The Textile and Clothing Agreements

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Executive Summary

Demand for textiles and clothing (T&C) has been rising quickly in the developed world (the European Union and United States), and it is forecast to grow further in the future. At the same time, especially during the past decade or so, low-income developing countries have greatly increased their T&C production, allowing them to develop their T&C industry and utilize their vast resources of low-skilled labor.

For 30 years the world’s richest countries have imposed stringent quotas on imports of T&C. From 1974 to 1995, the Multi-Fiber Arrangement (MFA) defined the regulations for tariffs and quotas on all T&C trade categories. The Uruguay Round (UR) Agreement on Textiles and Clothing (ATC) stipulated that import quotas be eliminated in a four-stage process between 1995 and 2005. Over that period T&C quotas were gradually reduced, and on January 1, 2005, all T&C categories were brought under the regular World Trade Organization (WTO) rules that apply to other manufactured goods.

It was certain that after the lifting of T&C quotas there would be winners and losers. Although Canada, the European Union (EU), and the United States have implemented safeguard measures as permitted by the general WTO agreement, imports were projected to rise and prices to fall. The T&C producers in these countries would face serious competition and their market shares would shrink. It was also likely that China would capture a large share of the market, leaving smaller developing countries with very little of the market.

Aside from these concerns, quotas present many other policy issues in bilateral and multilateral trade. Quotas undermine the competitive advantage of developing countries and restrict them to producing at lower levels than they would have under free trade. Quotas also impose additional costs and distortions owing to the monitoring needed to keep track of country of origin, as well as the rent seeking and rerouting that occur in an attempt to bypass the provisions.

Your assignment is to prepare recommendations for a new international agreement for trade in textiles and clothing that would be acceptable to Bangladesh, China, the EU, Honduras, and the United States. Discuss the policy issues with regard to support for and resistance to eliminating the quotas. Justify your recommendations, and assess the consequences for stakeholder groups.

Background

Since the early 1990s, demand for T&C has been rising quickly in the developed world (the EU and the United States), and forecasts show that it will continue to grow. Meanwhile, T&C production in low-income countries has increased substantially, allowing these countries to expand their industry and utilize their vast resources of low-skilled, cheap labor. Low-income countries that can produce both textiles and clothing at very low prices make it increasingly difficult for domestic industries in the EU and United States to compete.

On the other hand, developed countries imposed stringent quotas on imports of T&C under the Multi-Fiber Arrangement (MFA). Although intended to protect domestic industry, the quotas led to a series of perverse consequences, which grew worse the longer the quotas remained intact (Rivoli 2005b). Importers and subsidized manufacturers in the EU and United States succeeded because they could avoid risks and competition through trade protection, which in turn forced poorer countries to lower their prices further and further to compete. Because the quotas “protected” producers at each stage of production (yarn, fabric,
finished goods), the removal of the quotas imperiled rather than enhanced protected producers’ chances of remaining competitive. High-end producers in the EU and United States now face with even higher costs and fewer choices in purchasing inputs (Rivoli 2005b).

Trends and Trade Patterns

Textile and clothing trade is strongly influenced by established networks and geographical proximity. Africa, Eastern Europe, and the Middle East dominate the EU market because of their proximity to the EU and their relatively cheap labor. In 2004 EU enlargement made trade with the newly acceding—and mostly poor—Eastern European countries even easier. For the United States, the most important suppliers are Latin America, China, and the Asian newly industrializing countries (Hong Kong, Singapore, South Korea, and Taiwan) because of either geographic proximity or preferential trading agreements.

Although they are two distinctly different industries, T&C have become increasingly meshed and their fates increasingly dependent on each other, as their supply chains have been vertically integrated. It is common today for clothing retailers to manage the supply chain of manufacturing (exemplified by the large multinational corporations that operate all over the world). This vertical integration has occurred simultaneously with the rise of globalization and the corresponding increase of goods traded internationally. In the low- to middle-priced clothing market, the role of the retailer has become increasingly prominent in the organization of the supply chain. As the retail market has become more concentrated, the multinational retailers have attained more power because they can capitalize on their integrated vertical supply chain. They have market power in both the consumer market and the input market (because of their buying power). Given their wide consumer base and often well-built brand name, multinationals are attractive investors for developing countries with cheap labor ready to supply the T&C industry.

