Life after Quotas? Early Signs of the New Era in Trade of Textiles and Clothing

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On January 1, 2005, the system of quotas that had regulated imports of textiles and clothing into rich countries for 30 years was finally dismantled.[1] That step came despite a last-gasp attempt by certain importing countries, in alliance with a number of developing countries that had benefited from the system's restrictions on China and other Asian countries, to delay the reform. In liberalizing the most protected manufacturing sector, the expiration of the quota system completed a major achievement of the Uruguay Round of multilateral trade negotiations concluded 10 years earlier.[2] Textiles and clothing remain subject to relatively high tariff barriers in both developed and developing countries, and certain developing countries, notably the least developed (LDCs), still receive significant tariff preferences in developed-country markets.

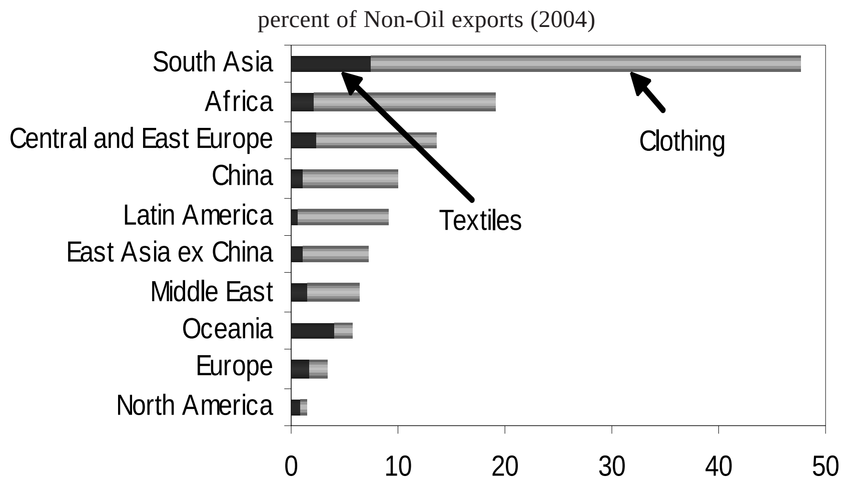
Much has been written about the likely impact of the reforms and the fear that markets will become swamped by Chinese products, with adverse implications for other developing-country producers that export to the developed countries. This note takes a first look at the initial impact of the changes and discusses what they suggest for developing-country strategies in textiles and clothing.

The development significance of exports of textiles and clothing

Although both can be crucial to development, the textiles and clothing sectors are distinct. The modern textiles sector is capital intensive and subject to growing automation. Production has tended to become geographically concentrated, with only a few developing countries having the capacity to export substantial amounts of standardized textile products. The clothing sector remains labor intensive, technology is relatively simple, start-up costs are comparatively small, and scale economies are not important. All of these factors favor production in locations where labor costs are low.

Diversification into export categories with greater value added than traditional agricultural exports is a major objective for many developing countries. Through manufactures of clothing developing countries have been able to significantly increase and diversify exports with positive effects on incomes, employment, and poverty.[3] The relative importance of clothing, in terms of the share of total non-oil exports, exceeds that of textiles in all but the developed-country regions (figure 1). Both textiles and clothing are particularly important in the exports of South Asian and African countries.

Figure 1. Textiles and clothing are important for developing countries



Source: COMTRADE data accessed through WITS.

Changes in trade following the removal of remaining quotas

Changes in trade in textiles and clothing products hit the newspapers first with predictions that world markets would be swamped with Chinese products and thousands of jobs lost in other developing countries.[4] The issue was back in the headlines after the United States (U.S) and European Union (EU) acted to restore protection (at least temporarily) against certain Chinese products under safeguard agreements negotiated at the time of China's accession to the World Trade Organization (WTO).[5]

Despite the ink spilled over the issue in the media, it is still too early to draw firm conclusions about the impact of the removal of quotas. Here we look at information on imports of textiles and clothing products into the European Union and the United States in the first six months of 2005 and show that the impact is likely to be more nuanced than many commentators have suggested. It is quite likely that many developing countries will have opportunities to continue to export clothing products provided their domestic business climate is favorable.

