more towards a regionalized approach: producing in Asia for the Asian market; producing in the Americas for the American market; producing in Africa for the European market. Some refer to this approach as a "hub and spoke"; centralizing production lines in various countries and using those to provide product to more narrow markets. Taking a "hub and spoke" approach to sourcing provides significant opportunity for the region if they operate as a vertically integrated source for apparel.

Rebalancing

Other brands noted that the pandemic revealed they have overcommitted manufacturing to certain regions. These companies sourced from multiple locations, for example 60% of sourcing out of China, 15% out of the study countries, 15% from Vietnam and 10% from Bangladesh. This distribution of resources demonstrated that as the pandemic reached each supplier, the need to shift manufacturing to other existing vendors could not always be met due to the imbalance. As a result, these companies will continue to have a global supply chain, but they will begin to rebalance the suppliers more evenly. Such a rebalance could result in some production shifting to the region.

Verticality and Sustainability

Brands also noted the need for more vertical suppliers, either as individual countries or as small regional production centers that cooperate to provide a vertical supply chain. This comment frequently focused on the ability of El Salvador, Guatemala and Honduras countries as a possible location for creating a vertical supply chain when combined with the raw cotton fibers from the United States.

In addition, many brands are looking at the sustainability of sourcing more regionally as compared to how they have historically procured goods, inputs, etc. The prospect of climate change and potential carbon taxes for goods crossing borders is a growing concern. By regionalizing production, brands believe they can address two problems at the same time and that the additional costs which may be associated with production in this hemisphere for example can be justified to shareholders through minimizing exposure to the next pandemic and by minimizing the carbon footprint for which the brand is responsible. This dual strategy could be used as a benefit for sourcing from the study countries.

Reduce lead times

One of the pandemic factors influencing brand sourcing decisions is the shift in consumer shopping preferences. Analysts predict the shift to online or e-commerce shopping will remain post-pandemic due to the convenience of the experience and as more companies provide the direct-to-consumer experience, and by the end of the pandemic, will become the new normal.

As a result, brands do not see the need for the large retail operations. If retailers shrink the square footage of sales space, the need for large inventories will diminish. Brands and retailers will be looking for partners that can supply goods quickly and either provide them to restock smaller inventories or ship direct to consumer.

The historic mode of sourcing apparel was based on a wholesale model. In this model, stores project what consumers will buy about nine months before placing the items in the stores. The goods then take months for development and design, manufacture and shipping. The shift to ecommerce will require that historic long lead time to be condensed to weeks not months.

Further, most stores now have about 100 days of inventory – which requires real estate to warehouse. Because of the costs associated with holding large inventory, brands traditionally looked to find the cheapest labor and manufacturing location. If retailers determine they can get rid of the costs associated with holding large inventory, the savings can be used for higher cost manufacturing locations. In the post-pandemic world, we anticipate that brands will want production partners that can link with their stores to know when specific goods are selling and begin to make restock goods and drop ship them to the stores located throughout North America. They also want partners that can ship direct to consumers to assist in ecommerce fulfillment.

These shifts in consumer shopping behaviors, the desire to re-examine sourcing suppliers, the desire to "near-shore" goods are all expected to impact global sourcing going forward. However, the study countries need to focus on becoming a vertically integrated source of quick response goods, drop ship goods and ecommerce fulfillment goods in order to take advantage of the changes.

Some brands noted that during the pandemic, they were able to respond more quickly, recognizing it was a life-or-death situation for their business which necessitated quick decision making and that in many instances they found the long lead times in production were related in part, to lack of quick decision making.

These shifts in consumer shopping behaviors, the desire to re-examine sourcing suppliers, the desire to "near-shore" goods are all expected to impact global sourcing going forward. However, the study countries need to focus on becoming a vertically integrated source of quick response goods, drop ship goods and ecommerce fulfillment goods in order to take advantage of the changes.

Manufacturing in the Study Countries During the Pandemic

The companies interviewed for this study all stated that they were frustrated by the different approaches in their host country to the pandemic and with the level of policy communication by governments to the factories. Many apparel manufacturers switched their production to PPE including face masks, level 1, 2 and 3 surgical gowns and some bedding for hospitals. The shift to PPE production enabled most factories to be deemed essential in the host country and therefore able to continue working albeit at reduced work hours, with a reduced work force and under strict health protocols.

The lack of clear communication from the governments to the supplier manufacturers was a consistent complaint of the brands. Some countries were particularly inept in communication resulting in conflicting information coming from the presidential office, the ministry of health, the ministry of economy and in some instances, the state or local governments. Some brands believed their vendors were being targeted by governments for extortion.

Some countries, in particular Guatemala and Honduras, were viewed as having had the best approach to the manufacturing sector with government officials being willing to work with the industry to reopen factories quickly and safely. The health protocols developed by the apparel industry were adopted for other sectors as a model which demonstrated the effectiveness of the apparel industry in most countries.

Brand/Retailer Opinions of Study Countries

All the brands/retailers that were interviewed[28] expressed a frustration with Mexico, Honduras, El Salvador, Guatemala, Haiti and the Dominican Republic. These companies noted that despite the potential to become a significant manufacturing hub, the countries were not innovative nor coordinated in their approach to the sector. Some of the problems were attributed to lack of government industrial planning and guidance. However, they all noted that there is great possibility for the region if there is a greater commitment by the governments and the region to work together.

Potential for Countries

All the interviewed brands noted that the countries have a significant opportunity now to reinsert themselves into the global sourcing structure of apparel brands and retailers. The manufacturers demonstrated that when necessary they can move at lightning speed to adapt, adjust and change when they reorganized, shifted production to new products and innovated in order to be a contender for continued manufacturing.

