

Quota-free Trade in Textiles and Clothing: Policy Issues and Options for ASEAN

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Constrained until 2005 by import quotas, the production and trade of textiles and clothing (T&C) has become widely dispersed with substantial losses in global income and welfare. Meanwhile, quota and tariff preferences from major importing countries have enabled a large number of developing economies to embark on this “starter industry” and to gain a larger market share than would have been the case under an open trade regime. The People’s Republic of China (PRC) and India are expected to benefit most from a quota-free T&C trading environment but at the expense of many economies with preferential treatment, including a large number in the Association of Southeast Asian Nations (ASEAN). There is, however, much scope and several options for the regional economies to mitigate some of the adverse repercussions. Suitable procurement and production mixes of imported inputs, including for up-scale applications in T&C, can yield preferential market access, for example, in the European Union and Canada. An integrated supply chain within ASEAN or linking ASEAN with South and/or East Asia can help global buyers, including those from the United States, to reduce their overdependence on and to offset supply problems from the PRC. Joint ventures with T&C firms in the PRC are an appealing option for the more developed ASEAN economies.

I. INTRODUCTION

At one time or another, the textiles and clothing (T&C) sector was a major source of domestic employment, industrial skills and know-how formation, and foreign exchange earnings in many countries. A large number of them had effectively internalized the economic efficiency and surpluses gained from this starter industry for the subsequent upgrading, deepening, and diversification of their knowledge, technology, and skills base (Gereffi 2002, 1). Indeed, Japan and the fast-growing, newly industrialized economies (NIEs) in East and Southeast Asia have consequently become an important source of complementary capital, technologies, and markets for the late industrializers in Asia and elsewhere.

A good illustration in the above context is the cross-border commoditization of information and communication technology (ICT) products, especially from the 1990s. The process is mediated through trade and driven by foreign direct investment (FDI) so that dispersed supply networks in the

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developing economies of East and Southeast Asia became a major global player within that decade (Yusuf et al. 2003; Borrus, Ernst, and Haggard 2000; Ito and Krueger 2000). Trade-based T&C production has also been fragmented globally but unlike the case of the microelectronics industry, the process is governed not just by the imperatives and impulses from industrial upgrading and rising costs from the FDI source countries.

Other contributing factors to such transboundary dispersal of supplies include the significant and wide-ranging tariff and nontariff barriers on global T&C trade for many decades. A series of Multifiber Arrangements (MFAs), for example, governed such trade under the General Agreement on Tariffs and Trade (GATT) between 1974 and 1994. The Agreement on Textiles and Clothing (ATC) came in force in 1995 and, until its expiry on 1 January 2005, was administered by the World Trade Organization (WTO), the GATT successor. But that termination does not signify the end of tariff and nontariff barriers to global trade in T&C, the only industrial goods that had until then remained outside the ambit of multilateral trade rules.

Textiles and clothing have long been of significant policy interest to ASEAN. Several of the regional countries (including Indonesia, Philippines, and Thailand) are among the top ten exporters of T&C products in major import markets. Meanwhile, the T&C sector accounts for the bulk of export earnings and has a major share of domestic employment in Cambodia, Lao People's Democratic Republic (PDR), Myanmar, and Viet Nam (or ASEAN-4). As a result of industrial upgrading and diversification, however, T&C are of limited and/or declining importance in the other ASEAN members such as Brunei Darussalam, Malaysia, and Singapore.¹

The paper looks at some of the main features of the MFA and ATC trade regimes, including the integration of MFA quotas into the GATT (Section II). It then examines in Section III the patterns and structure of world trade in T&C and some of the expected developments in T&C trade post-MFA. In Section IV, the related policy options and implications for developing country exporters are analyzed with special reference to those in ASEAN. The People's Republic of China (PRC) dominates global trade in T&C, and the related challenges and opportunities for ASEAN deserve a separate discussion. This is carried out in Section VI, followed by a number of concluding remarks in the last section of the paper.

II. BUILT-IN CONSTRAINTS IN GLOBAL T&C TRADE

Among the major exporters of T&C in the early postwar period were India; Japan; Hong Kong, China; Republic of Korea (Korea); Pakistan; and Taipei, China. They had agreed to voluntary export restraints (VERs) on cotton textile

¹A detailed and useful profile of the T&C sector in ASEAN countries and in many other supplier economies is provided in United States International Trade Commission (USITC 2004).

products shipped to the United States in the 1950s (Nordas 2004). The VERs were then incorporated into a series of Long Term Agreements Regarding International Trade in Cotton Textiles (LTAs) between 1962 and 1974. Subsequently, LTAs were replaced by the MFA, which was negotiated and renewed five times between 1974 and 1994. MFA extended restrictions in T&C trade to wool and man-made fibers (including silk) and to products made from those raw materials.

A. MFA Quota Restrictions

As such, global trade in T&C was excluded from the core principles under GATT and WTO—namely transparency, nondiscriminatory treatment, and avoidance of absolute quantitative limits. MFA quotas were imposed on most exported T&C goods by major importing countries such as Canada, European Union (including Austria and Finland), Norway, and United States. MFA restrictions were then carried over to the ATC by those countries except Norway, which eliminated all the remaining MFA quotas between 1996 and 2001. Quotas were negotiated on specific T&C items, and allocated on a country-by-country basis. With few exceptions, quotas were more restrictive on imported garments than on textiles;² the former are subject to steeper escalation in import tariffs as well (more in Section IIC below).

Progress in information and communication technology (ICT) has stimulated the proliferation of FDI-driven, cross-border commoditization of most manufactures and the vertical dispersion of the value chain. The quota system provided a further impetus to these trends, including quota-hopping relocation and quota “skirting” practices in the T&C sector.³ Quota concessions have been

²About 40 percent of garment imports into the United States during the 1990s came under binding quotas (defined as those with a fill rate of 90 percent or above). Meanwhile, there has been a progressive liberalization of the T&C import regime in the European Union so that imports under binding quota (with a fill rate of 95 percent or above) were 25 percent of the total in the early 2000s. In addition, no quotas were applied on T&C imports from the least developed countries (LDCs). Moreover, a nonreciprocal tariff preference of 20 percent of the most-favored nation (MFN) rates was granted on imports from all developing countries except those bordering the Mediterranean for which T&C trade liberalization was postponed until the last phase of the ATC (Evans and Harrigan 2004, Memedovic 2004).

³Rapid expansion in T&C exports by competitive producing countries will inevitably invoke quota limitations. Thus, as quotas become restrictive in one country, relocation investment will be made by that country to other countries that are initially unconstrained or less constrained by quantitative export restrictions. Those host countries will eventually face quota barriers to their T&C exports, causing both domestic and external investment as well as other resources to be footloose again. For example, constraints on T&C exports from Japan generated investment flows to several of the first-generation NIEs in East Asia, and then from these NIEs to several countries in Southeast Asia and South Asia. Meanwhile as a short cut, T&C products from a quota constrained country may be shipped to and exported by third countries. Notwithstanding rules-of-origin (ROO) requirements and the related inspection and certification for compliance, quota skirting practices may be quite widespread among the

supplemented by tariff preferences in many regional trade agreements (RTAs) and preferential trade programs (PTPs).⁴ These arrangements have enabled a large number of developing economies to embark on T&C as a starter industry for mass poverty reduction, large-scale employment generation, and export-oriented industrialization. Many of them have subsequently gained a bigger market share than would have been the case under a nondiscriminatory trade regime.