Vertical integration has become commonplace because of the increasing popularity of lean retailing. Lean retailing requires frequent, smaller stock replenishments to retailers, giving them the flexibility to adjust to quickly changing consumer tastes and styles. It is dependent on bar codes, uniform product codes, and electronic information processing. This technology has allowed retailers to monitor extremely precisely and quickly what sells, what does not, and when. It may have been the fundamental advance that allowed the textile industry to take off and expand as it has.

In practice, lean retailing works as follows: lean retailers in the United States replenish their stores weekly; sales data are analyzed over the weekend, and replacement orders are placed Monday morning. The manufacturers may have one week to fill the order. This organizational structure, with the appropriate technology to accompany it, allows the retailer to hold less inventory with less risk, reducing costs in two areas. With a constant stream of sales and inventory information, retailers can produce accurate and up-to-date demand forecasts, maintain good control, and sell to a larger market. It also allows them a high degree of flexibility to quickly discontinue goods that are not selling as well. For manufacturers, this system means a very short lead time. This arrangement explains why vertical integration is so attractive and why trade in textile and clothing has become more and more international at all levels as it has become more and more decentralized: a multinational in the United States buys raw materials from one low-income country, ships it to another for manufacturing, and then ships it to Europe, the United States, or both for retail sale.

When a corporation can vertically integrate in a single country, it gains an even more economical and flexible production chain and achieves even faster time to market. For a poor country, having a well-integrated production network is a great asset in entering the export market and being competitive. The quality of infrastructure is important because it helps ensure timeliness, good tracking, and the ability to meet production targets. Improvement in infrastructure is necessary in many developing countries; this is often their differentiating factor, especially in Asia. The poorer and smaller Asian countries have tended to specialize in one stage of the production chain (Nordas 2004), because they must often import a lot of the fabric and textiles for manufacturing (The Economist 2005a). China was originally a producer of fabrics...
and outsourced much of its assembly and manufacturing to nearby Asian countries like Bangladesh. As the industry (and its regulations) undergoes constant change, other textile producers are concerned about China’s developing strong infrastructure all the way along the chain.

U.S. T&C Trade and Employment
Textiles and clothing account for 7 percent of global trade. The EU and the United States together import 70 percent of the world’s T&C. Between 1995 and 2002, the share of the EU and the United States in the world’s total textile imports increased from 35 to 44 percent, mainly owing to an increase in the U.S. share of imports from 14 to 21 percent. The shares of Canada and the EU remained stable during this period.

For U.S. T&C imports, the changes in market share reflected the impact of the North American Free Trade Agreement (NAFTA). Honduras entered the list of top 10 suppliers. India and Pakistan took higher shares of imports at the expense of Hong Kong and Taiwan, higher-income and more distant Asian suppliers, whose market shares sharply decreased (Nordás 2004). Total imports of clothing grew slightly less than textiles in the United States. Mexico increased its export market share in the United States from 7 to 12 percent. There was an increase in the market share of the “other countries,” from 37 to 41 percent, showing that a number of smaller suppliers are gaining market share (notably Sri Lanka).

The United States has witnessed a much stronger decline in employment than the EU in the textile and clothing sectors, primarily in clothing. Employment figures dropped nearly 50 percent between 1995 and 2002 (Buelens 2005). In some EU countries, like Greece and Portugal, textile and clothing account for a larger share of their economies than in the average EU country, and T&C employment levels in those two countries buoyed the total EU T&C employment level. Between 1995 and 2002, absolute employment figures dropped in China and India, yet the sheer size of their workforces dwarfs other countries. Other developing countries with notable changes are Mexico and Morocco, both of which showed increases in employment over this period because they directly border major importers (the United States and the EU, respectively).

