ANALYSIS: Textile industry concedes defeat on DR-CAFTA

Ivan Castano Freeman
Just-Style
September 11, 2009

It's no secret that the Dominican Republic – Central American Free Trade Agreement (DR-CAFTA) has failed to meet its once highly touted benefits on the region's textiles and apparel trade. But many industry observers are now abandoning the notion that it will ever do so, writes Ivan Castano Freeman.

Battered by the global economic downturn and regional governments' failure to support the industry to successfully implement the legislation, the highly controversial trade accord remains a major failure.

When DR-CAFTA was signed in summer 2005, industry leaders and politicians from Guatemala City to Honduras rejoiced about the purported benefits it would bring to the region's impoverished economies.

Boastful estimates were drawn out with many saying the accord would bring 600,000 jobs and US$1.6bn in investments to the Central American countries – Guatemala, Honduras, Nicaragua, El Salvador, Costa Rica and Dominican Republic –that signed to trade duty free with the US.

But four years on, very little of that has happened.

"Neither the jobs nor the investment (goals) have been realised and probably won't be without some considerable support from governments," says Walter Wilhelm, chief executive of trade consultancy Walter Wilhelm Associates, echoing other views.

DR-CAFTA's snail-pace and problematic implementation, government's failure to drive reforms to help transform a massively maquila-based export industry into a fast and efficient "full package" machine, combined with the recession to wreak havoc, he explains.

The outlook is indeed gloomy, with the possibility that more than 50% of the region's textiles jobs will go while many firms will continue to fail, adding to a string of bankruptcies in the past 24 months when many cash-strapped factories and struggling Asian players shut down amid plunging US orders.

"The viability of many the best companies in DR-CAFTA is now of concern," adds Wilhelm.

"Some of the very good ones will survive, probably pick up market share and grow, but many of them are not showing strong results in this period."

Global economy

The main reason is the global economy, he adds. However, he notes that poor marketing of the region's advantages and uncommitted governments (which are creating obstacles in some cases) are also contributing to the crisis.

The region has lost “tons” jobs, concurs Mike Todaro, managing director of the American Apparel Producers’ Network (AAPN), adding that soaring energy costs, lack of financing and huge debts are also leading many firms into insolvency.

Another industry observer adds: “Instead of job creation, the region has been in job preservation mode.”

However, he adds to a chorus of other views that the recession’s impact would have been worse without DR-CAFTA.

Worsening matters is a growing number of lawsuits from US apparel producers against local custom authorities for failing to streamline slow and inadequate customs – allowing surging contraband goods to trickle into the US with estimates valuing the trade at USD 22bn.

Disastrous implementation

Some industry leaders blamed CAFTA’s delayed and fragmented implementation (in which different countries used different rollout timelines) for hindering its benefits.

They also cited the rule of origin legislation forcing countries to use local fabrics to make US-export garments as an obstacle.

“The rolling implementation was a disaster,” says the industry observer who manages a local Central American mill.

“The rule of origin impacted several companies which were unable to ship and obtain materials on a timely basis.” Also, “we lost a major account and had to fund big duties for items made from Guatemala and Honduran fabrics to keep our shipments in schedule.”

Logistic woes aside, most observers agree the region could have done things better.

They say many firms failed to adapt their business models to the speedy, full package requirements to of US customers.

This, coupled with governments’ lack of support to encourage the process, streamline customs and improve the investment environment (by improving infrastructure, cutting big crime rates and fixing the legal system), helped spoil DR-CAFTA’s promise.

“Just because it’s close, it doesn’t mean it’s fast and just because its fast, it doesn’t mean it’s right,” adds Todaro, underscoring the wider view that many regional players failed to satisfy their US customers’ needs.

This allowed more nimble Asian rivals such as full-package firm Li & Fung, which enjoys generous government subsidies like other Chinese peers, to win market share.

Indeed, Asian companies have become nearly as fast in delivering product to the US as Central American spinners – while selling cheaper.

Will CAFTA make it?

So will CAFTA ever deliver? Most observers say no.

Regardless of the economic outlook, the region will never truly benefit from CAFTA unless governments and companies do more to win US orders at a time when Asian rivals continue to take North American markets by storm.

Another setback is the fragmented relationships between Central American countries.

“Fragmentation is built into the region’s DNA,” says Todaro. “The region seems to work harder to remain apart than to make an effort to work together.”

The reason is that some governments don’t view the apparel trade as lucrative as they once did, preferring instead to develop other more sophisticated manufacturing sectors such as electronics.

This protectionist mentality is stalling cross-border trade, experts point out.

“There needs to be more political action among all the DR-CAFTA countries and strengthened customs enforcement throughout the region,” says a US fibre and yarn producer.

But even if governments make a fresh scramble to meet these challenges, most observers remain negative on DR-CAFTA.

“I have been a big supporter of DR-CAFTA and the companies in the region, some of which are definitely world class.

“But no, I don’t think DR-CAFTA will ever fulfil its promise or potential.”