However, most of those economies have inadequate resources and support industries and other marketing linkages to upgrade themselves to large-scale, full-package suppliers or original equipment manufacturers. They have thus become mired in a T&C sector assembling standardized products by low-skilled labor and yielding limited value addition locally. A low share of domestic value added may shield exporting economies somewhat from the ensuing disruptions and relocations of T&C production activities from 2005. Such an impact, however, is still serious due to mass poverty and unemployment and to the limited resources, skills and opportunities for changed specialization, especially among the smaller exporting economies.

Indeed, quota allocations have often been portrayed as a cashless form of aid giving between the donors and the intended beneficiaries (Wehrfritz and Seno 2005, Bhagwati and Panagariya 2004). The most efficient suppliers and large-scale production clusters were penalized in the process, and the resulting losses in world income and welfare (through resource misallocation and higher consumer prices) have been very substantial (more below in Section III). Meanwhile in the beneficiary countries, the accorded quotas tended to “lock in” T&C production and trade activities during the rolling periods of the negotiated bilateral agreements. In turn, this has prevented timely adjustments, a major element of competitiveness in an environment of rapid changes in market conditions and consumer preferences.

Additionally, the quota system itself is also very complex, thus entailing high transaction costs for monitoring and compliance on both sides. Quotas were typically specified at the 6-digit Harmonized System (HS) level and were applied to a very large number of products (some 800 in the case of the United States). Meanwhile, there is the conspicuous absence of harmonized ROO, product standards, and other conformance requirements among RTAs and PTPs.⁵ Thus,

interlinked, multicountry production networks. As grey-market activities, however, there are few precise data on the values, volumes, and frequencies involved. Such a practice will become less important under a more open trade regime.

⁴In particular, some 250 RTAs had been notified to GATT/WTO by 2002, of which 129 came into existence between 1995 and 2002. Furthermore, these RTAs involved all WTO members at that time, except five, namely PRC; Hong Kong, China; Japan; Macau, China; and Mongolia.

⁵These rules typically set the benchmarks and thresholds for the origin(s) of the imported T&C products and/or the minimum levels or volume of domestic contents or transformation embodied in the products concerned. They are necessary to ensure that the quota and tariff concessions flow to the intended beneficiary countries, rather than to their competitors or the

quota-granting importing countries may have varying sets of ROO, standards, and required conformance on specific products under different trading arrangements from different import sources and/or in different years (Evans and Harrigan 2004, 7).

Likewise, diverse sets of ROO, standards, and other conformance requirements are also applicable on specific T&C goods exported by the same beneficiary country but under different trading arrangements, to different countries and/or in different renegotiated preference regimes. Consequently, compliance by exporters becomes a very complicated and often costly issue, contributing thus to the uneven utilization or even abandonment of the allocated quotas. In 2000, for example, 21 out of 43 specific quotas in the United States (the largest global market for T&C) had a utilization rate below 50 percent, with zero utilization for three quotas. In the European Union, 28 out of 37 T&C quotas had a utilization rate below 50 percent (WTO 2001), while Canada had 19 out of 27, respectively.

B. Quota Integration under the Interim ATC

Textiles and clothing are among the few sectors where developing countries expect to gain the most from multilateral trade liberalization. These countries had been skeptical at the outset about the proposed inclusion of services and intellectual property in the Uruguay Round. It was, however, the prospect of substantial gains through T&C liberalization that had induced developing countries to enter into negotiation on those two sensitive areas. The ATC was thus part and parcel of the single undertaking reached under the Uruguay Round. Like the MFA it replaced, the ATC was supposed to be a transition regime leading to the full integration of T&C into the multilateral trading system.

The integration process has a 10-year timeframe (from 1995) to provide the necessary lead time for adjustment by both the producing and consuming countries. This target has proven unrealistic as a result of inertia and complacency, lack of resources and opportunities for upgrading and diversification, and inadequate political will. In fact, all those have led to suggestions and pressures at WTO and elsewhere for some forms of extended T&C quotas to avoid the unintended effects of quota removal. Thus, one unexpected by-product in quota allocations—particularly those under preferential RTAs and PTPs—is the provision of a “wrong” signal to many beneficiary economies (Wehrfritz and Seno 2005, Bhagwati and Panagariya 2004, Mayer 2004).

lowest-cost (but nonpreferential) suppliers. Paradoxically, however, a sufficiently restrictive ROO can be counterproductive to the beneficiaries, especially those that do not have or are not able to accumulate the resources, expertise, and production scale required for full compliance (Mattoo, Roy, and Subramanian 2003). In extreme cases, a set of restrictive ROO can work in favor of domestic suppliers in quota or preference granting countries, especially when their own inputs such as fabrics (instead of those from third countries) qualify or are required for ROO compliance purposes.

There are two components to the integration process under the ATC. First, all importing countries were required to incorporate, in four progressive steps, T&C products (whether or not these had been restricted under MFA) into GATT in 1994. The relative share of (quota-free) integrated T&C trade was to be 16 percent (of their 1990 T&C import volumes) at the beginning of 1995; 33 percent at the beginning of 1998; 51 percent at the beginning of 2002; and 100 percent at the beginning of 2005. Second, as regards the very large number of T&C items still subject to MFA quotas (or not yet integrated) in the transition period, the importing countries must increase progressively their base annual growth rates. The increase was to be 16 percent in 1995, another 25 percent in 1998, and a further 27 percent in 2002.⁶

Through the mandated growth-on-growth provision, ATC quotas were expected to become nonbinding on a de facto basis for many of the quota-restricted items by the end of the 10-year transition period.⁷ The ATC, however, provided considerable flexibility in the selection of products to be integrated, provided that those products came from each of these four categories: tops and yarns, fabrics, made-up textiles, and apparel. As it was, the major importing countries decided to integrate numerous T&C goods not covered by MFA, including MFA articles not under quota, with largely unfilled (or underutilized) quotas, or having limited commercial importance. Integration of the most "sensitive" items in the major importing countries, which were also of greatest export interest to developing countries, was deferred until the last step.

Among the large T&C importers, Japan had not applied MFA quotas while Norway had eliminated those quotas in 2001, as noted earlier. Technically, all minimum ATC requirements as regards the integrated quota volumes and the growth-on-growth provisions had been carried out by other major importers of T&C. The overall impact of the integration process actually carried out was modest, however. Canada, European Union, and United States had removed about 12 percent of the 1,271 quotas carried over from MFA. The United States integration schedule, in particular, showed that up to 89 percent of imported garments and 47 percent of textiles imports would be integrated on 1 January 2005 (Mayer 2004, USITC 2004, WTO 2002 and 2001).

Such extensive back loading in implementation among the large T&C importers would, and does in fact, cause an adjustment shock in 2005. This is because T&C products slated for last-minute integration on 1 January 2005 typically carried higher import tariff rates; tariff escalation is very significant on

⁶For small suppliers (with a share of 1.2 percent or less of another WTO member's total import quota in 1991), the mandated quota growth rates were to be accelerated by one step. This meant the growth rates were to be raised by 25 percent in 1995, by another 27 percent in 1998, and by a further 27 percent in 2002.

⁷The base quota growth rates varied by country and per specific T&C product. They ranged from less than 1 percent to as much as 6–7 percent. As a whole, the trade-weighted annual growth rate for WTO members' quota averaged 4.9 percent under the MFA regime in 1994. Under the ATC, they were expected to rise to 5.7 percent in 1995, 7.3 percent in 2000, and 9.3 percent in 2002 (USITC 2004).

such processed goods as made-up textiles and apparel (more below). The frequent reliance on safeguard measures under Article 6 of the ATC, meanwhile, was an indication of the persistent lack of will to liberalize T&C trade. Moreover, quantitative restrictions associated with imposed safeguard measures contributed further pressures to pent-up import demand as well as to the consequent high prices borne by T&C consumers and the misallocation of related investment and other resources.

