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Textiles

On January 1, 2005 the World Trade Organization agreement on textiles and clothing (ATC) expired. From that date, all WTO members would have unrestricted access to the American and European markets for their textiles exports. As expected, this caused a tremendous impact on both growth in the world textiles industry as well as on short term political and economic challenges to established European businesses. European textile producers saw themselves faced with low cost rival imports from China and other "tiger" economies. Import statistics from the European Commission show that in the first nine months of 2005 the volume of textiles and clothing goods from China, the fastest growing exporting country, rose by 40 per cent. Overall, China's market share in textiles, clothing and leather goods' imports to the EU rose to 31.4 per cent in 2005. In order to mitigate these impacts, six months after liberalization of the market, in June 2005, the EU signed a Memorandum of Understanding (MoU) with China. In this "Shanghai Agreement" China and the EU agreed on managing the transition to free trade cooperatively through capping growth of some textile and clothing imports to between 8 per cent and 12.5 per cent per annum until January 1, 2008, which has become the postponed date for full liberalization. In October 2007 the Commission and the Chinese Ministry of Foreign Trade decided to follow-up on their MoU by developing a system of joint import surveillance. This "double checking system" will operate for one year in 2008 and binds both sides on monitoring the licensing of (then unrestricted) exports from China and of imports into the EU. The new agreement aims at providing a clear picture of the development of trade patterns in order to provide predictability for EU businesses. Although formal adoption of the new agreement was not yet reached in October 2007, the product categories included to be subject to double-checking are to be T-shirts, pullovers, trousers, blouses, dresses, bras, bed linen and flax yarn. The monitoring of shipments and licensing will be administered by EU Member State licensing offices.

Despite proposals for prolonged protectionist actions of, in particular, Italy and France, the Commission decided that quotas on Chinese textile imports are to be ended at the start of 2008, thereby harmonizing EU and WTO rules. A high increase in European imports from China is very likely to occur, as current high quota fill-rates suggest a pressure for more imports. Also, in 2008, the US will still be imposing limits on Chinese products. In combination with a dramatic dollar-euro exchange rate, Chinese products will find the Single European Market more easily than the US market. The effects in countries with a relatively large sector of high-cost manufacturers, such as Italy, are likely to be acute. Because of an unfavorable exchange rate for European exporters, the cheap imports that challenge domestic firms will exacerbate the already weak economic stance of these manufacturers. As it has become clear that those European sectors will not be able to compete with Chinese traders in terms of quantity, a new strategy seems to

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emerge that focuses on a different market segment by underlining the quality of European goods.

Gradual Liberalization Did Not Lead to Adjustments in High-cost EU Manufacturers

The liberalization of the textile industry has been gradual. The Agreement on Textiles and Clothing (ATC) that expired in 2005 protected "industrialized" countries from cheap imports to the disadvantage of "developing" countries for over forty years. The agreement had explicitly provided for a ten-year transition period (starting in 1995) in order to let high-cost textile manufacturers adjust to the competition of low-cost and more productive newcomers in the international textiles market. For the WTO members in general, from 2005 onwards, the textile market has been governed by the general WTO/GATT rules and disciplines as agreed upon in the multilateral trading system.

The ATC started liberalizing a sector that had been protected since long time. From 1974 until the end of the Uruguay Round (1995), the rules of the Multi-fiber Arrangement (MFA) governed bilateral agreements in textile and clothing quotas. The application of the MFA meant to apply selective quantitative restrictions when surges in imports of particular products caused, or threatened to cause, serious damage to the industry of the importing country. It did not respect the GATT principle of non-discrimination and was replaced in 1995 by the ATC.

The textile industries were thus regulated for long time by a complicated system of import quotas which had the effect of restricting the absolute level of imports and protecting the textiles industries within the EU area. Sadly, the textile industries of many EU member states did not take the opportunity to restructure, even though the forty years of protectionist agreements afforded them to do so and even though in the last decade the movement to liberalization has been explicit; the need for restructuring has been very present. Thus, in 2005, after the expiration of the WTO multi-fiber arrangement, the European Commission came under serious pressure from the large textiles producing member states (especially Italy, France, Spain, Portugal and Greece) to place tariffs or sanctions on Chinese-made items as a protectionist measure. There was no realistic possibility of EU producers having to adapt to new levels of competition at that time. The breathing space created with China in 2005 until the end of 2007 provided a further opportunity for EU textile producers having to adapt to new levels of competition, to invest in technological change and innovation and to focus on high value added products. However, European textiles manufactures are not in a position to compete in quantity and price with their Asian counterparts. As a consequence, despite the extra time granted, European manufacturers will face serious competition from low-cost manufacturers in China when they will have full access to the EU market in 2008. Recently, through its Global Europe Strategy, the European Commission has put new efforts and new resources in a focus both on opening new markets for EU textile exports as well as on reducing the level of counterfeiting of European textile goods. The Commission now

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states that EU manufacturers in textiles are competitive and strong enough to withstand Chinese competition, using the quality and uniqueness of their products as selling points.