While U.S. imports from China have increased strongly since the quotas expired, imports from a number of other developing countries also have increased significantly (figure 2). U.S. imports from Bangladesh, a country that many thought would be hit hard, increased by more than 20 percent in the first half of this year. In fact, U.S. imports from a range of countries across Africa, Asia, and South America have increased, while imports from other countries in the same regions, as well as imports from developed countries, have declined. In absolute terms the largest declines in imports are from Hong Kong (China), Republic of Korea, Mexico, Taiwan (China), and Macao, in that order.[6]

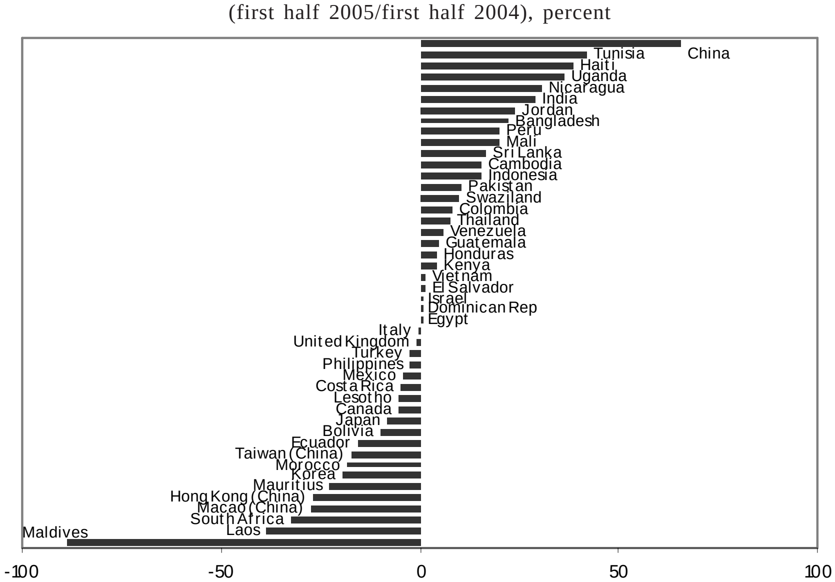
A similar situation prevails in the EU market (figure 3). Imports from China have increased strongly, but so have imports from certain other developing countries, including Bangladesh, Cambodia, Arab Republic of Egypt, Madagascar, and Vietnam. Large declines in imports have been recorded for Hong Kong (China) and Macao, while significant reductions in imports are reported from a range of countries in Asia, Eastern Europe, and the Middle East.

Because the initial response to the removal of quotas in the United States and the European Union was far from homogenous, identifying clear patterns is difficult. On balance, removal of quotas appears to have led to a much more competitive global market for textiles and clothing products. After years of suppression, EU and U.S. imports from China have grown strongly, but opportunities remain for efficient suppliers in other countries to expand output and exports.

Chinese exports have increased substantially in many product categories, but

Figure 2. Winners and losers in the US, post ATC

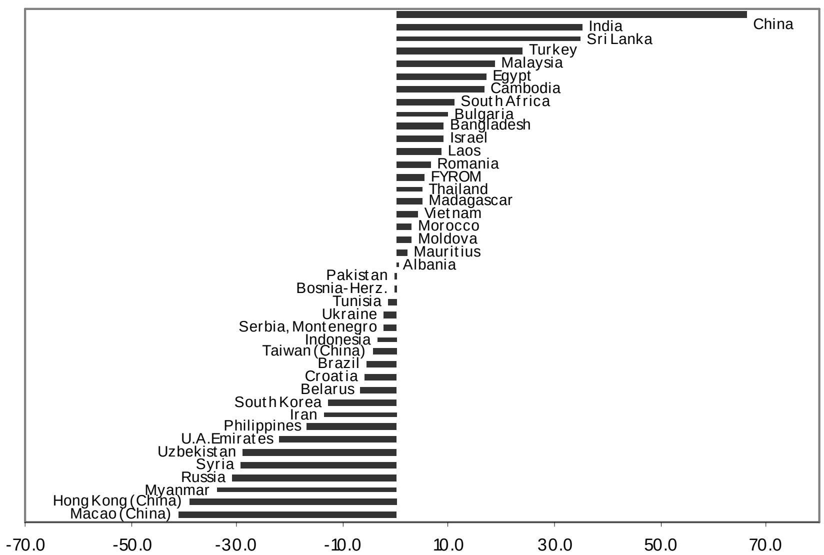
Proportionate change in US textile and clothing imports by supplier
(first half 2005/first half 2004), percent



