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Returning Textiles and Clothing to GATT Rules[*]

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1. THE WORLD TRADE ORGANIZATION AND ABOLISHING THE MULTIFIBER ARRANGEMENT

Textiles and clothing have been traded under restrictions since the 1930s. Sluggish domestic demand in industrial countries, which led to stagnant or even declining output and employment, accompanied by the penetration of Japanese cotton textile exports, increased pressure on countries to impose restrictions.

Protectionist measures adopted during this period took the form of relatively high tariffs and some voluntary restraints on exports, notably against Japan. In 1961 a Short-Term Arrangement (STA) on the cotton textile trade was reached at the initiative of the United States and under the auspices of the General Agreement on Tariffs and Trade (GATT).

Subsequently, the Long Term Arrangement Regarding International Trade in Cotton Textiles (LTA) was concluded in 1962. It imposed a 5 percent growth limit on imports of cotton products and placed a large share of the exports of developing countries under a trade regime.

Despite the LTA, developing countries, especially Hong Kong, Taiwan, and Korea, were able to expand their textile exports and penetrated industrial countries in the 1960s. Technological changes and the emergence of synthetic fibers allowed these countries to strengthen their competitiveness, and they were also able to exploit loopholes in the restrictions imposed by industrial countries. Furthermore, the restrictions on Japanese exports also created opportunities for these developing countries to expand their exports.

With the new pressure of competition from these countries, the U.S. initiated negotiations on the Multifiber Arrangement (MFA) in 1973, and it took effect on January 1, 1974.

The nature of the MFA is bilateral, discriminatory and markets access limitation under the supervision of the GATT's Textile Surveillance Body. While the MFA allowed 6 percent growth of textile exports from developing countries, the growth rates of bilateral quotas in practice were frequently below this. In addition, it covered a much wider range of textiles and clothing than the LTA.

The MFA includes most major industrial and developing countries and covers products made of cotton, synthetic fibers, wool, silk and ramie. Under the MFA, all exports are subject to quotas when total exports from an exporting country reach a certain share of total imports in the country of destination (Yang et al. 1997).

This discriminatory trade distortion imposed by industrial countries severely affected exports from developing countries. As a result, in 1985 they formed an International Textile and Clothing Bureau to seek an end to the MFA and return trade in textiles and clothing to normal GATT rules.

However, given the long history of trade restrictions it was no easy task, and compromises had to be made in the form of adopting a gradual liberalization approach.

On 1 January 1995 the MFA was replaced by the World Trade Organization (WTO) Agreement on Textiles and Clothing (ATC), which sets out a transitional process for the ultimate removal of quotas and the full adoption of textile and clothing products into GATT rules.

The liberalization process takes effect over a 10-year period (1995-2005), with MFA-restricted goods returning to normal GATT rules in three phases.

At the start of each phase of integration, importing countries must integrate a specified minimum portion of their textile and apparel imports, based on total trade volume in 1990. The quota growth rate of products remaining under quota is also specified for each phase. In addition, import tariffs are being reduced under this agreement, on both textiles and clothing, and on a wide range of other goods.

The first phase of the liberalization process started on January 1, 1995 with a 16 percent minimum trade integration and an increase of the quota growth rate to 16 percent. The second phase started at the beginning of 1998 with a specified minimum trade integration rate of 17 percent and an increase of the quota growth rate to 25 percent higher than the previous stage rate. The third phase is due to begin in 2002, with targets of 18 percent (integration rate) and 27 percent (quota growth rate).

Finally, all remaining products will be integrated at the end of the transition period on January 1, 2005.

The agreement also contains a specific transition safeguard mechanism that can be applied at any stage to products not yet integrated into GATT. Action under the mechanism can be taken against individual exporting countries if it is demonstrated by an importing country that a sharp and substantial increase of imports from an individual country would cause serious damage or threaten its domestic industry. Action can be taken by mutual agreement, following consultation, or unilaterally, but subject to review by the Textile Monitoring Body.

Bringing the MFA under GATT rules was a big accomplishment in trade negotiations. Given the distortions that had arisen from the MFA over a wide range of products and countries, it was to be expected that the impact of the changes would be strong. Importing countries stand to benefit from lower import prices due to the abolishment of quota rents. They can source from the most efficient exporters, while resource allocation in importing countries will improve as a result of import competition.

Exporting countries may benefit or not, depending mainly on their comparative advantage.

