

Chapter 2

International and Domestic Policies Associated with the Textile and Apparel Industry and Trade: An Overview

Abstract The textile and clothing (T&C) industry of India has faced enormous changes in policies in both international and domestic spheres over time. The potential of this industry is particularly important in the light of liberalization in T&C trade with the phased removal of MFA quota, enhanced competition created by China's WTO accession as well as ambitious export-led growth and the domestic sector reforms undertaken by the Government of India. This chapter discusses the international and domestic policies affecting the trade potential of this industry in a meticulous detail. It also takes into account the diverse projections and resultant effects stated by earlier studies for ensuring a complete knowledge about the present scenario embracing this industry.

Keywords Textiles and apparel trade • Multi-fibre arrangements (MFA) • Agreement on Textile and Clothing (ATC) • General Agreement on Trade and Tariff (GATT) • Textile policies

India's share in the total world exports of textile and clothing had historically been small but it began to grow significantly after 1986, reaching 3.3 % of world exports in 1998.¹ While apparel made in India is exported to more than 120 countries, the markets of the USA and EU account for 76 % of the total exports. The multi-fibre arrangement (MFA) provided a framework under which developed countries imposed quotas on exports of textiles and apparel from developing countries. These quotas were typically applied on a bilateral basis and were product specific as defined by fiber and function. This had allowed discrimination not only against specific fibers and products but also among exporting countries. The exporting countries' governments administered the MFA export quotas, which were allocated to them, based on predetermined criteria. This iniquitous system of quotas thus violated all the fundamental principles of the

¹According to the estimates of United States International Trade Commission (USITC) (2001).

multilateral trading system, and discriminated against the poorest countries and those seeking to move up from reliance on commodity trade toward an emphasis on manufactures.

The Ministerial Declaration of GATT negotiations at Punta Del Este that launched the Uruguay Round stated that the negotiations in the area of textiles and clothing should aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened GATT rules and disciplines. The Uruguay Round of GATT eventually led to the Agreement on Textiles and Clothing in 1995, the institutional shape given to the promise to end quotas in an orderly process within 10 years divided into three consecutive phases. The ATC featured mechanisms for the gradual expansion of quotas and deliberate graduation of whole product categories from the regime. The agreement was flagged as a major showpiece in the Uruguay Round Agreements, and an important source of trade-based income gains linked to the introduction of the WTO.

The elimination of MFA quotas were expected to create a new environment for world trade in textiles and apparel by vastly increasing the scope for developing countries to expand their exports and thereby creating employment in this sector. It was also claimed that, the prospective abolition of these quotas would not necessarily generate automatic benefits to individual countries; the competition would also be fierce. The abolition of the quotas was expected to create opportunities for developing countries, but also exposed them to additional competition from other, formerly restrained, exporters. The ultimate outcome for any individual country therefore depends heavily on its policy response. Countries that take the opportunity to streamline their policies, and improve their competitiveness, are likely to increase their gains from quota abolition. A brief snapshot view of the changing events that have been taken place in international scenario for monitoring textile and apparel trade is presented in the following Table 2.1.

The domestic policy constraints had long affected the textile and clothing industries in South Asia, the impact of which was particularly severe in India. Many of the regulations were quite complex and reduced the efficiency of this sector. Better late than never, India agreed to a package of tariff reforms during the implementation of the Uruguay Round trade negotiations of the GATT that substantially reduced tariff levels on import-competing industries. In addition, India lowered its tariff protection unilaterally in a wide range of areas including tariffs on imports of synthetic fibers. There had also been important domestic reforms, including the abolition of the reservation of the garment sector for small-scale firms. We can also present the changes in domestic textile policy in a tabular form (Table 2.2), which helps to create an impression at a glance.

It is in this changing global context that we would like to present a study of reviewing the national or domestic aspects of the textile and clothing industry of our country in Sect. 2.1 of this chapter. Section 2.2 deals with the global aspects with special reference to the international rules monitoring the textile and clothing trade worldwide and how these can affect the export competitiveness of our own industry while Sect. 2.3 summarizes and presents concluding remarks.