[28] See Annex A

The timing of the U.S. tariffs on Chinese goods, the withhold release orders on XPCC cotton[29] and on XUAR cotton[30], the possible legislation[31] both impacting a significant portion of the world's cotton product supply, the need for tracking and tracing, the desire for "near shoring" of goods and the increase in ecommerce and smaller inventories, all position the countries to be more globally competitive. The action by Canada to ban forced labor goods will impact these countries as well.

However, the countries need to recognize that they simply cannot compete from a production capacity standpoint with China and Vietnam, absent significant investment. The lack of resiliency in the supply chain with yarns, trims, fabrics, etc. not being made either in country sufficiently, or in the region, are a significant detriment to substantial increases in sourcing.

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The governments should work towards building integrated agreements that allow for accumulation of inputs across trade agreements.

Collaboration not Competition

Almost every brand stated the need for the countries to collaborate in order to take advantage of the current situation. Countries do not have the scale and capacity individually to absorb the orders that companies would want to have in the region. Honduras is the largest supplier to the U.S. of the study countries, yet it produces five times less than Vietnam and eleven times less than China. Even a small shift of five to ten percent from these Asian producers would have a significant impact on the region.

A regional development plan that the industry presses upon its individual governments will be critical to moving forward. The countries need to work to remove barriers among themselves to demonstrate to investors that the region is ready to expand production. It should not take longer

[29] XPCC cotton withhold release order.

[30] XUAR cotton and tomato withhold release order.

[31] H.R. 6210

to ship goods from these countries that it does to ship from Asia – which in some instances it does.

A regional strategy was noted as a need to move the region into a more globally competitive position. Partnerships with U.S. brands and outreach to large global and best in class manufacturers is seen as critical for investment in the region unless the governments undertook extensive investment. U.S. companies/brands do not invest in brick-and-mortar manufacturing in large part. Of the interviewed companies only a few own their own factories. Most of them partner with manufacturers from around the world that they rely on for goods and that they trust to produce according to their corporate and social responsibility codes. Thus, the outreach for investment is not to U.S. companies to locate factories in the region, but to partner with brands to encourage their reliable global partners to move some production to the region to supply them with the quick response goods and "near shoring" they are seeking.

FTA Integration

The companies all have a presence in multiple retail markets in addition to North America. However, the free trade agreements with individual various countries creates a spaghetti bowl or rules of origin and does not allow for leveraging investments in FTA countries to produce for multiple retail markets. The governments should work towards building integrated agreements that allow for accumulation of inputs across trade agreements. Such a concept was first used by the European Union in the early 2000's when the Union was expanding and adding new member nations. Because the new EU members may have had trade agreements with different countries, the EU unilaterally allowed a triangulation of origin rules. While technically such a program is not WTO compliant, the U.S. and the EU were embroiled in a WTO dispute over the foreign sales corporation tax and thus, the U.S. determined not to challenge the triangulation rules of origin, effectively allowing them to stand and deemed "acceptable" by WTO countries. More recently, in EU free trade agreements, they have provisions that allow for the use of inputs with free trade partners from one region to be incorporated into the production of finished goods in another FTA region and still maintain FTA eligibility. That concept should be pursued by the governments to build a competitive western hemisphere to combat the likes of the TPP and the RCEP agreements.

The FTA accumulation provisions should be fully reciprocal, thus the countries in this study may need to negotiate trade agreements with additional partners in order to comply with a reciprocal provision to all FTA partners.

Further, governments could consider using free trade agreements to modify market access for goods that incorporate some originating components. For example, if a product is not a yarn forward good, but it is a fabric forward, the value of fabric making process could be considered when importing the good and a reduced normal tariff rate could be applied. Thus, a good that may be made in Honduras from fabric made in Guatemala from yarns originating in South Korea with an NTR of 13%, would not be completely disqualified from benefiting under an FTA, but perhaps the FTA rate would be only 75% of the NTR or a rate of 9.75%. This concept will recognize that some value is being added in the FTA partner countries but does not give full duty-free access unless it fully complies with the rules of origin.

The short supply provisions in the CAFTA-DR agreement should be those applied to the USMCA as well and any products that are deemed in short supply in one agreement should be extended to another agreement automatically unless the other parties can demonstrate they manufacture the short supply yarn or fabric in commercially available quantities. This overlapping of short supply provisions recognizes that global production exists until such time as investment can be made in respective regions/countries to remove the short supply provision.

Free Flow of Goods and Company Personnel

Several companies complained of the unnecessary border crossings and delays caused by the Customs service of individual countries. The delays at the border demonstrate a lack of cooperation by the region to the buyers. Simple changes such as coordinating the hours customs officials work in bordering countries is an easy first step that will encourage companies to invest in the countries. Complete elimination of customs procedures at the border or the creation of trusted trader programs in which the governments know the companies, know the flow of goods crossing borders, etc. will facilitate in attracting investment.

The free movement of company professionals should also be instituted to enable companies to quickly address problems in factories that may be located in multiple countries. The delays in manufacturing professionals attempting to move among the countries that was caused by COVID caused problems in factories needing technicians who were isolated in neighboring countries, resulting in production ceasing or slowing. The region should work to integrate a mutually recognized testing and approved protocols to allow manufacturing personnel to travel freely.

Speed to Market

The geographic proximity of the countries should make them a logical source for ecommerce and drop shipments to stores in North America. However, legal policies and government procedures hinder the speed of production and delivery. Several manufacturers reported samples being detained by the Customs service in country for sometimes weeks at a time. These delays have become a factor as to why brands are not placing “fashion” products in the region. Countries need to remove customs barriers to industry in order to “speed” up responses and shrink the development, production and delivery time to days or weeks to respond to the changing needs of the retailers and brands. All countries should be able to ship goods 24/7 and there should not be restrictions on when goods can set sail or be flown to the U.S.

