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Economic and Employment Impacts on the Dominican Republic of Changing Global Trade Rules for Textiles and Apparel

Submitted to

USAID/Dominican Republic

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Submitted by

Nathan Associates Inc.

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Nathan Associates Inc.
Support for Trade
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Prepared by
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Glossary

ATC	Agreement on Textile and Clothing
CA-5	Guatemala, Honduras, El Salvador, Nicaragua, and Costa Rica
CBTPA	Caribbean Basin Trade Preference Act
MFN	most favored nation
NAFTA	North American Free Trade Agreement
OTEXA	U.S. Department of Commerce, Office of Textiles and Apparel
US-CAFTA	U.S.–Central American Free Trade Agreement
WTO	World Trade Organization

Executive Summary

By January 1, 2005, U.S. textile and apparel quotas will be eliminated. As a result, low-cost suppliers in Asia will no longer face a significant constraint on their exports and the Dominican Republic will lose an important benefit of preferential access to the U.S. market.[1] In this paper we estimate the impact of the quota phase-out on Dominican Republic apparel shipments and on employment in the sector. We project that apparel shipments will decline by 35 percent, inducing a drop in direct employment in the sector of 41, 500 jobs. Losses in direct employment do not include losses in supplier industries and the informal sector, which are estimated at two to three times the number of direct employment losses.

At the same time as the quotas are nearing their end, the United States and five nations of Central America—Costa Rica, El Salvador, Honduras, Guatemala, and Nicaragua—are negotiating a free trade agreement (US-CAFTA). We also estimate the impact of the quota phase-out under three scenarios that assume a successful conclusion to the US-CAFTA talks:

1. The Dominican Republic is not a party to the US-CAFTA.
2. The Dominican Republic is a party to the US-CAFTA.
3. The Dominican Republic is a party to the US-CAFTA, including relaxed rules of origin for textiles and apparel.

The Dominican Republic's failure to participate in a US-CAFTA, the first scenario, would magnify the impact of the quota phase-out. Losses in the textile sector of the free zones (*zonas francas*) are projected to be more than 46,000 direct jobs. Losses in export shipments are projected at nearly $850 million, or 39 percent of 2002 apparel shipments.

If the Dominican Republic becomes a party to a potential US-CAFTA (the second scenario), the negative impact of the quota phase-out would be attenuated. At least 16,640 direct jobs would be saved, and shipments would recover by US$305 million, which would reduce losses

[1] The primary benefits of preferential access to the U.S. market are (1) reduced or zero duties and (2) unrestricted access (quota free) for garments constructed of U.S. materials.

due to the quota phase-out to 29,633 direct jobs and US$544 million in shipments, or 25 percent of 2002 textile exports.

If the US-CAFTA provided for a liberal rule of origin enabling Dominican producers to lower material costs by 10 percent (scenario 3), the effect of the phase-out of U.S. quotas would be further moderated.

A sharp increase in U.S. imports of apparel from China accounts for as much as half the projected impact of the quota phase-out on Dominican producers. If the United States determined that surges in imports from China warranted invoking special China-specific safeguards, the Dominican Republic could have up to three years to adjust to the new competition in the market.

What will a quota-free world be like and how can the Dominican Republic prepare for it? According to a U.S. Department of Commerce survey, U.S. apparel buyers plan to reduce by half the number of producers from whom they source apparel soon after quotas end. Buyers also indicate that they require the value-added knowledge and services of large firms, such as design shops, floor-ready merchandise, and full-package production, so it is also likely that opportunities for basic "cut, make, and trim" operations, which are characteristic of many Dominican operations, will be reduced. Adjusting to this new trade environment may require implementing the following strategies:

- ***Clustering of small and medium-size firms to share resources and knowledge.*** As U.S. buyers reduce the number of firms from which they source apparel, they will be looking for partners that can offer full-package capabilities, including broad product lines and value-added services.[2] Many Asian firms already offer these services, and their importance is expected to grow in a quota-free competitive environment. To improve competitiveness, access to capital, and ability to partner with U.S. buyers, small and medium-sized Dominican textile firms need to improve coordination among themselves and share resources and knowledge to gain an equal footing with large, integrated textile firms.
- ***Improving knowledge of material sourcing.*** In a quota-free world, a significant benefit of using certain U.S. materials will be eliminated.[3] Some producers may improve their competitiveness by sourcing new or similar fabrics and yarns from low-cost suppliers in the region or elsewhere. By forgoing tariff benefits, some producers may gain advantage in material cost and variety.
- ***Diversifying production from products with significant* quota *protection to products with significant* tariff *protection***. Today, more than half of the Dominican Republic's exports are

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[2] Full-package services include design capabilities, logistics, fabric sourcing, product selection, and customer service.

[3] The average tax equivalent paid for quotas in Hong Kong, India, and China is 19 percent, while duties on these same products are only 18 percent.

in categories for which liberal quota access to the U.S. market is the most significant benefit of preferential access. When quotas end, U.S. tariffs will offer the most important benefit. Successful producers will likely change product mixes to include more products with high U.S. duties rather than restrictive quotas to maximize the benefits of preferential access to the U.S. market.[4]

- ***Ensuring new customs regulations are efficiently implemented***. The Dominican Republic currently enjoys one of the most efficient customs and transportation hubs of any supplier to the United States. New U.S. customs regulations since September 11 threaten to increase the time and uncertainty of shipping products by containerized cargo. Delays and costs due to new regulations could disproportionately affect Dominican Republic exports. However, if the Dominican Republic implements U.S. customs regulations rapidly and cost effectively, it could capitalize on its reputation for swift and reliable customs clearing and delivery.
- ***Engaging in free trade negotiations and ensuring that negotiated provisions benefit the Dominican Republic.*** Concluding a free trade agreement with the United States and changing the rules under which apparel can claim duty-free treatment may be the most effective means of countering the competitive challenge posed by the elimination of quotas. A 10 percent reduction in selected material costs, combined with free trade access to the United States, could reverse much of the negative impact of quota elimination. Fabric prices might be reduced if the rule of origin granted duty-free benefits to Central American, North American, or certain nonregional fabric. Alternatively, eliminating duties on regional value added, regardless of material origin, could benefit the Dominican Republic. For example, if the material costs of trousers alone were reduced, in addition to the remaining duties being removed, losses due to quota elimination would be cut in half to just 12 percent of baseline 2002 textile shipments and employment.
- ***Diversifying exports from textiles and apparel.*** According to the estimates in this report, even in the best scenarios, apparel exports from the Dominican Republic cannot be counted on to maintain employment and income growth. Officials in the Dominican Republic should explore nontraditional export opportunities in goods and services.

In sum, by participating in US–CAFTA negotiations the Dominican Republic could improve Dominican producers' access to the U.S. market. Even merely "docking on" to the agreement could moderate the detrimental impact of the quota phase-out, while failure to participate in either the negotiations or the resulting agreement could magnify the impact by weakening producers' market access position vis-a-vis suppliers from the five Central American countries participating in the negotiations. A free trade agreement is unlikely to eliminate all the negative effects of quota elimination on production, employment, and poverty in the

[4] While U.S. apparel duties average 17 percent, peak duties exceed 30 percent on synthetic knit products. Currently, the Dominican Republic principally exports apparel products with duties near the average of 17 percent.

Dominican Republic. Producers, therefore, would do well to improve their ability to produce cost effectively, meet buyer demands for full-package services, diversify production, and streamline transportation and customs processing delays to boost their competitive position in the U.S. market. And Dominican officials should consider decreasing the nation's dependence on textile and apparel exports to the United States by diversifying the industrial base into other products such as processed food, electronics, and value-added services and into other markets, perhaps in the Latin American and Caribbean region.