The Agreement on Textiles and Clothing (ATC)
The UR Agreement on Textiles and Clothing was created to reduce trade distortions in T&C gradually and to allow both importers and chief exporters to adjust. The impact of the ATC had four main dimensions: (1) political gain from a credible multilateral trading system, (2) efficiency gains after quota elimination, (3) loss of quota rents, and (4) gains to consumers. The idea was that the gradual changes, with each stage allowing for more graduated change, would allow the industry to adjust over time to the four dimensions of impact.

The ATC had four stages of quota reduction, until quotas were eliminated in 2005. Each stage integrated more products into the category of non-restricted products, but by the third stage (beginning on January 1, 2002) it became apparent that the products that were being integrated accounted for a minimal share of the total amounts of T&C being traded on the world market.

To illustrate why these stages were not effective in “gradually” reducing quotas, it is helpful to look the unit value of the categories that were freed from quota restriction. China, with its cheap labor, scant regulation, and seemingly unending potential for cheap textile production, entered the WTO in 2002 and has achieved domestic economic growth while maintaining its competitive strength internationally. As it opened itself more and more to foreign markets, China took a larger share of the import market, and the unit value of these goods decreased. Market share declined for the remaining Asian countries, mostly smaller producers and all smaller than China. Thus, a large part of China’s import share gain was at the expense of smaller developing countries (Buelens 2005). This outcome was in line with the trends of the past 10 to 15 years. In 2002 in China, every category of T&C exports decreased in unit value, with some decreases as high as 55 percent (11 categories total). Thus, for China there has been an inverse relationship between its change in market share and changes in unit value, reflecting the impact of increased competitiveness. Although Bangladesh and India also saw a decline in unit value in some categories, other categories saw an increase (Buelens 2005). The general trend in the T&C industry at the time was that more categories were
becoming cheaper, and those were growing the fastest.

On January 1, 2005, the quotas were lifted. As expected, exports from China soared. Total Chinese textile and clothing exports to the United States were 60 percent higher in the first quarter of 2005 than in the same period in 2004 (The Economist 2005a). China’s exports to the EU rose by more than 30 percent, pushing China’s total share in global clothing trade to 28 percent. China’s growing market share had striking effects on both importing and exporting countries. Exports from Bangladesh, Cambodia, India, Pakistan, and Sri Lanka to the United States all declined. African and Latin American textile and clothing producers were hit particularly hard. Exports to the United States under the African Growth and Opportunity Act4 (AGOA) fell by 25 percent in the first three months of 2005, and thousands of jobs disappeared. The International Labor Organization reported that the main losers in the world clothing market overall were South Korea, Taiwan, and a number of other smaller developing countries.

Thus, the lifting of the quotas had positive effects and some immediate negative effects. Large importers found their long-protected domestic industries bombarded with cheap imports with which they simply could not compete considering their higher labor costs. These cheaper imports did, however, benefit consumers. Across the EU, consumers were paying billions of euros more for protected domestic production of T&C goods. The new arrangement would also allow the retail and sales sectors to grow in an unwarped manner, based on consumer demand and market supply, and would allow the retail sector to grow in an uninhibited fashion, diversifying or homogenizing depending on consumer preferences.

Owing to surging imports from Asia (mostly China), by June 2005 the United States had reinstated quotas under the safeguard protection clause in 7 of the 11 categories. Annual growth of imports in each category is restricted to 7.5 percent, and the restriction is renewable for three years until 2008.

