

Apparel Rules of Origin in New NAFTA 2.0 – The devil is in the detail <sup>1</sup>  
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On 30 September 2018, the United States and Canada, alongside Mexico finally reached an agreement on the updated North American Free Trade Agreement (NAFTA), now called the United States-Mexico-Canada Agreement (USMCA). Specifically for the textile and apparel chapter, according to the Office of the U.S. Trade Representative (USTR), USMCA includes new provisions that intend to incentivize greater North American production in textiles and apparel trade. USMCA also will strengthen customs enforcement, and facilitate broader consultation and cooperation among all parties.

As the saying goes, “the devil is in the detail.” Based on the analysis of the released USMCA full text, this article intends to provide a detailed and comprehensive summary of the USMCA apparel specific-rules of origin (RoO) provisions in plain language. Understanding RoO is critical for companies that are interested in using USMCA for apparel sourcing. In general, RoO is criteria used to determine the “nationality” of a product in international trade. Only apparel products that meet the USMCA RoO are eligible for the preferential tariff treatment under the agreement.

#### General rules of origin for apparel in USMCA

**In general, USMCA still adopts the so-called “yarn-forward” rules of origin.** The “yarn-forward” RoO means that fibers may be produced anywhere, but each component starting with the yarn used to make the apparel garments must be formed within the free trade area, i.e., by USMCA members. The “yarn-forward” rule sometimes is also called “triple transformation,” as it requires that spinning of the yarn or thread, weaving or knitting of the fabric, and assembly of the final apparel garments all occur within the free trade area.

Specifically, if an apparel item is made of the following yarns and fabrics, these yarns and fabrics need to be sourced from the USMCA region so that the apparel item can be eligible for the import duty-free treatment under USMCA.

HS code	Product description
51.06 through 51.13	Wool yarns and fabrics
52.04 through 52.12	Cotton yarns and fabrics
53.10 through 53.11	Woven fabrics of jute and other vegetable textile fibers
Chapter 54	Man-made filament yarns and fabrics
55.08 through 55.16	Man-made filament, staple, fiber yarns and fabrics
60.01 through 60.06	Knitted or crocheted fabrics

Notably, compared with NAFTA:

- USMCA **no longer requires** some jute or vegetarian yarns to be sourced from the U.S., Mexico or Canada, including products under HS code 53.07 through 53.08.
- USMCA **newly requires** some additional knitted or crocheted fabrics to be sourced from the U.S., Mexico or Canada, including products under HS 60.03 through 60.06.

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<sup>1</sup> Sheng Lu (2018). New NAFTA 2.0 – The devil is in the detail. *Just-Style*. <https://www.just-style.com/analysis/new-nafta-2-0-the-devil-is-in-the-detail/>

Other than the source of yarns and fabrics, USMCA also newly requires that some specific parts of an apparel item need to use inputs made in the USMCA region so that the finished apparel item can be qualified for the import duty-free treatment. Meanwhile, USMCA creates a transition period ranging from 12 to 30 months for the implementation of these new requirements (as shown in the table below).

Applicable HS chapters	Product required to be made by USMCA members	Transition period
61, 62	Narrow elastic bands: Fabrics of subheading 5806.20 or heading 60.02	Effective <b>18 months</b> from the date of entry into force of the agreement
61, 62	Sewing thread of heading 52.04, 54.01 or 55.08, or yarn of heading 54.02 used as sewing thread	Effective <b>12 months</b> from the date of entry into force of the agreement
61	Pocket or pockets, the pocket bag fabric	Effective <b>18 months</b> from the date of entry into force of the agreement
62	Pocket or pockets, the pocket bag fabric for apparel that made of blue denim fabric of subheadings 5209.42, 5211.42, 5212.24, and 5514.30	Effective <b>30 months</b> from the date of entry into force of the agreement
62	Pocket or pockets, the pocket bag fabric for apparel that made of fabrics OTHER THAN blue denim fabric of subheadings 5209.42, 5211.42, 5212.24, and 5514.30	Effective <b>18 months</b> from the date of entry into force of the agreement

