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Textile and Apparel Quota Phaseout: Some Economic Implications

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Summary

Because of their importance to both industrialized and developing country economies, textiles and apparel have been major issues in trade relations. A number of agreements (multilateral and bilateral) were signed over the years restricting the amounts of textiles and apparel traded — in attempts to resolve issues between the interests of exporters and importers. This report analyzes the effects of the phaseout of the quotas on textiles and apparel that occurred January 1, 2005 — focusing on the consequences and on implementation issues. The report will be updated as events warrant.

Context

Textile and apparel manufacture, and international trade in their products, have been important elements of economic activity and growth since the Industrial Revolution. Major reasons for this are: (1) textiles and apparel are basic items of consumption in all countries, and (2) apparel manufacture is labor-intensive, requiring relatively little fixed capital to establish production facilities. Thus, with fiber and fabric essential inputs to apparel, these industries are major generators of jobs. Modest capital requirements contributed to textiles and apparel being major industries at the start of the Industrial Revolution and being important to developing countries now. The percentage of total manufacturing value added accounted for by textile and apparel production among developing countries in 2002 was two and a half times that for industrialized countries.¹

Lower wage rates in developing countries together with the labor-intensiveness of textile and apparel manufacture tend to give developing countries a comparative advantage in textile and apparel manufacture. Thus, textile and apparel manufacture is shifting to developing countries, with textiles and apparel constituting large portions of their exports. Developing countries' share of world textile manufacture (measured by constant-dollar value added) increased from 21.5% in 1980 to 37.5% in 2002; and their share of world apparel manufacture rose from 18.4% in 1980 to an estimated 30% in

¹ United Nations Industrial Development Organization. *International Yearbook of Industrial Statistics 2004*. Vienna: 2004. p. 55. 2002 is the latest year for which such data are provided.

2002.² Between 1980 and 2002, textile and apparel exports of developing economies (in nominal dollars) in 2002 were more than seven times their 1980 level. In contrast, developed economies' textile and apparel exports in 2002 were less than two and a half times their 1980 level. Textiles and apparel comprised 12% of developing economies' exports in 2002, versus 4% for developed economies.³

Because of their importance to both industrialized and developing country economies, textiles and apparel have been major issues in trade relations among and between many countries. In attempts to resolve conflicts between the interests of exporters and importers, a large number of agreements (multilateral and bilateral), mainly between developing and developed countries, were signed over the years bearing on, and generally restricting, the quantities of textiles and apparel traded.

The Multifibre Arrangement. In 1974, virtually all of the principal existing multilateral and bilateral agreements were combined into the Multifibre Arrangement (MFA). A common set of rules was applied, which, among other things, provided for quantitative restrictions when surges of imports of particular products caused, or threatened to cause, damage to the industry of an importing country. The MFA did not adhere to the basic rules of the General Agreement on Tariffs and Trade (GATT), particularly with respect to the principle of GATT non-discrimination. The MFA was intended to be temporary, but was extended several times.

Agreement on Textiles and Clothing. The Agreement on Textiles and Clothing (ATC) replaced the MFA on January 1, 1995. The ATC provided for a ten-year four-stage transition period for producers in developed countries to plan for and adjust to prospective intensified competition from developing countries, ultimately placing textile and apparel trade under the rules governing other products; and it aimed to improve access to the textile markets of developing countries. The ATC, which was under the supervision of the World Trade Organization (WTO), was approved by Congress as part of the Uruguay Round Agreements Act, and signed into law by President Clinton.

The ATC called for reductions of 16% (January 1, 1995), 17% (January 1, 1998), 18% (January 2002), and 49% (January 1, 2005) of the quotas pertaining to specified textile and clothing products based upon 1990 volumes. In addition, the growth rates of quotas of products not liberalized as above or of products otherwise restrained were increased during the first three steps of the phaseout period. There were numerous exceptions; and, in the four-stage process of liberalization, importing countries had the choice of how much of each (defined) product category to liberalize at which step; and they could, and did, defer liberalization of the most "sensitive" products until the final stage of the ATC. Many developing countries saw the ATC as a constraint on their economic growth. They believed it was unfair, and regularly advocated a faster phaseout.

