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# TEXTILES AND CLOTHING: THE END OF DISCRIMINATORY PROTECTION

***The dismantling of the Multi-Fibre Arrangement by 2005 and China's forthcoming membership of the WTO, as the world's largest exporter of clothing, will alter profoundly international competition in textiles and clothing. A simulation of these two components of trade liberalisation makes it possible to identify the broad scale of the shocks which are likely to affect production and world trade. The results show how Asian competition could well bring into question the regionalisation of trade, which has emerged around the United States and the European Union, favouring a system of differentiated protection[1].***

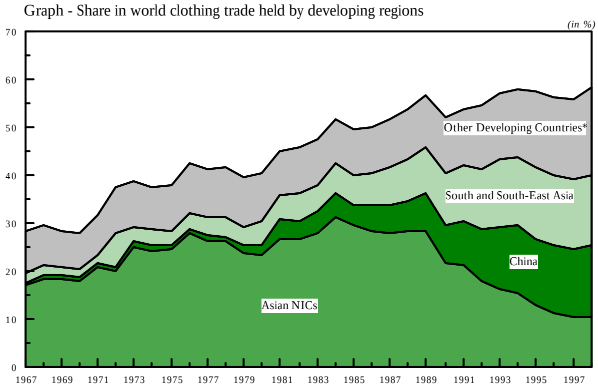
The textile and clothing sectors have been especially affected by the emergence of new exporting countries over the last decades. The industrialised countries responded to such competition very early on, by setting up means for protecting their producers. The first Multi-Fibre Arrangement (MFA) was implemented in 1973: bilateral quotas on quantities exported were imposed on developing countries, essentially in Asia. The stated aim was to achieve progressive liberalisation and controlled trade, so as to avoid excessive shocks to markets. The MFA has been extended three times, and has profoundly altered competitive conditions, not only between developed and developing countries, but also within both of these groups.

During the negotiations of the Uruguay Round, it was agreed by the participants that the sector should progressively come under the non-discrimination rules of the GATT: the Agreement on Textiles and Clothing (ATC) sets out the conditions for such integration, by 2005. However, the ATC does not cover the world's top clothing exporter, namely China, which is not yet a member of the WTO. Indeed, it is China's membership of the WTO which will bring about the elimination of quotas that the industrialised countries place on it. Given the weight of China in world clothing trade, its membership of the WTO will constitute a shock whose amplitude will at least equal that of the application of the ATC.

## COMPETITION DISTORTED BY QUOTAS

Since the MFA was established, important changes have affected the production and trade of the textile industry. Nevertheless, it is very difficult to distinguish what the exact impact of the Arrangement has been on the organisation of the industry and on the relative performance of the various producers. While it may be thought that quantitative restrictions have slowed down the penetration of industrialised country markets by developing countries (see graph), the exact effects of the MFA remain controversial[2]. Quotas lead to strong distortions which may have contradictory consequences. For an exporting country, the quota is both an imposed limit

Graph - Share in world clothing trade held by developing regions




* including Central and Eastern Europe

*Source* : CEPII-CHELEM.

1. This ***Lettre du CEPII*** has been written on the basis of a report prepared in conjunction with the Institut Français de Mode, and which is to be published during the second quarter 2001. The results presented here are the full responsibility of the authors of the CEPII.
2. See G. Barba Navaretti, R. Faini & A. Silberston, ***Beyond the Multifibre Arrangement: Third World Competition and Restructuring Europe's Textile Industry***, Development Centre Documents, OECD, 1995.

to the growth of its exports and a guarantee for market access. Importers are in fact forced to take supplies from countries (and companies) benefiting from export quotas of the products in demand. Some of these suppliers would not be competitive under normal market conditions. Thus, at the beginning of the 1990s, it was estimated that 50% of the demand going to Hong Kong would have gone to other Asian countries had there been no quotas[3]. In other words, the shift of clothing production from the Asian Newly Industrialising Countries[4] (Asian NICs) towards countries nearby with lower wage costs has been accelerated, by the system of quotas, and retarded in others.

Within the industrialised countries, the modulation of tariffs and quotas imposed on various partners has contributed to the regionalisation of trade (see Table 1). The tariff preferences accorded to nearby developing countries for the US market (notably within the NAFTA accords) and for the European Union market (within the framework of association accords and cooperation with the EU), which cover all industrialised products, have been supplemented by trade measures favouring a regional division of labour throughout the industry.

Table 1 - The Regionalisation of Trade
Share of Asia and neighbouring regions in US and EU clothing imports

| | Imports of the US | | Imports to the EU* | |
|---|---|---|---|---|
| | Asia | Latin America | Asia | Medit. & CEECs |
| 1978 | 68.7 | 9.3 | 52.2 | 23.7 |
| 1988 | 71.3 | 11.5 | 53.5 | 27.7 |
| 1998 | 48.0 | 32.6 | 38.2 | 41.8 |

*not including intra-EU trade.
*Source* : CEPII-CHELEM.



