➢ Textiles and clothing: Reflections on the sector's integration into the post-quota environment

by

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Abstract

This paper tracks developments of the global textile and clothing quota regime from its early stages in the 1960s to the final integration of the sector into world trade on 1 January 2005. This is followed by a brief analysis of trends in the textile and clothing trade, focusing on key markets in general, and that of the United States in particular, while highlighting the importance of the sector for developing countries. With the Agreement on Textiles and Clothing (ATC) likely to cause substantial shifts in both trade and production within the sector, with a resultant range of economic impacts, the paper concludes by outlining key outcomes that can be expected in the post-quota environment.

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1 Introduction

This paper begins by tracking the development of the global textile and clothing quota regime from its early stages in the 1960s to the final stage of the sector's integration into world trade on 1 January 2005. This is followed by a brief analysis of trends in the textile and clothing trade, focusing on key markets in general, and that of the United States in particular, while highlighting the importance of the sector for developing countries. Never before has an international trade agreement, such as the one governing the removal of quotas, caused such divergent reactions among developed and developing country stakeholders. The paper concludes by outlining the key outcomes that are likely in the post-quota environment.

2 Early Stages of Textile Quotas: The Multifibre Agreement

Quotas to restrict imports of textiles and clothing into developed countries, notably Europe and the United States, have been in place for at least the past four decades. During the early phases of quotas these were imposed arbitrarily by importing countries, without any kind of formal structure or explicit multinational agreement and coordination.

The 1974 Multifibre Agreement (MFA) created the formal basis for quantitative restrictions by developed countries against textile and clothing imports from developing countries. By that stage, industrialized countries still accounted for a substantially greater share of global textile and clothing exports, but there were clear signs of developing countries gaining a strong foothold in the global market. Indeed, by the late 1980s the share of textile and clothing exports by developing countries began exceeding that of industrialized countries. A decade later, developing countries were responsible for over half of global textile exports, and nearly three-quarters of global clothing exports (from a less than 20% aggregate in the early 1960s) (Diao and Somwaru, 2001). The growing competitiveness by producers in some of the less developed countries began to pose a serious threat for the profitability and indeed viability of some long-established segments of the textiles and clothing sector in developed countries.

The MFA signaled a departure of the principle of non-discrimination between trade partners being promoted by the General Agreement on Tariffs and Trade (WTO, 1994a). Textiles and clothing consequently became the only sector where quantitative restrictions were permitted in such a broad manner. Quotas were determined annually and applied differentially between countries and product categories. As a result, some countries faced substantial restrictions while others remained largely unaffected. The

latter in effect benefited through superior or even unconstrained access to the markets of developed countries without facing the competitive pressures that would have prevailed in a free market. When exports face quantitative restrictions, quotas are in effect a tax on exports from the source country. A study estimated that quotas on India's exports in 1999 were equal to a tax equivalent of 40% and 19% for exports to the US and EU respectively (Kathurina et al, 2001).

More than two decades after the MFA, which had originally been put in place as a temporary measure to manage the uncontrolled influx of textiles and clothing into certain developed markets, agreement was reached that would see the bulk of these market restrictions phased out. The Agreement on Textiles and Clothing (ATC), as it became known, was a multilateral instrument agreed on within the WTO framework that would provide for the regulated removal of quotas over a 10-year period, starting in 1995. It is discussed in greater detail in Section 3.

While quotas remained firmly in place over the period that the MFA was in force, textile and clothing exports continued to move into the European and US markets. Further development and expansion of the sector took place predominantly in *developing* countries, as lower production costs became an increasingly important basis for competitive advantage. Quotas nevertheless continued to provide a reasonable incentive for pockets of textile and clothing sector development in industrial countries, especially in higher value-added categories and where substantial design and fashion elements prevailed. But quotas also led to a much wider diffusion of textile and especially clothing manufacturing capacity in developing countries, as the ad hoc nature of quantitative restrictions provided incentives for the establishment of productive capacity in countries not directly constrained by quotas. Prime examples include Mauritius and Bangladesh, both of which benefited from preferential and quota-unconstrained access to the European market under the Lomé Conventions and / or various forms of the Generalised System of Preferences (GSP).

The MFA (and later the ATC) required substantial resources in order to monitor compliance with quota restrictions, as is the case with many market interventions. These costs in effect became a dual burden both on importing as well as exporting countries, thereby raising the price of textile products and garments. Compliance monitoring was motivated by the fact that the quota restrictions, administrative and cost burdens imposed by the quota system had created incentives to circumvent these rules, with transshipment (whereby quota-constrained exporters channel their goods through countries with fewer or no constraints) and false declarations (in terms of origin status or quantity shipped) being particular areas of concern.

But quota restrictions also had an entirely positive effect on many developing countries, especially those without quantitative restraints yet with at least a basic manufacturing infrastructure. Investors seeking market openings were attracted to countries that were not necessarily traditional participants in textile and clothing production, yet who offered a ready availability of price-competitive labour and in many instances attractive government backed start-up incentives. Quotas increased the effective margin of preference (or, it could be argued, lowered the margin of *disadvantage*) for countries having preferential market access to the European and US markets.

3 Removal of quotas within a structured WTO Framework

Following protracted negotiations within the Uruguay Round, the precursor to the establishment of the WTO, agreement was finally reached to phase out trade-restricting textile and clothing quotas in a structured manner. The Agreement on Textiles and Clothing (ATC) – as indicated earlier – was to be the legal instrument to guide the decade-long liberalization process beginning in 1995. Being a WTO Agreement, it was binding on all Member States. China, one of the most quota-restricted countries in terms of access to the US and European markets, became a member of the WTO only in December 2001.

The ATC was a “self-destructing” Agreement, meaning that it would cease to exist after the mandated removal of quotas had been completed in accordance with the stipulated provisions. The Agreement provided no scope for renegotiation, with its final phase having been implemented on 1 January 2005 in accordance with its schedule (and despite vehement opposition from a number of stakeholders).