Further, the countries need to address the cost of freight and shipments to North America if they want to become the “third border” for the United States particularly in light of ecommerce needs. Only a few companies have the capacity to either drop ship to stores located throughout North America or to ship direct to consumer. The countries need to invest in training and development of policies that will enable manufacturers to participate in the new production environment.

Production Visibility

Consumers are more interested in knowing how and where their goods are being made. Because these countries all have either free trade agreements or preference programs for duty free access to the North American markets, they have visibility into their supply chains that manufacturers in Asia do not have. Brands will need to know the source of a product basically from "dirt to shirt" – i.e., knowing the origin of the cotton fiber, the yarn spinners, the fabric makers, the cut, make and trim providers. Consumers want to know this information as well.

The study countries have years of experience supplying this type of information readily to U.S. brands and retailers. To support a duty-free claim under the FTAs or preference program, manufacturers today have to present certification and affidavits as to the origin of the yarns and fabrics for many products. The majority of the cotton yarns are spun from U.S. cotton fiber; thus, these countries offer a "safe" manufacturing location with full visibility into the tier 1, 2, 3 and 4 suppliers. This visibility will be highly desirable for brands and retailers in the face of the WRO on XPCC cotton and the pending legislation. Building on the traceability used for free trade or preference eligibility upon importation into the United States, these countries can add one more layer of affidavit and visibility desired by consumers, brands and retailers.

> Governments that implement new wage rates, impose new taxes, adjust the currency rapidly, target specific companies with harassment, or disregard private sector complaints in moving goods quickly and efficiently in and out of the country will not attract investment.

Perception vs. Reality

A major factor in making global sourcing decisions is based on the perception of a country or region's ability to supply quality goods, in a timely fashion, with consistent policy and political stability to minimize disruption in the supply chain. The brands interviewed all had direct experience with sourcing from the region and globally. They noted the above concerns with the region and highlighted the perception that the governments in some of the countries viewed the apparel investing community as a source of income rather than as a partner for national development. While industry cannot take the place of a nation/state in development of social safety nets for its populace, developing countries that have harnessed the power of its industrialists and particularly those exporting U.S. standards and expectation, have been successful in becoming global partners with brands. However, this level of commitment and partnership with the industry must be reflected at the highest levels of government. Consistency in laws and regulations or if changes are implemented, sufficient time for the industry to adjust and respond are essential.

Governments that implement new wage rates, impose new taxes, adjust the currency rapidly, target specific companies with harassment, or disregard private sector complaints in moving goods quickly and efficiently in and out of the country will not attract investment. The study countries have reputations that have tainted the perception for many global sourcing managers. The foregoing notwithstanding, a series of interviews conducted with manufacturers in the countries substantiate some of these perceptions.

However, it is clear that the industry has made some significant progress over the past fifteen years and these improvements and the perception, or misperception, of the region should be addressed by the governments and the industry itself to “reintroduce” a comprehensive plan for the region to be part of a brand/retailers global sourcing strategy in the post-pandemic market.

Part V: Manufacturers’ Experience During the Pandemic

This paper examined not only the buyers, but the producers in the study countries to understand what they did during the pandemic, what they felt worked or did not work, how they plan to prepare for a post-pandemic environment and what they believe will help them move forward. Each country has had its own unique response to the pandemic; thus, each country’s response can be used as a learning tool for the region. Below, we amalgamate the interview responses from manufacturers of yarns, fabrics and apparel as well as conversations with apparel association personnel to outline the needs the industry identified for post-pandemic success.

El Salvador

The producers in El Salvador expressed the greatest amount of frustration with the government’s response to the pandemic. The producers stated that they did not have clear direction from the government with conflicting information being received through twitter, executive orders, national directives and local enforcement. Complaints were made that specific companies were targeted for undisclosed reasons which put all companies in a state of fear from government reprisal. The companies identified several areas that must be addressed by the government if they hope to be able to compete in the post-pandemic supply chain.

Government bureaucracy and unnecessary hurdles to investment were a frequent complaint. For example, approval to begin operations for a new facility took months for an inspector from the government to visit and after a very short visit by the inspector was quickly granted. The delay cost months in potential production.

Customs' policies with respect **to clearing goods**, in particular samples for production, taking weeks frustrates the ability of factories to respond to demands and prevents the region from shifting into higher value fashion production. Similarly, **delays in getting approvals for exporting** goods is a hindrance to becoming an ecommerce supplier despite the close proximity to the U.S. markets and frequent flights.

The **high cost of shipping freight** in the form of a tax on each "package" that is shipped is a severe limitation on El Salvador's ability to participate in this growing business. Current producers that ship direct to consumer will not ship small individual packages but will wait until a significant quantity is ready to ship all at once and pay the fee only one time to Customs. This results in delays in shipment, in additional costs in the U.S. where the larger boxes must be unpacked and more costs when the goods must be shipped using couriers in the U.S. to reach their destination.

Restrictions on goods being returned is another significant hurdle to participating in the ecommerce business. If goods are shipped to consumers and do not fit, or are rejected for any reason, companies need to be able to get the goods returned easily, without fees (as they are El Salvadoran goods returned and should not be taxed) and with no restrictions or delays by the Customs service.

There is **a lack of training** that could be used to build the ecommerce fulfillment niche, including in using software to meet the production needs, English speaking operators to respond to calls from consumers and online marketing experience.