Winners and Losers of Ending Protection: China Threatens to Dominate the World Textile Market

In 2004, the EU was the world's second largest exporter of textile products, with EU-25 exports accounting for a 12.5 per cent share of the world textile export market. Nevertheless, it has to be kept in mind that the economically developed members of the EU will not suffer from the deregulation of the textiles market. Next to the threat to established European producers, the surge in Chinese exports also threatens to undermine other developing countries which currently benefit from preferential trade agreements. These countries include Turkey with the EU and Mexico with the US. Under the previous arrangements, developing countries were able to rely upon established trade quotas with "western" markets to remain economically viable. Producers in these countries, for example in Bangladesh or Indonesia, now face competition from China not only over price, but also over quality, quantity, and reliability as well. Levels of productivity in China are significantly higher than in their competitor developing countries, which further suppresses the cost per unit of Chinese items and make them proportionately more attractive to commercial buyers in the west. Furthermore, China (along with India) is not dependent on importing raw materials to supply its textiles industry as it is already the largest producer of cotton in the world. Similarly, China has made very substantial capital investments in leading-edge production technology that allows flexibility and responsiveness to the demands from western buyers.

In 2005, after the expiration of the ATC, China increased its exports to the EU by 42 per cent in value and by 36 per cent in volume. This has been at the expense of all other major export countries to the EU. For example, Thailand saw its exports to the EU fall by 10 per cent, and South Korea suffered a 50 per cent loss in EU-exports. Textiles exports from ACP countries in 2005 fell by 17 per cent. The EU has given this harm to more vulnerable producers as one of the reasons for its prolonged market protection.

The end of quotas on textile exports and imports will work to the advantage of a small number of countries.

- China is likely to be the main beneficiary of these developments. This is because its exports are high quality, rapidly produced and very low cost.
- The largest losers from this process will be the sub-Saharan countries as well as countries in the Caribbean basin, Cambodia, Bangladesh, Sri Lanka and Indonesia.
- Additionally, countries that traditionally benefited from their geographical proximity to the EU and the US as a result of preferential treatment (e.g. Mexico, Eastern Europe, North Africa and Turkey) will also suffer disadvantages from the end of the agreement.

- Out of those countries on the list of secondary "losers" in these developments Turkey will feel the greatest sense of loss. Turkey was the EU's most important supplier of textiles and enjoyed a degree of preferential treatment through its free access to the EU trade area from 1996 and because of its geographical proximity to the Union. In the last few years Turkey has already lost out to China as the largest supplier of textiles to the European Union. This is a very important development to Turkey as textiles represent 32 percent of all its exports (around $15bn in 2003). Turkey does, however, still have the advantage of geographical and political proximity, which still gives it commercial leverage in the EU, enabling it to offer faster deliveries and also to respond to short notice orders. To maintain competitiveness Turkey will, however, also need to reform its textiles industry to focus on quality rather than the price of its products, as this is where its comparative advantage should lie.

The Sensitivity of the EU to the Textiles Trade

The European Union is the world's second largest importer and exporter of textiles and clothing after the US. The European textiles industry employs 3 million people and its value added was around 60 billion euro (2003 Eurostat figures). A little over one third of the value added generated by the textiles, clothing and leather manufacturing sector of the EU came from Italy, followed by France, Germany, Spain and the UK. However, in relative terms, Portugal, Lithuania and Estonia have even more niche industries specializing in textiles, clothing and leather manufacturing. The textiles sector is notable for the high number of Small and Medium-sized Enterprises (SMEs) and the high proportion of female workers within it. It is the only industrial sector in the EU in which women account for more than half of the labor force (64.5 per cent in 2005). More than half of Europe's textile companies are Italian, and they tend to cluster in and around the regions of Biella and Como in the north of the country, where around 50,000 textile companies are located. They are usually small, often family-run firms employing on average ten people. Nearly two-thirds of their production is exported. The majority of these firms had to cut production and/or workers or has moved their production abroad to take advantage of lower wages. Another interesting case is France, where textiles industry has led the way in reforming and reshaping itself to meet the demands of a more competitive world, shedding a third of its workforce since 1993. As a result, more than 60 per cent of French brands are now produced outside of France. In general, the EU's textiles industry underwent a marked downward trend in the index of production, with an average decline of 4.3 per cent per annum from 1995-2005.

Response to Challenges

Despite the recent attempts of France and Italy to obtain a one-year extension of textile quotas - until the end of 2008 - the European Commissioner for Trade (Mandelson) has rejected this postponement and was backed by for example the UK and Sweden. The

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direction taken by the Commission is one of admittance that Europe cannot compete with China's advantages head-on. Therefore, it should not try to compete in mass production and quantity – but rather in quality, creativeness and thus uniqueness. The Commission has identified the European comparative advantage in its faster logistics, its shorter reaction time and its greater ability to adapt, which should prove its advantages in the fast moving fashion driven textile businesses.