According to the ATC, the first stage of quota removal, lasting from 1995 to 1997, would see 16% of developed countries’ imports freed from quota restrictions. Each subsequent period would see a larger proportion of trade brought into the quota-free fold. However, since quota removal is heavily back-weighted (the largest proportion of imports – namely 49% – was to be integrated on 1 January 2005), the Agreement only started removing effective quotas in the latter stages of the 10-year period. At the root of this also lies the Agreement’s rule that countries had some degree of autonomy over the timing of when specific product line items had to be freed from quotas. All that the ATC required was that at every stage of quota removal (see Table below), goods from all four of the predefined categories (namely “tops and yarns”, “fabrics”, “made-up textile products” and “clothing”) had to be included (WTO, 2004b). As a result, product

segments that were least threatened in terms of domestic productive capacities, or where quotas had been largely ineffective or unconstraining[1], were liberalized first.

It must be noted that the quota-removal percentages, as outlined in the following table, are based on countries' *total* textile and clothing trade in 1990, rather than merely trade in categories that were quota-constrained. A study shows that in 2001 (this still forming part of the second phase of quota removal), well over 50% of Asian countries' aggregate textile and clothing exports to the US were still constrained by quotas (Nathan Associates, 2002). The ATC also provided for an *increase* in the remaining quota levels. This meant that existing quota levels had to be raised according to a certain percentage, and that the *rate* of expansion should also increase at each stage.

The last stage of quota removal is by far the most significant, not only in nominal terms, but also because of the large degree of autonomy contained in the Agreement. Naturally, developed countries sought to shield their domestic industries from a predicted influx of imports for as long and by as much as possible, which gave competing suppliers to the European and US markets (notably those with preferential market access) additional years in which to compete on an "uneven" footing. As a result, the final integration of the textile and clothing sector is likely to have very far-reaching effects, especially on producers in previously unconstrained or less-constrained countries, as well as on previously directly protected markets.

[1] In this context a quota is said to be constraining when quota utilization levels are in the region of 85% (US interpretation) and 95% (EU interpretation).

Table 1

Structure of Quota Removal in terms of the ATC

Stage of quota removal	Percentage of products to be brought under GATT (including removal of any quotas)	Percentage of products to be brought under GATT (including removal of any quotas)
Stage 1: 1 Jan 1995 to 31 Dec 1997	16% (minimum, taking 1990 imports as base)	6.96% per year
Stage 2: 1 Jan 1998 to 31 Dec 2001	17%	8.7% per year
Stage 3: 1 Jan 2002 to 31 Dec 2004	18%	11.05% per year
Stage 4: 1 Jan 2005 Full integration into GATT (and final elimination of quotas, termination of ATC)	49% (maximum)	No quotas left
The actual formula for import growth under quotas is: by 0.1 x pre-1995 growth rate in the first stage; 0.25 x Stage 1 growth rate in the second stage; and 0.27 x Stage 2 growth rate in the third stage.		

4 Global Textile and Clothing Trade

The textile and clothing industries are among the most widely distributed of all economic sectors. Reasons for this include obvious ones such as the fact that the sector provides vital commodities that no country can do without, while also being labour intensive, relatively easy to establish (this being the case mainly in clothing manufacturing) and in most product segments also highly dependent on low-cost labour. For many countries, the textile and clothing sectors provide one of the first stages of economic upgrading or diversification away from a dependency on primary commodities.

Quota and other restrictions that prevail in these sectors have also contributed significantly to their current locational characteristics. Market distortions, where countries are unable to access leading textile and clothing markets in line with their productive capabilities, have substantially widened the reach of these sectors beyond what may have been the case had natural market forces been allowed to prevail. As a

result, the sector's reach has broadened to include in particular many developing countries that may otherwise have been second or third-choice locations.

In the four decades between 1962 and the late 1990s, textile and clothing trade has outpaced the growth in general goods trade. In fact, total exports of textiles and apparel have increased more than fiftyfold in nominal terms over this period, from less than US$ 6bn to almost US$ 350mn in 2001 (WTO, 2004c). Of this value, approximately 57% is accounted for by clothing exports, while the smaller share is made up of textiles. Most of the sectoral growth in these sectors has taken place in developing countries, with the latter exceeding the global share of exports by industrialized countries in the late1980s. Today, developing countries account for close to two-thirds of all textile and clothing exports globally, a figure that is set to rise in the post-quota era.

5 The Importance for Developing Countries of Textile and Clothing Exports

China is today by far the largest exporter of textiles and clothing. According to 2001 data, more than 26% of exports originated in China (including Hong Kong). According to some predictions (for example, see WTO, 2004), the country's share of global sector exports is expected to rise even further, with its relatively low-cost and increasingly quality-driven manufacturing base proving highly competitive. Having become the new superpower among textile and clothing producers, the country has also been the subject of most quota restraints. In 2001, almost 60% of China textile and clothing exports faced quotas on exports to the US. This is in contrast to the 53% average for Asia overall (Nathan Associates, 2002).

The majority of large clothing exporters are located in Asia, with only few exceptions (see Table 2 below). Many have shown significant export growth over the past decade, with notable increases recorded foremost by China, but also by Mexico, Bangladesh, Sri Lanka and Morocco. The situation is similar among textile exporting nations, with China likewise the dominant player. No SSA countries are among the leading textile or clothing exporters in the world.

