POLICY BRIEF

OECD

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A New World Map in Textiles and Clothing

Adjusting to Change

Introduction

The textile and clothing industries provide employment for tens of million of people, primarily in developing countries, and accounted for USD 350 billion in merchandise exports in 2002, or 5.6% of the world total. The current rules governing world trade in textiles and clothing will change drastically at the end of 2004, when countries will no longer be able to protect their own industries by means of quantitative restrictions on imports of textile and clothing products. What will this mean for cotton growers in Burkina Faso and Turkey, fashion retailers in France and the United States, or shirt factories in Bangladesh, the Dominican Republic or China?

One thing is clear. The elimination at the end of 2004 of quantitative import restrictions under the World Trade Organisation (WTO) Agreement on Textiles and Clothing will put an end to a complex trade regime built up over decades, and will have huge implications for all those involved in the entire supply chain, from growers to retailers and from the least developed to the most developed countries.

But who stands to lose or to gain; where will jobs be lost or new markets found, and how can governments help their own textile and clothing industries adjust to this new trade regime? The OECD has examined the most recent market developments in both developed and developing countries and the challenges facing governments to ensure that their industries are ready to compete in a new and less distorted trading system. This Policy Brief looks at the main policy and regulatory challenges in the areas of trade policies, labour adjustment, technology and innovation, and other regulatory areas which are important determinants of a country's ability to integrate in the world economy. ■

oecd Observer

What are the main challenges?

The fact that countries will no longer be able to restrict the quantity of textiles and clothing they import after the end of 2004 will mean considerable adjustment for everyone in the sector worldwide. In particular, the textile and clothing community in both developed and developing countries is worried about the emergence of more competitive suppliers in China that may capture what they would regard as a disproportionate share of the economic benefits arising from the phasing out of quantitative restrictions.

More than four million jobs have already disappeared in developed countries as suppliers have responded to competitive pressures by shifting production towards faster growth products, modernising their equipment and adopting new working methods involving the transfer of sewing activities to low-wage countries. But suppliers in small developing and least developed countries that have specialised in the final assembly of clothing products from imported textiles are also vulnerable to competition.

Governments need to introduce a policy and regulatory framework that will strengthen the private sector's capacity to deal with rapid change and growing competition, and to capture the trade opportunities that are being created through improved market access.

The textile and clothing industries have distinctive characteristics and involve a large and diversified range of activities that use a varying mix of labour and capital. The entire supply chain can be presented in four production segments: 1) the preparation of natural fibres drawing on various agricultural activities; 2) the preparation of textile products that involves manufacturing activities where technological developments have resulted in huge productivity gains; 3) the clothing production goes through several steps before soft materials are sewn together into three-dimensional products, whereas the sewing techniques remain basically those of a century ago; and 4) the retailing activities which have changed significantly with the blurring of the traditional boundaries between retailers and manufacturers. ■

What will change?

Vulnerability of low-wage countries

The trade restrictions up to now have contributed to the international fragmentation of the supply chain, where low-wage countries only sew together imported textile components. This fragmentation process began when exports from Hong Kong, China reached their maximum levels under the quota system. Clothing assembly processes were then sub-contracted to low-wage, developing countries throughout the Asian pacific region which had spare export quotas, such as Bangladesh. In effect, the system of quotas restricting exports penalised the more competitive suppliers from Hong Kong, China and benefited less competitive suppliers located in countries that had spare export quotas and whose only competitive advantage was low wages.