The quota system restricts competition and allows less competitive exporters to export more than their competitive share. These less competitive exporters will lose their market share. Export countries previously limited by the MFA will gain from increased market access. However, exporting countries will face lower prices as a result of increased competition, although production and export will be rationalized, with a move to more efficient sectors.

Yang et al. (1997) simulated the benefits of abolishing the MFA. The study concludes that MFA liberalization is important for the Uruguay Round (UR). The benefit from MFA reform is more than one-third of the total gain from the complete round of trade liberalization. The simulation also warns of losses resulting from delays in MFA reform. It concludes that “the cost of the MFA would have increased had it been allowed to stay beyond the round, while agriculture is being liberalized and industrial tariff rates are being reduced. This is because non-MFA reforms, if implemented alone, would lead to increases in the trade restricting impact of MFA quotas.”

Furthermore, the study urges that speedy non-MFA reforms would benefit both efficient and less-efficient exporting countries.

2. TEXTILE AND CLOTHING TRADE AFTER THE ATC

The period is too short to evaluate the actual impact of the ATC, and with the Asian economic turbulence, it is not possible to absolutely distinguish the significance of the ATC. However, investigating trade patterns will be useful for making some comments on WTO negotiations.

Exports of Major Exporters

Table 1 presents the exports of the top 13 textile and clothing exporting countries in 1997. In the case of textiles, these countries' exports constituted 72.1 percent of the world total. The trend from 1966 to 1997 shows the rise of China, Korea and Taiwan, which became number one, two and five respectively. The rankings of Germany, Italy and the U.S. are stable. China and Korea held the number one and two spots in 1997 while they were number three and six in 1990 when Germany and Italy were the top two. These export trends also show the declining comparative advantage of Japan and the United Kingdom.

The clothing market is more diversified. The top 13 exporters have a 59 percent market share. China was number one in 1997 with a market share of 18 percent as a result of high growth since 1965. Italy and Hong Kong have always been high in the ranking, indicating their sustainable comparative advantage, especially at the top end of the market. It should be mentioned that developed countries still held a high share of exports in 1997. Korea, Taiwan and Japan were ranked high in 1973, but their ranking and share significantly declined, while India's share has been improved.

Considering Pre-Uruguay Round and Post Uruguay Round Trade

To further explore world trade patterns after the ATC, the paper adapted Spinanger's (1999) tables and showed world exports in 1990, 1994 and 1997 in Table 2. The concentration of the top 13 exporters in textiles has not changed much, sharing about 72 percent, while the top 53 countries take up almost the whole market.

China's share declined after the ATC, but its ranking improved to number one in 1997. Countries whose rankings improved were Korea, Taiwan, Japan, Mexico, Canada and Australia. Rankings dropped, for among others, Hong Kong, Thailand, Indonesia, Malaysia, Singapore and the Philippines. Thus, many East Asian countries did not do well after the UR. Note that the share and ranking of India have been quite stable, while those of Mexico have improved.

On the clothing side, the top exporters accounted for 60 percent and the top 53 exporters exported 93 percent of total trade. China dominated with a share of 18.01 percent in 1997.

East Asian countries have not performed well after the ATC, with the rankings of Korea, Taiwan, Thailand, Malaysia, Indonesia, Singapore and the Philippines all declining. Mexico has significantly gained since 1994; her market share rose from 1.21 percent in 1994 to 3 percent in 1997, with its ranking moving from number 21 to number eight in the same period. India's share slightly declined in 1997, but its ranking improved.

If we consider the total market of textiles and clothing, the pattern also shows the dominance of China, which was the biggest exporter in 1994 and 1997. Furthermore, its share of 13.75 in 1997 was much greater than that of Italy, in second place, with 8.4 percent (not shown in the table).

For East Asian countries, Korea and Taiwan have been the major traders, ranking fifth and sixth. All East Asian countries listed in the table saw their market shares of textiles and clothing trade decline after the ATC, with the exception of Malaysia, whose share rose from 1.07 percent in 1994 to 1.09 percent in 1997. Mexico gained at the expense of East Asia. Its share significantly rose from 0.98 percent in 1994 to 2.14 percent in 1997, probably resulting from the North America Free Trade Area (NAFTA). One should note also that the market share of India rose consistently.

Structure of MFA Imports in the U.S.

For a more detailed analysis, we look at the U.S. market, the major one for East Asian countries. Table 3 presents the share of MFA product imports of the U.S. in terms of quantity and value of imports from selected East Asian countries, Mexico and India from 1994 to 1997. China was the largest exporter to the U.S. in textiles in 1994 and 1995, and then Mexico took over in terms of volume, although China remained top in terms of value.