Table 2

Top 20 Exporters of Clothing and Textiles in 2001 (excludes EU, US and Canada)

Rank	**Clothing**	1990 US$ mn.	2001[a] US$ mn.		**Textiles**	1990 US$ mn.	2001[a] US$ mn.
	WORLD total	108,130	193,690		WORLD total	104,350	146,980
1	China *	9,669	36,650		China *	7,219	16,826
2	Hong Kong, China	15,406	23,446		Hong Kong, China	8,213	12,214
3	Mexico *	587	8,011		Korea, Republic of	6,076	10,941
4	Turkey	3,331	6,661		Taipei, Chinese	6,128	9,904
5	India	2,530	5,483		Japan	5,859	6,198
6	Indonesia	1,646	4,531		India	2,180	5,375
7	Korea, Republic of	7,879	4,306		Pakistan	2,663	4,525
8	Bangladesh	643	4,261		Turkey	1,440	3,943
9	Thailand	2,817	3,575		Indonesia	1,241	3,202
10	Romania	363	2,780		Mexico *	713	2,091
11	Dominican Republic *, **	782	2,712		Thailand	928	1,888
12	Tunisia	1,126	2,601		Switzerland	2,557	1,443
13	Taipei, Chinese	3,987	2,484		Czech Republic *	-	1,325
14	Sri Lanka	638	2,441		Malaysia *	343	1,056
15	Philippines *	1,733	2,384		Brazil	769	855
16	Morocco *	722	2,342		Poland	284	796
17	Pakistan	1,014	2,136		Singapore	903	730
18	Malaysia *	1,315	2,071		Iran, Islamic Rep. of **	510	674
19	Poland	384	1,949		Israel	270	534
20	El Salvador *	184	1,725		Russian Federation	-	470

Source: WTO (2004c) based on various statistical databasesNotes: * includes processing zones, ** includes Secretariat estimates, [a] data for 2001 was used as 2002 data was incomplete

However, the scenario is substantially different when analyzing the relative importance of textile and clothing production for developing countries' economies. A proxy indicator for this would be the ratio of textile and clothing exports to total merchandise exports, which provides a guide to the extent to which countries rely on these sectors in terms of sectoral economic activity, employment, foreign exchange receipts, and so forth. This ratio therefore also indicates the extent to which a country is vulnerable to the phasing out of quotas, assuming that its productive capacity provides little to attract manufacturers beyond the obvious advantages of a previously quota-free environment. Countries most likely to see the removal of quotas as a highly significant development are those with high dependency ratios on textile and clothing exports. Where they previously faced significant quota constraints yet remain competitive producers, the removal of quotas is likely to affect them positively. Where they showed a high dependence on exports without being quota constrained, or where the sector would not otherwise be globally competitive in the home country, the consequences are likely to be very negative.

WTO estimates show that that as a global average, textiles and clothing sector exports in 2002 accounted for 2.4% and 3.2% of total merchandise exports respectively. A disaggregation of the data shows that significant intra-country variation exists, with some countries showing an extremely high reliance on this sector's exports (see Table 3).

Cambodia, Macao (China) and Bangladesh show the highest degree of reliance on clothing exports, with ratios between 67% and 82%. Each of these three countries recorded clothing exports of well in excess of US$ 1bn, with the value of Bangladesh's clothing exports reaching over US$ 4bn in 2002. With the exception of China, India and Mexico, Bangladesh was the leading exporter of clothing among all developing countries in 2002. To place this into perspective, this was at the time five times the value of clothing exports recorded by Mauritius in that year, being the Sub-Saharan African country with the highest dependence on clothing exports according to WTO data (2004c).

Among textile producers, exports as a percentage of total merchandise exports are generally lower than within the clothing sector. This probably relates to the higher capital intensity of textile production, making the sector less accessible (among developing countries) than the relatively labour-intensive clothing manufacturing sector. Pakistan ranks highest in terms of its textile export to total commodity export ratio, while at the same time also being a fairly substantial exporter in value terms. Among both textile and clothing exporters, most countries showing a high reliance on this export sector are located in Asia, while Mauritius (clothing exports) is the sole representative

from Africa featuring on the list. Curiously, Lesotho does not appear among the specified countries, despite the fact that data from UN's *Comtrade* database shows the ratio of clothing exports (classified under HS61 and HS62) to *total* country exports to be in the region of 65% (data accessed January 2005).

China, the single largest exporter of textiles and clothing, shows a substantially higher reliance on clothing exports as against textiles. Under the MFA quota system as well as the phase-out schedule of the ATC, clothing exports have generally been more quota-constrained than textiles.

Table 3

20 Countries with largest clothing exports as percentage of total merchandise exports (excludes EU, US and Canada)

Rank	Clothing	2002 Exports US$ mn.	2002 %		Textiles	2002 Exports US$ mn.	2002 %
	WORLD	200,850	3.2		World	152,150	2.4
1	Cambodia * *	1,125 [(a)]	81.7		Pakistan	4,790	48.3
2	Macao, China	1,648	70.0		Nepal	165 [(a)]	22.4
3	Bangladesh	4,131	67.8		Macao, China	326	13.8
4	El Salvador *	1,841	61.5		Turkey	4,244	12.3
5	Mauritius	949	54.1		India	5,375 [(a)]	12.1
6	Dominican Republic *,**	2,712 [(a)]	50.9		Bangladesh	469	7.7
7	Sri Lanka	2,326	49.5		Taipei, Chinese	9,532	7.0
8	Tunisia	2,687	39.5		Egypt	290 [(a)]	7.0
9	Honduras	475	37.4		Korea, Republic of	10,586	6.5
10	Morocco *	2,413	30.4		China *	20,563	6.3
11	FYR Macedonia	319 [(a)]	27.7		Hong Kong, China	12,374	6.2
12	Romania	3,251	23.4		Latvia	131	5.7
13	Turkey	8,057	23.3		Indonesia	2,896	5.1
14	Pakistan	2,228	22.5		Belarus	407	5.0
15	Nepal	154 [(a)]	20.9		Sri Lanka	202 [(a)]	4.2
16	Bulgaria	1,066	18.6		Lithuania	227	4.1
17	Jordan	296 [(a)]	12.9		Slovenia	355	3.7
18	China *	41,302	12.7		Czech Republic *	1368	3.6
19	India	5,483 [(a)]	12.4		Tunisia	232	3.4
20	Hong Kong, China	22,343	11.1		Iran, Islamic Rep. **	674 [(a)]	2.8

Source: WTO (2004c) based on various statistical databases

Notes: * includes processing zones, ** includes Secretariat estimates, [a] 2001 figure, as 2002 unavailable

5.1 Protected markets: the case of the United States

The United States is the single largest importer of textiles and clothing. WTO data shows that in 2002 the US imported US$ 17bn worth of textiles and US$ 66.7bn worth of clothing. Only the fifteen countries of the European Union together imported more clothing and textiles during that period. The US percentage share of global textile and clothing imports was 11% and 32% respectively.