C. Tariff Barriers

High import tariffs are characteristic of the T&C sector. They averaged, for example, 6.2 percent for textiles and 16.1 percent for clothing among OECD countries in the early 2000s, compared to 6.2 percent on all manufactured products. In particular, the simple average tariff rate on imported textiles and apparel was respectively double and triple that on imported manufactures in the three largest global markets (European Union, Japan, and United States) in 2003. Import tariffs on T&C among developing countries, however, were even higher. They averaged 18.1 percent on textiles and 23 percent on clothing, compared to 13.5 percent on all manufactured goods in the early 2000s (Mayer 2004, OECD 2004, UNCTAD 2002).

Additionally, tariff peaks in the developed countries can be punitive, ranging from 30 to 40 percent of the value of many imported T&C items. Tariff escalation is also significant, for example, from raw to processed cotton goods in the European Union (from 0 percent on raw cotton to 3 percent on woven cotton fabrics in 2002) and the United States (from 4 to 7.9 percent on the same goods in 2004). In Japan, tariffs on imported fabrics was 2.5 percent but escalated to 12.6 percent on made-up garments in 2003. Tariff escalation and higher tariff peaks are also present in developing countries, including among the large T&C exporting countries in ASEAN and South Asia. Those peaks are typically in the low double-digits for raw and semifinished materials, and much higher for finished products, such as garments (Mayer 2004, OECD 2004, WTO 2003).

An offsetting factor to high tariff barriers in developed-country markets has been the proliferation under WTO of RTAs and PTPs, bilaterally or between groups of countries. Many developing countries are the signatories and beneficiaries of quota and tariff concessions in those arrangements and programs. For example, the second largest suppliers of T&C products are Mexico to the United States under NAFTA, and Turkey to the European Union as part of a Customs Union. Meanwhile, the applied tariffs on T&C goods from countries in Eastern and Central Europe (including the Czech Republic, Poland, and Romania) and developing economies in North Africa (such as Morocco and Tunisia) are virtually zero.

Across the Atlantic, other developing country exporters of T&C from the Caribbean, Central America, and Africa have also benefited, respectively, from the United States' Caribbean Basin Trade Partnership Act (CBTPA), the African Growth Opportunity Act (AGOA), and the Andean Trade Promotion and Drug

Eradication Act (ATPDEA). The former two Acts were consolidated into the United States Trade and Development Act of 2000. Several smaller ASEAN members have also gained directly and indirectly from trade preference schemes in North America and the European Union; this is considered further in the next section.

III. PRODUCTION AND TRADE IN T&C

The value of world trade in clothing, which has exceeded that of textiles from the late 1980s, was rising twice as fast (at 6 percent on annual average) than the amount of global trade in textiles (3 percent) between 1990 and 2001. Indeed, several T&C products (including silk, knitted and textile undergarments, and knitted textiles) were among the 20 most dynamic items traded globally, with export values increasing at 12–13 percent annually during 1980–1998 (UNCTAD 2002).

A. Overview

Generally, less than one half of global production of textiles is used in clothing making. Nonclothing textiles of single or composite materials (e.g., plastics and fiberglass) are present in such diverse industries and applications as residential and office furnishing and furniture, automotive and other transport vehicles, health and hygiene products, construction, and environment. Notably in this connection, textiles production has become highly capital-intensive and technologically sophisticated. That has helped to sustain the competitiveness of several NIEs and other industrialized countries in high-quality and top-end fabrics manufacture but not in standard segments of garment making (which requires large inputs of mostly low-skilled labor).⁸

In absolute terms, world trade in clothing reached US\$200 billion (or 3.2 percent of the value of global merchandise exports), and that in textiles US\$152 billion (or 2.4 percent) in 2002. The combined share of Canada, European Union, and United States in world import of textiles expanded from 35 to 43.5 percent between 1995 and 2002. Of those proportions, the United States alone accounted for 14 and 21 percentage points, respectively. As regards clothing, the combined share of the same groups went up from 62 to 67 percent in the respective

⁸The increasing sophistication of machinery and equipment for spinning, weaving, dyeing, printing, and finishing has greatly boosted both the operating speeds and productivity levels of such activities. The basic production technology in clothing has not changed much over the past century, however. This sector involves low-skilled assembly operations in the mass production of lower-quality and/or standard products. On the other hand, up-scale segments in the sector (e.g., high fashion and sportswear) involve high-skilled design and marketing functions. Indeed, the competitive advantage of (and hence the price premium gained by) fashion-based firms depends less on cost efficiency. It has more to do with their ability to produce designs that capture and, even better, set the trend in consumer tastes and preferences.

benchmark years. However, the European Union share fell from 32 to 30 percentage points while that of the United States rose from 30 to 35 points between 1995 and 2002.

Thus, the United States is not only a faster growing market among the countries applying MFA import quotas. Its demand for imported textiles was rising by 9 percent, and that for clothing by 5.5 percent a year in nominal terms between 1995 and 2002. The country has also remained by far the largest single destination for textiles, worth US\$17.2 billion; and clothing, worth US\$68.1 billion in 2003 (USITC 2004, OECD 2004).

In particular, the United States absorbed virtually all T&C products (88–96 percent) exported under NAFTA by Canada (valued at US\$3.1 billion in 2003) and Mexico (US\$7.9 billion). It also took in 92–95 percent of all clothing from Honduras and the Dominican Republic, with total export under the CBTPA amounting to US\$9.7 billion in 2003. The T&C exports under AGOA were worth US\$1.5 billion and under ATPDEA, US\$1.1 billion in the same year.⁹ Clothing constitutes the large bulk (75–90 percent) of exports to the United States from developing economies in Asia except India, Korea, and Pakistan. Meanwhile, the largest Asian suppliers of T&C to that market in 2003 included the PRC (US\$14.7 billion). Following at a distance were Hong Kong, China; and India (US\$ 3.6-3.9 billion); then Thailand, Viet Nam, Indonesia, Pakistan, Philippines, and Bangladesh (US\$2.0-2.5 billion). Cambodia and Malaysia earned US\$1.25 billion each from T&C exports to the United States (Table 1).

⁹Also notably, duty-free exports of T&C to the United States reached 95.5 percent in the case of Canada and Mexico, and 75–78 per cent under CBTPA, ATPDEA, and AGOA. Comparatively, the value of duty-free T&C exported to the United States was in the range of 2–3 percent in the case of India and Thailand, and one per cent or less in the case of the other Asian countries (OECD 2004, 56).

Table 1. Textiles and Clothing Exports from Asia to the United States in 2003
(US\$ million)

Economies	Textiles (T)	Clothing (C)	Total	
			Value	Percentage of T/T&C
PRC	3,347.1	11,341.2	14,688.3	22.8
India	1,415.4	2,158.7	3,574.1	39.6
Pakistan	1,173.8	1,102.3	2,276.1	51.6
Korea	924.2	1,925.9	2,850.1	32.4
Japan	506.3	0.0	506.3	100.0
Turkey	500.2	1,297.6	1,797.8	27.8
Thailand	298.5	2,154.6	2,453.1	8.2
Indonesia	166.4	2,208.6	2,375.0	7.0
Bangladesh	110.4	1,849.0	1,959.4	5.6
Iran	129.7	0.0	129.7	100.0
Philippines	106.7	1,868.6	1,975.3	5.4
Hong Kong, China	98.7	3,760.3	3,859.0	2.6
Malaysia	64.3	1,189.9	1,254.2	5.1
Sri Lanka	53.6	1,474.9	1,528.5	3.5
Viet Nam	37.4	2,337.6	2,375.0	1.6
Cambodia	11.6	1,239.9	1,251.5	0.1
Singapore	0.9	270.0	270.9	0.0
Lao PDR	0.0	3.9	3.9	0.0
Myanmar	0.0	152.4	152.4	0.0
Total (including rest of the world)	17,198.8	68,060.1	85,258.9	20.2

Source: USITC (2005).