In the case of the European Union, for example, quotas attributed under passive processing trade (PPT) have been extended regularly. Yet such PPT quotas, which were accorded to products made from European textiles, have favoured countries neighbouring the Union, as European importers are encouraged to work with nearby producers in order to reduce delivery schedules and transport costs. This regional division of labour has helped keep European industry in the upstream part of the industry. Thus, in 1998, for every $100 worth of clothes imported from the Mediterranean basin and central Europe, the EU exported $55 to these countries in textiles and yarns. The corresponding figure of Asian imports amounted to only $9.

The elimination of all discriminatory measures will profoundly alter the rules of the game to which textile and clothing companies have adapted their strategies.

## Two scenarios for liberalisation

The analysis of the effects of current trade liberalisation in the textile and clothing sector requires interdependencies between countries and sectors to be taken into account. General equilibrium models are key to such work, and were retained to simulate two scenarios. Scenario 1 (SC1) is based on the application of the ATC. Scenario 2 (SC2) adds to this liberalisation by including Chinese entry into the WTO. The simulations are carried out using Version 4 of the GTAP model (base year 1995), with 13 geographic zones and 7 sectors including textiles and clothing.

The ATC, which came into force the 1st January 1995, is a transitional agreement that should lead to the complete abolition of quotas by WTO members, by 1st January 2005. The ATC includes two principal measures: first, the progressive integration of products concerned by the quotas in the general regime of the GATT; second the liberalisation of restrictions, in other words, the progressive rise in the growth of import quotas set out in the bilateral agreements concluded with the MFA framework (Table 2). The simulation also includes the reduction of tariff barriers for textiles and clothing, to which the industrialised countries committed themselves during the Uruguay Round. As far as China's membership of the WTO is concerned, it includes two dimensions: the opening of industrialised country markets to Chinese products (in this case, the elimination of quotas based on tariffs) and the opening up of the Chinese market to products from other WTO members[5]. The latter is simulated by a reduction in Chinese tariffs of 5% for spun products, of 10% for woven products and of 17% for clothes.

The simulations indicate the impact of liberalisation for each zone, taking into account the competitiveness of the different producers and the price elasticities of demand. The results provide the “welfare gains” stemming from liberalisation on the one hand, and the effects of liberalisation on world trade and production on the other hand.

Table 2 - The implementation of the ATC

| | Jan.-95 | Jan.-98 | Jan.-02 | Jan.-05 |
|---|---|---|---|---|
| ***"Integration into the 1994 GATT Rules"*** | | | | |
| Share of products for which quotas are to be eliminated (cumulative share)[1] | 16% | 33% | 51% | 100% |
| ***"Liberalisation of restrictions"*** | | | | |
| Rise in the growth rate of quotas for not yet integrated | 16%[2] | 25%[3] | 27%[3] | |
| *Example* : Annual rate of growth of quotas for a MFA rate of 6% | 6.9% | 8.7% | 11.1% | |

1. As a % of the share of imports in 1990 of all products subject to quotas.
2. With respect to MFA rate.
3. With respect to the previous rate under the ATC.
*Source :* WTO, Textiles Monitoring Body.

## Welfare Gains

Protection carries a cost. Quotas prevent production from being allocated to more efficient sectors: they segment import markets; they prevent prices from falling and are a source of rents. Suppressing quotas leads to an overall gain in “welfare”. According to the simulations undertaken here, the welfare gain for the world as a whole would amount to $5.6 billion in

3. See G. Barba Navaretti, R. Faini & A. Silberston, ***op cit.***
4. These countries include South Korea, Hong Kong, Singapore and Taiwan.
5. See F. Lemoine, “Pourquoi la Chine veut-elle adhérer à l'OMC ?”, ***La Lettre du CEPII***, n°189, April 2000 (available in English on the CEPII website: http://www.cepii.fr).

Scenario 1, and to $14.3 billion in Scenario 2[6]. The distribution of this gain across countries is proportionate to the costs of the protection bore by each party (Table 3).

Table 3 - Welfare gains or losses by main region

| *Billion dollars* | SC1 | SC2 |
|---|---|---|
| NAFTA | 3.2 | 5.2 |
| EU | 0.4 | 1.6 |
| Japan | 0.1 | 1.3 |
| Asian NICs | 0.1 | 2.1 |
| China | -1.4 | 3.6 |
| South and South-East Asia | 3.3 | 1.3 |
| Rest of the World | -0.1 | -0.9 |
| World | 5.7 | 14.3 |

*Source* : Simulations by the CEPII.

In scenario 1, the principal beneficiaries of the liberalisation are the countries of the South and South-East Asia[7], which bear the highest costs of import restrictions, on the one hand, and the industrialised countries, whose consumers were previously unable to benefit from supplies provided at the best price. In both cases, each country gains overall, due to the aggregate gains and losses faced by the various agents concerned. Thus, for a developing country which previously faced restricted exports, most producers will gain from liberalisation, though some may be pushed out of the market due to lower prices. As for the State, it will lose out in as far as the management of quotas attributed to the exporting country may have provided it with some rent. For the industrialised importing country, consumers, both intermediate and final, will benefit from market opening. But opening developing markets to competition will penalise national producers. Thus, clothes producers will benefit from enlarged access to imported yarns and fabrics, but could face stronger competition in their own markets. The overall gains (or losses) for each zone will result from the sum of these different effects.