Source: USITC.

Figure 3. Winners and losers in the EU, post ATC

Proportionate change in EU textile and clothing imports by supplier
(first half 2005/first half 2004), percent



Source: European Commision.

they have declined in others. For example, U.S. imports of T-shirts from China have increased by around 350 percent in the first six months of this year, but imports of certain woven cotton fabrics have declined. Accompanying the surge in U.S. imports of T-shirts from China has been an increase in imports of T-shirts from countries such as Indonesia and Thailand, but not from Vietnam. Imports of T-shirts from South Africa and Lesotho have decreased by 20–35 percent, but imports from Mauritius and Swaziland have shown a modest increase. While U.S. imports of T-shirts from Kenya have declined, imports of men's or boy's cotton shirts from Kenya have increased strongly. Even within product categories such as women's or girl's suits (HS 6104), where overall imports from China have increased by more than 200 percent, the growth of imports from China at a very detailed (10 digit) product level ranges from –45 percent to +1,400 percent. Of the 15 detailed products specified in the trade classification for women's and girl's suits, 7 show a decline in imports from China this year.

It is not yet possible to distinguish clear outcomes even for specific countries. For example, analysis prior to the removal of quotas painted a fairly bleak picture for Lesotho, where the clothing sector dominates exports and has been the major source of employment growth in recent years. Initial reports in the press early in 2005 appeared to confirm those fears, suggesting that at least 10 factories had shut down and at least 10,000 workers (roughly one-fifth of the industry workforce) had lost their jobs.[7] However, exports of clothing to the United States, which accounts for almost all of the output of Lesotho, decreased only slightly (by 5.3 percent, or about $10 million) over the first half of 2005 compared to the same period in 2004. Some commentators suggest that a portion of the job losses reflects substantial improvements in labor productivity. Others report that during the course of this year some factories have reopened and others have opened for the first time. No official data are available on job losses in the clothing sector in Lesotho this year, nor have any official pronouncements been made. The picture is further clouded by the fact that very similar products have exhibited quite different export performance. Exports to the United States of women's and girl's cotton trousers have declined substantially, but exports of men's and boy's cotton trousers have increased significantly. Thus, diagnoses that concentrate on broad sectoral factors will have limited power in explaining developments in the clothing industry in 2005. A careful analysis will need to dig down to identify firm-specific characteristics and responses.

The changes for countries such as Sri Lanka and Bangladesh are in sharp contrast to predictions of the dire impact of the end of quotas. It was suggested that one million jobs would be lost in Bangladesh and that one-half of factories in the industry in Sri Lanka would close down (as reported in Oxfam 2004). It is too early to conclude with confidence that the expiration of quotas will not have a major negative impact on these countries. Buyers in the European Union and United States may be postponing decisions to begin sourcing in China while uncertainty persists concerning official protection against Chinese products. Nevertheless, some countries that were expected to be hit hard by the removal of quotas have managed to *increase* the value of their exports to the European Union and the United States, even in product categories in which Chinese exports have grown the fastest, suggests that opportunities for a range of developing countries to export, especially in the clothing sector, will remain.