B. Estimated Impact of Quota-free T&C Trade

A large number of research studies have been carried out on the global and regional impact of trade liberalization, generally and in the T&C sector. The estimates show significant variations, a result of various conceptual problems, specification differences, and data limitations (Mayer 2004, Nordas 2004, OECD 2004, USITC 2004, WTO 2003). Thus, the aggregate estimates discussed below are useful as an approximate indication of the order of magnitudes involved only.

1. Global Dimensions

Firstly, virtually all of the studies show substantial gains in real income at the global and regional levels as a result of multilateral trade liberalization under the Uruguay Round. The estimated global benefits range from US\$6.2 billion to as much as US\$324 billion a year. Of those amounts, liberalized T&C trade is expected to account for between 42 percent (in static models) and 65 percent (in dynamic models) of the overall gains from the Round.

Secondly, large income gains would accrue to the prime movers of the MFA and ATC such as Canada, European Union, and United States. Such gains are in general significantly in excess of the short- to medium-term costs in

structural adjustment, including through further domestic consolidation and overseas relocation of the T&C sector, in the above groups of major importing economies. The tariff equivalents of the T&C quotas in the European Union, for example, lifted the landed prices of textiles by 1.3 to 21.6 percent, and of clothing by 3 to 34.8 percent in 1997. Quotas are estimated to have added 20 percent to the costs of T&C imports borne by American consumers (*Asian Wall Street Journal* 2004, A7).¹⁰

Generally, the projected gains in income and export earnings by developing countries, many of which are in Asia, are respectively US\$24 and US\$40 billion a year (*Asian Wall Street Journal* 2004 and Nordas 2004). Textiles imports from developing countries would account for 20.9 percent of domestic demand in North America before and 21.5 percent after the ATC expiry. The corresponding ratios for clothing are higher, 33.8 percent before and 45 percent after. Textiles (clothing) import shares in the European Union, which has a less restrictive T&C regime, would meet 52.5 (48.5) and 53 (51) percent of domestic demand before and after 2005, respectively.

2. Regional Dimensions

Dramatic changes, however, are expected as regards the sources of T&C supplies to North America and the European Union (Figures 1 and 2). Firstly, the PRC's clothing share is expected to rise from 16 to 50 percent of import demand in North America, and from 18 to 29 percent in the European Union (Nordas 2004).¹¹ The estimated gains in clothing market share by India are more modest, from 4 to 15 percent in North America, and from 6 to 9 percent in the European Union.

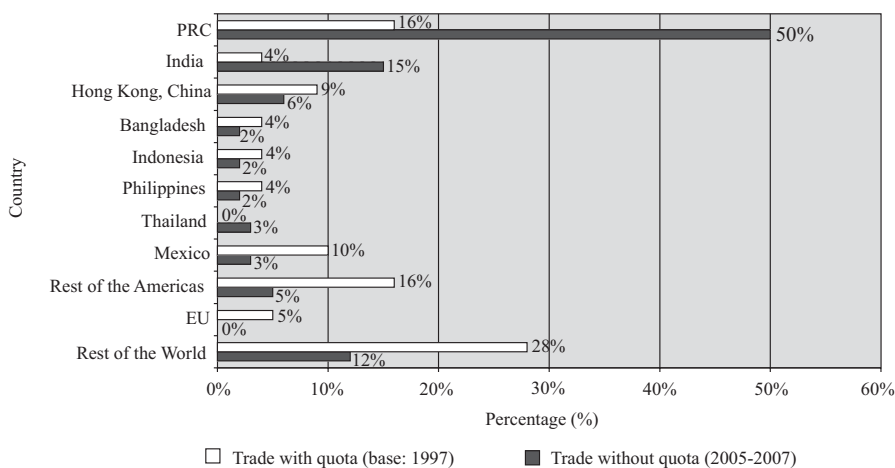
Second, among the top 10 exporters of T&C to North America are Indonesia, Philippines, and Thailand. Indonesia is also one of the top 10 exporters to the European Union, and the country is expected to maintain its market shares of T&C in the European Union, but only of textiles in North America. However, in quota-free trading, Indonesia and the Philippines are expected to lose their garment market shares, from 4 to 2 percent in each case, in North America. This is due in part to the growing competition from the PRC and India from 2005.

¹⁰For comparison, the export tax equivalent of the ATC quotas for the PRC in 1997 was 20 percent for textiles and 33 percent for clothing in the North American markets. The corresponding figures in the European Union market were 12 and 15 percent (Nordas 2004, 25).

¹¹Notably, computable general equilibrium (CGE) models tend to yield somewhat overstated simulation results. Those models often assume homogeneous industry structures of suppliers and similar sourcing strategies among buyers, and smooth and orderly transition and rapid and costless supply responses. Additionally, many CGE models fail or neglect to take due account of highly complex schemes of tariff preferences, quota restrictions and ROO (and the consequent dynamic relocation and quota and tariff skirting efforts) while assuming that maximized T&C output and exports remain an optimum development strategy among supplying countries (Mayer 2004, 10–21).

Thailand is likely to retain its 3 percent share in North American clothing demand, a market foothold achieved since the early 2000s.

Figure 1. Top Ten Exporters in the Clothing Market of North America



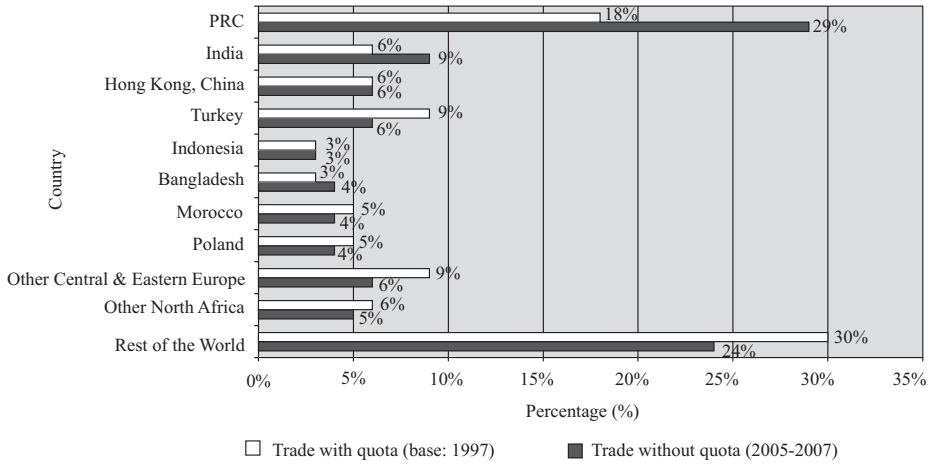
Source: Nordas (2004: 30)

Third, the post-ATC shares of clothing exported by suppliers from the rest of the world are projected to fall sharply from 24 to just 10 percent in North America, and from 30 to 24 percent in the European Union. Characteristically, the losses are borne by the main beneficiaries of various RTAs and PTPs. In the European Union clothing market, for example, Turkey's share is expected to decline from 9 to 6 percent; that of Eastern and Central European countries from 15 to 10 percent; and the share of North African countries, from 11 to 9 percent. A similar trend is also observable in imported clothing in North America. Mexico's market share is expected to fall from 10 to just 3 percent, and that of the rest of the Americas, from 16 to 5 percent. Meanwhile, the market share of Bangladesh is halved from 4 to 2 percent.