Concerns with **government limitations on shift work** in factories was another significant complaint. While there are some limited provisions to working beyond the typical eight-hour day, the policy is confusing and too restrictive. Manufacturers realize the limitations on workforce capacity due to COVID-19 restrictions, but if they were allowed to utilize existing investments with reasonable shift work and more flexibility in scheduling workers, the producers predict they could triple current production capacity; nearly triple the number of employees; and reduce production times by at least 1/3 to help meet the faster demands of an ecommerce environment.

The lack of transportation for workers was a significant limitation to production and placed an undue cost on manufacturers. The government needs to develop an approach to meeting transportation needs for workers in preparation for the next pandemic.

Greater need for regional cooperation was cited as essential for each individual country to succeed. Removing barriers at the borders among countries, coordinating documentation requirements and developing production hubs in each country so that not each country has to manufacture all necessary inputs will maximize the current production and the region.

Dominican Republic

The Dominican Republic producers expressed frustration with the continued delays in production

resumption. Manufacturers quickly shifted production from apparel to PPE, especially face masks, medical clothing, gowns, coveralls and scrubs. Some companies were able to grow this business and it has sustained the workers. The continued curfews have been frustrating to manufacturers but allowing exceptions for workers has been helpful. The reopening of factories was effectuated rather quickly after a short shutdown. Regardless, there are some areas that need to be addressed comprehensively by the government to make the DR more competitive for the post-pandemic environment.

Freight Costs must be reduced. Currently it costs approximately 30-40% more to ship goods to New York from the DR than an equivalent good from Mexico to New York. There are tariffs at the airport and taxes on fuel which will hinder the development of ecommerce out of the DR. There are many regular flights into North America which could be used for ecommerce fulfillment if the barriers and hidden costs are removed.

There are **duplicity costs in the labor legislation** that need to be updated and modified. The "Cesantia" has increased costs on a per employee basis of 55%. While a company can "opt out" of paying the cesantia, it has become an expected payment by workers and good companies pay the cesantia to compete for the better workers. However, the continued increase in the cost has made it a barrier for producers.

The **transportation of goods in country** needs to be addressed. The trucking industry in the DR is not aligned with, nor cooperating with, the industry. The government needs to facilitate a comprehensive understanding among the manufacturers, the logistics providers and the labor laws in order for good in country to transit smoothly and effectively.

While some producers can meet retailers' needs for drop shipments to outlets across North America and can fulfill ecommerce, there needs to be **more training** for the "back room" service required to fulfill ecommerce production. Specifically, more English language speakers are necessary to be able to field service calls from consumers as well as **training of technicians** to repair machinery particularly as the industry innovates and updates machinery. Many skilled technicians are resident in other countries and during the pandemic were prohibited from visiting the island to make repairs.

Access to capital needs to be updated as companies face slower payment terms from customers as a result of the economic downturn in the North American retail market. Longer payment terms by customers combined with the need to procure inputs for manufacturing (yarns, fabrics, trims) means that producers are being pinched at both ends. The banking industry needs to work with the producers and investors to be able to build more capacity and remain resilient during another pandemic.

Guatemala

The factories in Guatemala all had favorable opinions of the Government handling factory closures during the pandemic. Many producers were able to remain open during most of the pandemic and by using the apparel association were able to work with the government to get permission to manufacture, and to develop and demonstrate to the government the health protocols that they put in place to protect workers. Because neighboring countries were completely shut down, Guatemala was able to capitalize and increase production for orders that otherwise would have been placed in Honduras or El Salvador. The companies identified several areas however, where they believe the government can take action to improve Guatemala's ability to compete in a post-pandemic supply chain.

Some issues did impact production however, such as shutting down **transportation** which was a significant issue for the factories and a plan needs to be developed for the next pandemic. Companies had to self-fund transportation at a time when they could least afford to pay additional for commuting. There is a concern by factories that if a service is provided to an employee for more than sixty days, the government can make the provision of services permanent. Factories are therefore cutting off transportation for workers periodically to ensure they do not exceed the sixty days. Such short-sighted policies will negatively impact additional investment by existing producers.

The **labor laws are a concern** from the perspective of right to work and terminations. The laws require workers to be paid while their case is pending and due to the government slowness, can take months to resolve; meanwhile the employee gets paid sometimes for months for not working. The **changes to wage rates** with short or no notice is also discouraging additional investment in the country. Some factories suggested perhaps looking at different wages depending on the location of the factory as a way to attract more investors. For example, in Vietnam, rural workers make 75% of the hourly rate of city dwellers. This structure is better than the current wages in the rural community, recognizes the costs of living in the rural areas is not the same as in the cities and has helped drive development outside the cities. The government should work with the investors/factories to develop a **strategy for the work force**.

Additional investment will be needed to become an ecommerce provider. The need **for training of workers and language skills** are essential in an ecommerce environment. The couriers will need to work with the government and factories to reduce costs and provide **sufficient cargo space** for shipments that are smaller.

The **costs of energy** need to be addressed from a government level if the region wants to be more vertically integrated. Guatemala may not be the location for yarns and fabrics production with energy costs of $0.17 per kilowatt compared to $0.05 in China. These upstream industries are very energy intensive, thus are sensitive to the cost of electricity. Perhaps partnering with neighboring countries that are bringing alternative energy to the grid will help lower energy costs.

The **customs examinations at the borders** with neighboring countries need to be eliminated. Guatemala relies on inputs and trims from its neighboring countries. Fabric shipments are routinely delayed at the borders severely impacting production times. The Government needs to consider developing a trusted trader's program or cooperation among the countries' customs service (for example ensuring Guatemalan customs officials work the same hours as the agents in the neighboring country as an easy first step). These steps could speed production.