The US has long been at the forefront of controlling the flow of textile and clothing imports into its domestic market. This largely stemmed from a realization that its domestic textile and clothing manufacturing sectors would in the long term be unable to compete with the low-cost producers found in many developing countries, especially since labour costs were such a prime factor affecting the sectors' competitiveness. In 2004, the US imposed quotas on imports of textiles and clothing from at least 50 nations, including Bangladesh, China, India, Sri Lanka, Pakistan and Vietnam[2].

The volume of US imports of textiles and clothing, as measured in square meter equivalents (SME or m^2), has grown from 17,3bn SME in 1994 – the last year prior to the start of the ATC – to 47bn a decade later. Relatively little has changed with regard to the source of imports, with China already forming the leading source in 1994. At the time, textile and clothing imports from that country amounted to 2bn SME, or 12% of the total. In 2004 China was still the leading source of imports, but has strengthened its relative position substantially by increasing the volume of imports almost sixfold and accounting for almost 25% (up from 20% the previous year) of imports into the US within these sectors. Imports from a few other sources have shown greater growth rates, albeit off a far lower base. Total US textile and clothing sector imports have increased by 175% between 1994 and 2004.

The strong growth in Chinese imports would have reinforced US fears about the threat that unchecked imports would pose in the long term. This is underlined by the fact that trade during the period under review would have only been marginally affected by the removal of quotas as phase-out was still in its early stages. Initially (and this is shown by the data), quota liberalization would have targeted sectors that are least vulnerable to imports. Also, China became a WTO member only late in 2001, meaning that the US was not bound by the ATC with respect to textile and clothing imports of Chinese origin. In the period 2002-2003 however, following China's WTO accession, imports into the

[2] For 2004 US quota information, see http://www.customs.gov/xp/cgov/import/textiles_and_quotas/archived/2004_year_rpt/

US virtually doubled. This coincided with the third stage of quota removal, which saw a further 18% of imports liberalized.

The growth of Sub-Saharan African (SSA) textile and clothing exports to the US has been far less spectacular, and among the leading 100 foreign suppliers to the US market, only 10 SSA countries feature (and this only after AGOA had kick-started the industry in a number of African countries). Of these, the leading supplier is Lesotho, holding position 40 (with a volume of 111mn SME in 2004), followed by Kenya (position 46; 73mn SME), Madagascar (47; 69mn SME), Swaziland (53; 61mn SME), South Africa (54; 57mn SME), Mauritius (67; 37mn SME), and so forth. Africa's lack of penetration of the US textile and clothing market is despite origin rules that must count among the most liberal of all preferential trade arrangements: since 2001, the African Growth and Opportunity Act (AGOA) has permitted beneficiary countries (all of the above mentioned qualify) to export garments duty-free and effectively quota-free to the US, irrespective of the source of the material inputs[3]. While African countries are mere minnows in the context of aggregate imports into the US, they nevertheless managed to substantially increase the volume of their exports, especially in recent years. AGOA's trade preferences are a clear source of competitive advantage, especially since it covers categories that are most severely constrained for the larger exporters. Whether AGOA will remain a sufficient incentive in the post-quota environment remains to be seen, but it is certain that the relative advantage it brings will be reduced.

Many of the leading exporting countries have faced particularly severe restrictions in the US market. With regard to the US, this notion is supported not only by the fact that these countries had quotas imposed against their exports, but also by the extent to which these quantitative measures actually worked to restrict imports. As indicated earlier, a high fill-rate of an existing quota is said to be constraining when quota utilization levels are in the region of 85% (this being the US interpretation) and 95% (EU interpretation). The highest number of quotas appears to have been leveled against China, with approximately 90 quota categories (of which at least half were constraining) and a further 30 categories filled in excess of 50%. It is also interesting to note that the US allocation of quotas does not necessarily reflect each country's productive strength, or existing exports.

For example, in category "336" (dresses, in dozens), China's quota limit in 2004 was 0,21mn doz., Indonesia's 1,2mn doz., Pakistan's 1,1mn doz. and India's 1,9mn doz. Based on a sample number of categories analysed, it appears to the author that

[3] This rule does not apply to South Africa, which must utilize local or regional fabrics.

Chinese exports are subject to particularly strict treatment, for example in comparison to exports from India and Indonesia.