Small T&C exporters are not featured in CGE simulation models. However, North America and the European Union are also very important markets to smaller exporting countries in ASEAN and other regions, as noted previously. The estimated sharp losses in market shares borne by developing countries after 2005 discussed above are therefore a matter of significant concern to them. This is because of the comparatively greater importance of the T&C sector in smaller economies and the more limited resources, scale, and skills available to them for the necessary structural adjustments and diversification, as also noted before.

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Figure 2. Top Ten Exporters in the Clothing Market of EU



Source: Nordas (2004: 28)

IV. POLICY IMPLICATIONS AND OPTIONS IN ASEAN

In the post-ATC environment, the margins of tariff preferences are even more important in sustaining T&C production and trade in Cambodia, Lao PDR, and Myanmar, among other less developed countries (LDCs) and small exporters. Tariff preferences and special and differential treatment for disadvantaged economies are among the major items for negotiation under the Doha Development Agenda; such negotiations have proved more intractable and more time-consuming than earlier anticipated. More generally, most T&C exporting countries are facing difficult policy choices in quota-free trading, a subject for examination below.

A. Preferential Arrangements for LDCs and Non-WTO Members

As non-WTO members, Cambodia (until 13 October 2004), Lao PDR and Viet Nam were not eligible for benefit under ATC phased-in quota liberalization but are liable to very high import tariffs on their exports. In particular, exporters without the MFN status (currently designated as the normal trade relations or NTR status) with the United States are subject to import tariff rates, for example, in the range of 45–50 percent on cotton shirts and sweaters (two major and fast-growing categories of T&C trade). Those rates are more than double the corresponding MFN tariff levels of 17–20 percent. Tariff concessions under RTAs and PTPs, if they can be secured at all, have been an interim way out for non-WTO member countries.

Cambodia had earned less than one million US dollars on T&C exports in 1995, the year before the country received the MFN/NTR status from the United States. The subsequent expansion of the local T&C sector and of exports to the United States gave rise in January 1999 to a three-year bilateral T&C agreement that was extended until Cambodia's accession to WTO. This agreement had favorable quota provisions as well as Cambodia's commitment to improve labor conditions in the T&C sector. It was also the first time such a commitment was obtained by the United States in a bilateral accord (USITC 2004).

Cambodia's exports to the United States went up from US\$236 to US\$740 between 1999 and 2000, and further to US\$823 million in 2001. However, a large part of such expansion represented diverted trade as merchandise shipments to Singapore were down from US\$182 million in 1999 to US\$18 and 28 million in the following 2 years, while exports to Viet Nam decreased from US\$107 million in 1999 to US\$19 and 24 million during 2000 and 2001, respectively (Wattanaputtipaisan 2003, 45). In 2002, Cambodia exported US\$1.35 billion worth of T&C products to the United States; this represented 76 percent of Cambodia's export earnings and about 71 percent of its T&C shipments. Exports to the European Union were worth 392 million euros in 2001, of which 27.4 percent were admitted duty free (Mekong Capital 2003).

The agreement on trade in T&C between the European Union and the Lao PDR came into force in December 1998. Exports were on the rise so that in 2001, T&C shipments to the European Union were worth 127.5 million euros, of which 57.6 percent came in duty free. That amount was equivalent to 87 percent of all the garments exported from the Lao PDR (Mekong Capital 2003). There is a bilateral trade agreement between the Lao PDR and the United States but no separate T&C accord as yet. The T&C exports to the United States are consequently insignificant, in the annual range of only US\$3.6-3.9 million during the early 2000s. Meanwhile, a Working Party on WTO accession for the Lao PDR was set up in February 1998 and a memorandum on the foreign trade regime in the Lao PDR circulated in March 2001. Negotiations on accession, which started on 28 October 2004, would also be a multiyear process for the Lao PDR.

A bilateral trade agreement between the United States and Viet Nam in December 2001 provided the latter with a MFN/NTR status. Subsequently, T&C exports to the United States were boosted from US\$49 million to US\$0.9 billion between 2001 and 2002. As a result, a T&C agreement (with quota provisions) came into force between the United States and Viet Nam from May 2003 to December 2004, with subsequent automatic yearly renewal until renegotiation or until Viet Nam's accession to WTO. Quotas, which are imposed on 25 T&C categories (valued at US\$1.7 billion at the 2003 quota levels), are allowed an annual growth of 7 percent with the exception of woolen products (2 percent). Viet Nam's T&C exports to the United States reached US\$2.4 billion in 2003. Meanwhile, preparations for WTO accession by Viet Nam have been under way for a decade with the Working Party having been set up on 31 January 1995. However, negotiations are unlikely to be completed by the WTO Ministerial Meeting in Hong Kong, China in December 2005 as planned by Viet Nam.

B. Fostering Regional Cumulation and Linkages

An attractive option for both Cambodia and the Lao PDR concerns Canada's market access initiative for quota- and duty-free exports from LDCs. Canada imported US\$3.8 (US\$4.1) billion of textiles (clothing) in 2002. Its ROO requirements are much more flexible from 2003: a minimum of 25 percent of import content can come from Canada, from other LDCs, or from developing countries eligible for Canada's General Preferential Tariff scheme (OECD 2004, 15). Those developing countries include all economies in ASEAN (except Myanmar) and East Asia (except Taipei, China). This raises the attractiveness of an integrated T&C supply chain within ASEAN, or across East and Southeast Asia.

The European Union comes into the picture in the above regard. Imports from ASEAN members (less Myanmar) as well as from those of the South Asian Association for Regional Cooperation (SAARC) are qualified for regional cumulation in the Union. In particular, preferential tariffs are given to T&C imports with double transformations (or double jumps) from yarns to fabrics and from fabrics to garments. Single transformation is acceptable under certain circumstances. However, the import contents (e.g., imported yarns or imported woven fabrics for knitted or woven garments respectively) must be less than or equal to 40 percent of the ex-factory prices of the products concerned (Mekong Capital 2003, 11).

Those ROO requirements account in part for a lower proportion of Cambodian garments (27.4 percent or 107.5 million euros in 2001) entering duty free in the European Union, compared to 57.6 percent (equivalent to 73.5 million euros) in the case of the Lao PDR. That is because many inputs for Laotian garments are linked to sources from Thailand, thus qualifying for regional cumulation (ASEAN less Myanmar). On the other hand, Cambodia tends to rely more heavily on imported inputs from East Asian economies that do not qualify for such regional cumulation or for regional derogation under the ROO requirements in the European Union (Mekong Capital 2003, 14).

Through suitable procurement and production mixes, therefore, the European Union market has much to offer ASEAN and SAARC economies that are interlinked in a regional supply chain. Indeed, a significant scope is still open for greater regional cumulation and greater regional use of European Union textiles and other fabrics in high-end garments for duty- and quota-free exports by ASEAN and/or SAARC economies to the Union. On their own, many economies in these two regions (including the regional LDCs) cannot meet the ROO requirements for better market access in the European Union, or the intensified competition in the post-quota trading environment.

In that context, India can play a complementary role in a supply chain spanning the ASEAN and SAARC. Textiles provide almost 50 percent of India's T&C global export value (and 40 percent of T&C exports to the United States), compared to 8 percent or less in the case of ASEAN (Table 1). Such a marked

difference in trade specialization means that the potential complementarity from India is more important to several larger ASEAN economies than the potential competition from India, for now. As regards competition, for example, labor productivity in textiles (indexed at 107) and clothing (107) in India during 2000 was much lower than those in Indonesia (158 and 148 respectively), Malaysia (209 and 151), and Philippines (140 and 145). In addition, labor efficiency has risen at a generally slower pace in India than in ASEAN, relative to the same base year of 1990 (UNCTAD 2003, 104).