#### Exceptions to the “yarn-forward” rules of origin in USMCA

Since the yarns and fabrics needed to make apparel are not always available in the area of the free trade agreement (FTA), it is a common practice that FTAs include exceptions to the “yarn-forward” rule to provide flexibilities to users. USMCA will keep most of the exceptions to the “yarn-forward” rule allowed by NAFTA. However, the new agreement also will make some changes to the details of these exceptions. Specifically:

##### *De minimis*

According to USMCA, apparel garments might still be qualified for the duty-free treatment under the agreement, should all non-originating fibers and yarns make up less than 10 percent of the weight of the “major part” of a garment. Further, within the total 10 percent cap, the total weight of elastomeric content may not exceed 7 percent.

In comparison, NAFTA only allows up to 7 percent of the total weight of the “major part” of a garment to be made by non-NAFTA members. However, NAFTA allows elastomeric yarns to be sourced from anywhere in the world.

### *807A provision*

USMCA will continue to offer the duty-free treatment for apparel assembled in Mexico but using fabrics that are wholly formed and cut in the United States (commonly known as the 807A provision). However, when applying the rule, USMCA will allow visible lining fabrics to be sourced from anywhere in the world, which is more liberal than NAFTA.

### *Tariff Preference Level (TPL)*

TPL allows for a certain quantity of textile and apparel goods (usually yarns, fabrics and cut pieces) from a third country (i.e., a country which is not a party to the agreement) to qualify for the benefits. For a long time, the U.S. textile industry has regarded TPL as a damaging loophole. In its testimony before U.S. trade negotiators, the National Council of Textile Organizations (NCTO), which represents U.S. yarn and fabric producers, strongly called for complete elimination of TPL in the NAFTA renegotiation. According to NCTO, TPL “circumvents the yarn-forward rules of origin and directly undermine benefits for NAFTA regional textile manufacturers. Worse yet is the fact that TPL transfers lucrative benefits to non-signatory countries, such as China.” Not surprisingly, NCTO’s proposal to eliminate TPL in the NAFTA renegotiation meets strong opposition from U.S. fashion brands and apparel retailers, represented by industry associations such as the American Apparel and Footwear Association (AAFA) and the United States Fashion Industry Association (USFIA). According to these industry groups, eliminating TPL will disrupt supply chains in the NAFTA region that have been in place for more than two decades.

On the other hand, the TPL mechanism has played a critical role in facilitating the export of Canada’s wool suits to the United States and the U.S. cotton or man-made fiber apparel to Canada. Statistics show that in 2017 more than 70% of the value of Canada’s apparel exports to the United States under NAFTA utilized the TPL provision, including almost all wool apparel products. Over the same period, the TPL fulfillment rate for U.S. cotton or man-made fiber apparel exports to Canada reached 100%, suggesting a high utilization of the TPL mechanism by U.S. apparel firms too. Not surprisingly, the apparel industry in Canada also strongly supports the TPL mechanism in the NAFTA renegotiation.

**USMCA seems to be a “balanced deal” that has accommodated the arguments from all sides regarding the TPL mechanism.** As shown in the tables below:

- **Compared with NAFTA, USMCA will cut the TPL level, but only to those product categories with a low TPL utilization rate.** For example, for cotton or man-made fiber (MMF) apparel exported from Canada to the U.S., USMCA will cut the TPL level from its current level of 88,326,463 square meters equivalent (SME) to only 40,000,000 SME per year. However, with the actual TPL utilization rate as low as 4.46% in 2017, the lower TPL level set by USMCA should have a minimal or no impact on companies’ sourcing.
- **Compared with NAFTA, USMCA will expand the TPL level for a few product categories with a high TPL utilization rate.** For example, for cotton or man-made fiber (MMF) apparel exported from the U.S. to Canada, USMCA will substantially expand the TPL level from its current level of 9,000,000 SME to 20,000,000 SME per year. With a TPL utilization rate as high as 100% in 2017, the more generous TPL level could help expand the trade flows and allow more companies to take advantage of the rule.