1. Overview

On January 1, 2005 the United States and the European Union will conclude a decade-long phase-out of textile and apparel quotas, ending nearly 45 years of trade regulation and relative stability. The Dominican Republic, having been granted liberal quota access to the U.S. market, will see its margin of preference in the U.S. market erode with the elimination of quotas. In contrast, low-cost suppliers, principally in Asia, will benefit from the elimination of quotas, which have constrained their exports to the U.S. market. More than one-half of the trade barriers Asian countries face today are a result of restrictive quotas. Tariffs on U.S. imports from Asia average 18.7 percent[5] while the average tariff equivalent of quotas constraining Asian suppliers in the U.S. market is an additional 19.1 percent.[6] When quotas are eliminated, the Dominican Republic will encounter greater competition for the U.S. market and this is projected to curtail Dominican apparel exports and the jobs they support.

In early 2003, the United States and five Central American countries (Costa Rica, Guatemala, Honduras, El Salvador, and Nicaragua)—significant suppliers of textiles and apparel—initiated negotiations for a free trade agreement. One goal of these negotiations is to improve the textile and apparel benefits these countries currently enjoy. If the Dominican Republic does not become a party to these negotiations it will confront the elimination of quotas without any improvement in its preferential access to the United States that its local competitors may obtain under the prospective United States–Central American Free Trade Agreement (US–CAFTA).

The Caribbean Basin Trade Preference Act (CBTPA) provides apparel from the Caribbean Basin with duty-free access to the U.S. market through September 2008. These benefits apply to both the Dominican Republic and the five Central American countries (CA-5) engaged in the free trade agreement negotiations with the United States. The US–CAFTA would benefit the CA-5 by granting duty-free access permanently on a negotiated basis, rather than subject

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[5] Average of the products the Dominican Republic ex ports; the overall U.S. average is 17 percent.

[6] Economists refer to the tariff equivalent of a quota as the export tax equivalent (ETE) of a quota because an export tax is levied before the import tax (tariff) is charged. The ETE is the level of duty that would restrict exports to the amount allowed by the quota.

to unilateral approval by the U.S. Congress (as under the CBTPA).[7] Other potential benefits accruing to US–CAFTA partners are changes to the rules of origin that define the products that receive duty-free access to the U.S. market. The CBTPA rule of origin for apparel requires apparel to be constructed of U.S. fabric and yarn to qualify for duty-free privileges.[8] Permitting the use of local fabric and yarn can increase opportunities for local producers to integrate into textile production and reduce the costs associated with purchasing fabrics and yarns from the United States.

The rapidly changing trade environment will surely result in a world market that looks different from the current one. Textile and apparel producers will face newly empowered buyers looking to reduce the number of suppliers from which they purchase apparel. Buyers will seek suppliers who can provide value-added services and broad product lines. Dominican Republic suppliers can do several things to meet these challenges, including clustering firms, improving design capabilities, handling all aspects of production including transportation and fabric sourcing, and ensuring efficient customs processes to meet the challenges of new U.S. antiterrorism programs.

In the following chapters we first estimate the potential impact of quota elimination on Dominican Republic exports and employment. Next, we assess the potential effects of the US–CAFTA on the Dominican Republic. We model scenarios that include the Dominican Republic in the US–CAFTA and that exclude the Dominican Republic from the agreement. We then simulate the effects of a reduction in material costs such as may be achieved with a liberal rule of origin and with Dominican Republic participation in the US–CAFTA. We conclude by reviewing several strategies the Dominican Republic may pursue to improve the competitiveness of textile and apparel producers and encourage diversification of the economy from its concentration on the textile and apparel sectors.

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[7] Caribbean Basin countries run the risk that the CBTPA is not renewed, as has been the case with preferences granted to Andean countries. Moreover, because the CBTPA is a unilateral preference granted by the United States, its benefits may be changed or revoked at any time.

[8] Current CBTPA rules permit knitting and dying in the Caribbean subject to an annual cap. Woven fabric used in apparel certified for the elimination of duties must use fabric constructed in the United States and, in some cases, U.S. thread is required.

2. Quota Elimination

Background

Trade-distorting quotas have governed trade in textiles and clothing for most of the past half century. The WTO's Agreement on Textiles and Clothing (ATC), negotiated during the Uruguay Round and effective January 1995, is the basis for reintegrating textiles and apparel into the world trading system, which generally prohibits nontariff barriers such as quotas. Under the ATC, the 10-year, four-stage transition to quota-free textile and apparel trade will end December 31, 2004 (Table 1).[9]

Table 1
Stages of ATC Textile and Apparel Quota Phase-out

Stage	% of US textile and apparel trade (1990 quantity) to be free of quota	Annual increase in growth rates permitted by quotas (%)
I. 1995–1997	16	16
II. 1998–2001	17	25
III. 2002–2004	18	27
IV. 2005 (final)	49	No quotas left

SOURCE: U.S. Department of Commerce Office of Textiles and Apparel: http://otexa.ita.doc.gov.

The first two stages of quota elimination (1995–1997 and 1998–2001) had no sizeable effect on either exporting or importing markets because quotas were removed principally from products that had not been constrained by them, so imports were generally below quota levels. Changes during the third stage, 2002–2004, are expected to have substantial effects,

[9] Quotas will remain in effect for a small number of non-WTO countries such as Vietnam. Other trade remedies also may take a quota-like form.

however. Tariff lines accounting for 49 percent of trade, including the most restrictive quota categories (based on 1990 import volume), will be liberalized only in the tenth year.

Competition among exporters of textiles and apparel in developing countries has intensified during Stage III. Knowing which product categories and countries are quota-constrained and which are not is crucial to understanding how the Dominican Republic will fare in Stages III and IV of quota elimination and to appreciating how the pace of reorganization and adjustment in the global textile trade will accelerate in the period leading up to December 31, 2004, and especially after that date and with China's accession to the WTO (discussed later).

Many countries and products are included in the quota system, but only a small number is actually constrained by quotas because many countries, including the Dominican Republic, do not completely fill their quotas.[10] Eliminating an unfilled, nonconstraining quota has little effect on a country's ability to export because the country could have continued to export until reaching the quota in any case. Alternatively, when a constraining quota is removed, such producers experience a marked increase in competition from the exports by previously constrained competitors. Table 2 presents U.S. imports from quota-constrained and quota-unconstrained countries, including the Dominican Republic, by major product group.

Of all the textile products the Dominican Republic exports (according to 2002 figures), 85 percent are in categories for which the United States has constraining quotas on other countries (Figure 1). The remaining 15 percent are in categories for which the United States does not have quotas or for which the quotas are not constraining.[11]

The number of countries constrained by U.S. quotas varies by product, with four countries having constraining quotas on swimsuits, coveralls, and headwear, and 17 countries constrained by quotas on cotton knit shirts.[12] Countries that are constrained by quotas include China, Hong Kong, India, Pakistan, Bangladesh, Thailand, and Indonesia; a full list of the countries constrained in each category is provided in Appendix A.

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[10] A quota is defined as constraining if it is 85–90 percent filled because complexities in the quota management system can make it difficult to fill a quota completely (U.S.ITC 2002).

[11] More than half of the 15 percent of Dominican Republic exports not affected by quota elimination in 2005 include body support garments and selected babies' clothes.

[12] U.S. quotas on knit shirts sometimes categorize T-shirts and tanks separately from other knit shirts. Quotas on non-T-shirts and non-tank shirts are significantly more restrictive than those on T-shirts and tank shirts.