Haiti

The factories in Haiti were closed for a short while but most factories quickly shifted production to PPE and sought essential status from the government to keep working. The factories had to provide the workers with pay because Haiti has no social safety net. While the government did provide a stimulus package, the money was given to the factories and not to the workers. Some factories did not share the money with its workers. The pandemic impact on production however was due more to orders being cancelled than a result of the virus in country. Several hurdles are in place that impact production and the ability to adapt to the new post-pandemic supply chain. The items listed below were raised by the companies as areas for the government to address.

Access to capital is a big issue for factories in Haiti. Manufacturers import all inputs and do not make yarns, fabrics, trims or threads. Companies must therefore pay in advance for the inputs. At the same time, their customers are asking for extended invoice payment terms forcing Haitian producers to have significant cash tied up for longer periods of time. The banks need to make capital available on beneficial commercial terms.

Training for workers is essential for Haiti. There is no comprehensive approach to training management level or technicians thus when they are trained on the job, there is great competition among factories to employ the trained workers resulting in employee shifts that are disruptive. **More English speakers** are also needed particularly if the island moves to be an ecommerce supplier to North America.

More flexibility in shift hours is needed to allow the factories to increase capacity by increasing shift work and hiring more people. While it is allowed currently, it is very complicated and restrictive. When capacity of workers is limited especially, accommodations should be made to allow factories to work three shifts without penalty or additional costs.

Customs procedures need to be streamlined and aligned with factories to facilitate the movement of goods into and out of the country. Delays and unanticipated "fees" to move the goods more quickly are routine and disruptive.

Currency manipulation that is currently in place has made production costs in Haiti double for those companies trading in U.S. dollars. The gourde's rapid appreciation does not allow factories to adjust to increased costs and stifles new investment thereby threatening existing investment. Producing in Haiti presents significant challenges to factories which when compounded with the economic impact of COVID 19 and unforeseen appreciation of the currency while brands/retailers are rethinking their global sourcing strategies lends more companies to rethink their presence in Haiti.

Restrictions on personnel travel during the pandemic have made work difficult as technicians and trained personnel are generally imported from neighboring countries. The restrictions at the border for travel have hampered businesses by slowing repairs and manufacturing.

Honduras

The Honduran companies overall were satisfied with the response and reaction of their government during the pandemic. The association in Honduras is strong and quickly collaborated to develop factory health and safety protocols then met with the government to develop plans to quickly return to manufacturing by shifting to PPE production. The time frame for development of fabrics and products for PPE use was condensed from months to days/weeks and working with suppliers, factories were able to move into PPE production quickly. The free zones recently presented an industrial development plan to the government which it adopted, but there is fear that the law could be reversed by the government and such action would set back industrial development as a result. There were some issues that remained, and the companies expressed a desire for addressing these through governmental action.

Border crossings need to be open and free flowing with neighboring countries. Reports of goods being held at border crossings overnight or the two governments' customs agencies not working the same schedule which interrupts the flow of goods across borders. **The border checks should be eliminated for trusted traders or all goods among the three northern triangle countries.** Chemicals and fabric treatments that were necessary for developing the PPE were delayed at the border upon importation. The Pandemic demonstrated that government could have "electronic" governance and should be continued in a post-pandemic environment. There should be **no need for original documents and signatures**.

Costs for air shipments must be reduced to participate in the ecommerce environment. Additional taxes and fees paid for air shipments need to be removed. The per package requirements limit the ability to ship direct to consumers.

Lending parameters need to be updated as currently banks can easily take over assets for highly leveraged companies. The ease at which assets can be seized puts companies at risk and minimizes a desire to invest significantly in domestic production. Absent more generous lending programs, current investors will not undertake loans needed to invest in expansion or updating efforts.

Access to capital in the industry should be provided by not only the private sector but by the government and/or international financial institutions. The lack of vertical supply chain and attempts to address it will require significant investment. The domestic companies do not have sufficient funds to undertake the necessary investment to build the required infrastructure for an ecommerce world. The Private sector has undertaken significant steps towards developing a vertical supply chain, but it is limited by funds available. The government needs to explore sector specific areas of investment and replicate or make funds available for investor development.

Permitting process should be revised to remove the need for inspection and approval when new investment is coming online. A post investment audit process should be used to ensure the factory is meeting its obligations for the loans and development. Currently the process can take up to two years to establish a company.

Mexico

Textile and apparel companies in Mexico had a different experience from many in El Salvador, Guatemala, Honduras,, Dominican Republic and Haiti countries. Mexico is much more vertically integrated with significantly more yarn and fabric capacity than its neighbors. As a result, its reliance on other country inputs impacted by the virus were less impactful. However, because of the size of the country and the diversity in the spread of the virus, sections of the country experienced different impacts. Companies suffered however as the government failed to respond with a coordinated plan on factory closures and designations of essential businesses. The Ministry of Health was in charge at the Federal level, but this ministry had no understanding of the supply chain in apparel manufacturing, resulting in designations of apparel factories that switched to PPE production as essential but not allowing fabric and yarn mills to continue production to supply the PPE production. Further, each state had its own policies, and, in some instances, localities had a specific agenda for work. Some factories felt intimidated by enforcement officers visiting the premises with locks and seals for the factories to shutter production if certain conditions were not met, which some felt bordered on extortion.

Mexico needs to **review the current pandemic to identify essential operations** for possible future similar situations. Many factories suffered early during the pandemic due to a **lack of clear guidance from a national level.** The policies published by the Ministry of Health with respect to "essential business" were vague and allowed for each locality to interpret whether a factory met the essential criteria. Apparel factories were able to quickly switch to manufacturing PPE, but yarn and fabric mills were not granted essential status as quickly. Similarly, companies with locations in multiple states were subjected to different rules and requirements.

