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2005, The Big-Bang for Trade in Textiles and Clothing

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During the Uruguay Round, developed countries obtained the conclusion of the TRIPS (trade-related aspects of intellectual property) Agreement in exchange for some concessions in agriculture and textiles. Today, developing countries harshly criticize the TRIPS Agreement, but also fear that the dismantling of quota barriers to trade in textiles and clothing finally serves the interests of very few countries, if not China alone. Were this the case, the deal would have been doubly bad.

1974-2004, The Era of Quotas and Trade Distortion

The evolution of the legal framework

The 1974 Multi-Fiber Agreement (MFA) created a general exception to the GATT discipline for textiles and clothing: GATT Contracting Parties were authorized to impose quotas on imports and to discriminate amongst other parties. The object of the agreement was to enable developed countries to reform their textile and clothing industries and to increase their competitiveness vis-à-vis emerging countries with low production costs. Initially adopted for a limited period, the MFA was renewed five times, and was replaced by the Agreement on Textiles and Clothing (ATC) in 1995. The ATC planned the progressive phase out of all quotas and the application of GATT principles (including non-discrimination) to trade in textiles and clothing by 1 January 2005. It also provided WTO Members with special safeguard mechanisms which will disappear with the end of the transition period (with the exception of China due to safeguards contained in the accession package).

Typically, the major importing countries have managed their quotas and tariffs with a view to:

- Restricting imports of some ‘sensitive’ products – quotas being tailored to the threat that each exporting country represents for the local industry;
- Providing some trading-partners with more favorable treatment – including the preferential allocation of quotas to the least-developed countries (LDCs);
- Promoting some core political values – by granting additional quotas to countries respecting certain conditions, e.g. labor standards.

The perverse effects of quotas

The regime of quotas has had numerous perverse effects, both in developed and developing countries. In the developed countries:

- Some non-competitive industries have been artificially kept alive;
- Trade diversion has contributed to the maintenance of artificially high prices and to restrictions on consumers’ choice.

In the developing countries:

- Specialization has often been based on the allocation of quotas rather than on comparative advantages – thus increasing the dependence vis-à-vis targeted markets;
- Some countries, although not competitive, could gain market shares because the most competitive countries had fulfilled their quotas;
- Producers in the most competitive countries had to invest in neighboring less competitive countries in order to continue exporting once they had fulfilled the quotas available to their home country.

The development of the clothing industry in Cambodia is a good illustration of the system's perversity. Today, the clothing industry represents about 80% of total exports and 200,000 jobs in Cambodia. In order to benefit from increased export entitlements to the US, Cambodia has complied with high international labor standards: Working conditions and salaries are better in the clothing industry than in other sectors, with women the primary beneficiaries of this progress. However, Cambodia's costs are around 10-20% higher than those of its major competitors, despite the overall poor quality of its products. The origin of the foreign investment in the Cambodian clothing industry is also illustrative: only 9% of all businesses are owned by Cambodians, while more than 50% are owned by companies from Hong Kong China, Taiwan and China. Moreover, 49% of inputs in the Cambodian clothing industry originate in China. In other words, the clothing industry in Cambodia has boomed despite its lack of competitiveness, merely because of the quota system and the need for Chinese producers to relocate part of their production to countries which had not, by themselves, filled their quotas.

2005, Back to the mainstream

Anticipated Changes in Supply and Demand

The effect of the elimination of quotas will vary with the level of competitiveness of each country. The most competitive countries, which had previously quickly filled their quotas, will benefit greatly from the restoration of more competitive practices. On the contrary, the least competitive countries, which benefited from preferential allocation of quotas and artificial export 'niches', will suffer an important prejudice. For example, when the US eliminated its quotas on luggage and handbags in 2002, Chinese exports to the US increased by more than 400%, while other countries' exports decreased by 10-20%. In other words, Chinese imports of luggage and handbags boomed as a result of the substitution of US and other country-made products by cheaper Chinese ones. This is a common feature in all segments of the textile and clothing market which were previously liberalized. In Japan, where quotas were not applied under the ATC, 80% of the clothing imports come from China. Some estimate that half of the current exporters of textiles and clothing to the US will cease having access to this market after January 1, 2005.

Consumers will be the main beneficiaries of this reform, because they will gain access to cheaper and more diverse products. However, jobs will be lost in the developed countries, and the main losers will probably be the less competitive developing countries, due to the combination of two factors: the loss of market shares in favor of the most competitive exporters and the repatriation of capital towards these countries. For example, some estimate that the Republican Republic might lose 50,000 out of 120,000 jobs in its textile and clothing industry. In Cambodia, there is concern about the future plans of the foreign-owned (mostly Chinese) companies, which account for 90% of the clothing industry.