The following sample countries are not only among the world's leading textile and clothing exporters, but each has in the past year (2004) fully utilized at least some quota-categories with its exports to the US:

- **China**: approximately 90 quota categories, of which half constraining (>85% fill-rate), a further 30 categories filled >50%;
- **India**: approximately 23 quota categories, of which 8 constraining, a further 6 filled >50%;
- **Pakistan**: 30 quota categories, of which 10 constraining, a further 5 filled >50%;
- **Bangladesh**: approximately 20 quota categories, of which 2 constraining, a further 16 filled >50%;
- **Indonesia**: approximately 45 quota categories, of which 13 constraining (85-100% utilized), a further 15 filled >50%;
- **Turkey**: approximately 35 quota categories, of which 1 constraining, a further 6 filled >50%;
- **Mexico**: approximately 7 quota categories, of which 3 constraining, a further 2 filled >50%;

While the US has resisted calls by many of its domestic stakeholders to support a postponement of the phasing out of quotas, it has nonetheless introduced certain measures aimed at reducing the immediate impact of an expected surge in imports. Countervailing measures remain an option if imports threaten irreparable harm, while the country also has the option of using countervailing measures as part of China's WTO accession agreement (although this facility, not being WTO-compliant, is a temporary measure only available until 2008). The US Committee for the Implementation of Textile Agreements (CITA) has recently invoked special quotas on Chinese imports in 2003 (on knitted fabric, brassieres, robes and dressing gowns) as well as in 2004 (on cotton, wool and man-made socks). At least a further 12 petitions for safeguard action have since been received by CITA, although apparently all based on the *threat* of market disruptions rather than *actual* disruptions (Just-Style, 2005).

One of the measures already being employed by US customs authorities is to limit the import of textiles and clothing shipped *prior* to the expiry of the ATC but in anticipation of quota-free entry. This measure entails limiting the release of goods into the US market up to a monthly limit of 5% of the previous year's quota ceiling. For example, where the quota may have been 100,000 pairs of jeans for a specific country, excess shipments would be allowed entry at a rate of 5,000 pairs per month until all excess shipments (sent in 2004) have been cleared. The starting date is February 2005, rather than January of that year.

Vehement opposition to any delay in quota removal has come from the US retail sector and large brand-name manufacturers, all of which stand to gain from cheaper imports. For example, in late 2004, the US Department of Commerce was served with an injunction by the US Association of Importers of Textiles and Apparel (USA-ITA) that prevents it from introducing further restrictions (Just-Style.com, 2005). A quota-free environment will for example provide brand-name manufacturers (most of whom already outsource production to low-cost countries) with a greater choice of production locations, which in turn will help reduce production costs.

6 Some Implications of an End to Quotas

Never before has an international trade agreement, or rather the expiry of an agreement, caused such a global uproar amongst stakeholders as has taken place with the expiry of the ATC. While it may at first glance appear strange that it was only in 2004 that the debate around the ATC, and a possible extension, reached such a crescendo, it is the heavily back-weighted nature of the Agreement that sees by far the largest changes and possibly market disruptions technically taking place in the immediate post-quota environment.

Quota removal, in terms of the ATC, took place in 4 unequal stages: the first integrated 16% of trade (based on 1990 levels), the second a further 17%, the third 18% and the final stage (on 1 January 2005) removed quotas from the remaining 49% of trade. But countries were given free rein as to which categories were liberalized when (with the exception that each stage of integration had to include items from each of four pre-determined categories[4]). Naturally, categories in which trade was relatively low anyway, or where quotas were not being exceeded making them ineffective in the first place, were the first to have quotas removed. The largest tranche, and including the most

[4] See earlier section on the ATC

sensitive sectors, was integrated on 1 January 2005, effectively making it the threshold date when quota removal was to be of greatest consequence.

While the looming end of the formal quota regime led to frantic last-minute efforts by some countries (often at government level) to postpone the implementation of the final stage of quota phase-out, these efforts were notably not driven by the US and EU governments (perhaps mindful of the negative repercussions that could have resulted in terms of their own and the WTO's credibility, and of the fact that under China's WTO accession agreement, importing countries may limit the growth in Chinese imports to 7.5% per annum until 2008). Proponents of a postponement to the final phase-out had emerged mainly from the ranks of developing countries that were likely to be the most negatively affected (for example Mauritius, Bangladesh, etc.), as well as manufacturers' organisations both in Europe and the US (for example ATMI, the American Textile Manufacturers Institute).

One such initiative includes the *Istanbul Declaration*, which called for an extension of quotas by three years to 2007. It was initially conceptualized and endorsed by leading American and Turkish textile and clothing industry organisations early in 2004. Since then, almost 130 industry organisations from approximately 50 countries including Kenya, Lesotho, Mauritius, South Africa, Swaziland and Zambia have endorsed this initiative.

Since quotas were applied differentially between countries and product lines, quota removal will see the emergence of clear "winners" and "losers". These will not consistently emerge from the ranks of either developed or developing countries, but their status will depend entirely on a host of factors. These include the pre-2005 status quo (i.e. the extent to which countries were subject to quotas), as well as a number of competitiveness issues. Foremost among these will be the extent to which countries are already competitive producers of textiles and clothing (especially in the context of the all-important price-quality nexus), their market orientation (commodity-type production vs. high fashion content), distance to market and responsiveness (competitiveness through short lead times) and so forth.

While producers in industrialized countries are most likely to count among the 'losers' of quota removal, there will be *both* winners and losers among the ranks of developing countries. Already the often seen unity between developing countries has been undermined as the last quota year drew to a close, with some economies facing major economic upheaval. Proponents of an extension of the quota system, by at least a few years, vociferously drew attention to the likely structural impacts a quota-free

environment would have on their economies, especially where a large proportion of merchandise exports consisted of clothing and textiles within categories that were quota-constrained in other countries. A resultant emergency meeting in the WTO's Goods Council during October 2004 however failed to lead to an extension. .

The removal of quotas is likely to have multiple dimensions, including economic, political, consumer and efficiency considerations. The political dimension relates to the credibility of WTO agreements, their binding status on member states, and the credibility of the multilateral rules-based trading system in general. The latter has been undermined repeatedly through ineffective enforcement of agreements or inadequate follow-through of commitments made especially by industrialized countries. The consumer perspective relates to the probable gains in welfare through lower prices that are likely to emanate from quota removal. The efficiency dimension relates to market distortions brought about by artificial trade barriers (which distort production and inevitably drive up world market prices), and the loss of benefits to producers and employees (who would have benefited from indirect protection either through an absence of quotas and / or through preferential trade agreements with industrialized countries).