Because of the symbiotic relationship of many textile and apparel companies in Mexico with the United States, companies suggest **coordination with the U.S. on definitions of essential manufacturing, health protocols and operations at the border.** The difference in designations between the two nations sometimes led to manufacturing slowdowns and conflicting protocols between U.S. brands and Mexican workplaces. These conflicts had to be resolved at the local levels with health inspectors resulting in confusion and disruption.

Mexico should **institute an extraordinary and expedited TPL allocation policy during times of a pandemic.** The provision of PPE to the United States and Canada was stifled by the terms of the USMCA. Some surgical scrubs, sheets and other PPE equipment required the importation of fibers and filaments from outside the FTA countries. These inputs when incorporated into a finished product would render the goods ineligible for duty free origin, but the goods could enter duty free if they were allocated quota under a Tariff Preference Level (TPL). The Mexican government's oversight and historical methodology for TPL allocation restricted companies that previously did not use TPL or have TPL allocations from being able to use the quotas to enter PPE into the U.S. and Canada duty free thus putting these products at a cost competitive disadvantage.

The government should consider **discussions with the United States and Canada on domestic buying requirements to incorporate a USMCA qualification** as these nations are moving more towards limitations on the use of non-national inputs in making certain goods. The symbiotic relationship in the textile and apparel industry among the U.S., Canada and Mexico makes it difficult to separate production and should recognize that all three nations consider the agreement as an exception when establishing any "buy national" new laws. Additionally, the trading bloc should work together for **nearshoring production** and establish understandings based on the agreement to ensure cooperation.

Companies suggest that the Mexican government consider **tax breaks for corporations that continue production or other benefits if employment is maintained for certain percentage of normal work force.** The lack of a sufficient safety net for the average Mexican worker is a concern for employers. Many companies were faced with paying workers regardless of their ability to come to work due to reduced production or shutdowns from the pandemic. These companies watched their counterparts in the United States receive funding assistance for workers and other benefits. The toll on the companies risks some companies' ability to withstand the full pandemic.

Recognizing that work force may be diminished during a pandemic, Mexico's Aduanas and SAT need to **ensure that the border is being policed with the same vigilance**. Concerns were raised that during the pandemic the Mexican customs service was not sufficiently policing the border with the United States and that goods were being rerouted from the U.S. into Mexico from Asia and undercutting local production, especially of PPE.

Efforts to address the increase in ecommerce within Mexico and externally with the United States and Canada need to be a focus of the private and public sector. The companies in Mexico were not prepared for the increase in ecommerce activities. Logistics and delivery need to be addressed as well as the limitations caused by insufficient infrastructure both for **roads and transportation as well as digital traffic**, within Mexico especially.

The prospects of nearshoring and the shift to drop shipment and ecommerce as well as requiring suppliers to maintain inventory could benefit from **increased training and resources sponsored by the government or international financial institutions.**

PART VI: Conclusion and Recommendations

COVID 19 has had a business altering impact on all countries and in particular in the textile and apparel industry in this hemisphere. The changes exhibited by manufacturers to adapt and quickly shift production in an effort to stay open demonstrated that the preexisting methods of new product development should be eliminated, and the pandemic level quick response should be implemented. Decisions should not be delayed, and product inputs and samples should not be held at ports. Barriers to moving goods quickly whether legislative, regulatory or administrative should be removed to allow manufacturers to supply the post-pandemic world of ecommerce and drop shipment sourcing.

The natural benefits of geographic proximity and duty-free access remain attractive to buyers, but the need for greater capacity, more flexibility, more verticality and more speed are essential for the future. Because these countries have been supplying brands/retailers with information on country of origin for inputs, they have an advantage in ensuring full visibility into the supply chain which is essential as more U.S. policy action is taken with respect to preventing the import of any goods containing cotton that may have been produced using forced labor.

As set forth above by the buyers and retailers when looking at the study countries for expanded operations, there are specific areas that need to be addressed in each country. But as also elaborated by the interviewed companies, is the need for a regional vertical supply chain that is a collaborative not competitive interaction. A special emphasis should be placed on businesses in country and in consistency across political changes within a given country. Business thrives on certainty and the governments of the countries need to ensure that there is a consistent, transparent and cooperative investment incentives and maintenance structure for existing investment.

On a regional basis, the countries can take specific action to address some of the concerns surfaced in this study.

Recommendations

1. **Regional Pandemic council.** The countries should develop a northern triangle pandemic preparedness approach for El Salvador, Guatemala and Honduras that coordinates with Mexico and Dominican Republic and Haiti. Each government should individually and then collectively ensure a streamlined and direct line of communication with the factories. Definitions of essential businesses should be coordinated to ensure the entire supply chain is able to function during a pandemic. Communication from the government should be clear with respect to shutdowns and limitations on production, transportation, etc. with timetables affixed noting that such timetables may be adjusted pending pandemic outbreaks and that such restrictions may be limited on a local basis and not country wide. Each country may task various agencies to govern pandemic preparedness but should include not only the Ministry of Health, but also the Ministries of Commerce, Economy, Industry, Customs and Finance. Each ministry governs a different aspect of trade, employment, investment and currency which if regulated and coordinated in the next pandemic can help ensure that working with manufacturers; employees can continue to work to minimized economic strife, and inputs can continue to flow to ensure production. Countries should consult to develop travel protocols recognizing that the workforce needs to move as freely as possible following clearly elaborated health protocols. In recognition of the shared borders, the Customs agencies of the countries should be aligned with respect to hours of operation and procedures to follow for goods and for individuals. The Pandemic council should ensure it works closely with the investor community as during the COVID 19 pandemic,

the manufacturers were able to develop and implement a health protocol within a matter of days while the bureaucracies were still trying to determine whether to develop one or not.