By diversifying EU textiles from mass Chinese textiles, the Commission also focuses on new export markets for high quality EU textiles, in particular in developed and emerging markets, even including China. The Commission identifies China and also India as future key growth markets for European textiles, arguing that by 2010 the Chinese middle-class will be a market bigger than France, Germany and Spain combined. This is one reason why many EU member state are in favor of ending protectionist measures, as they expect reciprocal opportunities to export high-value items. Relatedly, the EU actively seeks to address problems of Intellectual Property Rights (IPRs) that EU industries encounter in third country markets, such as in breaches of trademarks and counterfeits. A good example of this is the Commission putting pressure on the Chinese to crack down on piracy. For the moment, EU textile exports to China increased 15 per cent in 2005 and 16 per cent in value for the first quarter of 2006. It has to be kept in mind that the starting point for percentage growth is relatively low, as yearly exports account for less than 1bn euro.

EU Guidelines and the EU-Chinese Relations

On April 6, 2005 the EU published guidelines that clarified the circumstances under which it would consider protecting indigenous textile businesses against textile and clothing imports from China. The safeguard action, which can run until 2008, can be invoked in cases where there is "market disruption...impeding the orderly development of trade in clothing and textiles products". This protection is a clause written into China's protocol of Accession to the WTO in 2001 and has been incorporated into EU law in 2003. According to EU officials, the purpose of these guidelines is to provide clarity and predictability for both Chinese and European textile producers. Legally, the EU may thus still impose quotas until the end of 2008. However, the EU is reluctant to go down the route of imposing tariffs or restrictions on Chinese imports for wider diplomatic reasons. China is the second largest trading partner of the EU after the US. Since 1978, EU-China trade has increased more than 30-fold and reached around €175 billion in 2004. Beijing, keen to protect its high value technology industries, has mooted imposing trade restrictions on imports into China, independently of the EU's investigation into textile tariffs. Beijing's response to the EU's investigation into Chinese textiles imports has been to suggest that there will be a cooling of diplomatic and economic relations should the EU follow this path, a pattern that will likely be replicated in the years to come.

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Summary

Facing competition from countries with low labor costs, the EU's textiles industry remains competitive owing to its high productivity and its strengths (innovation, technology, quality, creativity, design and fashion). The textile/clothing sector is economically significant for a number of new member states and candidate countries, and therefore remains a priority for the EU.

Even if in the short-term the EU and US impose protectionist restrictions – and the EU has now run out of legal instruments - in the medium and long term they will be forced to reshape and reform their textiles industries. The key way to protect these industries without the use of protectionist measures is to specialize in technologically advanced products. Since the "Safeguard quotas" only run until 2008, a Euro-Chinese commercial alliance would provide a key opportunity to create a win-win outcome. As China's purchasing power increases, the EU can benefit by exporting technologically advanced fabrics and high quality and well designed clothes.

The end of the quota system does not mean the end for tariffs. Tariffs will remain a legitimate way of controlling the flow of imports and means that countries that belong to regional free trade economic areas still have a comparative advantage. Countries like Turkey and Mexico might remain the principle providers of clothing as long as they continue to import textiles from the EU and the USA, respectively (for example, USA exports over 40 per cent of its textiles to Mexico and only 2 per cent to China). Additionally, given their geographical proximity, improvement in their logistics chain could provide these countries with a marginal competitive advantage over China given the sensitivity of the clothing market to timely supply and swift changes in orders.

Aware of the fact that it will not be able to compete with China in mass produced goods, the EU puts emphasis on high quality and uniqueness and focuses on opening up new markets for these goods. The Commission concludes that, with no more restrictions on imports in 2008, the EU textiles industry will survive, as long as they will exploit the comparative advantage they have in producing high quality goods. It is thus in the EU's economic and diplomatic interest to try and enter markets that are currently closed to its products. European companies with pre-existing international operations or those that specialize in high-grade textiles (technical fabrics) as well as design, marketing and sales in the garment sector like Germany are particularly well suited to breaking into these new markets. Additionally, "factory-less" companies, meaning companies that specialize in trading rather than manufacturing will also benefit from closer relations with China and other low-cost production countries. An advanced commercial relationship with China would also benefit companies seeking to relocate their production facilities abroad. The high wage countries of the EU are likely to gain, even though countries like Portugal, Spain and Greece will suffer economically, through damage to their textiles industries. Overall, efficiency and gains from lower wholesale prices will benefit the EU consumers.

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The increased importance of subcontracting, relocation of production, pressure for restructuring and modernization of the industry, and the definitive elimination of the quota system that happened on January 1, 2008, pose major challenges to the future of the textiles industry in the EU and US. Nevertheless, the end of the quotas in textiles and clothing is only the beginning of a new era in global garment production, the future of which is likely to be shaped by international market forces but also by private and public decisions.

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