It has thus been suggested that substantial investment and on-going policy reforms are needed in T&C production and trade, among other sectors, in India. All these are to better meet international quality standards, to shorten turnaround and lead times through leaner manufacturing and distribution, and to modernize T&C machinery and transport infrastructure. In addition, it is essential to encourage more domestic competition and entrepreneurship, to upgrade and widen the skills base, and to promote high-value services such as design, packaging, and marketing in India (Nordas 2004, OECD 2004).

V. CHALLENGES AND OPPORTUNITIES FROM THE PRC

Most of the suggestions and implications noted above are also applicable to many ASEAN economies in the highly competitive, post-ATC environment. The PRC, currently the world's largest clothing supplier and second largest textiles producer, is also expected to be the biggest gainer in quota-free trade. As such, the country is both a formidable competitive threat and a great source of complementarities for ASEAN (Wattanapruttipaisan 2005b, Lyall and Albaladejo 2004).

A. Overview

The PRC's share of the G-7 clothing market doubled to 20 percent during the 1990s.¹² Such a rapid gain in market share was achieved mainly at the expense of East Asian economies. Nevertheless, the major ASEAN exporters (Indonesia, Malaysia, Philippines, and Thailand) were not able to increase their (combined) G-7 market share, which remained largely constant at 8 percent in the same period (OECD 2002, 138-40).

The third largest and most liberal global market for T&C goods, Japan,¹³ has long been dominated by the PRC, which accounted for 41.1 and 66.5 percent

¹²The G-7 group consists of Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

¹³Japan does not apply ATC quotas on imports and has not invoked any transitional safeguard measures under the ATC. Moreover, Japan's Generalized System of Preferences program, currently extended until March 2011, provides tariff-free entry for T&C products from LDCs as well as large preferential tariff margins for goods from other developing economies. The ROO requirements from Japan are relatively easier for compliance as well (Mekong Capital 2003, 26).

of Japan's textiles imports between 1995 and 2002 respectively. The corresponding figures for clothing were even more significant at 59.1 and 77.5 percent. Additionally, the PRC has become dominant in other important T&C markets, supplying 19.3 (54.3) and 5.9 (29) percent of textiles (clothing) imported into Australia and South Africa, respectively, in 1995. Those market shares had expanded to 35.2 (70.4) and 18.5 (56.3) percent, respectively, by 2002 (Nordas 2004).

Likewise, the substantial post-ATC surge in T&C exports from the PRC to the European Union and the United States (by 48 percent in value between the first quarters of 2004 and 2005) was not without precedents. Sweden's clothing imports from the PRC had more than tripled (by over 22 percentage points) after the elimination of all T&C quotas in 1991. Sweden joined the European Union in 1995 and the subsequent reimposition of quotas lowered the PRC's market share back to close to the pre-1991 level where it has remained largely unchanged since. India's market share showed a similar, although much more muted, trend (Mayer 2004, 13-4). More recently, 12 categories of garments from the PRC were removed from ATC quota restrictions in the United States at the beginning of 2002 as part of the third-step integration. This led to a substantial export surge in combination with a sharp fall in unit prices, as will be discussed further below.

B. The Competitive Edge of the PRC

The PRC's competitive advantages are sizable. Firstly, labor is more productive in the PRC. With 1990 as the base year, productivity levels were indexed at 182 in textiles and 224 in clothing in 2000, compared to around 150 in both T&C among the major exporting countries in ASEAN, and 107 in India (UNCTAD 2003, 104). Higher efficiency helps to counteract more expensive labor as T&C sector wages in the PRC are significantly larger than those in Bangladesh, Cambodia, India, Indonesia, and Viet Nam, for example.

Secondly, better productivity levels are also due to heavy investment in state-of-the-art machinery (some US\$15.9 billion between 1994 and 2002). Shuttleless looms for cotton and filament weaving are three times more efficient than shuttle looms. In 2001, for example, the PRC had 145,000 of them and most of the equipment was less than 10 years old. In comparison, there were 27,000 shuttleless looms in Indonesia; 21,000 in Thailand; and 10,000 in India (Wattanaputtipaisan 2005a). Meanwhile, high levels of operational efficiency and vertical integration are achieved through clusters of huge factories and significant investment in upstream production activities. Textiles imports, for example, were equivalent to 8.7 percent (or US\$5.3 billion) of import spending in 1990, 8.3 percent (US\$10.9 billion) in 1995, and 3.4 percent (US\$ 14.2 billion) in 2003.¹⁴

¹⁴The PRC's clothing imports, which were insignificant at US\$49 million in 1990, went up to 0.7 percent (or US\$1 billion) of merchandise imports in 1995 but fell to 0.3 percent (or US\$1.4 billion) in 2003 (WTO 2004). Generally, imported textiles and clothing have

All those contribute much, thirdly, to massive economies of scale and scope in T&C production in the PRC. Garment assembly time in many Chinese firms is as much as 30 percent less than those in other countries (Wehrfritz and Seno 2005, 39). Significantly, these firms can make almost any type of T&C products at any level of quality and at competitive prices—from Wal-Mart and K-Mart, to upscale Burberry, Giorgio Armani, Hugo Boss, Nike, Polo, and the like. Lastly, modern infrastructure in coastal regions permits fast overland transport and quick turn-around of ships in ports in the PRC and Hong Kong, China, another important element of competitiveness. In fact, survey results indicate that the PRC is the “supplier of choice” and “factory of the world” in a wide range of merchandise, including T&C, for major retail groups and brand-name marketers (Engardio and Roberts 2004, USITC 2004).

Most of these groups and marketers are located in developed countries. They are now a major force in T&C production and trade: the five largest retailers (including Wal-Mart and K-Mart) in the United States, for example, account for 68 percent of all clothing sales in public outlets. They invest heavily in integrated, lean retailing systems, and in sustaining brand-name recognition. In protecting their distinctive corporate trademarks, furthermore, they exert great pressures on their suppliers and subcontractors for strict compliance to both price and nonprice parameters. The latter include working conditions and various social, ethical, and environmental matters.

C. Potential Opportunities for ASEAN

Despite the significant commercial advantages reviewed above, the PRC is facing a number of potential supply problems. These provide several latent opportunities for exploitation and complementation by ASEAN in T&C production and trade. As noted earlier, an integrated network of T&C production within ASEAN and with other regions is an option for ASEAN economies to secure preferential supplies to markets in Canada and the European Union. It is also a means for the regional LDCs (except Myanmar at present) to export duty-free to Canada and to the European Union under the Everything-but-Arms program.

1. Integrated Regional Supplies and Transboundary Relocation

However, a regional T&C supply chain, discussed above, plus the expected cross-border relocation of T&C activities from the developed countries and the neighboring NIEs can also yield other opportunities. For example, they can help ASEAN to emerge as an alternative or supplementary source of T&C supplies for large retail groups and brand-name marketers across the globe, including those from Japan and the United States. Indeed, excessive dependence on one principal producer, and the consequent dilution of bargaining power, does not make

accounted for a declining share of trade value in the PRC, a proportion now comparable to those of the more advanced industrial countries (Nordas 2004, 9).

practical or commercial sense. A good case in point is the current scramble by global buyers to secure additional and alternative supplies in the wake of invoked safeguards and imposed import restraints on the PRC's T&C exports to the United States (May 2005) and the European Union (June 2005), respectively.