It is highly probable that there will be substantial consolidation in global textile and clothing production, and with it changes in the geographic location of producers. In the Southern African region alone, various news reports have described factory closures (in January 2005) in countries including Lesotho and Swaziland, accompanied by substantial job losses (see AGOA.info, 2005). Some observers have predicted a substantial reduction in the number of countries that major textile and clothing retailers will buy from. Predictions also see the strengthening within the textile and clothing value chain of large multinational companies, due to the fact that the absence of quota restrictions will likely increase their buying power.

Studies focusing on the likely future purchasing decisions of US retailers have found that they would likely reduce by two-thirds the number of countries they deal with at present in a post-quota era. It is worth noting that in 1995, the 29 largest apparel retailers in the US (for example Wal-Mart, Sears, etc.) accounted for 98% of all US apparel sales (UNIDO, 2003). A similar study of the UK retail market by PricewaterhouseCoopers (2004) predicted lower sourcing costs for retailers, leading to price deflation, as retailers increasingly shift their purchase orders away from local sources to low-cost Asian countries.

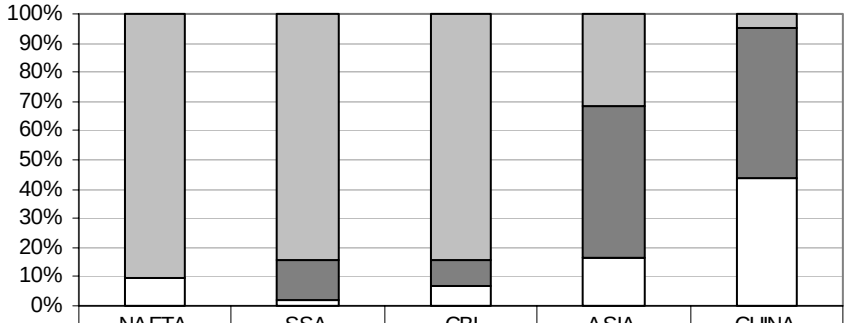
There are likely to be two shifts in production: from industrialized to developing countries, and *between* developing countries. The largest relative shifts are however predicted to occur among low-cost locations, these being from the ranks of developing countries. However, factors that may hold back this trend in the short term include the continuing uncertainty about whether countries will invoke safeguard measures. The heavy reliance and downward pressure on labour costs as a defining factor of competitiveness is often referred to as a “race to the bottom”.

A further study undertaken by Nathan Associates, calculating the level of risk associated with the removal of quotas (based on trends in US imports), found that current ‘preferential’ regions of supply – namely NAFTA, SSA (through AGOA) and the Caribbean Basin countries – were highly dependent indirect beneficiaries on the quota constraints faced by China and other Asian-based exporters. The diagram below reflects the large proportion of textile and clothing exports from NAFTA countries, SSA and the South American / Caribbean countries (under the Caribbean Basin Initiative - CBI) that took place in categories heavily constrained by quota restrictions in other parts of the world.

As a consequence, three regions (namely NAFTA, SSA and CBI countries) are likely to face particularly significant increases in competition in the post-quota environment. The diagram below indicates levels of risk, ranging from ‘low’ (product categories where the ATC has already eliminated quotas, or for which no constrained suppliers exist), to ‘high’ (associated with products for which producers in the given region are unconstrained by quotas, but for which producers in other regions at that stage faced quota restraints).

Fig. 1

Predictions of US apparel imports 2002-2005, by source and risk level (US$ mn. and percent)



	NAFTA	SSA	CBI	ASIA	CHINA
High	8,461	802	12,768	7,662	304
Medium	47	129	1,311	12,768	3,189
Low	876	21	1,049	3,997	2,749

Source: Nathan Associates (2002), based on US Dept. of Commerce

It is clear from the previous assessment that China and India are expected to draw the greatest benefit from the removal of quotas, both with respect to the US and EU markets. Drivers of this include the level of current quota constraints, the size of each country's domestic textile and clothing industries and installed capacity, and their attractiveness as a destination for investment resulting from a relatively low-cost and productive workforce (which is largely non-unionized and subject to few minimum working conditions).

Various sources also point out the contribution by China's direct and indirect export subsidies (for example in the form of low-cost loans to manufacturers and currency manipulation by deflating the value of the local currency against the US dollar) as an important factor in that country's global competitiveness. A perhaps somewhat contentious WTO study, on account of its predictions of drastic surges in certain countries' share of the export market, sees Chinese textile and clothing exports to the US surge threefold (in terms of market share), and those from India to record a fourfold increase albeit off a lower base (WTO, 2004d) The same report predicts the largest losses to accrue to African countries and to Mexico, the latter constituting the second largest foreign supplier of textiles and clothing to the US market. One analysis shows that China's exports during Stage II of quota phase-out already doubled in 12 out of 18 categories. This however seems more to do with that country's accession to the WTO, and integration into the ATC-fold, than with the particular stage of quota-liberalization.

7 The Mitigating Impact of Preferential Trade Arrangements for African Countries: The Cotonou Agreement and AGOA

Most African countries are able to export a range of goods to key world markets both duty and quota free, notably to that of the EU and US. 78 developing countries currently benefit from preferential access to the EU for textile and clothing exports under the Cotonou Agreement, subject to compliance with specific rules of origin. For preferential access to the US, the country's Generalised System of Preferences (GSP), and more recently the African Growth and Opportunity Act (AGOA), apply to 37 African countries. Both AGOA and the Cotonou Agreement provide preferential access to textiles and clothing (the former for clothing but only a small number of textile categories). Other preferential schemes giving developing countries preferential access to the EU also include the Everything-But-Arms (EBA) initiative, which is an offshoot of the GSP. As is the norm among similar trade programs, specific origin rules set the conditions that require compliance in order to benefit from preferential market access.