Table 2
U.S. Apparel Imports Constrained and Unconstrained by Quotas, 2002

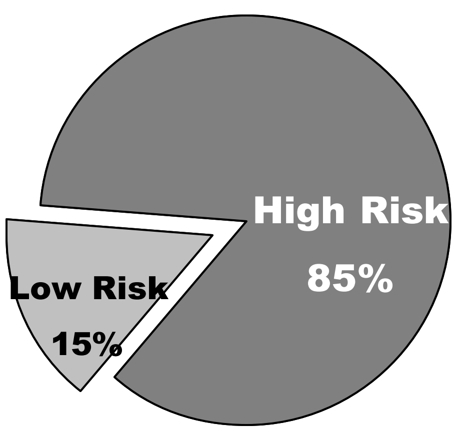
Product	Dominican Republic		Countries Quota-Constrained		Unconstrained (US$ Million)
	Value (US$ Million)	Share	No. of Countries	Value (US$ Million)	
Cotton trousers	729	34%	16	3,384	6,292
Cotton underwear	276	13%	10	456	1,654
Synthetic trousers	251	12%	15	1,586	1,471
Knit shirts, including T-shirts, tanks shirts, and other knit shirts	198	9%	17	3,601	6,113
Other synthetic apparel, including swimsuits, overalls, and headwear[a]	89	4%	4	192	750
Other, including robes, nightwear, woven shirts, and products not listed elsewhere	307	14%	22	7,428	18,598
Subtotal constrained categories	1,850	85%	14	16,648	34,879
Unconstrained categories[b]	327	15%	--	--	5,373
Total	2,177	100%	14	16,648	40,251

SOURCE: *Data from U.S. Department of Commerce Office of Textiles and Apparel (OTEXA).*

[a] *Figures do not match OTEXA statistics because part categories integrated before 2002 were recategorized as non-restrained .*

[b] *Primary products are brassieres and babies' garments.*

Figure 1
Dominican Republic Exports to United States that Risk Being Affected by Quota Elimination on January 1, 2005



When producers in quota-constrained countries export, they often are required to obtain quota rights, increasing the cost of apparel exports to a quota-constrained market such as the United States.[13] Calculated quota costs differ according to product and country. Table 3 presents the average tariff-equivalent quotas constraining China, Hong Kong, and India and the average most-favored nation (MFN) tariff paid by nonpreferential suppliers, such as producers in Asia, for the products exported by the Dominican Republic.[14]

Table 3
Some Average Tariff Equivalents and MFN Tariffs for Some Categories of U.S.-Imported Garments, 2002

Product	Average Tariff Equivalent of Import Quotas for China, Hong Kong, and India	Weighted Average of MFN Tariff[a]
Cotton trousers	44%	17%
Cotton underwear	17%	10%
Synthetic trousers	18%	28%
Cotton knit shirts[b]	32%	18%
T-shirts and tank shirts	12%	17%
Knit shirts	43%	18%
Other synthetic apparel	12%	18%
Other—constrained	19%	18%
Total constrained categories	19%	18%

SOURCE: Calculation of Chinese, Indian, and Hong Kong export tax equivalents presented in Appendix A.

[a] *MFN tariffs are the duties that WTO members pay. These are averages because each category represents many products for which duties vary.*

[b] *Quotas for China and Hong Kong are subdivided into T-shirts and tank shirts and all other knit shirts of cotton.*

Combined, the tariff equivalent of quotas and the average MFN tariff equal the barriers imposed on quota-constrained exporters. Tariff equivalents of quotas vary from a low of 12 percent on cotton T-shirts and tank shirts to more than 40 percent on knit cotton shirts and cotton trousers, with synthetic trousers and cotton underwear in a middle position. More than 55 percent of the Dominican Republic's exports are in three categories for which quotas are the principal constraint on China, Hong Kong, and India (cotton trousers, cotton underwear, and knit shirts).

[13] Although some producers do not bid on quota rights each year, they often have the opportunity to sell their rights, and so incur an opportunity cost if they do not use them to their full value. Calculating quota prices is an effective way to gauge the competitiveness of quota-constrained countries.

[14] China, Hong Kong, and India are the only countries in which public markets for purchasing quotas permit firm estimates of the cost of the quota system. Tariff equivalents of quotas are calculated as quota cost divided by export price minus quota cost. See Kathuria, Martin and Bhardwaj 2001 and United States International Trade Commission (USITC 2002).

After December 31, 2004, average duties of 18 percent will remain, but a substantial barrier to these countries' exports will be eliminated. These data illustrate that quotas for low-cost Asian products likely generate half or more of the benefits that preferential access to the U.S. market provides to the Dominican Republic.

Competitive pressure from low-cost suppliers in Asia can be expected to increase before 2005 because the ATC provides for accelerating the loosening of quotas in the years leading up to their elimination. Projected average annual growth rates for U.S. textiles and apparel quota categories filled in 2002 are presented in Table 4.

Table 4
Projected Average Annual Growth Rates Permitted by Constraining Quotas for Selected Apparel Products, 2003-2005

Product	Growth Rate Permitted by Constraining Quotas
Cotton trousers	8
Cotton underwear	12
Synthetic trousers	7
Knit shirts	8
Other synthetic apparel	Rates for these categories cannot be calculated because of part categories that differ among importers.
Other constrained	

Source: Data from U.S. Department of Commerce Office of Textiles and Apparel (OTEXA) bilateral agreement files.

Annual growth rates permitted by quotas on constrained suppliers range from a low of 7 percent on synthetic trousers to 12 percent on cotton underwear. Because these growth rates exceed the average annual growth of U.S. apparel consumption (2–3 percent), the Dominican Republic can expect considerable competitive pressure from quota-constrained suppliers in the interim period (Stage III, 2002–2004) before quotas are removed (Stage IV, January 1, 2005).

Impact of the Elimination of Textile and Apparel Quotas on the Dominican Republic

In estimating the impact of textile and apparel quota elimination on the Dominican Republic, we used a variety of variables, including detailed, product-by-product estimates of how significantly quotas constrain the products of greatest interest to Dominican Republic producers, shares of various suppliers in the U.S. market, tariff equivalents of quotas, production costs, and elasticity of demand. With a large number of countries constrained by quotas, and the tariff equivalent of some quotas equaling 40 percent or more, the elimination of quotas is projected to have a substantial impact on exports from the Dominican Republic and employment there. However, considerable variation exists among product lines.

ASSUMPTIONS

Many variables can affect the performance of an industry, and no economic model can account for all the possibilities that are generated in the course of everyday life. War, disease, and the threat of terrorism, for example, all affect world trade. Several assumptions specific to the textile and apparel industry also need to be made. First, the estimated impacts assume that long-term adjustments in the market have taken place. In the short term (approximately 1–3 years), buyers may be reluctant to switch producers to diversify their sourcing base for fear of losing a reliable supplier. Likewise, producers may sell products below cost for some time, expecting an improvement in market conditions. However, with the passage of time, buyers and producers adapt. Buyers find new suppliers and unprofitable producers close business.

The impact of quota elimination on the Dominican Republic will also depend on the product mix on January 1, 2005. For example, trousers and knit-shirt sales will decline more than sales of cotton underwear, T-shirts, and tanks. If Dominican producers move toward producing more T-shirts and fewer trousers, the impact of quota elimination will be reduced.

The simulation also assumes that the United States does not apply trade remedies such as antidumping duties or safeguards (such as those applied against U.S. steel imports). It also assumes the United States does not use safeguards provided for in China's WTO Accession Agreement. Estimates of impacts show that between one-third and one-half of the sales and employment losses will result from competition with China alone. Therefore, this assumption must be given careful consideration.

China's accession agreement to the WTO includes provisions that WTO members may invoke in response to import surges of Chinese products.[15] The most important of these is a sector-specific safeguard affecting textiles and apparel that allows the United States to apply constraints on import surges that are "due to market disruption, threatening to impede the orderly development of trade in these textiles and apparel products."[16] It provides one year of protection and can be renewed after increasing the restricted level of trade by 7.5 percent. The textile and apparel safeguard will be available through 2008, and China will not have a right to retaliate.[17]

[15] WTO Working Party Report on the Accession of China, paragraph 242 (a).
[16] WTO Working Party Report on the Accession of China, section 13.
[17] For a discussion of safeguards in China's WTO accession agreement, see chapter 3 of "Changes in Global Trade Rules for Textiles and Apparel: Implications for Developing Countries," by Peter Minor and published by Nathan Associates and USAID (2002).