Table 2.1 A brief overview of international events

Year	Events
1955–1957	U.S.-Japan dispute leads to a 5-year agreement limiting textile exports
1958	UK imposes “voluntary” limitation on cotton textile and clothing products with Hong Kong, by threatening to otherwise imposition of quotas at levels lower than prevailing volumes
1959	UK signs restraint agreements with India and Pakistan
1960	GATT Contracting Parties recognize the problem of “market disruption” to serve as an “excuse” for establishing future NTBs
1961	STA: The Short-Term Arrangement is agreed
1962	LTA 1: The Long-Term Arrangement is agreed, to commence on October 1, 1962, and last for 5 years
1966	The UK implements a global quota scheme in violation of the LTA. The LTA provides only for product-specific restraints
1967	LTA2: Agreement is reached to extend the LTA for 3 years
1969–1971	The USA negotiates VERs with Asian suppliers on wool and man-made fibers
1970	LTA3: Agreement is reached to extend the LTA for 3 years. It was later extended for three months more, to bridge the gap until the MFA came into effect
1973	MFA-I: The MFA is agreed, to commence on January 1, 1974, and to last for 4 years
1977	The EEC and the USA negotiate bilateral agreements with developing countries prior to agreeing to extension of the MFA
1977	MFA-II: The MFA is extended for 4 years
1981	MFA-III: The MFA is renewed for 5 years. The USA, under pressure from increased imports resulting from dollar appreciation, negotiates tough quotas
1986	MFA-IV: The MFA is extended for 5 years, to conclude with the expected end of the Uruguay Round
1991	MFA-IV+: The MFA is extended pending outcome of the Uruguay Round negotiations
1993	The Uruguay Round draft provides for a 10-year phase-out of all MFA and other quotas on textiles in ATC. MFA extends until UR comes into force
1995	ATC1: 1st ATC tranche liberalized 16 % of 1990 imports
1998	ATC2: 2nd ATC tranche liberalized 17 % of 1990 imports
2001	ATC3: 3rd ATC tranche liberalized 18 % of 1990 imports
2005	ATC4: 4th ATC tranche liberalized 49 % of 1990 imports
	All over again: USA and EU reimpose quotas on China

Source Based on an update of Francois et al. (2000)

2.1 Past Trends of India's Textile and Apparel Trade

Given the vast size and early development of her textile industry, it was natural for India to start out as an exporter of primarily textile (almost exclusively, cotton textile) items. Clothing exports, however, grew rapidly in the 1970s from a negligible base. The precipitous decline in the share of textiles from a level of around 88 % in 1971–1974 to 51 % in 1983–1986 and the corresponding rise in the share of clothing is quite apparent from the article of Jethnandani and Bhalla (1989).

Table 2.2 A brief overview of the domestic events

Year	Events
1948	The ' Cotton Textiles (Control) Order ' introduced to protect the large handloom weaving industry and thus to protect rural employment
1985	Textile Policy , the first separate policy statement made for the textile sector to enable the industry to increase production of good quality clothing at reasonable prices
1993	As per the Textiles (Development and Regulation) Order the industry has been de-licensed, import duties on textile fibers, yarns, intermediates and raw materials have been brought down
1994–1996	Export Entitlement Distribution Policy (Quota Policy) , aims at making the system of quotas more transparent and simple and encourages nonquota export of garments
1999	The Technology Upgradation Fund Scheme (TUFS) launched to enable the textile units to take up modernization of the projects by providing an interest subsidy on borrowings
1998	Set up of an Expert Committee under the Chairmanship of Shri S.R. Sathyam to review and evaluate the impact of the existing Textile Policy and identify the changes that are necessary, particularly in terms of the new imperatives of international competition
1999	Submission of the report by the Expert Committee to the Govt., which formed the basis of the New Textile Policy
2000	New Textile Policy with a target to push the value of textile and apparel exports from US\$11 billion to US\$50 billion by 2010 with the share of garments at US\$25 billion

By the late 1980s, around 80 % of India's total exports of clothing and textiles were to the Developed Market Economies (DMEs) of western Europe and North America, around 10–15 % to Centrally Planned Economies of the Eastern Bloc with which trade took place on a rupee basis, leaving a relatively minuscule percentage of exports to the fast-growing nonquota markets such as Hong Kong and Japan. It could probably be argued that the market distribution of India's textile exports was one of the factors accounting for its relatively poor performance—the direction of its exports had been more to areas where import demand grew at a relatively slower pace than those which were more buoyant (Misra 1993).