In addition to the need to maintain diverse sources of production (e.g. to enable Chinese producers to avoid the special safeguard applied to China as part of its WTO accession or to avoid being the target of antidumping measures), two elements might play in favor of some less competitive developing countries. First, some countries may benefit from tariff preferences, which could compensate for their lack of competitiveness. Absent quotas, tariffs will play an increasing role. For example, countries eligible under the AGOA (African Growth and Opportunity Act), the CBI (Caribbean Basin Initiative) or NAFTA (North-American Free-Trade Agreement) have free or more favorable access to the US market (considering that the average tariff on Chinese textile and clothing imports amounts to 12%, these preferences could compensate for a proportional gap of competitiveness). Second, some countries may benefit from their geographical situation: flexibility and speed of reactivity are crucial in the (fashion) clothing industry. For example, a Mexican or Caribbean enterprise can ship its products to the US overnight, while it takes one week for Asian products to arrive on the US market. Some countries cumulate both elements (preferential treatment and geographical proximity) and have a good chance of staying in the market. For example, in recent years, Central and Eastern European exports to the EU have grown more rapidly than Asian exports to the EU; similarly, South American exports to the US have grown more rapidly than Asian exports to the US. On the other hand, countries which do not enjoy either of these elements might get in trouble. For example, while Cambodia exports 70% of its clothing production to the US, it won't benefit from any kind of preferences after the elimination of preferential quota allocations on January 1, 2005 – and this will further decrease its competitiveness. Cambodia could eventually rely on its exports to the EU (27% of its clothing exports), which are eligible for a zero-tariff under the EBA (Everything but Arms) scheme, but EU rules of origin exclude about 75% of all Cambodian clothing exports from these benefits. In both cases, Cambodia does not enjoy any geographical proximity.

Strategies for Optimizing the Benefits of Liberalization

The liberalization process will be beneficial overall. However, in every such process, there are winners and losers. The question is whether developed countries, which incited some of the poorest countries to specialize in textile or clothing production through the preferential allocation of quotas, can be indifferent to the latter's further impoverishment. There is no miracle 'winning' strategy, but each country should try to play its own cards.

For some, mostly developing, countries competitiveness is based on low prices. These countries, which will have to compete directly with China and other Asian low-cost producers, could achieve some gains through, for example:

- A reduction of production costs – without cutting wages (which would have a negative impact on productivity). For example, in Cambodia, this would imply improving the efficiency of export formalities and procedures (which represent 40% of the cost of production, including 7% attributable to corruption);
- The conclusion of free-trade agreements or compliance with existing rules of origin in order to benefit from tariff preferences. For example, the US-Morocco free-trade agreement could ultimately benefit the Moroccan textile and clothing industry. By importing more inputs from neighboring ASEAN countries (and then respecting the regional 'cumulation' rule), Cambodia could also have more clothing exports eligible for the EBA preferences.

For some countries, competitiveness is based on the differentiation of products. Here, gains could be achieved through, for example:

- An improved quality of the products and a better specialization of the production. For example, the developed countries have focused on the fabrication of high-tech textiles and invested in the design and marketing of their products. Increased specialization by India on higher value-added products has contributed to a 46% increase of Indian exports of cotton-made products to the US in 2003. Considering that most lower-income developing countries are dependant on the import of inputs, a sound strategy could involve moving up the production and value-added chains.

- The adoption of 'ethical' labels in countries, like Cambodia, which respect high labor standards. Although costly, this strategy could prompt the investments of some large companies eager to invest in their image (Nike syndrome) and could be attractive to some consumers in developed countries.

These elements of a possible strategy suggest that the elimination of quotas will not necessarily lead to a concentration of production in very few countries, but could also lead to a better division of labor worldwide. There are of course some adjustment costs, but each country has to find its comparative advantage in the production chain (e.g. growing cotton in Africa, making the fabric in India, designing in Europe, cutting/assembling/sewing in Cambodia).

Finally, it is worth noting that WTO provides its Members with some safeguard mechanisms (GATT Article XIX on safeguards and Article VI on antidumping). In addition, the accession agreement of China, provides additional safeguard mechanisms (including some specific to textiles, which could be invoked until 2008). Finally, the Doha Development Agenda could deliver some of its promises for the least-developed countries, and in particular a free access to the developed countries' markets and effective special and differential treatment provisions.

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