China and the EU engaged in bilateral trade negotiations to “manage China’s integration into the global economy in a sensible and smooth way” (The Economist 2005c) and came to an agreement in July 2005. If the quota removal were to remain, the mix of products in each designated category (goods produced are each assigned to their appropriate category with assigned quotas) would likely shift toward lower-priced goods, and thus it was expected that the unit values would decrease significantly. The final decision made allowed quotas to remain in place, limiting the growth of 10 categories of Chinese textile exports to 8 percent to 12.5 percent each year until the end of 2008 (The Economist 2005c). During these month-long negotiations, however, Chinese exporters were rapidly expanding production of apparel and textiles in anticipation of the opening of the EU market. When the negotiations were finalized, there was a stockpile of goods well over the decided quota at European and Chinese ports waiting to be imported. Further discussions continued and reached a solution: half the goods were allowed free entry into Europe and the rest were imported by borrowing from 2006 quotas. For the United States and China, no such bilateral agreement was reached. The two sides apparently kept getting stalled on basic elements such as the length of the pact.

The pressure to protect domestic textile industries in both the EU and the United States is immense; lobbyists and unions alike are putting pressure on the government to “keep jobs at home” and “protect the workers.” Moreover, it is generally more difficult to pressure a national government to make an active fundamental change. Politically, the protectionists probably have a slight advantage because they are merely pressuring the federal government to keep the status quo.

Policy Issues

The ATC’s phasing out of T&C quotas has raised a number of issues. First, although there is an apparent consensus to eliminate quotas, there is resistance from the most-developed countries and the main importers, as well as from smaller developing countries that cannot compete with China. Second,
despite the 10-year period of the easing of quotas in the T&C sector, countries did not use that time efficiently to make the necessary adjustments in domestic markets. Third, the legal provision of safeguard measures in the WTO agreement underscores the authority of the EU and the United States to continue their protectionism. Domestic policy issues, such as the protection of domestic jobs in the EU and U.S. textile and clothing sectors, must also be considered.

China remains a special concern. China was welcomed into the WTO in 2002 after making a series of important commitments to open and liberalize its market in order to better integrate into the world economy and offer a safer and more predictable environment for trade and foreign investment in accordance with WTO rules.

For the 12 years following accession, there will be a special transitional safeguard mechanism in cases where imports of Chinese products cause, or threaten to cause, market disruption to the domestic producers of other WTO members. Previous prohibitions, quotas, and other restrictions against imports from China that are inconsistent with the WTO agreement, however, will be phased out or otherwise dealt with.

With respect to T&C trade, this means that when China acceded to the WTO it became subject to the rights and obligations of the ATC. There is a safeguard mechanism in place specifically for T&C categories from 2005 until the end of 2008, permitting any WTO member country to take action to curb imports in case of market disruptions caused by Chinese exports. Chinese textile factories have tended to specialize in one process and finish goods overseas to avoid quotas. But unlike its main rivals, China has the advantage of huge domestic fiber and fabric production. Without quotas, it could build vertically integrated firms, lowering costs, raising quality, and cutting time to market (The Economist 2005a). This situation offers an attractive opportunity for foreign multinationals to either contract with or own Chinese factories (most of which specialize in one production process) and then to ship the goods overseas to be finished and thus avoid quotas. Here is yet another area where removal of quotas would allow China to produce at an even lower cost—vertical integration in a variety of areas throughout the industry will give them an advantage over many other countries. It also will provide new opportunities for Chinese T&C businesses, which have grown over the years.

As discussed earlier, an area of serious concern for governments is the impact of the dramatic fall in T&C prices on domestic industries in the EU, the United States, and other developing countries. Many forecasts show that China will take 50 percent of the U.S. market and 29 percent of the EU market once quotas are lifted. This shift could be bad news for many of the smaller and poorer nations (mostly in Asia) that have had no direct foreign investment to beef up manufacturing and for others that may have slightly higher living standards, and thus labor costs, that make it harder for them to compete with China’s labor force. One model shows that Bangladesh, Turkey, and countries in North Africa and Eastern Europe could be squeezed out of the EU market, and African and Mexican apparel manufacturers out of the U.S. market (Nordás 2004).