Mexico's exports to the U.S. rose significantly after NAFTA. Its share of textile exports by volume to the U.S. increased from 8.57 percent in 1995 to 11.77 percent and 12.87 percent in 1996 and 1997 respectively; while its share of export value rose from 5.05 percent to 7.03 percent and 7.85 percent during the same period.

Between 1994 and 1997, the export value shares of East Asia have fluctuated. The trends of Hong Kong, Korea, Malaysia, Singapore, and Thailand have declined, although Thailand's share rose in 1997 from

1996. Indonesia, Taiwan and the Philippines showed positive trends; but the market share of Taiwan and the Philippines moderately declined in 1997. India's export share also showed an increasing trend up to 1996, which was 6.04 percent, but it declined to 5.8 percent in 1997.

On the clothing side, the pattern was similar to that of textiles. Mexico has been the top exporter since 1995, with a share of 11.38 percent and 13.70 percent in 1996 and 1997 respectively (Table 4). China was the second biggest exporter in 1997, although it was top in 1994-1995. The share of all the NICs declined during the investigated period. The combined market share of the NICs was 15.04 percent in 1997, while it was 23.91 percent in 1994. For the Association of South East Asian Nations (ASEAN), only Indonesia showed a positive trend, with the market shares of the others declining. The market share of India fluctuated; it was 2.79 percent, 3.12 percent and 2.78 percent in 1995, 1996 and 1997 respectively.

3. ISSUES UNDERMINING BENEFITS FROM THE ATC

Given the compromise that was reached as a result of conflicting interests and the long history of trade restriction; it is understandable that the process would involve only gradual liberalization. Under the present mechanism, skeptics might argue that nothing is being done and liberalization would be postponed once the deadline arrives. There is some evidence to justify this view.

Product Integration

The underlying principle of MFA liberalization is to gradually integrate textile and clothing products into the ATC. The percentage of integration for each phase is fixed, as mentioned in Section one, and importing countries can select the products. From the list of the integrated products, it is clear that major importing countries' strategy is not to integrate the major products exported by developing countries, and to put off liberalization as long as possible. Consequently a high percentage of the products of interest to developing countries will only be integrated into the ATC in the final stages of the liberalization.

Tables 5-8, adapted from Spinanger (1999), clearly demonstrate this argument. Table 5 presents the structure of EU imports of textiles and clothing in 1990. Developing countries export a high proportion of clothes in Textiles & Clothing (T&C) to the EU (Table 6). However, clothing shared only 1 percent of the total coverage of the first phase of liberalization of the EU. India, Thailand and Bangladesh would gain nothing in the first phase. Considering the percentage of total integration for East Asian countries, in terms of volume, the coverage was 36 percent for Thailand and 33 percent for China. NICs had less—22 percent for Taiwan, 15 percent for Korea, and 5 percent for Hong Kong (Table 6).

With only 15 percent in terms of volume coverage (in the first phase), 85 percent of MFA products will still have to be integrated. Table 7 illustrates that from 2002, 56 percent of total product volume will still have to be integrated, with a high proportion in the clothing category. For East Asia countries, Hong Kong gains the least from the scheme since 91 percent of the volume of exports to the EU would be liberalized after 2002. Taiwan would have the least share, with 48 percent coverage of its exports.

The case of the U.S. is not any better. Table 8 shows that the most products to be liberalized in the final stage are in the clothing category, i.e., 65 percent of the total.

Since this is a major product of East Asian countries, the benefits of integration will come very late. More than 85 percent of the total volume of imports from Malaysia, Singapore, Indonesia and Hong Kong would be integrated in the final phase. Other East Asian countries would have 65-71 percent left, compared to 51 percent in the case of Mexico.

Transitional Safeguards

The ATC permits quantitative restrictions by WTO members[1] on products that have not been integrated under the ATC. To impose restrictions, an invoking importing country has to prove both that: "(a) the domestic industry is suffering 'serious damage' or 'actual threat of serious damage' from imports; and (b) damage is due to a sharp and substantial increase in imports" (United Nations 1996).

The importing country will seek consultations with the concerned exporter. If agreement cannot be reached, the case will go to the Textiles Monitoring Body (TMB), which will investigate the issue. If the TMB cannot reach a consensus decision, the case will be referred to the Dispute Settlement Body (DSB).