Both AGOA and Cotonou have been providing beneficiary countries with a significant competitive advantage over their Asian counterparts, mainly because they provided trade opportunities in categories that were heavily quota-constrained in competing countries. For example, AGOA has provided not only a saving on the average 15-20% US duty on garment imports, but includes most garment categories that were otherwise quota-constrained. A USITC report notes that in 2002, 73% of SSA clothing exports to the US were in quota-constrained categories (2004). The same report, which bases its empirical findings on interviews with US importers (retailers etc.), finds that "industry sources (have) indicated that this region's overall share of U.S. apparel imports will fall, notwithstanding AGOA preferences…AGOA preferences may spur U.S. firms to source products from the region that are subject to high U.S. duty rates, such as manmade fiber and wool apparel…" (USITC, 2004:3-21).

While AGOA allocates quota restrictions to these preferences, quota utilization has only been in the region of 35% (for the 2004 quota year) of the allocated quota, and thus not a constraining factor at all (AGOA.info, 2005). AGOA quotas within this preference program are not affected by the ATC provisions, since they are linked to a special market preference (this being duty-free entry and liberal origin rules). However, AGOA is time-bound, with the third-country fabric waiver expiring in 2007. After that date, market access will still be duty-free but subject to stricter origin rules. In the 2006/2007 year, the (sub)quota allocated to the third-country fabric provisions will be halved, which at current quota utilization rates (LDC category) may very well cause restrictions in the use of this facility.

AGOA in addition contains liberal origin rules, which permit so-called lesser developed beneficiary countries to use fabrics irrespective of their origin, provided attractive incentives to manufacturers located in Africa. In fact, these incentives were sufficient to attract widespread investment from outside of Africa, mainly from operators in quota-constrained Asian countries.

Preferential access to the EU market, under the EU's GSP and Cotonou Agreement, likewise provided an important driver to EU-bound exports. While the EU rules of origin regime is less flexible than that of AGOA (as a guideline, it requires two stages of manufacturing to take place locally, for example spinning and weaving), it nevertheless formed an important incentive for the development of for example the Mauritian garment manufacturing sector. Mauritius used preferential market access opportunities, together with the establishment of export processing zones, as an incentive to attract in particular knitwear manufacturers to its shores (UNIDO, 2003). Mauritius has become Sub-Saharan Africa's largest exporter to Europe of quota unconstrained textiles and clothing, making it one of the most vulnerable countries in the face of pending quota removal (together with the fact that over half of the country's merchandise exports is in clothing categories). But a study that asked medium and large-scale manufacturers in the year 2000 how they saw their position five years on (coinciding with quota removal) found that only half of them felt that they would "still be around", with the remainder expressing highly pessimistic sentiments (Gibbon, 2000).

With the removal of quotas, the relative benefit of these preferential trade programs will clearly be substantially reduced. Nevertheless, they remain an important *mitigating* factor against losses stemming from quota removal in that they continue to provide savings on import duties. The extent to which African countries will continue to benefit will also depend on global supply chain developments, the ability of African manufacturers to compete in terms of quality, lead-times and price (considering tariff preference), as well as possible legislative developments around the AGOA legislation and Cotonou as the trading relationship between the EU and ACP countries enters a new (and more reciprocal) era in the form of Economic Partnership Agreements (EPAs). Bearing this in mind, the likelihood of EU and US policymakers invoking measures (or threatening to do so) to avert an excessive surge in imports from low-cost Asian countries, especially from China, means that the retail sector there will most probably continue to source at least some of its textile and garment requirements in Africa.

8 The Remarks and Summary of Key Issues

Trade-restricting quotas imposed on the trade in textiles and clothing under the MFA had the primary objective of regulating the uncontrolled expansion of exports from low-

cost producers into the markets of certain developed countries, most notably European countries and the US. The unintended consequence, of course, was that quotas led to the wide profusion of the sector globally, and became an important cog in the wheel of many developing countries seeking to diversify their economies away from being based largely on agriculture. Ironically, the structured removal of quotas under the ATC, while initially heralded as an important "victory" for developing countries, began exposing deep economic vulnerabilities of a number of developing countries in particular. Now, as the final stage of quota removal has been completed, evidence is emerging that as predicted, *developing* countries are likely to be amongst the greatest "losers" in the post-quota environment.

It is clear that there is no simple solution to the concerns of affected stakeholders. The ATC's schedule for the removal of quotas had been largely adhered to over the past decade, and despite opposition from many quarters, its final stage was implemented as scheduled. After all, countries have had a decade to prepare themselves for the post-quota environment. Nevertheless, with the quota regime gone, countries will continue to have access to selective quantitative restrictions not only as part of China's WTO accession agreement (until 2008), but also in terms of the WTO-compliant trade remedies available to member states.

While it is impossible to accurately predict winners and losers in the post-quota environment, the summary of key issues further below outlines some of the main results that can be expected, while summing up the key issues. An awareness of the possible impacts of quota removal will allow both industry stakeholders and policy makers a greater chance to respond appropriately to the many challenges facing the sector.