Furthermore, the analysis assumes that macroeconomic variables such as exchange rates and labor costs remain as they are today. A significant reduction in the value of the U.S. dollar, for example, could reduce the cost of U.S. fabric. Because U.S. fabric is the primary material used in constructing Dominican apparel, a reduction in its price would make garments exported from the Dominican Republic more competitive.

ESTIMATED SHIPMENT IMPACT

Table 5 presents the effects of quota elimination on U.S. imports from the Dominican Republic. Total U.S. imports from the Dominican Republic are projected to decline by 35 percent. The effects are not shared equally among product groups. Shipments of cotton and synthetic trousers are projected to decline by approximately 50 percent. This is in part because of the high export-tax estimates on the quotas for these products—cotton trousers having among the highest—and the market shares of constrained suppliers of synthetic trousers, also among the highest. The impact on shipments of cotton underwear,[18] swimwear, coveralls, and headwear (included in the category Other Synthetic Apparel) is likely to be half that of trousers—about a 25 percent reduction. This is in part due to the low tariff equivalents of quotas and the relatively small number and market shares of countries constrained by

Table 5

Impact of Quota Elimination on U.S. Imports from the Dominican Republic ($ million)

Product	Imports from the Dominican Republic, 2002	Impact of Quota Elimination	
		Value	Percent
Cotton trousers	729	-362	-50
Cotton underwear	276	-67	-24
Synthetic trousers	251	-127	-51
Cotton knit shirts	198	-84	-42
Other synthetic apparel	89	-23	-25
Other	307	-104	-34
Total affected by quotas	1,850	-759	-41
Total unaffected by quotas	327	0	0
Total	2,177	-759	-35

SOURCE: *Partial equilibrium model.*

[18] This result compares well with recent financial results from Sara Lee, a major producer of knit underwear in the region, which have been strong. Sara Lee does note that it expects increasing competition to reduce some of its strength in the near future (Inteletex, April 2003).

quotas.[19] The impact of quota elimination in all cases is reduced because other unconstrained producers, such as Mexico, Honduras, Guatemala, and Sri Lanka, will lose substantial market share.

The results for cotton knit shirts reflect the low impact on cotton T-shirts and tank tops and the high impact on non-T-shirts and non-tank tops.

Shifts in world trade patterns of this magnitude will change the structure of the value chain in which apparel is made. Buyers will no longer be required to maintain suppliers across the world in order to manage the constraints of the quota system. Orders will probably be consolidated with the largest, most capable, manufacturers. In short, the elimination of quotas is likely to change the way business in the textile and apparel industry is conducted.

ESTIMATED EMPLOYMENT IMPACT

About 98 percent of the Dominican Republic's exports of apparel come from the more than 40 free zones (*zonas francas*).[20] Textile activities in the *zonas francas* comprise mostly cut, make, and trim operations, which are labor-intensive.[21] Several companies knit their own fabrics, but most import fabrics. The United States is the predominant source of materials for more than two-thirds of textile companies in the free zones.[22]

The estimated impact of quota elimination on direct employment in the *zonas francas* apparel industry of the Dominican Republic, according to the *Consejo Nacional de Zonas Francas de Exportación* figures for the average output/sales ratio for the period 1996–2002 are a loss of 41, 528 jobs, or 35 percent of the 2002 level of 118,652 jobs. These estimates may be conservative because the loss in shipments due to quota elimination will affect labor-intensive garments such as trousers much more than material-intensive garments such as T-shirts, tank shirts, or cotton underwear.

Moreover, these estimates do not include indirect employment losses in other sectors that depend on the *zonas francas*, such as utilities, transportation, and services. Additionally, jobs will be lost in the informal sector (such as child care and street vending) that employees of apparel firms support. In El Salvador, indirect employment generated from *zona franca* firms in the textile sector is estimated at two jobs for every direct job.[23]

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[19] Each small subproduct group, such as swimwear or hats, is vulnerable to rapid shifts in market share because if a large supplier, such as China, focuses on one of these products, it could easily supply most U.S. import requirements.

[20] Discussions with Dominican Republic officials.

[21] Larger companies such as Grupo M and Inter Americana and some medium-sized companies design, knit, and finish garments.

[22] Consejo Nacional de Zonas Francas de Exportación 2003.

[23] Embassy of the United States in El Salvador, "Maquila Sector Survey 2000," www.sansalvador.usembassy.gov.

These losses will be added to the reduction in labor that normally occurs in the textile industry, which constantly pursues cost-reducing measures by lowering labor content to keep pace with competitors. If the Dominican textile industry is not growing, it is probably shedding jobs because of gains in productivity, and employment can be expected to continue to decline. The new competitive environment will likely accelerate these losses.

Countering the trend of job loss due to productivity gains is increasing integration within the textile and apparel industries. As more firms extend their activities into the value chain, such as design, logistics, and the manufacture of materials, employment losses will be reduced.

3. Regional Free Trade Agreements

Background

The Caribbean region, including the Dominican Republic, has benefited from preferential access to the U.S. market since the early 1980s. Preferential access provides virtually quota-free access and reduced (but not zero) duties.[24] After the signing of the North American Free Trade Agreement (NAFTA) by the United States, Mexico, and Canada, and the completion of the ATC in 1995, with its promise to eliminate textile quotas, Caribbean countries lobbied the U.S. government for improved access for textile products. In October 2000, the Caribbean countries' request for NAFTA parity was granted, at least in part, with the authorization of the Caribbean Basin Trade Preference Act (CBTPA). The purpose of the CBTPA was to improve and extend benefits beyond those granted under the prior preferential arrangement—which generally excluded the fabrication of textiles and value added in the region from duty-free treatment in the U.S. market. In many ways the CBPTA provided NAFTA-like access to the U.S. market for certain products made by Caribbean countries by permitting

- Fabrication and finishing of fabrics knit from U.S. yarns (subject to a cap);
- Cutting of U.S.-formed fabric made of U.S. yarns and sewn with U.S. thread;
- Construction of foundation garments (brassieres), at least in part, from nonregional materials; and
- Complete elimination of duties on qualifying apparel, including duties on value added.

The result of the CBPTA is that several Caribbean countries pay minimal duties on their U.S. apparel exports. In 2002 nearly 90 percent of U.S. imports from the Dominican Republic entered duty free (Table 6). In contrast, Central American countries such as Nicaragua and

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[24] Liberal quota access and reduced duties have been tied to the use of U.S. materials in the construction of garments.

Guatemala have chosen not to take advantage of U.S. preferential access to the extent that the Dominican Republic has.[25]

Table 6
Central American and Dominican Republic Tariff Benefits under the CBPTA, 2002

Country	U.S. Imports (US$ Million]		Duties and Preferences	
	Value	Duty Free[a]	Average MFN [b]	Applied Rate [c]
Nicaragua	433	31%	17%	12%
Honduras	2,502	80%	16%	3%
Guatemala	1,659	36%	18%	12%
El Salvador	1,675	72%	16%	5%
Costa Rica	727	80%	10%	2%
Total CA-5	6,997	65%	17%	6%
Dominican Republic	2,133	89%	17%	2%

SOURCE: *U.S. Department of Commerce Imports of Merchandise Trade 2002.*

[a] *U.S. imports meeting the U.S. rule of origin under the CBTPA are duty free.*

[b] *The average MFN rate is the duty that would be paid if there were no preferences for CBTPA countries.*

[c] *Applied rate is the average rate paid by suppliers and is a mix of products paying zero duty and those not eligible for duty benefits.*

The CBTPA improved the benefits that exporting countries enjoy, but a free trade agreement could provide additional benefits. Because the CBTPA is not a negotiated trade agreement between countries, it is subject to change at any time, or it can be withdrawn or not renewed when it expires in September 2008. A free trade agreement would grant permanent trade status and thereby remove investor uncertainty about producing textiles and apparel in the region.