#### TPL for U.S. Apparel Imports: NAFTA vs USMCA

Exporter	Product	<a href="#">NAFTA (current level)</a>	<a href="#">TPL utilization Rate in 2017</a>	<a href="#">USMCA</a>	Impact evaluation
Mexico	Cotton/MMF apparel	45,000,000 SME	99.98%	45,000,000 SME	No change from NAFTA
	Wool apparel	1,500,000 SME	100.00%	1,500,000 SME	No change from NAFTA
Canada	Cotton/MMF apparel	88,326,463 SME	4.46%	40,000,000 SME	Minimal/no impact
	Wool apparel	5,325,413 SME	54.25%	4,000,000 SME	Minimal/no impact

#### TPL for Canada Apparel Imports: NAFTA vs USMCA

Exporter	Product	<a href="#">NAFTA (current level)</a>	<a href="#">TPL utilization Rate in 2017</a>	<a href="#">USMCA</a>	Impact evaluation
Mexico	Cotton/MMF apparel	6,000,000 SME	25%	6,000,000 SME	No change from NAFTA
	Wool apparel	250,000 SME	32%	250,000 SME	No change from NAFTA
US	Cotton/MMF apparel	9,000,000 SME	100%	20,000,000 SME	<b>More generous TPL</b>
	Wool apparel	919,740 SME	28%	700,000 SME	Minimal/no impact

Note: SME refers to square meters equivalent (SME); MMF refers to man-made fiber

#### *Commercial availability/short supply list*

Similar to NAFTA, USMCA also allows textile inputs (fibers, yarns, and fabrics) that are determined not available in commercial quantity in the FTA region to be sourced from anywhere in the world and the finished apparel garments can still enjoy the duty-free treatment provided by the agreement. In general, the request to add a product to the short supply list will be assessed within 90 days, followed by a no more than 60-day consultation among all USMCA members.

To be noted, there is a reason why nobody wants to touch the “short supply list” mechanism in the NAFTA renegotiation. For example, the U.S. textile industry does not like “short supply list” for the same reason as TPL, whereas for U.S. fashion brands and retailers, “short supply list” is less convenient to use than TPL (e.g.: not always the yarns and fabrics companies want to source from outside the FTA region are on the short supply list). Therefore, US fashion brands and retailers are unwilling to sacrifice TPL for more products on the “short supply list” either.

Nevertheless, USMCA will keep the NAFTA-style approval process for the request unchanged, meaning it will remain extremely difficult to get the new request approved and added to the short supply list.<sup>2</sup>

## **Conclusion**

Most companies currently using NAFTA for apparel sourcing should be able to continue to do so when USMCA takes into effect. However, it remains to be seen whether USMCA will boost the Made-in-the-USA fibers, yarns, and fabrics by limiting the use of non-USMCA textile inputs. Notably, around 15% of U.S. apparel imports from the NAFTA region in 2017 did not claim the NAFTA duty-free benefits, largely because of the strict yarn-forward rules of origin. To produce and source apparel products in the least expensive way possible, sometimes companies would rather use non-NAFTA textile inputs for the apparel products despite being hit with higher tariffs. The utilization rate of USMCA will be something important to watch in the future.

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<sup>2</sup> In general, there are two types of “commercial availability/short supply list” mechanisms. One is called the NAFTA-style, which requires impact assessment by the U.S. International Trade Commission (USITC) and approval from U.S. Congress to add any products to the short supply list. Understandably, the process is extremely long (For example, some requests submitted in 2009 are still pending for approval [http://34.232.160.87/CA/Ca\\_nafta.htm](http://34.232.160.87/CA/Ca_nafta.htm)). The NAFTA-style short supply list is also used in most US free trade agreements with countries not in the western hemisphere. In comparison, the CAFTA-style short supply list only requires the U.S. Department of Commerce to review and approve the request. This is why the “short supply list” is much longer for CAFTA-DR (for example: <http://web.ita.doc.gov/tacgi/CaftaReqTrack.nsf/AllPetitions!OpenView&Start=1>)