The promotion and facilitation of an ASEAN network of integrated T&C supply nodes is clearly an attractive option. However, the significant potential for greater supply networking in the region has to be considered against a backdrop of current constraints and issues in ASEAN complementarities in T&C sector development and integration. ASEAN leaders selected T&C among the 11 priority sectors for accelerated integration during their summit meeting in October 2003. Deeper integration is expected to transform ASEAN into a competitive and dynamic player in the global supply chain. The process is to be carried out through a faster removal of tariff and nontariff barriers on priority sector goods and services, by 2007 in ASEAN-6 and 2012 in ASEAN-4. Other stimuli to accelerated integration include simplified customs (clearance) procedures and harmonized standards and technical regulations.

The economies of scale, scope, and agglomeration plus lower logistical expenses gained from simplification and harmonization are estimated by the consulting firm McKinsey and Company to shave as much as one fifth of production costs in the case of consumer goods (Schwarz and Villinger 2004). An important issue in this context, however, is that the potential of ASEAN as an integrated supplier of T&C remains largely untapped as yet. Most ASEAN countries have in fact been competitive producers of labor-intensive garments for the extraregional markets. This accounts for the limited reliance of regional T&C producers on tariff preferences on intraregional trade available under the Common Effective Preferential Tariff (CEPT) Agreement of the ASEAN Free Trade Area (AFTA).¹⁵ Other factors contributing to that limited reliance include the relatively high transaction costs (e.g., red tape and delays) in obtaining tariff concessions and the low margin of tariff preferences between the AFTA/CEPT and the MFN rates (Rajan and Sen 2004, 30-1).

Largely as a result, intra-ASEAN trade in the T&C sector has been very modest. Intra-ASEAN exports of T&C in 2001, for example, were worth US\$2.3 billion, or about 9.3 percent of global exports of T&C by ASEAN. What is more, the absolute amount and relative share of intraregional trade has changed little,

¹⁵AFTA was initiated in January 1992. The CEPT Agreement of AFTA provides for 0–5 percent tariff rates on a wide (and increasing) number of included (or qualified) products by 2003 in ASEAN-6, by 2006 in Viet Nam, by 2008 in the Lao PDR and Myanmar, and by 2010 in Cambodia. Currently, some 99 percent of the products in the CEPT Inclusion List of ASEAN-6 have been brought down to the 0–5 percent tariff range so that the average CEPT tariff is now around 1.5 percent from 12.8 percent when the tariff cutting exercise started in 1993. As regards ASEAN-4, almost 80 percent of their traded products have been moved into their respective CEPT Inclusion Lists. About 66 percent of those items are already within the 0–5 percent tariff band. (Further details on these matters can be accessed at <http://www.aseansec.org/12021.htm>.)

for example, since 1997 (Austria 2004). Intra-regional exports of T&C in 2004, at US\$2.2 billion, were equal to 9.6 percent of the value of global exports of T&C by ASEAN. Meanwhile, the value of intra-ASEAN exports of T&C was equivalent to just 0.6 and 0.4 percent of total merchandise export earnings of ASEAN in 2001 and 2004, respectively. As such, it has also failed to keep pace with the expansion in regional exports in recent years, in spite of concerted ASEAN efforts to foster intra-regional trade and other linkages. For perspective, intra-regional trade as a proportion of total trade rose by 41 percent in the first 10 years of the European Union, by 17 percent in the first 7 years after the inception of NAFTA, and by 67 percent in the first 9 years in the operation of Mercosur, a free-trade zone comprising Argentina, Brazil, Paraguay, and Uruguay (Schwarz and Villingger 2004).

A second option stems from the persistent, heavy dependence of ASEAN on imported cotton, yarns, and fabrics. In 2003, for example, imports of cotton (HS52), manmade fibers and filament (HS 54 and 55), and knitted fabrics (HS 60) were worth US\$1.2 billion. About three quarters of this amount were attributable to just four countries (Indonesia, Malaysia, Singapore, and Thailand). As noted previously, cotton spinning (and other preparations of yarns), including fabric weaving, knitting, and finishing (including dyeing) are highly capital-intensive and technologically sophisticated. An integrated division of labor in the region may thus prove attractive and/or complementary to the expected increase in T&C relocation of upstream goods and the related production activities from the developed countries and the East Asian NIEs in the post-2005 environment. Indeed, the importance of a strengthened textiles subsector in ASEAN is again highlighted by the recent setbacks in textiles exports to the United States. Earnings on such exports by Indonesia, Malaysia, and Philippines fell by 22–44 percent during the first four months of 2005, compared to the same period in the previous years (Ng 2005).

Again, ASEAN can become a competitive host for such FDI-driven relocation through deeper integration and denser networking within the regional T&C sector; after all, this process itself is part and parcel of the ongoing formation of the envisaged ASEAN Economic Community by or in 2020. Nevertheless, the major prerequisites to pull in and to anchor such upstream relocation are not yet operational and will take much time and resources to set up in many parts of the region. This applies especially to the availability of a skilled and technologically experienced workforce, of affordable and adequate power and water supplies, of an efficient and interlinked transport and communications infrastructure, and of speedy and inexpensive transborder clearance within ASEAN. Short turnover periods and speedy time-to-market, whether for intermediate or final products, are a major determinant of competitiveness in the T&C sector, among others.

The third option concerns the PRC's substantial imports of textiles, which stood at US\$14.2 billion (with another US\$1.4 billion for imported garments) in 2003. An integrated ASEAN or ASEAN-PRC supply chain could enable ASEAN to meet some of the PRC's import demand for high-quality textiles and

fabrics. As discussed in the second option above, the potential for transborder relocation to ASEAN of textiles-related upstream activities is considerable but is not yet tapped. Another downside in this third option is that textiles production involves high levels of capital and technological intensity. As such, the required technologies, expertise, and investment resources have to be attracted from extraregional sources. Additionally, the PRC has been developing its own upstream textile products through, among other means, the formation of joint investment ventures with overseas partners (more below). This has reduced the proportion of imported textiles in total T&C trade of the PRC: 31 percent in 1990, 28 percent in 1995, and 18 percent in 2003. This rapid decline, which can be expected to continue further, will severely limit the local needs for imported textiles and fabrics, including those coming from ASEAN, in the long run.¹⁶

Meanwhile, India can be a formidable competitor of ASEAN in textiles production and exports. As noted earlier, textiles have long accounted for a large proportion of export earnings by that country while garments predominate ASEAN exports of T&C. Indeed, India's built-up advantage in this subsector of the T&C industry can well be strengthened and upgraded through the competitive bidding for and hosting of FDI-driven relocation of textiles-related activities from the same developed countries and the East Asian NIEs themselves in the post-2005 trading environment. In these contexts, another option for some ASEAN countries is to share in the PRC's competitive strength by making direct investment in the T&C sector there. For example, Lu Thai Textile Company (a PRC–Thai joint venture) has a substantial share of 13 percent in the global market for high-quality, yarn-dyed weave cloth for undergarments (Lee 2004, M3). Korea, among several others, has meanwhile relocated textiles production facilities, with the PRC being the host country for one third of the offshore investment of US\$2.6 billion (Thomas 2005, 42).