2. **Regional Collaboration Council.** Outside of the pandemic, the governments need to work together to eliminate competitive restrictions that inhibit investment in any of the countries. Agreed protocols for free trade zone or manufacturing zones should be consistent and the movement of goods within the countries into or out of the zones as well as between countries should be free flowing and uninhibited by border crossings or time intensive reviews by the customs service. The number of investors and manufacturers in each country is relatively small and manageable thus allowing enforcement agencies to "know" the primary players. Trusted trader initiatives should be instituted that recognize "known" manufacturers. Trade lanes should be clear and swift for "known" or "trusted" traders. Innovative tracking of merchandise flows can be employed by the factories and shared with the governments helping to speed the goods to market from the factory loading dock. Within the context of textile and apparel manufacturing and becoming a more vertically integrated region, each country should undertake an internal examination of areas where it can excel and focus to expand the offerings of yarns, fabrics, trims, apparel and recognize that no one country can be all things at once. The individual countries cannot compete with apparel manufacturing in Vietnam, but together as a region they can be more competitive. The regional collaboration council should develop five-year and ten-year plans to set forth objectives and benchmarks that will move the plan forward and hopefully withstand political changes in each country. It is essential however that the industry and investors be included in the council and development of long-term plans as their buy-in and support will help ensure that the plans for industry development will withstand changes in government and provide a means to hold governments accountable.

3. **Factory innovation.** The factories need to undertake the same level of intensity and action that they took during the pandemic to modify production lines, employ health protocols, provide transportation, shift to new products or increase production to account for losses in other countries, now to take advantage of the opportunities being provided to them because of U.S. actions on competitor nations. Innovation and modernization of production needs to be a priority. Recognition of the changes in the consumer shopping experience, the decline in the need for huge retail physical locations and the desire by retailers to move away from holding more than three months of inventory need to be incorporated into new account management strategies by manufacturers. Industrialists need to understand that duty free access is no longer a decisive factor when brands place orders. Brands are looking for manufacturers that can be flexible, quick, provide drop shipments or direct to consumer shipments, can ensure visibility in the entire supply chain, are near shore, meet sustainability criteria and are vertically integrated with the U.S. market. The case study by the World Bank on PVH in Ethiopia should be reviewed to demonstrate the elements of commitment needed by industry, governments and customers to build a progressive and updated industry.

4. **Renewed Outreach and Rebranding.** Because brands/retailers will have to demonstrate to the respective Customs Agencies that their supply chains do not contain Chinese

cotton, these countries are perfectly positioned to offer a much greater level of security provided they can offer the variety of products required by brands. The existing U.S. withhold release order (detention) on XPCC cotton and cotton containing products issued on November 30, 2020, the WRO issued for all Xinjiang Uyghur Autonomous Region (XUAR) cotton and cotton containing products issued on January 13, 2021 and potential legislation on restriction all goods made in whole or in part from the XUAR along with the Canadian seven-pronged action on forced labor announced January 12, 2021. These restrictions on a major supplier of apparel offers a unique opportunity for Mexico, El Salvador, Guatemala, Honduras, Dominican Republic and Haiti for textile and apparel access to these markets. These free trade and preferential program partners have visibility already to the yarn level and can easily adapt to include visibility to the fiber supply and to the farm level. At the same time, the section 301 tariff on Chinese goods and the possible imposition of section 301 tariffs on Vietnamese goods offers textile and apparel producers even a more competitive price point for U.S. and Canadian brands and retailers. Study countries can provide the tracking and tracing U.S. brands need however, such information may require intensified documentation retention and availability protocols by producers. The countries should consider individually or jointly marketing the security and full visibility of their supply chain and ability to offer near shore options as the "new" reasons to invest in the region.

5. **Preclearance of goods in country to U.S.** The countries should explore cooperative agreements with the United States and Canada customs service to ship goods from the region into their markets without interruption. The customs services in each country can work to attain pre-approved customs clearance for shipments. Companies can participate in the Customs Trade Partnership Against Terrorism (C-TPAT) program, the Canadian Partners in Protection (PIP) program and explore if a program similar to the Canadian – U.S. Free and Secure Trade (FAST) program could be developed. These initiatives would help speed the flow of goods into the U.S. and into the countries. Puerto Cortes is already part of the CSI initiative but there has been no successive additional measures put in place to address the flow of trade in a seamless and rapid manner. All of the countries participate in in the Business Alliance for Secure Commerce BASC, but the program has not expanded. Building upon the existing commitments of the businesses and working with their respective and regional customs services, the countries could expand the measures taken to address the needs of increased speed to market and minimal delays/costs.

6. **Education and Training.** Each country needs to focus on increasing the managerial training, the engineering training, the English language training and the ecommerce training to address the changing supply chain. The training could be conducted online as we have learned in the pandemic indicating that not each country would have to develop a training program but could share resources and have similar training modules available to their employees. Leveraging training programs on a regional basis would build the collaboration and maximize the benefits of investment in such programs. The training programs however must be closely aligned with the needs of the industry. Manufacturers are aware of their needs and at what level the training

should be conducted. The industry and the training facilities must work together to train employees to do the work needed, not just to provide additional training.

7. **Individual Country Reviews.** Each country needs to conduct an internal needs assessment in the industry as well as a SWOT (strengths, weaknesses, opportunities and threats) analysis. These reviews can demonstrate if a country is more suited to develop yarns and fabrics, or trims and sewing thread, or manmade fibers and fabrics, or to produce more intricate and labor-intensive apparel. Each country can bring its assets to the regional planning council and target investment into the areas identified as strengths. If there are gaps in regional strength areas, the countries can collaboratively develop a strategy to turn the weakness into a regional strength.