While global buyers will review their sourcing strategies, many have indicated that they will not risk placing all their orders with China and will seek to maintain a more diversified sourcing structure. Moreover, China cannot fill every niche. The textiles and clothing sectors have a large number of niches that vary by country to suit vastly differing tastes. Even a small share of a small niche of the United States or a large European country can have a substantial economic impact on a small developing country.

Here it is worth stressing the differences between the European and U.S. markets. Large buyers in the United States, such as Walmart, look to suppliers that can satisfy economy-wide demand for standard products. The EU market, by contrast, remains considerably fragmented along national lines. Footwear is one sector in

Table 1. Applied import duties on cotton yarns, cotton fabrics and sewing needles in selected countries, 2005

Percent	Bangladesh	Brazil	Ethiopia	Kenya	Mexico	Morocco	Nigeria	Pakistan
Cotton yarns	15.0	14.0	20.0	20.0	15.0	32.5	40.0	5.0
Cotton fabrics	30.0	18.0	40.0	25.0	15.7	40.0	75.0	25.0
Sewing needles	30.0	17.5	20.0	15.0	20.0	10.0	20.0	10.0

Source: TRAINS database on WITS.

which the European Union and United States imposed quantitative restrictions against China and other East Asian suppliers in the late 1980s. Those restrictions were removed in the 1990s. In the United States, China now accounts for around 70 percent of U.S. imports. Its share of EU footwear imports, however, is less than 15 percent. As a last observation, China and India are experiencing high growth rates. Rising domestic demand will reduce some of the excess supply that can be exported. At the same time, rising wages will shrink competitive margins.

A strategy to support competitiveness of the clothing sector

What elements are likely to comprise a successful strategy to support the clothing sector in developing countries?

Review domestic trade policies to remove constraints that act against clothing exports

For clothing producers the ability to source fabrics and other inputs from the global market is a crucial competitive factor. Many developing countries apply high import duties on products used as inputs in textile and clothing industries, thereby limiting the capacity to export competitive final products. Producers in many developing countries pay considerably higher than world prices for yarns, fabrics, sewing needles, and other inputs (table 1). In many cases drawback schemes reimburse exporters for these duties, but poor implementation often leads to delays in payment, while exporters bear the cost of compliance with the schemes.[8]

The ability to fill orders quickly is a significant competitive advantage in the clothing sector. That makes the efficiency of customs procedures on both imported inputs and the exported product, and the availability, cost, and speed of transport services, important determinants of competitiveness. In many developing countries, and especially in Africa and South Asia, long delays in customs and poor transport infrastructure keep producers away from key global markets. Compared with China, the documentary requirements and customs procedures of many developing countries are onerous and complicated, thereby slowing imports and exports (table 2). Customs reform, improvements to ports and transport infrastructure, and the stimulation of competition among transport companies are all important measures to support the competitiveness of the clothing sector.

Improve the business environment

Many countries have lower labor costs than China in the production of clothing (the relevant metric is the price per one standard minute). Moldova, for example, has per minute costs that are two-thirds of those in China. Labor costs are also lower in Bangladesh and in many countries in Africa than in China. In many of these countries, however, the advantage of low labor costs is undermined by high indirect costs resulting from a hostile business environment. The World Bank estimates that the cost of doing business in Africa, for example, is as much as 40 percent higher than in other developing regions (World Bank 2005). Countries that implement policies to provide a favorable business climate can help their firms compete in both domestic and overseas markets.

Exploit cost advantages in areas other than labor

Labor cost is just one of the elements that influence the sourcing decisions of global buyers. The value of proximity and turnaround increases the competitive importance of efficiency in customs, handling, and transport. Many buyers, particularly in Europe, are turning to products with very limited shelf life and hence short production runs, so flexibility and responsiveness can give firms a critical competitive edge. At the same time, environmental and labor standards affect the sourcing decisions of growing numbers of buyers.[9]

Advocate for more effective trade preferences

The European Union, United States, and other developed countries offer substantial preferences on clothing products. Full preferences are available in the European Union to all LDCs and ACP (Africa-Caribbean-Pacific) countries. Partial preferences are available to other developing countries. The United States offers preferences on clothing products to Central and South American countries and to African countries under the African

Table 2. Average time required to satisfy import and export procedures in selected countries, 2004

Days	Bangladesh	Brazil	Ethiopia	Kenya	Morocco	Nigeria	Pakistan	China
Imports	57	43	57	62	33	53	39	24
Exports	35	39	46	45	31	41	33	20

Source: World Bank, Doing Business Database, www.doingbusiness.org.