A change in the rule of origin under a free trade agreement allowing regional producers to spin yarn and weave fabrics would provide an opportunity to not only increase investment and value added in the region, but also lower costs and improve competitiveness against Asian suppliers—an important benefit in light of the elimination of quotas.

Duty and quota benefits are not expected to be the primary benefits of docking to a US-CAFTA for the Dominican Republic. Because quotas will be eliminated in 2005 under the ATC in any case, it is unlikely that quota elimination under a free trade agreement would provide long-term benefits. Furthermore, it is likely that quotas on garments manufactured of

[25] Reports from the region indicate the low use of CBTPA benefits in the region is linked to Asian producers that prefer cheaper Asian yarns and fabrics to U.S. materials. The use of U.S. materials is required to receive U.S. duty reductions.

nonregional fabrics would remain—much as they did for Mexico under NAFTA. The duty benefits for the Dominican Republic would also be low because it already pays less than 2 percent in duties.

Impact of the US-Central American Free Trade Agreement on the Dominican Republic

In January 2003, the United States and five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) launched negotiations for the United States–Central American Free Trade Agreement (US–CAFTA). The parties have set the goal of concluding an agreement by the end of 2003.

The Dominican Republic is not a party to these negotiations, so any benefits the CA-5 receive for textile exports could reduce U.S. imports from the Dominican Republic. However, if the Dominican Republic becomes a party to the US–CAFTA, it too could benefit.

The degree to which any country gains market access from the potential US–CAFTA will depend on the rule of origin that is negotiated. In the textile industry, the rule of origin defines the fabrics, yarns, and materials that may be used in constructing garments eligible for duty-free access. The CBTPA rule of origin for fabrics knit of U.S. yarn in the Caribbean countries stands in contrast to the rule for woven fabrics, which can be constructed only in the United States.[26] Because the CBTPA rule of origin for woven products is more stringent than for knits, producers of woven apparel stand the most to gain if the rule of origin for woven textiles is relaxed.[27] Table 7 summarizes the value of U.S. apparel imports from the Dominican Republic and CA-5 by type of fabric—knit or woven.

About two-thirds of U.S. imports from the Dominican Republic are of woven fabric (principally trousers), with the balance being of knit fabric (shirts and underwear). The opposite is true of the CA-5 countries, which export primarily knit products to the United States (data for each CA-5 country are in Appendix B). Figure 2 illustrates these proportions.

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[26] Subject to a regional knit cap that has never been reached and does not permit the use of regionally spun or extruded yarns.

[27] The extent to which apparel producers gain from a relaxed rule of origin will also depend on the extent to which regional producers of fabric provide competitively priced fabrics in sufficient quantities and quality.

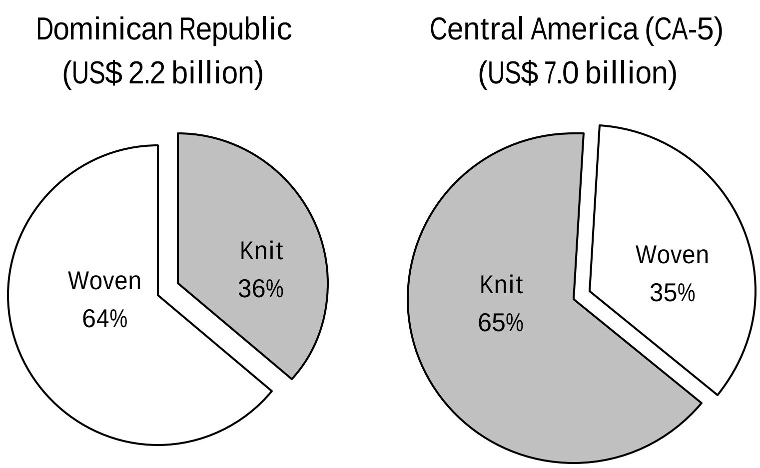
Table 7
U.S. Imports of Apparel from the Dominican Republic and CA-5, 2002 (US$ million)

Apparel Type	Dominican Republic		CA-5	
	Value	Share	Value	Share
Knit	775	36%	4,533	65%
Woven	1,359	64%	2,464	35%
Total	2,133	100%	6,997	100%

SOURCE: U.S. Department of Commerce Imports of Merchandise Trade.

NOTE: A small proportion of trade – primarily technical garments such as surgical materials – could not be categorized as knit or woven.

Figure 2
U.S. Imports of Apparel from the Dominican Republic and CA-5 by Material Type



The only exporter in the North American and Central American regions that exports more woven apparel than the Dominican Republic is Mexico, which would not receive benefits under the US–CAFTA.

ASSUMPTIONS

As discussed, the impact of the US–CAFTA will be determined in part by the ability of the parties to take advantage of its benefits and that, in turn, will depend on the rule of origin and textile capacities of each country. The following analysis assumes that the rule of origin allows the elimination of remaining duties within a reasonably short period of time (1–3 years) and that the rule of origin does not change the cost of constructing a garment.

If a restrictive rule of origin is implemented, such as a yarn-forward rule, impacts on the region would likely be lighter than described here. A yarn-forward rule,[28] as under NAFTA provisions specific to Mexico [29] and the draft U.S.–Chile free trade agreement, would confer duty-free status on most textiles and apparel made of materials wholly formed by parties to the US–CAFTA. Implicit in this rule is the exclusion of third-party fabrics and yarns, such as those from Mexico, Asia, or South America. To date, the United States has not supported "cumulating" between its various free trade agreements (see sidebar). If the Dominican Republic joins the US–CAFTA, its producers could be permitted to count CA-5 and U.S. materials in addition to their own toward eligibility for elimination of duties under the free trade agreement.

No change in the cost of constructing textiles and apparel is assumed, and the benefits come entirely from the elimination of existing duties. Producers should consider carefully the potential for lowering material costs through the rule of origin as well as transportation costs and fabric availability.

Cumulation and Regional Integration

The United States has not yet supported "cumulating" between free trade agreements. Cumulation would allow Central American countries to count Mexican and Canadian yarn and materials toward their eligibility for duty-free treatment.

The ability to cumulate would foster regional integration (e.g., Mexico and Guatemala), while raising demands for documenting regional materials. Effective use of any cumulating agreement (or with a Free Trade Area of the America FTAA) would require efficient regional customs and border crossings to take full advantage of regional materials.

Once quotas are eliminated, regional integration and regional markets may offer the greatest competitive advantages to textile and apparel producers in the western hemisphere against Asian suppliers.

ESTIMATED SHIPMENT IMPACT

Table 8 summarizes the potential impact of the US–CAFTA on the Dominican Republic, both with and without the country as party to the agreement. If the Dominican Republic does *not* join the US-CAFTA, total textile and apparel exports are projected to decline by 39 percent. Knit products fare considerably worse under this scenario than under simple quota elimination (Table 5), experiencing an additional 10 percent drop in exports. This greater impact is due to the CA-5 group's dominant position in these products. U.S. imports of woven apparel products (primarily trousers) from the Dominican Republic fall by only 2–3 percent under our model. The impact on woven apparel would be smaller because Central American countries' gains are projected to come at the expense of other major woven apparel producers, such as Mexico.

28 The yarn-forward rule requires that apparel be constructed of yarns and fabrics formed by parties to the free-trade agreement. Although yarns may be spun or extruded from fibers from third parties, fabrics must be of yarn wholly formed by the parties to the free trade agreement.

29 Although Canada and Mexico adhere to the same basic rules, a large portion of U.S. imports of apparel from Canada use tariff preference levels permitting non-originating materials.