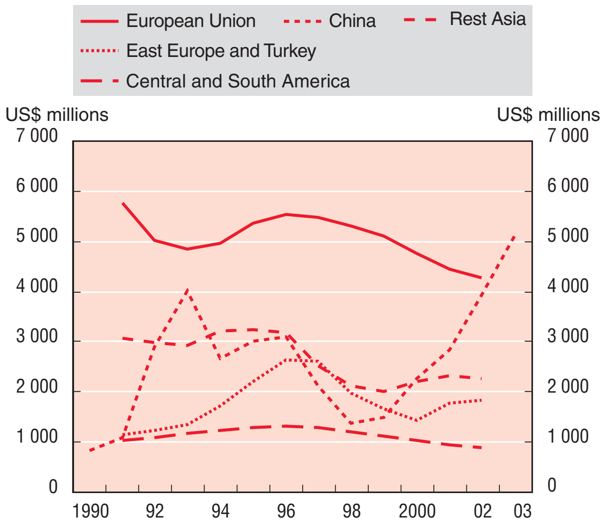
The fragmentation of the supply chain was further encouraged when developed countries granted preferential trade arrangements, known as production sharing arrangements or outward processing programmes, to a limited number of low-wage countries. Under these programmes, textiles or pre-cut materials were temporarily exported into low-wage countries for final assembly, with the finished clothing products then being re-imported under preferential provisions. Bulgaria, Costa Rica, the Dominican Republic, Madagascar, Mauritius, Mexico, Morocco and Tunisia were among the countries involved in these preferential programmes.

But ultimately this model discouraged low-wage countries from developing a competitive textile industry of their own, locking them into a situation where they would not go beyond offering a low-wage assembly line. In a new trade environment where export quotas no longer apply, the economic vulnerability of a global business model based on production fragmentation is exposed. If there is no quota restriction on the amount of production in a particular country, it is cheaper for a country that can produce both textiles and clothing to do so, thus avoiding the transport costs, time delays and management time needed to co-ordinate a production chain where shirts or seat covers are cut out in one country and stitched together in another. So in the post-quota environment, the most vulnerable countries are those small and remote developing countries and least developed countries that until now have handled only assembly.

Migration of textile capacity to the most competitive developing countries

The elimination of quota restrictions will open the way for the most competitive developing countries to develop stronger clusters of textile expertise, enabling them to handle all stages of the production chain from growing natural fibres to producing finished clothing. The recent surge in China's imports of up-to-date textile and clothing machinery bears witness to this trend and points to the future sources of textile and clothing production and exports. The main beneficiaries will be Chinese clothing suppliers who will be able to buy their textiles directly from domestic sources and hence meet tighter delivery dates. Access to high-quality textiles is considered one of the most important determinants of the competitiveness of clothing suppliers. Up-to-date equipment will deliver that quality. Other developing countries with both textile and clothing capacity may also be able to prosper in this new competitive environment. As a result, the textile industry in developed countries will face intensified competition in both their export and domestic markets. The migration of textile capacity will nevertheless be influenced by objective competitive factors and will be hampered by the presence of distorting domestic measures and weak domestic infrastructure in several developing and least developed countries.

Imports of textile and clothing machinery



The growing importance of the non-clothing use of textiles

The textile industry is also undergoing a major reorientation towards non-clothing applications of textiles, known as technical textiles, which represent the fastest-growing segment of total textile applications. Technical textiles are often defined as textile materials and products manufactured primarily for their technical and performance properties rather than for their aesthetic or decorative characteristics. They have many applications, including bed sheets; filtration and abrasive materials; furniture and healthcare upholstery; thermal protection and blood-absorbing materials; seatbelts; adhesive tape, and multiple other specialised products and applications. It is estimated that technical textiles are growing at roughly twice the rate of textiles for clothing applications and now account for more than half of total textile production. The processes involved in producing technical textiles require relatively expensive equipment and skilled workers and are, for the moment, concentrated in developed countries.

Shifting industrial expertise towards services-related skills

While low wages can still give developing countries a competitive edge in world markets, time factors now play a far more crucial role in determining international competitiveness. Developing countries that can offer low-wage workers for sewing garments or seat covers together may have a comparative advantage over developed countries for that one stage of the assembly process, but that does not necessarily translate into a comparative advantage in the management of the entire supply chain when no export restrictions apply. Countries that aspire to maintain an export-led strategy in textiles and clothing need to complement their cluster of expertise in manufacturing by developing their expertise in the higher value-added service segments of the supply chain such as design, sourcing or retail distribution. To pursue these avenues, national suppliers need to place greater emphasis on education and training of services-related skills and to encourage the establishment of joint structures where domestic suppliers can share market knowledge and offer more integrated solutions to prospective buyers.