² *International Yearbook of Industrial Statistics 1999*. Vienna, 1999, p. 46; *International Yearbook of Industrial Statistics 2004*. p.48. The 2002 percentage for apparel is estimated because leather items and footwear are combined with clothing in the 2002 data.

³ United Nations. *1994 International Trade Statistics Yearbook, Vol. II*. New York: 1995. p. S-20, 76, 92; *2002 International Trade Statistics Yearbook, Vol. II*. New York: 2004. p. 506, 562, and 578. Percentages based upon trade data published by the WTO may be different.

Implementation and Effects of the Quota Phaseout

Completion of the phaseout of quotas on textile and apparel trade removes a hindrance to industries in countries with competitively-advantageous characteristics to win markets from their counterparts in other developing countries and in industrialized countries. Exporting country industries that had some assured market access along with restricted quantities by virtue of an agreement with an importing country will face more open competition, particularly in labor-intensive apparel manufacture/assembly. There are uncertainties, however, as to the actual extent of implementation of the phaseout.

Implementation Caveats. If implementation is defined as the ability of countries' political leaders to permit the quota phaseout to take full effect, it can be argued that complete actual implementation may be difficult for at least three reasons: (1) The final stage of import quota phaseout was large in terms of the volume of textile and apparel items that were freed from quotas; (2) the final stage covered items that were left to the end because of their domestic sensitivities; and (3) the phaseout is a major symbolic as well as actual step toward further "globalization," considered by some as economically and environmentally oppressive and/or an intrusion into their economic or personal lives. The prospect of the consequences of the phaseout may aggravate those negative feelings.

With respect to procedure, it is likely that parties that are harmed by or perceive a threat from goods produced abroad will use the safeguard mechanisms available.⁴ China's WTO accession agreement allows the United States and other Member countries to impose temporary quotas on textile and apparel from the People's Republic of China if they determine that Chinese-origin imports of a product are causing "market disruption." Moreover, trade in textiles and apparel still is constrained by tariffs.

Competitiveness Factors. While low labor costs are important, numerous other factors in one country can combine to offset lower labor costs in another country, or provide an advantage over another country with comparable labor costs. "Other" factors include labor skills, workforce availability, managerial quality, proximity to markets, infrastructure suitability, degree of market access, quality and cost of material inputs, availability and cost of capital, level of service, and business climate.

Labor skills and work force availability are among the factors that determine effective labor costs. Better trained workers tend to be more productive, and wages tend to be higher if textile and apparel producers face substantial competition for workers from other parts of the economy. Geographical location and transportation availability and proficiency affect delivered prices and shipment times. The market access afforded by a trade preference (unilaterally provided or by agreement) might offset disadvantageous characteristics, but this can depend heavily upon the strictness or looseness of any rules of origin provisos. Quality and cost of inputs depends upon factors such as access to raw materials and intermediate inputs, including the sizes of any tariffs on imports of raw materials. Level of service includes product quality, scope of service, reliability, and flexibility. Political stability, citizen safety, security of operations, reliability of

⁴ This was anticipated at least by 1995. See, for example, J. Michael Finger. "Legalized Backsliding: Safeguard Provisions in the GATT," in *The Uruguay Round and the Developing Countries*, Will Martin and L. Alan Winters, Eds. World Bank Discussion Paper No. 307, 1995.

telecommunications, and the consistency, efficiency, and honesty of the legal and commercial systems are among characteristics determining a business climate.