Table 8
Impact of US-CAFTA and Quota Elimination on U.S. Imports from the Dominican Republic

Product	U.S. Imports from Dominican Republic in 2002 (US$ Million)	Impact Due to Quota Elimination and US–CAFTA		Net Impact of Dominican Republic Joining US–CAFTA
		Without Dominican Republic	With Dominican Republic	
Cotton trousers	729	-53%	-47%	6%
Cotton underwear	276	-27%	-27%	0%
Synthetic trousers	251	-54%	-47%	7%
Cotton knit shirts	198	-52%	-36%	16%
Other synthetic apparel	89	-26%	-17%	9%
Other	307	-37%	-1%	36%
Total affected by quotas	1,850	-45%	-34%	11%
Apparel not affected by quotas	327	-2%	24%	26%
Total	2,177	-39%	-25%	14%

SOURCE: *Partial equilibrium model*

Docking on to the US–CAFTA would moderate the impact of quota elimination. Apparel export shipments are still projected to decline, but by only 25 percent. The benefit to the Dominican Republic of being a party to a potential US–CAFTA is thus calculated to be 14 percent of its 2002 apparel and textile exports to the United States. Docking on to the US-CAFTA could cut the impact of quota elimination by nearly one fourth. The impact of docking on to a US-CAFTA varies according to product lines (Table 8).

ESTIMATED EMPLOYMENT IMPACT

Employment impacts mirror the effects of the US-CAFTA on export shipments. Failure to join a US-CAFTA would cause direct employment losses in the Dominican Republic's textile industry to increase; losses of 46,274 jobs are projected (compared to losses of 41,528 resulting from quota elimination.) If the Dominican Republic docks on to the agreement, direct employment losses would be moderated substantially. Although 29,663 jobs would still be eliminated, this is 16,611 fewer than in the scenario wherein the Dominican Republic does not dock on to the US-CAFTA.[30] These figures do not include indirect employment.

[30] *Consejo Nacional de Zonas Francas de Exportación*. Estimates are based on the average output/sales ratio for the period 1996–2002.

An important benefit of a free trade agreement would be additional investment in upstream industries such as the manufacture of buttons, zippers, and packaging. Textile production, such as spinning and weaving, in the Dominican Republic is, however, in doubt for several reasons. The elimination of quotas gives rise to considerable uncertainty in the world textile market, so investors are not rushing to install machinery that can cost $50–$100 million.[31] Furthermore, spinning yarns and weaving and finishing fabrics requires large quantities of cheap electricity and clean water, which are relatively scarce in the Dominican Republic.[32]

RULE OF ORIGIN

Dominican Republic textile and apparel exporters currently pay applied U.S. duties of less than 2 percent. Thus, the primary benefit of a free trade agreement would be not the elimination of tariffs but a relaxation of the rule of origin, which defines materials that can be used in textiles and apparel qualifying for elimination of duties. The potential benefits of a new rule of origin would arise from a broader definition of apparel that qualifies for duty-free benefits and a broader base of qualifying fabric and yarn suppliers.

Inclusion of apparel qualified for duty-free benefits depends not only on the final type of product (such as knit or woven) but also on the materials with which they are made and the processes used to make them. Having a broader base of fabric and yarn suppliers should increase competition and could lower fabric and yarn prices, reduce lead times, and increase fabric variety. Textile and apparel rules of origin can be divided into three categories corresponding to the segments in the apparel value chain:

- Single transformation—requiring only that a garment be cut and sewn by a party to the agreement (cut, make, and trim);
- Double transformation —requiring that the garment be cut and sewn of fabric formed (i.e., knit or woven) by a party to the agreement (fabric forward);

Lessons from the Caribbean Basin Initiative–US Textile and Apparel Partnership

In May 2001, hundreds of textile and apparel producers from the United States and Caribbean gathered in Miami to build partnerships crucial to their success. A key conclusion from the forum:

The way the CBI [Caribbean Basin Initiative] will work is if Caribbean garment makers can find the right U.S. fabric at the right price.

(Textile World, May 2001)

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[31] Inteletex, May 2003, reported that more than 90 percent of new looms installed during 2002 were in Asia.

[32] Lacking significant development of natural resources for cheap fuel sources, such as hydroelectricity, the Dominican Republic imports fossil fuels for nearly 90 percent of its electricity needs. Moreover, as an island with only one contiguous country (Haiti), it has little opportunity to import electricity from neighboring countries. Domestic problems in the collection of electric costs also elevate electricity prices.

- Triple transformation — requiring that a garment be formed by a party to the agreement from yarn that was spun or extruded by a party to the agreement (yarn forward).

Within these basic categories many variations are possible. For example, NAFTA generally provides for a triple-transformation (or yarn-forward) rule of origin. But the agreement makes exceptions for fabrics in "short supply" and has provisions for some non-NAFTA yarns and fabrics.[33] The number and types of variations will be limited only by the ability of customs officials to enforce the rules.[34]

The CBTPA requires that U.S. yarns and fabrics be used in apparel for which duty-free treatment in the U.S. market is sought.[35] The result of this rule is that the degree to which beneficiaries of the CBTPA actually benefit varies considerably (see Table 6). Nicaragua can claim less than one-third of its apparel as duty free, while the Dominican Republic claims nearly 90 percent duty free. A change in the rule of origin could confer duty-free status on the remaining two-thirds of Nicaragua's apparel exports virtually overnight.

Increasing the number of potential material suppliers can also improve the benefits of a free trade area. Currently, the United States does not support cumulating across free trade agreements. Therefore, parties to a potential US–CAFTA could not assume that they will be permitted to use Mexican or Canadian materials and still qualify for duty-free treatment.

Simulations show that if the Dominican Republic lowered its woven fabric costs by 10 percent, all but 12 percent of the negative impact of quota elimination could be offset.[36] (See Figure 3.) This underscores the importance of fabric sourcing and the rule of origin.

The majority of the Dominican Republic's exports are of woven fabric (Table 7). Because the Dominican Republic does not have weaving capacities for export and the development of significant capacity there is unlikely, the potential impacts of the US–CAFTA will be determined in large part by the quantity of fabric the Dominican Republic can source from other countries and for which it can receive preferential access.

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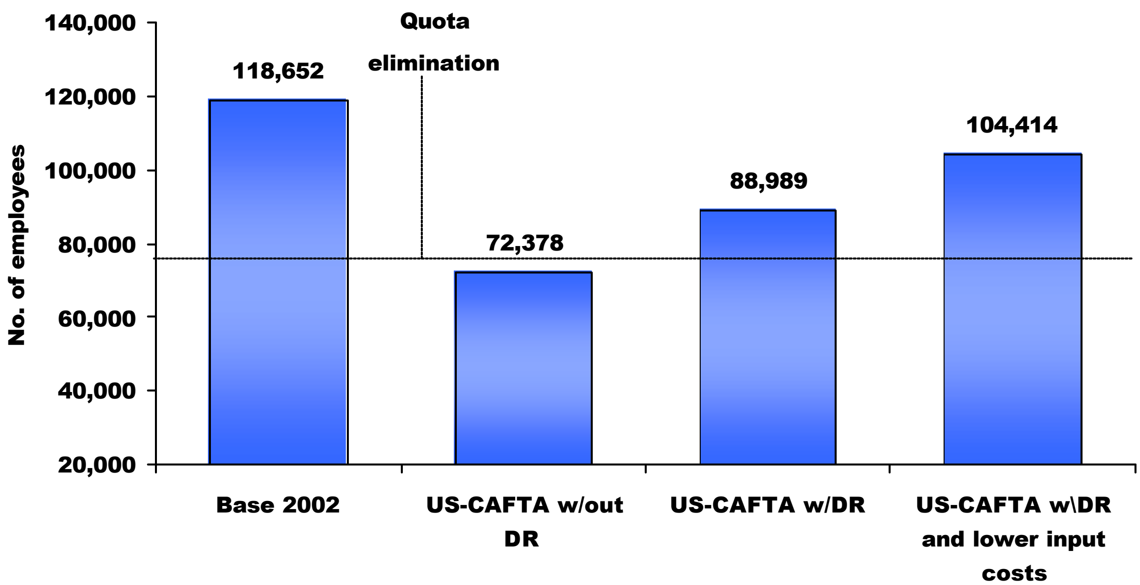
[33] Forty-five percent of textiles and apparel from Canada enter under special tariff preference-level provisions (TPLs) that permit the use of non-NAFTA materials, while only about four percent of U.S. imports of textiles and apparel from Mexico enter under such tariff preference-level programs because of additional restrictions on Mexico's use of these provisions (OTEXA).