Growth and Opportunity Act (AGOA),[10] but not to Asian LDCs such as Bangladesh and Cambodia.

But preferences typically are severely curtailed by restrictive rules of origin. In particular, EU and U.S. rules of origin (with the notable exception of imports from most African countries under AGOA) severely limit the ability of clothing producers to source fabrics from the global market, thus reducing the economic potential of available preferences. To obtain preferences, firms must use more expensive inputs from local firms or from the European Union or the United States, which usually negates the benefit of preferential access. In fact, it is apparent that for many producers of clothing in countries that receive preferences the higher cost of having to use inputs dictated by the rules of origin exceeds the margin of tariff preference. The result is that firms source their inputs globally and forgo preferences.[11] A significant liberalization of rules of origin would allow developing countries to take advantage of available preferences and thus soften the shock of the removal of quotas.

Conclusions

The end of three decades of quantitative restrictions on textiles and clothing products in developed countries entails both challenges and opportunities for many developing countries.

Countries that have a favorable business environment, efficient customs and transport systems, and competitive firms that are flexible enough to meet the requirements of overseas buyers can prosper—even in the face of unfettered competition from China. Developed countries can assist by (a) providing a stable trade-policy environment in which investors can make effective long-term decisions, (b) ensuring that all LDCs have access to preferences on clothing products, and (c) liberalizing the rules of origin governing those preferences in ways that better support development.

The early data discussed in this analysis give a preliminary and partial indication of the outcome of the removal of quotas on textiles and clothing products in the EU and U.S. markets. The analysis suggests that certain countries have seen large declines in the value of their exports of textiles and clothing products, declines that may entail substantial adjustment. Even countries that have continued to increase exports may experience significant adjustment toward more efficient firms in the textile and clothing sectors. A clear view of these adjustment pressures requires more detailed information on the impact on firms and workers of the expiration of the quota system. Nevertheless, it is clear that in the absence of other employment opportunities workers made redundant from the textile and clothing sectors may fall back into poverty. Thus, minimizing the costs incurred by released workers and their families and facilitating their adjustment into alternative employment will be a major challenge in a number of countries.

International organizations and bilateral donors can support developing countries, especially the least developed, in adjusting to the substantial trade shocks that may arise from the expiration of quotas on textiles and clothing. That support must include analytical work to lay the basis for effective decision-making, as well as technical assistance and capacity building in the areas of customs reform, trade facilitation, and improving the investment climate. In some cases, it should include financial assistance. The IMF's Trade Integration Mechanism may play a role in cases of large, adverse effects on countries' balance of payments.[12]

In sum, the paramount challenge facing international organizations, bilateral donors, and national governments is to provide a favorable business environment in which companies can restructure their operations and access the financing they need to compete more effectively, and to assist workers who lose their jobs as the textile and clothing sectors adjust to new global realities.

Notes

1. The authors are Paul Brenton, Senior Economist in the International Trade Department of the World Bank, and Mombert Hoppe, Junior Professional Associate in the Trade Department of the World Bank. They are grateful for the comments and suggestions of Richard Newfarmer.