Most economic models are created without factoring in the nuances of the textile and apparel industry, such as the time-to-market issue. Fashion has increasingly become a time-oriented, fast-moving market, and apparel is seen as “a perishable good” (The Economist 2005b), and it shows no sign of changing. China may be the cheapest option, with the largest supply of cheap labor and a newly opened economy, but if there is a disruption in the supply chain, retailers need to have other sources of imports. This need to reduce risk and diversify supply may create an opportunity for other developing countries to compete with China to meet the great consumer demand for apparel.

For the United States, Chinese monetary policy and the exchange rate is also an important issue. Most textile firms (and U.S. politicians) want to keep quotas unless China revalues its currency. Currently the yuan is fixed to the dollar at an artificially low exchange rate (although this is arguably likely to change). China is not currently subject to the U.S. antisubsidy law because it is deemed a “nonmarket economy” (which makes it easier for U.S. firms to file antidumping cases against it). But it is against WTO rules to declare China a market economy for the purposes of subsidies and a nonmarket economy for the purposes of antidumping. A new piece of U.S. legislation is in process—the Stopping Overseas Subsidies Act—that would allow U.S. firms to get countervailing duties to make up...
for Chinese subsidies, including a subsidized exchange rate. This act would make duties and subsidies dependent on the currency value.

Stakeholders

For the past 30 years the intertemporal T&C quotas have prevented many developing countries from reaping the full benefits of the growth in global trade in this industry. A variety of multinational corporations have contributed a lot of foreign direct investment to start-ups in the clothing and textile infrastructure in lower-income countries in East Asia (notably China), Southeast Asia (notably Bangladesh and India), and Latin America (notably Mexico), as well as in North Africa and Turkey.

Commercial subsectors such as textile producers, retailers, and import companies throughout the EU and United States also have an interest in T&C trade issues. There are also some differences within regions, such as among European countries. France, Greece, and Portugal are more concerned about the importation of T&C goods than other EU countries because their T&C manufacturing and production industries still count for a significant portion of their economy.

Different parties have different concerns. For example, Latin America is concerned about competition from China and its well-integrated production networks. China and other Asian producers have concerns about Latin America’s proximity to the United States and the proximity of Turkey, North Africa, and Eastern Europe to the EU. Asian producers may also be concerned about increasing energy prices.

Poor countries are concerned about China and its imminent development. In some small Asian countries, clothing makes up as much as 66 percent of exports (Bangladesh). These countries do not produce their own raw textiles and rely on imports, which raises the price of clothing, even if only marginally. This fact makes them less competitive as clothing exporters and can even put them into debt if clothing sales do not exceed the cost of imported inputs. China has maintained its position as the world’s largest exporter of both textiles and clothing since 1995. After the 2002 liberalization, China’s import share of global T&C jumped from 25 to 40 percent in the categories that had been the most restricted (Buelens 2005). This is a good illustration of how the lower the quotas were kept by importing nations, the larger their adjustment will be.

Policy Options

Complex policy issues face all the parties involved. Many do not believe that safeguard measures are justified, especially when they are costing consumers and taxpayers money. Although the transition period 1995–2005 was poorly used, this may no longer be an excuse to continue quotas or allow limitless safeguard measures. Large and instantaneous changes in prices, production, market shares are normal, and what will follow the transition is a normal and expected adjustment to the new trade and production patterns (Buelens 2005).

The likelihood that one or two big developing countries will take most of the market is of serious concern. This issue has united many parties that are commonly on opposing sides. A real hinging issue is the industrial countries’ reluctance to deal with adjustment issues directly, and there is no mechanism to force them to do so on any timeline other than their own voluntary one. Again, there is immense domestic pressure to continue to protect these industries, which are home to a long production line and many jobs. It appears that industrial countries do not want to eliminate quotas until they have “moved” enough citizens out of this industry, either through job creation or a simple cyclical downturn.