[34] An underlying premise of U.S. free trade agreements is that the rules of origin are enforceable and can limit illegal transshipments.

[35] A notable exception is in the case of brassieres.

[36] Assuming that the cost of woven fabric in a garment is 50 percent of its cost.

Figure 3
Impact of US-CAFTA and Quota Phase-out on Direct Employment



Several Central American countries do have weaving capacities. Weaving capacity in El Salvador is estimated at 200 million square meters and in Guatemala at 240 million square meters. Nicaragua has two Chinese denim plants; industry sources estimate that the combined capacity of these two plants when completed will be approximately 40 million square meters per annum.[37] Yet U.S. imports of trousers alone from the Caribbean region required nearly 600 million square meters of fabric. These data indicate a deficit of weaving capacity in the Caribbean region.

More important than overall capacity for weaving fabric is the ability of manufacturing plants to produce export-quality materials from regional inputs. A potential benefit of any relaxation of the rules of origin for Central America could result in new investment in fabric manufacturing. Because these capacities are changing rapidly, Dominican producers will want to monitor developments.

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[37] The two companies are Roo Hsing and Nien Hsing and are of Taiwanese origin.

4. Competitiveness

Improving the Value Chain

U.S. buyers indicated in extensive interviews that most will reduce the number of suppliers and countries from which they will source their apparel by two-thirds shortly after 2005.[38] This will have a profound impact on how successful apparel exporters do business in a post-quota world. Buyers are developing relationships with suppliers who can manage all aspects of production, from sourcing fabrics and designing to finishing and shipping floor-ready merchandise. Buyers are also looking for companies that can offer a broad range of products, from knit shirts to cotton trousers. In short, they are looking for producers who can manage the entire value chain and produce a variety of high-quality garments rapidly and at a competitive price. Asian suppliers have been doing so for many years and buyers have come to expect full service.

In contrast, the Caribbean region has a long history of sharing production with the United States. This has meant lower duties on apparel exported to the United States, but also that many manufacturers engage only in the cut, make, and trim operations.[39] Dominican producers must go beyond this to offer floor-ready merchandise to buyers, design capabilities, and perhaps most important, fabric and material sourcing expertise. Fabric sourcing will likely become an important task of apparel producers in the post-quota world. Cut, make, and trim operations will have to adapt to the new trade environment.

The ability of firms to take on these responsibilities will likely depend on their size. The smaller a firm, the fewer capital resources, both human and material, that it will have to serve customers. Moreover, smaller firms will not be able to negotiate prices with fabric and yarn

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[38] The President's Report to the Congressional Textile Caucus on the U.S. Administration's Efforts on Textile Issues at www.otexa.ita.doc.gov.

[39] Several Dominican producers interviewed for this study could not name the source of their material suppliers in the United States or the price of fabric because they took only orders with the fabric supplied by their customers.

suppliers as well as a larger firm could. One method for small firms to obtain some of the advantages of larger firms is to cluster and share resources, thereby sharing the costs of design facilities, materials sourcing information, and the management of complex logistics with advanced information systems.

Fabric sourcing is likely to be a highly valued expertise in the post-quota trade environment. As discussed in the section on the rule of origin, some apparel producers may choose to use non-U.S. fabrics and materials and forgo preferential access, thereby gaining a competitive edge in some products. Buying cooperatives could further provide small and medium apparel producers access to the low prices and better service.

Ensuring Rapid Shipment and Customs Processing

Transportation costs can comprise 2–20 percent of a garment's final cost and time in transit can reduce the value of shipments considerably. For example, the price of a knit shirt one week after Christmas can fall 50 percent from its price one week before Christmas. Although extreme, this example illustrates an important market dynamic. Currently the Dominican Republic enjoys one of the shortest average transit times of any country within or outside the region—approximately five days (Table 9). But some Asian countries, such as China, are just one week behind the Dominican Republic.

Data presented in Table 10 further illustrate the long reach of some producers into the U.S. market by air freight. With nearly one-fourth of Chinese apparel shipped overnight by air cargo, the Dominican Republic's time advantage is reduced considerably.[40]

[40] In the case of Mexico, trucking is the predominant transport mode.

Table 9
Ocean Vessel Shipping Time between Major U.S. and World Ports (Shipping Days)

Port Pair	Inbound to United States			Outbound from United States			Transit Total (inbound and outbound)
	Shipping Days	Average Wait (Days)	Total	Shipping Days	Average Wait (Days)	Total	
Puerto Plata–Miami/Port Everglade	3	2	5	3	2	5	10
Port Louis, Mauritius–Long Beach	--	--	--	27	6	33	--
Nairobi, Kenya–New York	48	13	61	45	17	62	123
Cape Town, South Africa–New York	21	4	25	28	6	34	59
Hong Kong–Long Beach	12	0	12	18	0	18	30
Cartagena, Colombia–Miami	3	7	10	4	5	9	19
Port-au-Prince, Haiti–Miami	4	3	7	4	3	7	14

SOURCE: *ShipGuide.com.*

[a] *The wait can exceed 30 days, exceeding the sample size, and so was not reported.*

[b] *Research by David Hummel, Princeton University, estimates the tariff equivalent of transport time in the apparel industry to be 0.8 percent per day.*

Transportation and business executives agree that the ability of a producer to get garments to market quickly is a major competitive advantage and that the reliability of transit and shipment times is equally important. If shipments average six days between port of embarkation and destination, but half take ten days and half take two days, it is not likely that garments can be delivered reliably. Because ocean freight vessels adhere to strict arrival and departure schedules, the principal causes of delayed shipments (apart from production delays) are the customs procedures of the exporting and importing nations. The threat of terrorism and the potential for a container to contain dangerous material have given rise to a new sense of urgency and uncertainty among customs officials. New rules implemented by the U.S. Customs Service could cause significant shipping delays if not implemented properly. Several new areas will require cooperation between Dominican producers and customs authorities.

Table 10
Ocean Vessel and Air Freight Shipments and Charges, 2002

Country/Region	Average Charge (% f.o.b)		Percent of Shipments by Air
	Ocean	Air	
Dominican Republic	1.6	4.5	8.7
Haiti	1.8	6.2	8.1
El Salvador	2.0	5.9	6.5
Nicaragua	2.8	4.8	11.1
Honduras	1.9	8.0	2.7
Guatemala	2.5	8.1	10.0
Costa Rica	2.4	4.7	7.6
Mexico	2.2	5.6	2.0
Argentina	6.9	11.8	33.4
Brazil	7.0	10.0	39.3
Colombia	1.6	4.3	56.3
Ecuador	5.0	15.3	36.3
Peru	2.6	7.2	41.5
Subtotal LAC	2.4	4.7	7.6
Bangladesh	5.3	22.9	11.3
China	3.6	11.1	24.3
Hong Kong	2.8	12.4	24.0
Indonesia	4.2	17.0	17.0
Subtotal Asia	4.2	17.0	17.0
Kenya	4.5	20.3	19.3
Lesotho	4.3	18.5	16.5
Mauritius	4.1	14.4	27.6
South Africa	5.1	17.1	18.2
Subtotal Africa	5.1	17.1	18.2

SOURCE: *U.S. Bureau of the Census, Imports of Merchandise Trade, 2002.*

24-HOUR RULE

As of December 2, 2002, carriers must submit a cargo declaration 24 hours before cargo is laden aboard a vessel at a foreign port. As of May 4, 2003, ports are permitted to load only cargo that is on the 24-hour list. If customs officials and suppliers fail to coordinate, shipments will be delayed. Dominican customs officials indicated that much progress was being made to meet these new requirements, but that more effort was required to coordinate shipments, perhaps with improved electronic information systems that would provide instant notification of container shipments between the ports and *zonas francas*.

