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Sheng Lu
University of Delaware, shenglu@udel.edu

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What Will Happen to the U.S. Textile and Apparel Industry if NAFTA Is Gone?

Sheng Lu, University of Delaware, USA
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Background: Since its taking effect in 1995, the North American Free Trade Agreement (NAFTA), a trade deal between the United States, Mexico, and Canada, has raised heated debate regarding its impact on the U.S. economy (Hufbauer, 2005). Particularly, in the belief that the NAFTA has affected the U.S. manufacturing sector negatively, the newly elected U.S. President Trump pledges to dismantle the agreement with the hope to bring more manufacturing back to the United States (USTR, 2017). The U.S. T&A industry is a critical stakeholder of the policy change, because of its deep involvement in the regional T&A supply chain established by the NAFTA (Platzer, 2016). With limited literature on related topics, this study intends to quantitatively evaluate how will the U.S. textile and apparel (T&A) industry be affected if the NAFTA no longer exists. For academia, findings of the study will significantly enhance our understanding of the T&A specific sectoral impact of the NAFTA. Results of the study will also provide valuable inputs helping U.S. T&A firms prepare for the changing business environment as well as government agencies for related T&A trade policymaking.

Literature review: Over the past decades, trade creation effect of the NAFTA has significantly facilitated the formation of a regional T&A supply chain among its members. Within this supply chain, the United States typically exports textiles to Mexico, which turns imported yarns and fabrics into apparel and then exports finished apparel back to the United and Canada for consumption (Platzer, 2016). If NAFTA no longer exists, however, this regional T&A supply chain theoretically will be disrupted when related trade flows have to face a substantial increase in tariff rate (WTO, 2016). Therefore, this study proposes that: **H1: If the NAFTA is gone, U.S. textile exports to the NAFTA region will decline. H2: If the NAFTA is gone, U.S. apparel imports from the NAFTA region will decline.** On the other hand, the United States exported nearly 30% of its textile outputs in 2015, of which half went to the NAFTA region (OTEXA, 2017). This suggests that if the NAFTA no longer exists, textile manufacturing in the United States could be affected negatively as well because of the shrinkage of overseas demand. With that, this study further proposes that: **H3: If the NAFTA is gone, U.S. textile manufacturing will decline.**

Methods and Data:
The computable general equilibrium (CGE) model developed by the Global Trade Analysis Project (GTAP) was adopted in this study to test the hypotheses. Compared with a single-equation econometric model, the GTAP CGE model has the advantage of capturing the input-output relationship between the T&A industry and other sectors in the setting of an open global economy and generate more robust results (Adams, 2005). Data of the analysis came from the latest GTAP9 database, which includes trade and production data of 57 sectors in 140 countries in 2015 as the base year (Narayanan & Walmsley, 2012). For the purpose of the study, we assume that if NAFTA no longer exists, the tariff rate applied for T&A traded between NAFTA
members will increase from zero to the normal duty rate (i.e. the Most-Favored-Nation duty rate) in respective countries (WTO, 2016; USTR, 2017).

Findings and discussions: First, results show that ending the NAFTA will significantly hurt U.S. textile exports. Specifically, the annual U.S. textile exports to Mexico and Canada will sharply decline by $2,081 million (down 47.7%) and $351 million (down 14%) respectively compared to the base year level in 2015 ($H1$ is supported). Although U.S. textile exports to other members of the Central America Free Trade Agreement (CAFTA-DR), will slightly increase by $42 million (up 1.5%), the potential gains will be far less than the loss of exports to the NAFTA region. Second, results show that ending the NAFTA will significantly reduce U.S. apparel imports from the NAFTA region. Specifically, annual U.S. apparel imports from Mexico and Canada will sharply decrease by $1,610 million (down 45.3%) and $916 million (down 154.2%) respectively compared to the base year level in 2015 ($H2$ is supported). However, ending the NAFTA would do little to curb the total U.S. apparel imports, largely because U.S. companies will simply switch to importing more apparel from other suppliers such as China and Vietnam. Third, ending NAFTA will further undercut textile and apparel manufacturing in the United States rather than bring back “Made in the USA.” Specifically, annual U.S. textile and apparel manufacturing will decline by $1,923 million (down 12.8%) and $308 million (down 3.0%) respectively compared to the base year level in 2015 ($H3$ is supported). Weaker demand from the NAFTA region is the primary reason why U.S. T&A manufacturing will suffer a decline.

Implications and future research agenda: First, findings of the study suggest the U.S. T&A will be a big loser if the NAFTA no longer exists. Particularly, ending the agreement will put the regional T&A supply chain in jeopardy and make the U.S. textile industry lose its single largest export market—Mexico. Second, findings of the study confirm that in an almost perfectly competitive market like apparel, raising tariff rate is bound to result in trade diversion. With so many alternative suppliers out there, understandably, ending the NAFTA will NOT increase demand for T&A “Made in the USA,” nor create more manufacturing jobs in the sector. Rather, Asian textile and apparel suppliers will take away market shares from Mexico and ironically benefit most from NAFTA’s dismantlement. Future studies can continue to evaluate how will ending the NAFTA affect employment in the U.S. T&A industry and relevant T&A trade flows at disaggregated product level.

References