2. From January 1995 to January 2005, international trade in textiles and clothing trade operated under the 10-year transitional program of the WTO's Agreement on Textiles and Clothing (ATC). Before the Agreement took effect at the end of the Uruguay Round, a large share of exports of textiles and clothing from developing countries to the industrial countries was subject to quotas under a special regime known as the Multifibre Arrangement (MFA), which operated outside the normal rules of the General Agreement on Tariffs and Trade (GATT), notably the rule against discrimination in trade. The MFA provided for the application of quantitative restrictions against specific countries for a wide range of textile and clothing products. The purpose of ATC was to gradually integrate textiles and clothing into GATT (now WTO) rules through the progressive removal of quotas.

3. Kabeer and Mahmoud (2004) suggest that the production of garments for export in Bangladesh has generated 1.6 million new jobs, most of which were captured by women. Many of these workers tend to be migrants from poorer areas. Kabeer and Mahmoud also find that wages for garment workers are double those of other workers involved in nontradable activities. There is, however, some evidence to suggest that workers in this sector are vulnerable to changing employment contracts and the increasing "casualization" of work (Nadvi 2004).

4. "Thirty Million Jobs Could Disappear with the End of Apparel Quotas." *Business Week*, December 15, 2003.

5. Both the European Union and the United States have introduced new trade restrictions against imports from China since early 2005, and China has "voluntarily" sought to limit certain exports by levying an export tax. In the European Union, new quota restrictions on 10 categories (8 of which refer to clothing products) have been justified on the basis that the rapidity of the change in trade "made effective adjustment impossible." Initially this argument was made in relation to EU producers, although it is not clear how many producers in the European Union really compete directly with Chinese products; recently it has been extended on the grounds that it is important for producers in the Maghreb and other developing countries. On the other hand, some commentators suggest that the restrictions in the European Union and United States are diverting Chinese products to large developing-country markets such as South Africa. In the United States safeguard cases have concluded that Chinese imports "are disrupting

and threatening to disrupt" U.S. markets. These arguments have been accepted despite the fact that the agreement to phase out quotas allowed for a 10-year period of adjustment.

6. The declines for Hong Kong (China), Macao, and Taiwan (China) may reflect that under quotas a portion of mainland China's exports were handled by middlemen in these countries and recorded as their exports. Hence some of the recorded increase in China's exports reflects the reorganization of trade. Similarly, part of the falling price of imports from China results from the elimination of middlemen (Mayer 2005).

7. "Southern Africa: Textile Industry Undone by Globalisation." IRINnews.org, September 26, 2005.

8. In Bangladesh, for example, it has been reported that reimbursement takes 58 days on average and requires 6 percent of additional expenditure to obtain the refund check (WTO 2005).

9. Reports in the press conjecture that the continued success of the clothing industry in Cambodia (where exports to the European Union and United States increased substantially in 2005) reflects a strategy of enhancing labor standards. That strategy has improved quality and captured the attention of international buyers. In addition, it has been suggested that constraints on cutting labor costs have led factory owners to push the government to tackle corruption and unnecessary bureaucratic rules. See, for example, "Labor Standards Help Cambodia Keep Customers." *International Herald Tribune*, May 11, 2005. This issue is ripe for detailed analysis and assessment.

10. See Brenton and Ozden (2005).

11. Thus, for example, in 2002 only 50 percent of the exports of Bangladesh to the European Union that were eligible for preferences under the Everything But Arms program actually requested preferences due to rules of origin. Similarly, only 36 percent of Cambodia's eligible exports requested EU preferences. A key feature of AGOA is that many African countries can export to the United States using globally sourced fabrics. This has led to substantial supply responses and higher exports to the United States in a number of cases including Lesotho, Swaziland, Kenya, and Uganda. South Africa, however, faces restrictive rules of origin requiring the use of domestic or U.S. fabrics. In 2004 exports of clothing from South Africa to the United States where almost 20 percent lower than in 2001.

12. See http://www.imf.org/external/np/exr/facts/tim.htm. However, certain countries, such as Lesotho and Haiti, have substantial clothing sectors but do not have immediate access to the IMF's Trade Integration Mechanism (TIM) as they are not engaged in an IMF program, and their sectors, unaided, could founder. (see WTO (2005) for more details).

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