Effects on Developing Countries (Including China). Developing countries as a whole were expected to gain from the phaseout of textile and apparel quotas. Removal of textile and apparel quotas tends to remove an obstacle to industries in lower-labor-cost nations (generally, developing countries) to win markets from their counterparts in industrialized countries. Elimination of quotas tends to provide more scope to countries whose industries are more efficient to gain at the expense of countries with less efficient industries. (In this context, efficiency particularly connotes the ability to produce at a lower cost measured in a common currency.) Inasmuch as industrialized countries still account for about 65% and 70% of world textile and world apparel output, respectively,⁵ it is reasonable to expect that the shift of textile and apparel production from developed to developing countries will continue.

In some cases, there will be offsets to whatever gains in sales volume developing countries may derive as a result of the quota phaseout. Under a quota regime, which limits competition and tends to raise prices, developing country textile and apparel producers benefitted by receiving higher prices (on smaller volumes) in many cases.

A derived effect of the shift of textile and apparel production from industrialized to developing countries has been a shift (smaller so far than the product shift) in textile machinery manufacture from industrialized to developing countries. This, in turn, stimulates the development of supplier industries to the developing country machinery industry. Another benefit is the associated, even required, improvements in technological and managerial skills and business networks. These include (1) process, product, and industrial engineering capabilities; (2) the ability to locate, purchase, and install equipment; and (3) the ability to establish linkages with other firms (suppliers, designers, customers) and with institutions.⁶ All of which benefit the economy as a whole.

China. By virtue of its rapid industrialization, large economy, fast economic growth, and large population, China is an especially vigorous and strong competitor in a world textile and apparel trading regimen with fewer restraints now that it is a member of the WTO, which it joined in December 2001. A major factor is China's quasi-privatization of its agricultural sector and consequent gain in productivity, which is releasing portions of its large rural population from agricultural work for employment in urban industrial centers. A continuing large availability of workers tends to restrain wages.

Thus, in contrast to initial expectations that the quota phaseout would result in increased exports of textiles and apparel by developing countries as a whole, which were the primary proponents of the phaseout under the ATC, it increasingly appeared — and has come to pass — that China will be a major beneficiary at the expense of most other developing countries. For example, in the first four months of 2005, U.S. imports of all

⁵ CRS estimates.

⁶ These points are taken from "Building Export Capabilities in Textiles and Clothing: Case Studies of German and Italian Companies' Exports," by Sanjaya Lall and Ganeshan Wignaraja, in *Beyond the Multifibre Arrangement: Third World Competition and Restructuring Europe's Textile Industry*, Organization for Economic Cooperation and Development. Paris, 1995.

textile and apparel products (on a value basis) from China were 52% greater than in the comparable 2004 period, accounting for 25% of total U.S. imports of textiles and apparel compared with 18% in the comparable 2004 period. Percentage gains for some products were considerably greater. Total U.S. imports of textiles and apparel rose 10%.⁷ China also has made large inroads in European Union textile and apparel markets in 2005.

However, U.S. and other major market importers are expected to reduce the risk of sourcing from only one country. India has a large, versatile, strongly competitive manufacturing base with low labor costs; and Pakistan, Bangladesh, and Vietnam have sufficiently low labor costs to compete well in some product markets. Vietnam has sharply increased its exports of clothing recently, but it will be subject to quotas until it becomes a member of the WTO.

Effect on U.S. Producers and on the U.S. Economy. Imports of textiles and apparel — especially the latter — into the United States increased steeply in the early 1960s, winning sizable portions of U.S. markets from U.S. producers; and such penetration has continued since then. U.S. textiles and apparel output has risen nevertheless, albeit modestly. Employment in U.S. textile and apparel manufacturing has fallen markedly however. Part of the decline in U.S. textile and apparel jobs is attributable to increases in imports, but part is linked to substantial productivity gains. U.S. textiles have fared less badly with respect to trade than apparel. Textile production is less labor-intensive, more easily automated, and, as a major input to apparel, can be exported to serve as inputs to foreign-made apparel that then is exported to the United States.