8. **Nearshore Opportunities.** The pandemic demonstrated that countries and manufacturers can work expeditiously when necessary. It demonstrated that governments could accept documents electronically. It demonstrated that working with "partner" countries is a solid strategy for future pandemics. The desire by the United States to relocate more manufacturing domestically or to "near shore" manufacturing presents great opportunity to the study countries.

   This desire combined with the attention now given to where a good is sourced and how it is sourced also present an opportunity to the countries. Coupled with the recent U.S. and Canadian government banning of goods made with forced labor and the potential U.S. law that will require brands and retailers to have full visibility into their supply chains from "dirt to shirt" gives the region even more options for becoming a near shore partner for the United States.

   Specific near shore options for the study countries include:

   1. Provide "drop shipments" directly to retail operations throughout the United States;
   2. Provide ecommerce fulfillment services;
   3. Provide PPE supply in cooperation with U.S. yarn, fabric, chemical makers;
   4. Provide cotton goods with full visibility to the source of the cotton fibers; and
   5. Provide manmade fiber goods with full visibility to the source of the fibers.

   These areas will require some investment and development, however, the visibility into the full supply chain is a growing an urgent need for brands and retailers. Because these countries have been in free trade or preferential arrangements with the United States, they have an advantage and a tracking and tracing system that other suppliers cannot offer. Most of the investment is not going to be U.S. or Canadian, but it will be Chinese, Taiwanese, S. Korean, Hong Kong, Sri Lankan, Indonesian, etc. These are entities that have invested in China and Vietnam and are seeking alternative sourcing. However, coordination with the brands to identify which of their Asian suppliers are those which they would like to see invested in the region is essential first.

9. **Target Investors from Asia and Cultivation of existing Investors.** Because of the U.S. and Canadian actions on forced labor especially in China, manufacturing is leaving China, but it has not come to this region. The individual countries should focus on global suppliers to the leading U.S. and Canadian brands/retailers as targets for solicitation. Partnering with U.S. brands/retailers to identify their best-in-class suppliers and working together to expand investment in the region will yield higher returns on effort. The host Governments, however, must commit to providing attractive investment climates.

   The host governments should also not neglect their current investors. Outreach with existing investors to address facilitation or bureaucratic concerns will increase the possibility of expanding existing investment. Eliminating restrictions on manufacturers to maximize their current capital investment (i.e., shift work requirements) will increase employment and expand capacity without requiring new investment.

   Changes to wages, benefits, taxes, or currency manipulation that is not conducted in a transparent and cooperative manner with manufacturers prevents expanded investment. Companies need certainty. Orders are secured months in advance and payment terms are concluded based on existing economic terms. Overnight or rapid changes by the governments frustrate company certainty. Manufacturers agree that they can adjust to changes but need sufficient consultation and time to gradually implement changes and minimize contract disruption.

   New investment or expanded investment licensing, certification, approvals should be provided in minimal time frames. Each government should hold accountable the entities authorized with oversight for such approvals to an investment ombudsman-type office.

   Banking institutions need to consider the extenuating circumstances that all countries and business are facing in the post-pandemic environment. Consideration for extended payment terms requested by buyers/retailers in the U.S. and Canada as well as the costs facing manufacturers who must procure the inputs up front should be included when making lending decisions.

10. **FTA Integration and Regional Integration.** The free trade agreements are all currently in "silos". Each agreement stands independent from the other with respect to agreements with the U.S. and Canada. The governments should consider enacting domestic provisions that would allow goods the same duty-free status of a direct party if the goods are processed or include inputs from another free trade partner. For example, Mexico would allow duty free treatment to apparel made in Guatemala from fabric made in the U.S. from yarns made in Mexico. This benefit can be proclaimed by the importing country through legislation or

regulation. Alternatively, the study countries could seek to amend existing FTAs to allow the accumulation of inputs, but such effort could result in changes to the agreement that may not be beneficial. However, the EU sets the example in its FTAs allowing regional accumulation among FTA partners which could/should be emulated.

The study countries are poised to take advantage of a post pandemic supply chain if they address some of the concerns raised in this paper. The region can re-brand itself and demonstrate to U.S. brands and retailers that it can be flexible and quick in supplying goods. The visibility into the full supply chain to the fiber level offers brands/retailers assurance they need to meet U.S. laws and regulations. The proximity to market helps with companies' desire to nearshore and their desire to reduce their carbon footprint. All of these factors work in the regions favor. However, the ability to take swift advantage of these factors rests in the hands of the governments and the industry.

Annex A: Brands/Retailers/Manufacturers Interviewed

U.S. Brands

- HBI
- GAP
- Fruit of the Loom
- PVH
- VF
- Under Armour
- Timberland

El Salvador

- Pettenati Centro America SA de CV
- Textiles Opico SA de CV "TExOps"
- Youngone El Salvador
- St Jack's
- Konffetty SA de CV
- Intradeco
- Varsity sports LTDA

Dom Rep

- RJ Torres MFG SRL
- Grupo M
- HanesBrands Inc.

Guatemala:

- Imperialtex
- Sae-A
- Texfor SA
- Textiles Paraiso SA, Texpasa
- Intradeco

Honduras

- United Textiles of America
- Elcatex
- Protexa
- Intradeco

Haiti

- **Grupo M**
- **Hansae**
- **HanesBrands Inc.**

Mexico

- **Provedencia**
- **Kaltex**
- **Espintex**
- **Canaintex**
- **Consultores Internacionales Ansley**