One policy option for industrial countries may be to enact a clause encouraging importation from multiple sources either in a WTO agreement or, better yet, in federal trade regulation. Such a clause would benefit a range of developing countries that are smaller than China and India. It would also assuage rich countries’ concerns about China’s rising too quickly and outcompeting them. Another issue that may need to be taken into account is the cost of transport and energy and how it may affect price of goods. If the cost is high enough to make goods from China less competitive, it opens the door for trade with countries that are closer geographically but that have slightly higher unit prices. Currently this issue is never cited as affecting the price of goods.
Export tariffs in the textiles and clothing sector may also be another policy option for developing countries to consider. In December 2004 China imposed an export tariff, raising the price of its goods and making them slightly less competitive, but the country was at least able to keep the cash and avoid safeguard measures enacted by importing nations. The optimistic theory is that the government can use the money it collects to benefit the population as a whole, although China's goods will be slightly less competitive. Export tariffs may be a viable option only for a country like China, but for most other developing countries, establishing a tariff would likely make them too uncompetitive and hurt their economy. The use of export tariffs has been a hotly debated issue in the WTO.

In May 2005 China increased export taxes unilaterally by up to 400 percent for 74 clothing products, which account for about 20 percent of clothing exports. The economic impact of this change should be minimal because it affects only 3 percent of the mainland's exports. The effect on the upstream textile industry will be more significant, however, because the percentage increase in price is compounded in each item. The new tax level represents 6 percent of the overall cost per item of clothing. When one considers that profit margins are already slim, this change could seriously reduce the competitiveness of the industry (The Economist 2005a).

Small low-income countries (LICs) that compete with China may want to focus on how policy can promote vertical specialization in the T&C industry. Most smaller LICs may have a lower average wage than China but cannot compete on speed, quality control, reliability, and scale, all of which affect the price (especially in an industry where time-to-market has become vital). Vertical specialization will help improve these characteristics, as well as improve communications, as these industries grow and develop. These improvements would allow them to better compete with China and, with quota removal, would make these countries more attractive to importing countries seeking to import from multiple sources.

Another tactic developing countries may consider is lowering import tariffs on textiles. Lowering tariffs may have a substantial positive impact in the short run, as lower and more uniform tariffs on inputs translate immediately into lower and less distorted input prices for producers. Textiles are often protected for industrial policy purposes—in industrial and poor countries alike—but the costs to the clothing and apparel industry should be weighed against the benefits to the textile industry. To thrive in an increasingly competitive environment, the clothing industry must be able to acquire its inputs at world prices.

Another issue is access to capital, which is difficult for clothing firms and constitutes a major entry barrier for new entrepreneurs. While weighing policy options, LICs must consider whether their business environment is adequate for foreign investment. (For example, do they have the capacity to handle large sums of money? Can business operate relatively easily?) Liberalization of the financial markets in LICs combined with sound macroeconomic policy could bring in new foreign capital and help overcome this bottleneck, but only in the long run. In the short run, the introduction of special credit facilities for small microenterprises may show some positive effects. Bangladesh is a good example.

In summary, governments of poor countries have a crucial role to play in leading and coordinating a coherent strategy for the textile and clothing sector, with significant help from donors and international organizations. Short-term measures such as technical training and streamlining of customs procedures have the potential to substantially and quickly improve the competitive position of firms. Bilateral agreements on trade liberalization may also be possible for short-term measures, and parties may be more likely to compromise on short-term issues than on long-term commitments. More generally, the debate on industrial policy and the appropriate role of governments is more open than ever. Each LDC has its own characteristics and therefore needs to define its own policy. Yet in today's international trade environment, policies must also be developed in the context of other countries' policies or they will fail.

Assignment

Prepare recommendations for a new international agreement for trade in textiles and clothing that would be acceptable to Bangladesh, China, Honduras, the EU, and the United States. Discuss the policy issues with regard to support for and
resistance to eliminating quotas. Justify your recommendations, and assess the consequences for stakeholder groups.

**Additional Readings**


[http://www.oecd.org/dataoecd/43/14/33824605.pdf](http://www.oecd.org/dataoecd/43/14/33824605.pdf)

**References**


[http://yaleglobal.yale.edu/displayarticle?id=5669](http://yaleglobal.yale.edu/displayarticle?id=5669)