The fourth option for ASEAN is associated with the PRC's long-term development strategy and priorities that will have a clear repercussion on this part of the world and elsewhere, too. Global demand for T&C products is not unlimited, and the quota-free export surge from the PRC has, in fact, generated frequent irritants in external commercial diplomacy (more in the text below). This consideration notwithstanding, T&C exports contributed 28.2 percent to the PRC's merchandise earnings in 1990 but the proportion went down steadily to 25.6 and 18 percent in 1995 and 2003, respectively (WTO 2004). Indeed, earnings on exported T&C have been eclipsed by those on machinery (including electronics) and transport equipment whose exports went up from 17 to 41 percent of total export values between 1993 and 2003 (Rumbaugh and Blancher 2004, 7).

Standard lines of garment manufacture, among several other segments of the T&C sector, require intensive inputs of largely low-skilled labor (generating therefore limited value added locally) and yield low margins because of stiff

¹⁶Reportedly, a meter of polyester fabric costs Rp.7,000 (about US\$0.70) to make in Indonesia compared to Rp.2,300 for the same material made and woven in the PRC (Ng 2005).

global competition. A compounding factor is the rising wages and other costs (especially those in the export-oriented industries), and labor and structural rigidities and bottlenecks (more below). It has thus been suggested that all those less-rewarding T&C segments may well become “sunset” activities in the PRC, especially in the more developed coastal regions. In this context, therefore, the country’s strategic advantage lies increasingly in domestic manufacturing and export of skill-intensive, higher-value goods and services, including upscale and luxury T&C goods (Mayer 2004, Mayer and Wood 2001).

However, these sunset activities may as well be moved inward and be spread over the PRC’s hinterland and other less developed provinces and locations. Such an internal relocation (or flying geese domestic development pattern) can certainly make a valuable contribution to employment generation and poverty alleviation in the PRC. It is thus far from certain at present whether there are built-in or inherent constraints to such an internal redeployment of resources there. Notwithstanding the need for extensive and costly development of transport and communications linkages, strict family planning may have resulted in a lower reservoir of available workers in the PRC (UNCTAD 2005, 81). Currently, it remains uncertain when the economic space for production and trade in lower-end T&C segments and in related niche products would be opened up or vacated by the PRC, including through transboundary relocation and outsourcing in favor of its neighboring countries in ASEAN.

2. Supply Problems in the PRC

Flexible operational schedules and frequent and timely deliveries are important to cater for limited production runs, mass customization, and fast-changing consumer tastes and preferences. For several reasons, however, there are considerable uncertainties concerning a steady, orderly, and uninterrupted flow of T&C supplies from the PRC in the coming decade. Firstly, power shortages have disrupted T&C production in the PRC, in 2003 for example. There are also emerging bottlenecks in the transport and distribution infrastructure for locally produced and imported coal and oil. All these problems will require remedies of a medium- to long-term nature (Asian Development Bank 2004).

Secondly, in its WTO accession package, the PRC’s “nonmarket economy” status at the WTO is to last for 15 years (or until 2016); to ASEAN and many other developing economies, however, the PRC is regarded as a market economy for trade purposes. Thus, antidumping duties on T&C products from the PRC can be higher than those from other market-economy members of WTO. A related problem is the issue of “illegal subsidies”, which can be challenged by WTO members. About 36 percent of textiles output, 7 percent of garment production, and 33 percent of manufactured T&C equipment and machinery come from state-owned enterprises (SOEs) in the PRC. Losses of SOEs are estimated as equivalent to 2–4 percent of the outputs in those three segments (OECD 2004, 41).

In particular, antidumping can be a difficult issue for management by the PRC because lower export prices may be largely due to market liberalization and greater competition among local suppliers. The removal of MFA quotas on 12 categories of the country's T&C exports to the United States led to a substantial surge of 166 percent in value and 417 percent in volume of their exports during 2002. However, unit prices fell by 49 percent in the same year and subsequently stabilized around that lower level despite another surge of 100 percent in value and 118 percent in volume of shipments from the PRC to the United States in 2003 (Mayer 2004, 15). Those drastic falls reflected lower costs from direct exports, thus yielding savings from bypassed export intermediaries in the greater PRC area. In addition, competition for market penetration and/or greater market shares has become greatly intensified among T&C producers in the PRC.

Thirdly, there is the special textiles safeguard provision and the transitional product-specific safeguard mechanism associated with the PRC's WTO accession package. The former, effective until the end of 2008, enables WTO members to restrict the growth of T&C imports from the PRC to 7.5 percent a year if such imports threaten to disrupt the orderly development of trade in the concerned products. The transitional mechanism, valid until December 2013, is to prevent severe disruptions to domestic markets and T&C producers in WTO members as a result of excessive T&C imports from the PRC. Generally, these two (PRC-specific) safeguard provisions are more stringent on the PRC than the requirements on (other) WTO members under the WTO Agreement on Safeguards (AS). Meanwhile, the PRC's ability to retaliate against safeguard action is also more restricted than the pertinent AS provisions for (other) WTO members.¹⁷

How often are the two safeguards utilized by WTO members is an open question. The United States, for example, invoked in November 2003 the textiles safeguard provision to limit for a 12-month period the growth of imports into the United States of knitted fabrics, dressing gowns, brassieres, and gloves from the PRC. Most recently, the scramble of global buyers and marketers to secure alternative or supplementary supplies was caused by the imposition of textiles safeguards (allowing for much lower annual growth rate of 7.5 percent) and import restraints (for 2–3 years) on the PRC's T&C exports by the United States and the European Union in May and June 2005, respectively.

VI. CONCLUSIONS

International trade in T&C will be free from quota restrictions among WTO members from 2005. The MFA and ATC have contributed to the

¹⁷For example, there is a waiting period of 2 years before the PRC can withdraw equivalent concessions on imports from the countries imposing transitional safeguard restrictions on the PRC's T&C exports. Liu and Sun (2004, 57-66) provide a detailed analysis of the differences between PRC-specific safeguards and WTO safeguard standards, and the related issues and implications of safeguard action imposed by the United States on four categories of the PRC's T&C exports in November 2003.

international fragmentation of T&C production and trade. Both developed and developing countries will benefit greatly from quota-free trading in T&C products although most of them are not well-prepared for the post-ATC environment, despite a 10-year transition period. The PRC and India are expected to gain most from the quota-free trading environment but many suppliers who used to rely heavily on favorable quota allocations and/or tariff preferences would lose a large part of their market shares. Those exporters include several smaller and less developed ASEAN economies that have to manage more difficult adjustments and challenges in the post-ATC era.

The PRC has a clear and present competitive edge over most T&C exporters. There are, however, several options and opportunities for ASEAN to mitigate some of the competitive advantages of the PRC and India. Through suitable procurement and production mixes for ROO compliance, for example, several regional LDCs and other regional economies could sustain their shares or even gain larger shares in the European Union and Canadian markets. Other options include concerted efforts to attract upstream T&C resources for relocation from developed countries and the East Asian NIEs, and the formation of an integrated supply chain within ASEAN or encompassing ASEAN, SAARC and/or other East Asian economies (including the PRC itself). These options can render ASEAN more attractive as an alternative or supplementary source of T&C supplies. They also reflect the uncertainties concerning a steady, orderly, and uninterrupted flow of T&C supplies from the PRC in the coming decade or even beyond as well as the PRC's dynamic comparative advantage that is increasingly shifting toward skill-intensive, high-value manufactures in the long term.

Lastly, joint ventures can be set up with T&C enterprises in the PRC. This is an appealing option for the more developed ASEAN economies that typically have sufficient resources and expertise in organization, management, and marketing. Besides, T&C are a sunset industry in these ASEAN members, and as such it is much less important as a source of employment and foreign exchange earnings to them. In this connection, the East Asian NIEs have relocated substantial resources and production activities to share in the PRC's growing dynamism in T&C, and in many other sectors for that matter.

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