It was envisaged that the safeguard mechanism be used as sparingly as possible. However, shortly after the ATC came into effect, the U.S. initiated almost 40 cases, including 24 actions against 14 WTO members. As mentioned in the United Nations (1996), of 24 actions invoked by the U.S, seven were rescinded at the consultation stage, and the TMB did not find any evidence to support restrictions on another six cases. This indicates that the safeguard mechanism was hastily employed without proper investigation. It is important to monitor this mechanism so that it does not disrupt the liberalization process.[2]

Regionalism

While the ATC liberalizes trade at the multilateral level, the Regional Trade Arrangement (RTA) provides preferential trade to its members. With this advantage, it creates trade diversion from non-members to members of the RTA. Thus liberalization may not fully benefit non-member countries.

In Mexico, exports of textiles and clothing to the U.S. rose significantly after 1995. NAFTA began in 1994 and the ATC took effect in 1997. The ATC should not have an impact on trade structure, as evidenced by the growth rates of East Asian countries. Rather, the effect of regional trade preference is worth investigating.

NAFTA imposes very strict rules of origin on textiles and apparel, more so than any other products. As James and Umemoto (1999) points out, “The triple-transformation rule (yarn to fabric to apparel) is in essence the equivalent of a 100 percent local content rule of origin. The restrictive rules are in contrast with the rule of origin for most other manufactured products. The rule for footwear requires 55 percent regional value content under the net cost method.” The U.S. has removed import quotas from Mexico on textiles and clothing that satisfied the rules of origin, and it also significantly lowered tariffs.[3] East Asian exporters, therefore, are disadvantaged, and this causes trade to switch to Mexico.

To provide evidence of trade diversion from preferential rules of origin and the trade preferences of NAFTA, James and Umemoto (1999) compares the growth rates of textiles and apparel with those of footwear before and after NAFTA. Table 9 shows that the growth rate of East Asia exports dropped significantly after 1994 in the case of textiles and even became negative in the case of apparel. Mexico’s export growth to the U.S. rose significantly after NAFTA. The growth rates of East Asian countries were lower than those of the world in both products. The pattern for footwear was much the same, but the degree of trade diversion was smaller than in the case of textiles and apparel. Strict rules of origin for textiles and apparel are one of the factors contributing to changes in the direction of trade.

Fear of Competition and Protectionist Sentiment

While free trade improves welfare, its benefits are not distributed evenly among concerned agents. Some will gain, and some will lose. Those who lose will protect their interests and always delay the process of liberalization. This is also the case in the textiles and clothing trade. Countries with established comparative advantages will benefit from the abolishing of the MFA, while countries that can export because of protection from the system will lose out after liberalization. This section will explore some indicators reflecting the comparative advantage of nations.

Quota utilization rates can be useful to evaluate the restrictive nature of quotas, although they are not perfect as they depend on both demand and supply conditions. Moreover, comparative advantage is dynamic and for a long time textiles and garments have been under restrictions. Consequently, the pure comparative advantage is not reflected in trade figures. However, it is possible that countries that fulfill their quotas will benefit when the quota system is terminated as they can expand their markets. Countries that under-utilize their quotas will not be affected if the quota is abolished.

We employ data on quota utilization rates from the U.S. Department of Commerce in 1997-1998. The restriction covers a large number of textile and garment products, therefore, to explore the comprehensive picture, we present the distribution of a number of product categories (in terms of share in the total number of the respective country) classified by the percentage of utilization. Countries with a high utilization rate in many products are considered affected by the restriction, and they might gain if quotas are abolished. Indonesia and China utilized their quotas more than other East Asian countries. Taiwan, Hong Kong, Thailand and the Philippines had about the same share of utilized products—more than 60 percent. Utilization in 1998 was better than in 1997 because of sluggish demand in 1997 (Table 10).

The pattern of quota utilization in the EU is similar to the situation in the U.S., China and Indonesia noticeably had high utilization rates. Thailand was better than Taiwan and Hong Kong. The Philippines was less effective than in its export to the U.S.

Past trends in the textiles and clothing trade indicate that Japan, which dominated the market in the 1960s, lost comparative advantage due to its high cost of labor compared to the NICs. In the 1980s, wages in the NICs rose and labor-intensive products could not compete with those of ASEAN. Then, China emerged as a low-wage producer and penetrated the labor-intensive market. Unit costs in China were only US$0.3 for textiles and US$0.24 for clothing (Table 11). Indonesia had the same unit cost as China in textiles and even lower for clothing. India also established itself as a low cost country, although slightly higher than China. ASEAN's unit costs were between those of China and the NICs, which still had a cost advantage over developed countries such as the U.S., Italy and Germany.