The simulations show that the gain for the industrialised countries will be more important for NAFTA than for the European Union, the United States being more protected and hence being subjected to greater costs prior to liberalisation.

In Scenario 1, China, which is not covered by the ATC, is a loser of liberalisation (experiencing a welfare loss of $1.4 billion). The opening up of markets in the industrialised countries to China's competitors, while it remains subject to quotas, penalises Chinese production. In contrast, in Scenario 2, China enters the WTO and participates in the liberalisation process. The world welfare gain is then considerably stronger. China records a gain of $3.6 billion. Compared to the first scenario, this is achieved to the detriment of other developing countries (South and South-East Asia, and the Rest of the World), whose producers suffer from competition by liberalised Chinese exports. However, the gains of the Asian NICs and those of Japan rise considerably compared to Scenario 1, notably because they are the first to benefit from the extended opening up of Chinese markets for textile products. In this scenario, the gains by NAFTA and the European Union are widened: the costs consumers must bear due to a restrained access to Chinese products are limited.

## THE PROGRESSION OF TRADE AND THE RETREAT OF REGIONALISATION

The suppression of quantitative barriers to trade and the fall in customs tariffs lead to a rise in international trade: textile trade grows by 2% in the first scenario, and by 10% in the second. Trade in clothing rises by 7% and 14% respectively.

For clothing, Asian exports, which were the most constrained, rise by 24% in Scenario 1, and by 54% in Scenario 2 (Table 4): their share of the world market, which stood at 40% in 1995, will increase to more than 50% in the first case, and to over 60% in the second. While the application of the ATC leads above all to a rise in exports from South and South-East Asia, Chinese membership of the WTO makes this country the main beneficiary of liberalisation: its clothing exports will rise by 87%, and its share of world clothing exports will rise by more than 10 percentage points.

Table 4 - Clothing exports
Trends in exports of major regions

| *in % with respect to initial situation* | SC1 | SC2 |
|---|---|---|
| NAFTA | -13 | -27 |
| Latin America (exc. Mexico) | -20 | -39 |
| EU | -7 | -19 |
| Mediterranean Basin and CEECs | +7 | -5 |
| Asian NICs | +34 | +18 |
| China | -10 | +87 |
| South and South-East Asia | +62 | +36 |
| *All three Asian regions* | *+24* | *+54* |
| World | +7 | +14 |

*Source* : Simulations by the CEPII.

This evolution throws doubt on the process of trade regionalisation growing up around the United States and the European Union. Producers in the peripheral regions to these blocs (in Latin America on the one hand, and in the Mediterranean Basin and Central and Eastern Europe on the other hand) will lose the benefits they obtain from existing trade measures applied to their exports and to those of their competitors. Their shares in the clothing imports of their Northern neighbours will fall (by 16 percentage points in the Americas and by 8 points in Europe).

The impact of trade liberalisation on clothing production in the different zones is significant, especially in the Asian developing countries, where exports represent a very large share of production. In Scenario 2, Chinese production rises



6. The liberalisation of trade in textiles and clothing has been the subject of many studies. The simulations provide results in terms of world welfare, which range from $7 to 28 billion (an estimate carried out with 2005 as a base leads to a figure of $50 billion), equivalent to a maximum of 0.1% of world GDP in 1995.

7. Essentially India and Pakistan, Indonesia, Malaysia, the Philippines and Thailand.

by 70%, and that of the other Asian countries by 26%. Thus, the share of the latter two zones within an unchanged, global level of output rises from 12% to 18%. The fall in American production (-19%) is stronger than for European production (-11%).

The consequences for trade liberalisation are less important in the textile sector, but the Asian NICs, and to a lesser extent Japan, which provide the bulk of Chinese textile imports (respectively 60% and 20%), will profit from the rise in Chinese output in clothing. The rise in Asian NIC textile output (up by 25% in Scenario 2) thus becomes the most marked change, in this sector, at the world level.

Both scenarios show what the impact of eliminating existing distortions to trade is, given the relative positions of different producers under the present discriminatory trade system. But, such changes are only one aspect of the outlook for the sector, whose overall future will also depend on macroeconomic trends and the transformations affecting production and trade conditions directly. The comparative advantage currently enjoyed by some countries with low wages will diminish as they develop. In contrast, new countries, notably in Africa, could emerge in a market no longer subject to a framework of quotas, provided such countries adopt economic policies favouring exports. A reduction in the protection of Southern markets, as has been simulated here for China, could not only generate new trade flows, but could also modify the relative competitiveness of producers. The strategies adopted by the industrialised countries will therefore have determining consequences. In the face of competition from low-wage countries, the different reactions that have been observed in Germany, France or Italy demonstrate that room for manoeuvre is not negligible. Changes in production techniques, in distribution conditions, or in product differentiation efforts may significantly alter comparative advantage. Lastly, the proximity to markets sought after by producers, just as the regional policies favouring co-development, are likely to preserve the dynamism of regional development and limit the relocation of production to Asia.

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