Some of the key impacts of quota elimination under ATC rules can therefore be broadly summarized to include the following:

- Main beneficiaries would be producers located in countries that were subject to high quota restrictions under the ATC. These would typically include India, China, Pakistan, and so forth;

- However, benefits are not likely to automatically accrue to producers in these countries: key determinants of competitiveness, for example low labour costs, reasonable or good infrastructure and telecommunications links (the absence of both of which can lead to delays and subsequent downstream problems) as well as product quality are important;

- Consumers are overall likely to be major beneficiaries, as the removal of market impediments should increase the competitiveness of the sector and drive down prices;

- Investors in textile and clothing enterprises in certain developing countries not subject to restrictive quotas (i.e. those benefiting indirectly from quotas on competing countries) may find their investments unsustainable when textile and clothing trade becomes increasingly based on principles of free trade rather than market restrictions. Evidence of this happening has recently emerged for example in Lesotho and Swaziland;

- The negative impact of quota phase-out is likely to be the most severe – barring mitigating factors – on countries with a high reliance on exports in previously protected and quota-constrained textile and clothing categories. Examples include Bangladesh, Mauritius and Lesotho;

- Workers in relatively high labour cost countries are likely to suffer firm shutdowns as leading global retailers switch to lower-cost sources. Examples of this happening once again already include Lesotho and Swaziland;

- Lead times and proximity to market will become increasingly important, and may become a differentiating factor that will mitigate some of the negative impacts of quota removal in countries located close to the US and Europe (such as Mexico, the CBI countries, North African and East European countries). For example, it takes about six weeks to ship a product from China to the UK. In the clothing sector in particular, retailers (and producers) must be able to react quickly to shifts in demand brought about, for example, to changes in fashion. This factor is of particular importance where lead-times are critical, and / or where smaller orders are the norm. Proximity between producers and retailers will thus continue to play an important rule in the foreseeable future;

- Manufacturers located in countries not directly affected by quota phase-out but with strong and established commercial ties with buyers in the EU and US are likely to be less adversely affected by quota phase-out;

- Linguistic and cultural barriers, especially between key importing countries and key beneficiaries of quota removal, should not be underestimated and will in the short to medium term mitigate against the “uncontrolled dominance” of certain Asian economies in the textile and clothing sectors;

- Safeguard mechanisms, for example the imposition of special tariffs and / or short-term quotas, will continue to be available to WTO members as a trade remedy against severe market disruptions, subject to conditions. It is thus entirely possible that safeguard mechanisms will be imposed in certain textile and clothing categories. Already, the US is severely limiting the import of any textiles

and clothing shipped from China before the 2004 year-end in anticipation of quota removal. Also, China's accession to the WTO was subject to certain safeguard provisions, which will continue to provide a measure of protection to other WTO members.

- Countries benefiting from preferential market access arrangements, for example AGOA, EBA, Cotonou and the CBI, are likely to see a reduction in their relative advantage. However, duty-free market access to the EU and US will continue to be an important factor in reducing the negative impacts of quota-removal. However, it is unclear whether the preference margin will be sufficiently large to counter the competitive price-advantage of some of the low-cost producers in Asia.

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The most recent data on US quotas, by country, may be found at
http://www.customs.gov/xp/cgov/import/textiles_and_quotas/textile_status_rpt/

For the most recent clothing trade data between Africa and the US, see
http://www.agoa.info/index.php?view=trade_stats&story=apparel_trade

10 Appendix: United States' Imports of Textiles and Clothing (Unit: Volume quantity in m^2)

Rank 2004	Country / Region	1994	2001	2002	2003	2004	1994 % of Total	2004 % of Total	% Change 1994-2004
	World	**17,277,792,688**	**32,811,746,901**	**38,288,154,090**	**42,226,774,742**	46,941,180,766	**100**	100	+ 144
1	China	2,042,048,860	2,210,674,207	4,963,116,352	8,287,651,470	11,667,688,553	**12**	24.9	+ 471
2	Mexico	976,737,209	4,289,934,334	4,335,089,072	3,926,220,831	4,100,480,277	**6**	8.7	+ 320
3	Canada	1,317,559,558	3,267,515,527	3,386,790,626	3,311,693,562	3,272,028,750	**8**	7.0	+ 148
4	Pakistan	678,495,087	2,189,346,410	2,536,916,992	2,689,901,701	2,970,149,648	**4**	6.3	+ 338
5	South Korea	864,138,594	1,383,482,147	2,032,157,832	2,097,148,176	2,301,417,912	**5**	4.9	+ 166
6	India	677,124,970	1,250,244,729	1,544,603,537	1,665,795,061	1,914,968,624	**4**	4.1	+ 183
7	Taiwan	1,236,779,898	1,224,378,725	1,391,379,424	1,356,240,168	1,302,060,812	**7**	2.8	+ 5
9	Indonesia	516,001,814	1,164,628,883	1,215,355,135	1,150,768,348	1,274,800,354	**3**	2.7	+ 147
8	Honduras	220,463,264	1,032,289,452	1,098,827,879	1,164,523,753	1,208,857,216	**1**	2.6	+ 448
10	Bangladesh	487,036,565	1,169,040,940	1,149,765,047	1,109,782,953	1,108,580,187	**3**	2.4	+ 128

40	Lesotho	17,906,347	50,913,298	84,386,129	103,864,876	111,162,852	**0.10**	0.24	+ 521
46	Kenya	17,119,977	18,573,025	36,513,907	52,627,014	73,395,781	**0.10**	0.16	+ 329
47	Madagascar	658,595	37,485,639	22,164,877	45,638,520	69,413,537	**0.00**	0.15	+ 10,440
53	Swaziland	6,054,769	11,433,411	25,269,976	49,166,281	61,469,076	**0.04**	0.13	+ 915
54	South Africa	23,831,156	59,319,128	74,613,948	85,899,278	57,364,606	**0.14**	0.12	+ 141
67	Mauritius	50,485,594	41,115,522	47,063,827	45,146,246	37,428,721	**0.29**	0.08	-26
78	Namibia	81,534	81,381	1,394,241	10,543,524	18,938,007	**0.00**	0.04	+ 23,127
93	Ghana	865,660	240,228	650,762	6,205,392	9,331,374	**0.005**	0.02	+ 978
96	Malawi	5,924,039	4,368,352	3,363,127	7,049,439	7,795,421	**0.03**	0.02	+ 32
98	Botswana	602,582	1,302,865	3,005,665	3,050,718	5,834,785	**0.003**	0.012	+ 868

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