Leadership role of large retail groups

Retail distribution is increasingly dominated by large retail organisations in the main consuming countries, where the trend is towards greater product specialisation, brand-name products and market segmentation. These large retail groups collect market information about the latest trends in styles and tastes, and their integration of this information gives them considerable leverage in dealing with suppliers. Nevertheless, offshore suppliers can benefit from working in close co-operation with large retail groups and brand-name marketers as they learn to manufacture quality products; apply the buyer's codes of conduct; and deliver products in a timely fashion. The development of business relationships between national clusters of expertise in countries around the world and the large retail groups in the main consuming countries plays an instrumental role in helping to transform the supply chain. For exporting countries seeking to develop their export-led strategies, nurturing contacts between domestic clusters and the large retail groups and brand-name marketers is a must.

Moreover, the large retail groups and brand-name marketers in textiles and clothing are expanding their distribution networks and pursuing business opportunities in countries with attractive growth prospects. Although these groups are predominantly headquartered in developed countries and owned by developed countries' interests, some leading manufacturers in Hong Kong, China have launched their own brand names and are entering retail distribution. This strategic move requires services-related expertise in designing, marketing, retailing, financing and the gathering of market intelligence on foreign markets. It also requires foreign direct investment (FDI) flows originating from Hong Kong, China or other emerging economies that are pursuing similar diversification strategies. ■

How will trade policies change?

Liberal trade and investment policies at the national level play a key role in the adjustment process. They can help limit upward pressure on the price of imported materials and thus encourage the emergence of firms that are able to compete on both domestic and international markets. Trade policies other than textile-related quotas have had a major impact on the geographical patterns of trade in textiles and clothing. In particular, the elimination of import quotas will make other trade arrangements more attractive, such as regional trade arrangements (RTAs) and the Generalised System of Preferences (GSP). But it will reduce the attractiveness of outward processing programmes (OPP) under which textiles or pre-cut materials are temporarily exported to low-wage countries and re-imported under preferential provisions, since exporters and importers will no longer need to find ways to get around export quotas.

But export quotas are not the only form of trade restriction. Countries can also apply tariffs on imports and tariff protection remains relatively high in textiles and clothing. There are also obstacles to establishing retail distribution services in many countries, although the situation varies widely. India, for example, does not allow FDI in retail distribution services, but in China, from December 2004 foreign retailers will have the right to set up distribution networks, through wholly-owned foreign enterprises, without any geographical or quantitative restrictions, thereby providing considerable retailing opportunities in a vast consumer market. In the context of the ongoing WTO multilateral trade negotiations, countries have an opportunity to negotiate improved access for wholly-owned foreign distribution services in countries where access is still hampered.

Preferential trade arrangements

As restrictions on exports of textiles and clothing come to an end, small developing countries and least developed countries are becoming increasingly vocal about their future vulnerability and are demanding access to developed country markets on an improved preferential basis as a way to compete more effectively with countries such as China and India. Most existing preferential trade agreements specify that the trade preference is granted only to products that actually originate from the beneficiary countries, the so-called rules of origin. But there are considerable disparities between the rules of origin applied under various preferential arrangements and, as a result, in the utilisation rates of these arrangements. For example, rules of origin under one preferential arrangement could require that a cotton shirt be produced from cotton fabrics that contain nationally produced cotton fibres; whereas another arrangement could require that a cotton shirt be produced from national fabrics, regardless of the origin of the fibres.