CONTAINER SHIPMENT INITIATIVE

U.S. Customs has set the goal of assigning agents in foreign ports to inspect containers before they depart for the United States. Suspect containers can be inspected while awaiting loading, resulting in little or no delivery delay. Alternatively, containers identified as a security risk will be required to be diverted to inspection facilities in the United States, possibly adding time to delivery. Currently, U.S. customs officials have targeted 20 foreign ports from which U.S. merchandise is exported for the initiation of this program. Expansion of this program is expected, and foreign officials' willingness to participate will help determine the selection of ports. Security enhancements will improve the reliability of shipments and shorten delivery times.

CUSTOMS TRADE PARTNERSHIP AGAINST TERRORISM

The Customs Trade Partnership Against Terrorism is a voluntary program that foreign ports can join to reduce the threat of terrorism and enhance the security of container shipments. The program allows ports to adopt the most advanced technology and implement new regulations in advance of official schedules to secure the rapid and safe transport of air and ocean-vessel cargo. Participation in this program is the first step toward a competitive customs program. Executing it reliably and cost-effectively will be a challenge for exporters and customs and government officials alike.

Diversifying Production

The findings presented earlier about potential impacts demonstrated that by diversifying away from quota-sensitive products, a producer could reduce the impact of quota elimination. Another strategy for diversification is to move into apparel products for which the United States has high duty levels. U.S. duties average 17 percent, but peak tariffs exceed 33 percent. Accordingly, countries such as the Dominican Republic that receive tariff preferences can benefit by exploiting this margin of preference, which will remain even in the post-quota environment. Producers in the Dominican Republic may find it valuable to diversify production by shifting to product categories for which tariffs remain high. Average U.S. tariffs in 2002 on knit and woven apparel by fiber are as follows: [41]

[41] Source: U.S. Imports of Merchandise Trade, 2001.

	Synthetic	*Cotton*	*Wool*
Knit	27	16	13
Woven	19	16	17

Average duties range from 13 percent on knit wool products to an average of 27 percent on knit synthetic products. The majority of Dominican Republic exports are cotton products, which have average duties of 16 percent.

Table 11 lists four products for which volumes of imports and MFN duty rates are high. Apparel manufactures wanting to reduce the impact of quota elimination could seek fabric sources and buyers in the United States. In doing so, they would diversify their product and customer base in a strategically advantageous direction.

Table 11
Promising Product Prospects (High Duties) Post-2004

Product	Fabric	Duties
Men's cotton sport shirts	Woven	20–29%
Men's synthetic sport shirts	Woven	29%
Women's and girls' synthetic blouses	Woven	15–27%
Infants' knitwear	Knit	8–33%

SOURCE: *American Textile Manufactures Institute*

5. Conclusion

When quotas are eliminated on January 1, 2005, the Dominican Republic will lose an important shield from open competition in its major market for apparel exports—the United States. The resulting competition will substantially affect free zone apparel exports to the United States and result in increased unemployment and poverty as jobs and income are lost. Three important options exist to reduce the impact of quota elimination:

1. Improve access to the U.S. market through active negotiations for a free trade agreement or "docking" on to a US-CAFTA.
2. Improve competitiveness in the apparel industry by focusing on fabric sourcing, full-package production, clustering of small and medium-sized firms, and rapid production and market delivery.
3. Diversify exports within the apparel industry and toward non-traditional exports, such as electronics assembly, food processing, and value-added services.

No single option will reverse the impact of quota elimination. Therefore, the Dominican Republic would do well to combine efforts in all three areas to achieve long-term growth and reduce risk while providing employment and income and alleviating poverty.

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Appendix A. Countries Constrained by U.S. Quotas, 2002

Table A-1

Countries Constrained by U.S. Quotas--Cotton Trousers

Country	Quota Growth Rate (%)	U.S. Imports (square meter. equivalent)
Hong Kong	0.9	115
Bangladesh	12.8	65
Turkey	11.0	60
Cambodia	6.0	59
Philippines	11.0	57
China	0.2	42
Indonesia	11.0	24
Sri Lanka	5.5	33
Pakistan	12.8	25
Thailand	11.0	24
Macau	12.6	22
India	12.8	20
Qatar	12.0	12
Emirates	12.0	10
Korea	4.6	9
Average/Total	7.5	615

Table A-2

Countries Constrained by U.S. Quotas--Cotton Underwear

Country	Quota Growth Rate (%)	U.S. Imports (square meter. equivalent)
Bangladesh	13	116
Thailand	11	53
Turkey	11	34
Philippines	11	33
India	13	27
Indonesia	18	16
China	6	14
Sri Lanka	11	11
Pakistan	13	11
Emirates	12	2
Average\Total	12	316

Table A-3
Countries Constrained by U.S. Quotas--Synthetic Trousers

Country	Annual Quota Growth Rate (%) 2002-2005	U.S. Imports (square meter equivalent)
Taiwan	0.0	66
Indonesia	11.0	65
China	1.2	50
Bangladesh	12.8	41
Philippines	11.0	27
Malaysia	11.0	26
Thailand	11.0	25
Sri Lanka	11.0	21
Korea	1.8	19
Hong Kong	1.8	16
Macau	12.6	15
India	11.0	13
Pakistan	11.0	11
Arab Emirates	12.0	6
Cambodia	6.0	4
Average\Total	7.4	404

Table A-4
Countries Constrained by U.S. Quotas--Cotton Knit Shirts

Country	Quota Growth Rate	U.S. Imports (square meter equivalent)
Pakistan	11.0	59
Turkey	11.0	46
India	7.3	38
Hong Kong	0.9	35
Philippines	7.3	25
Cambodia	6.0	22
Thailand	7.3	19
Macau	12.6	19
China	0.6	17
Bangladesh	12.8	15
Sri Lanka	11.0	13
Malaysia	11.0	13
Indonesia	11.0	12
Singapore	9.2	12
Korea	4.6	8
Taiwan	1.9	6
Emirates	12	5
Average\Total	8.2	364

Appendix B. Selected Industry Data

Figure B-1

U.S. Imports of Apparel of Woven Fabric from Dominican Republic and Central America 2002

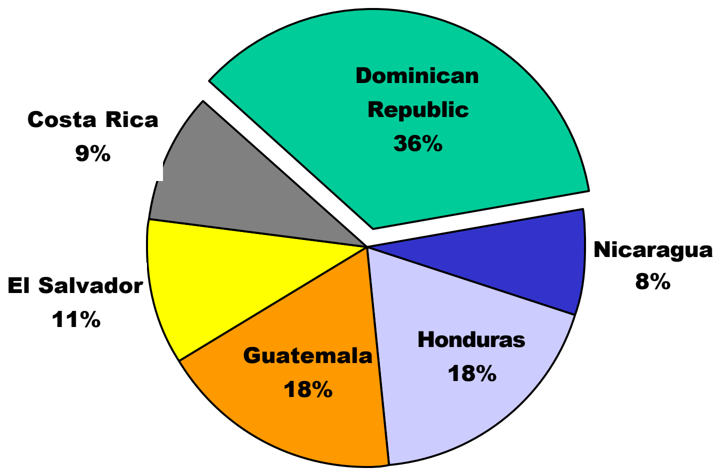

Figure B-2

U.S. Imports of Apparel from Knit Fabric, Dominican Republic and Central America 2002