China is also perceived as a quality producer. Moore (1995) interviewed textile and clothing firms in the U.S. The respondents indicated that in textile production, Japan, Hong Kong, Taiwan, Korea and China were in the top category. These countries were able to produce a wide range of products, illustrating a strong competitive position. Pakistan and India were regarded as producers of inferior quality products.

Moore (1995) also reported that in clothing, interviewed firms regarded Japan as having the highest quality, followed by Korea, Taiwan and Hong Kong. Thailand and China were perceived as medium to good quality producers. Respondents believed that Pakistan, India and Indonesia were at the lower end of the scale with regard to quality.

It is not clear who will corner a higher market share and who will receive smaller pieces of the pie following liberalization. However, many indicators imply that China has the potential to gain. Mexico is very strong in the U.S. market due to NAFTA. Indonesia and India can be competitive in the lower end of the market. The NICs have to compete at the higher end with developed counties, while ASEAN is in the middle and has to find a market niche for medium to high quality products.

In view of the uncertainty of the situation once the MFA is completely abolished, there will be pressure to further postpone liberalization. Exporters who receive rent from quotas and who are afraid of competition will not be in favor of liberalization. Import substitution producers in importing countries definitely have the incentive to keep the system. The issue of China's accession to the WTO reinforces fears of competition since it will strengthen China's competitiveness.

4. ISSUES FOR WTO NEGOTIATION

- *Speed up the process of integration*. The process of integration has been slow. A high proportion of important products of interest to developing countries, especially East Asia countries, will only be integrated at the latest stage. As mentioned above, that there is pressure over protectionism from exporters and producers on importing countries, a commitment to liberalization will lessen this pressure. Leaving too many products to the last stage of liberalization will place a high burden on this stage and make it harder to implement.

  More important, speeding up liberalization will increase welfare. Non-MFA liberalization in other sectors will spread resources to those sectors and will push up quota rents. Thus the delay of MFA reform will increase costs. The sooner the MFA is liberalized, the greater the benefits from abolishing quota rents and rent-seeking activities.

- *Support Comprehensive Negotiation*. More comprehensive liberalization will increase global welfare. Moreover, gains made through the liberalization of other sectors will compensate for some countries that may lose or which are afraid of losing from MFA liberalization. The next round will, then, assist in speeding up the abolishment of the MFA.

- *Further reduction of tariffs on textiles and clothing*. On average, the UR resulted in tariff reductions on the manufacturing products of developed countries by 40 percent, so that the average tariff became 3.8 percent. However, tariff reductions on each product are not the same. For textiles and clothing, the reduction was only 22 percent. The tariff rates for fish and fish products, leather, rubber, footwear and transport equipment, which are major exports of developing countries; all were reduced less than the average. Thus, the average tariffs for these products are higher than the average.

  The average rate for textiles and clothing is 12.1 percent; those of fish and fish products, transport equipment, and leather, rubber, and footwear are 4.5 percent, 5.8 percent, and 7.3 percent respectively (Pangestu and Stephenson 1996). With higher tariff rates than those of other manufacturing products, there is room to improve efficiency by further reducing the rates for textiles and clothing.

- *Assisting countries to adjust to changes*. After liberalization, competition will be intensified. Assistance from international agencies to help entrepreneurs in developing countries understand and adjust to the new environment will lessen protectionist pressure and increase welfare to recipient countries.

- *Avoid other protective mechanisms*. Evidence indicates that regional preferential trade agreements, especially restrictive rules of origin, divert trade and reduce welfare from liberalization. It is imperative to find a solution that lessens the impact of regional agreements on global liberalization. Other non-tariff barriers, such as anti-dumping, are used to protect domestic industries. These should be controlled; otherwise they will be employed after the abolishment of quotas.

- *Update accelerated quota growth*. The accelerated quota growth mechanism was based on growth rates before the ATC took effect. This initial growth rate is important, since an exporting country with higher initial growth rates receives a higher quota than a country with lower rates, even though it might not be as efficient. Relative efficiency among exporting countries also changes over time. To improve global efficiency, the quota-accelerated rate should consider the quota utilization rates. Countries whose quota appears to be restrictive should receive a higher quota growth to reduce rent. This will also reduce redundancies among quotas.

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