With imports of textiles and apparel already increasing, U.S. textile and apparel manufacturers, particularly apparel makers, already are being affected by the quota phaseout. It is likely that textile and apparel manufacturing employment will decrease further, perhaps faster than in the past. Textile and apparel industry sources predict job losses in the hundreds of thousands. On the other hand, U.S. importers of textiles and apparel (domestic apparel manufacturers that use or hope to use foreign-made textile inputs, domestic apparel wholesalers, and large chain stores) will tend to benefit vis-à-vis competitors who use less imports.

There will be benefits to the overall U.S. economy (and European Union economies as well) from acceleration of imports of textiles and apparel. To the extent that prices of textiles and apparel fall, or are lower than they would be without the quota phaseout, as a result of the expected increase in competition from foreign-produced goods, U.S. industrial users of these products and U.S. consumers should benefit. Also, substitution by foreign-made goods will tend to facilitate the ongoing long term shift in the United States from lower to higher value added industries, and increase average wages in the process. Value added per worker in textile and apparel production is considerably lower than in U.S. manufacturing as a whole. At the same time, there are calls for assistance to U.S. workers adversely affected by increased imports.

The effects of the textile and apparel quota phaseout on U.S. producers probably will be limited somewhat by provisions in China's WTO accession agreement. A major

⁷ U.S. International Trade Commission Dataweb (compiled from U.S. Departments of Commerce and Treasury data).

element of that agreement is a textile-specific safeguard provision, in effect through 2008, that allows the United States and other WTO member countries to impose temporary quotas on textiles and apparel from China if they determine that Chinese-origin imports of a product are causing market disruption. In addition, U.S. law created mechanisms to monitor China's compliance with the WTO and other trade agreements. The U.S. government already has made determinations of disruptions with respect to several products, and has imposed temporary quotas.

Countries With U.S. Trade Preferences. Inasmuch as tariffs were not phased out along with MFA quotas, countries eligible for duty-free U.S. textile trade preferences have a potential advantage over some other potential suppliers, depending to a great extent upon beneficiary countries' geographical proximity to the United States. It is unsurprising that the Caribbean countries constitute the largest market by far for U.S. fiber, yarn, and fabric among the three U.S. trade preference regions — Andean, Caribbean, and Sub-Saharan Africa — but it should not be inferred that geography is the only factor.

Regional Trade Agreements. Generally, it would appear that the phaseout will tend to diminish the benefits of regional agreements to the participating parties. On the other hand, the structural relationships formed as a result of such trade agreements may limit the hoped for gains of the textile and apparel quota phaseout.

Selected Pre- and Post-Phaseout Developments

Expectation of gains in textile and apparel exports by China and other Asian countries, and of market losses by developed country producers, has led to a series of requests by some governments and textile and apparel industries for measures to ease or extend the transition to quota-free trade in textiles and apparel. The so-called Istanbul Declaration by textile industry trade associations from Turkey and the United States (later joined by others) called for an emergency meeting of the WTO to review the possibility of an extension of the phaseout. The governments of Mauritius and six other developing countries asked the WTO to study adjustment-related issues arising from quota phaseout, and to establish a program to discuss solutions to the problems identified by the study.

In the United States, some Members of the U.S. Congress wrote to President Bush in mid-2004 requesting support for asking the WTO to re-examine the scheduled ending of quotas.⁸ Since the phaseout, the Administration has been receptive to industry petitions for the imposition of safeguard quotas.

U.S. and European Union implementation of safeguard quotas have provoked strong objections by China. In mid-June 2005, the European Union and China agreed to limit the rise in textile and apparel imports in the next three years.⁹

⁸ House of Representatives letter dated June 7, 2004, signed by 88 Members; Senate letter dated June 9, 2004, signed by 29 Senators. "Members of House, Senate Urge Bush Support for WTO Meeting on Textiles," *International Trade Reporter*, BNA, Inc., June 17, 2004, p. 1014.

⁹ Geoff Dyer and Raphael Minder. "EU and China in textile Truce," *Financial Times*, FT.com on June 10, 2005.