The challenge for policymakers in developed countries is to draft rules of origin for their preferential arrangements that will mainly benefit the least developed countries and small developing countries

Average import tariffs

Region/country	Manufactures	Textiles	Clothing
OECD countries	6.2	9.4	16.1
Japan	2.9	5.1	10.8
European Union	4.4	6.9	12.0
United States	4.0	7.6	12.3
Australia	5.4	9.8	23.6
Mexico	17.3	19.9	35.0
Developing countries	13.5	18.1	23.0
Hong Kong, China	0.0	0.0	0.0
Chile	9.0	9.0	9.0
Dominican Republic	14.6	5.7	19.9
China	9.6	20.1	23.5
Bangladesh	22.1	28.4	36.9
Morocco	28.2	35.9	49.8

that are most vulnerable to competition from large integrated suppliers in China and India. Recognising that there is at present virtually no production of high-quality textiles in least developed countries, preferential access arrangements in their favour must take into account that in order to compete on export markets they have to be able to use competitive textiles originating from third countries. Under these circumstances, it seems inevitable that in providing least developed countries with preferential access, there will be some collateral benefits for suppliers of high-quality textiles. Once export quotas under the WTO are eliminated, provisions on rules of origin will be at the forefront of the trade policy agenda as demands from vulnerable offshore centres become more insistent. In addition, improvements concerning rules of origin under preferential trade arrangements will increase the competitive pressures on the domestic textile industry of developed countries.

Relatively high tariff protection

The average tariff protection applied to textile and clothing imports remains high compared to average tariffs imposed on manufactured products for the overwhelming majority of developed and developing countries. In developed countries, the average tariff applied on clothing products is 16.1%, but it is 6.2% on manufactured goods. In developing countries, the average tariffs are 23% for clothing products and 13.5% for manufactured goods. Moreover, there are considerable differences among developed countries in the level of tariffs applied on textiles and clothing and in the imposition of very high tariffs on trade-sensitive products, the so-called tariff peaks that are often defined as those exceeding 15%. There are also similar imbalances among developing and least developed countries. ■

How to cope with job losses?

Although trade liberalisation yields economy-wide benefits, the opening of markets to international competition puts pressure on labour markets and results in hardship, whether temporary or permanent, for displaced workers. More than four million jobs have already disappeared in textile and clothing industries in developed countries and the elimination of export quotas will have a profound effect on employment levels in developing countries. Experience shows that displaced workers in the textile and clothing industries tend to have a low level of education, low skill levels (which also means low wages), and are predominantly women and minorities. All of these characteristics make it more difficult for these workers to adjust to changes in labour market conditions. Moreover, it is difficult to identify the individual causes of worker displacement as technological change, productivity gains, increased import competition and shifts in production can all contribute to job loss. Therefore, there is a need for broader programmes aimed at helping the unemployed in general rather than a specific programme designed only for those who lose their jobs because of increased import competition.

Governments increasingly rely on training as part of the toolbox of labour market adjustment programmes. Many workers coming out of traditional low-wage manufacturing industries lack basic language and math skills, which prevents them from learning the specific skills needed for the new jobs being created. The shift in structure of the labour market in developed countries has also resulted in a gap between the skills that workers needed in their old jobs and those required by their future jobs. Governments are employing various subsidies and tax incentives to encourage training and skill enhancement.

The main goal of any labour adjustment programme should be re-employment: either returning to one's previous job or finding a new job as soon as possible and with minimal disruption in earnings. With that objective in mind, countries have used various programmes to train workers and provide job search assistance. The recent introduction in Germany and the United States of "wage insurance" aims at encouraging workers to return to work as soon as possible. Wage insurance is designed for those workers whose new wage is lower than their previous wage. By subsidising some portion of the difference between the new and previous wages, it is hoped that workers will be encouraged to take a new job sooner. It is also hoped that new employers will provide the worker with on-the-job training, which has proven to be more effective and cheaper than government-financed classroom training. ■

What is the role of technology and innovation?

Technological development has had a different influence on the textile industry than on the clothing sector. Whereas huge productivity gains were achieved through innovations in the textile industry, the clothing industry can only point to various improvements in fragmented clothing processes. In fact, today's sewing techniques do not differ much from those of a century ago. And although the textile and clothing industries can be considered to be mature, they both use technological innovations that are largely generated in other industries, above all in chemicals (complex man-made fibres) and machinery (computer-aided design systems).

Technology transfer between machinery suppliers and users plays a pivotal role in the performance of textile and clothing suppliers. Hence, it is appropriate for governments to encourage the process of technology transfer by exploiting more efficiently the opportunities offered by modern information and communication technologies for the dissemination of advanced technological knowledge. Governments could also keep in mind that, in the long run, innovative capacities basically depend on the availability of suitable human capital. Therefore, a sound education and qualification system seems much more important for sustainable technical progress than public innovation programmes. ■

What are the regulatory challenges?

Lifting export restrictions in textiles and clothing will expose the vulnerable situation of countries whose regulatory framework is ill-equipped to deal with international competition. They stand to pay a high price for inefficient domestic regulatory regimes, obsolete infrastructure in essential business services, cumbersome customs procedures, and other distorted market structures. Here, governments can act to improve their policy and regulatory framework. From a trade policy perspective, efficiency in the areas of transport, telecommunications and electricity infrastructure and in customs services is an important determinant of a country's ability to integrate fully in the world economy. Achieving greater synergies among the various policy and regulatory areas that affect the competitive position of national firms is, in essence, the purpose of a business facilitation agenda.

Minimise transit time for shipments

Reliability of transport infrastructure and efficiency in customs procedures complement each other in minimising transit periods for shipments involved in international trade and can make geographically remote locations more internationally competitive. Recognising that exporting countries have different geographical positions relative to large consumer regions and different transport options, they need to assess the logistical costs involved in export markets with a view to: setting up a competition-enhancing environment in various port services; strengthening competition conditions in and between modes of transport; addressing the terrorist risks in transport without losing sight of the benefits of smooth transport systems; and better integrating the enforcement of national laws and regulations such as customs procedures, taxation, sanitary and environment protection, with other service providers in ports.

Ensure reliable telecommunications and electricity infrastructures

Reliable and up-to-date telecommunications and electricity infrastructures give textile and clothing suppliers a competitive edge. Outdated regulatory frameworks in electricity and telecommunications services act as taxes on textile and clothing suppliers and, more importantly, undermine the capacity of national suppliers to focus production on the higher value-added segments of the supply chain that depend on reliable infrastructure to ensure quick market responses. Once export quotas are gone, the international competitiveness of textile and clothing suppliers will be enhanced in countries that maintain a competitive environment and spur investment in innovative telecommunications equipment, electricity generation and distribution systems.

Nurture SME-related entrepreneurship

While it is important to nurture entrepreneurship in the small and medium enterprises (SME) sector, there is a danger of over-encouraging investment in lower productivity operations by offering excessive fiscal advantages and labour law exemptions to small-scale companies. Recent work by the OECD in the context of the Bologna Charter on SME Policies has found that education and training are the single most effective means of achieving the objective of fostering entrepreneurship.

Foster a dynamic macroeconomic environment

Above all, the role of government is to pursue a sound and stable macroeconomic environment able to sustain non-inflationary economic growth. There is strong evidence that real economic growth and, in turn, net employment creation are stimulated in an environment of low inflation. The pursuit of sound macroeconomic policies fosters market adjustment to changes in the competitive environment and facilitates the redeployment of affected resources to other productive sectors. The pursuit of a business facilitation agenda complements other government actions at the macroeconomic and microeconomic levels, *i.e.* trade, labour adjustment and innovation, and brings benefits that go well beyond the textile and clothing industries. ■

For further information

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For further reading

- OECD (forthcoming), **A New World Map in Textiles and Clothing: Adjusting to Change**, Paris. 210 pages.
- Audet, Denis (2004), **Structural Adjustment in Textiles and Clothing in the Post-ATC Trading Environment** (Synthesis Chapter).
  Available at: *www.oecd.org/trade*, under Publications and Documents/Working Papers, 24 pages.
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- OECD (2003), **Trade and Competition: From Doha to Cancun**, Paris. ISBN 92-64-10278-7, € 25 (E-book € 20), 72 pages.
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