According to Debroy (1996), if one focuses on India's garment exports, the first striking fact is the commodity composition. Almost two-thirds of the exports are accounted for by five categories viz. women's blouses, dresses, skirts, men's shirts, and knitted undergarments. India's exports of garments are made primarily of cotton because of its domestic availability of cotton fabrics at internationally competitive prices. Almost three-fourths of the garments exported are woven and the remainder is largely contributed by knitted garments, while the exports of handloom garments being negligible in importance. Accordingly, it can be inferred that Indian exports of garments primarily cater to the summer and spring clothing needs implying a large degree of seasonality.

However, there were some problems associated with India's garment exports during late 1980s. We have relied heavily on a small range of items; but given the

highly volatile nature of demand in the international market, such lack of diversification is not conducive for garment exports in the long run. Not only that, the heavy reliance on pure cotton as the fabric base also explains our inability to penetrate new markets, thereby remaining confined mainly to the USA and Former EEC (Chatterjee and Mohan 1993).

2.2 India's Domestic Textile Policy

India, a major producer and exporter of cotton textiles in 1950, steadily retreated from the world market over the next 30 years due to a combination of inward-looking macroeconomic policies and excessive regulation. These policies also led to restructuring within the industry and a decline in the importance of cotton textiles as a source of employment and income. From shortly after the Second World War, the share of handlooms in production of clothing declined steadily giving way to powerlooms. In order to protect the large handloom weaving industry and thus to protect rural employment, the "Cotton Textiles (Control) Order" was introduced in 1948.

2.2.1 Textile Policy, 1948

The Cotton Textiles (Control) Order, in 1948, introduced a regime mainly with four provisions:

- (i) Discriminatory excise duties were imposed on different types of textile items.
- (ii) A specifically defined set of products were reserved only for handlooms.
- (iii) The mills were supposed to get licenses for their operation.
- (iv) Special financial-marketing support schemes had been provided for handlooms.

Some of these provisions were later incorporated in a larger Small-Scale Industry Promotion Policy.

But the textile policy could not succeed due to its excessive regulations. Due to its discriminating nature, the mills could not modernize, diversify, and become suitable for exporting textile products and, thereby, almost got shattered. Moreover, the perverse kind of taxation made the domestic market stagnant on one hand, and increased the domestic relative price–ratio between man-made textiles and cotton cloth much higher as compared to the world market, on the other. Consequently, India had almost missed the export bus. The need was felt to review the Textile Policy in 1980s and from about 1985 regulatory policies were significantly relaxed in selected industries, including textiles (Roy 1999).

Since then, government policy has played a fundamental role in shaping the growth, structure, and technological evolution of the textile sector. Although the

development of textile sector was earlier taking place in terms of general policies, in recognition of the importance of this sector, a separate Policy Statement was made in 1985 in regard to the development of textile sector on the basis of the recommendations of an Expert Committee.

2.2.2 Textile Policy, 1985

With the aim of developing three sectors of this industry in an integrated manner, the government announced a new Textile Policy in June 1985. The main objective of this policy was to enable the industry to increase production of good quality clothing at reasonable prices for the vast population of the country as well as for export purposes. At that time, textiles were kept under the Essential Commodities Act (ECA)² and competition and market dynamics were unknown.

As a result of these initiatives, the domestic textile industry, aided by import controls, had attained some sort of “self sufficiency.” A wide variety of Indian-made fabrics in various price ranges were available in the domestic market. But world market experience clearly showed that sectors with big players had made rapid progress globally while in the decentralized sector India’s global share had remained minuscule (Ganesh 2002).

2.2.3 Textiles (Development and Regulation) Order, 1993

Facing these crises, the Indian government stepped forward in order to make the textile and clothing industry globally competitive. As a follow up of the Textile Policy, 1985, the industry has been delicensed as per the Textiles (Development and Regulation) Order 1993. Nevertheless, from the early 1980s, exchange rates in India began to be market aligned. The rupee devaluation followed by the adoption of measures for economic reforms in 1991, together with deregulated and liberalized international trade, paved the way for future growth and enhancement of the competitiveness of Indian textile and clothing industry as a whole.

The resulting implication was that no licenses were required, since then, for setting up of powerlooms, knitting units, ring frames, rotor spinning units, and units for producing synthetic fibers and fiber intermediates. The import duty on capital goods had been brought down to 25 %. Under the Export Promotion Capital Goods (EPCG) scheme, beyond a certain threshold, capital goods can also be imported duty free. Not only that, import duties had also been brought down on textile fibers, yarns, fiber intermediates, and raw materials and basic building blocks consistently (Debroy 1996).

²Cotton textiles are still covered by ECA.

On the other hand, the organized textile industry was saddled with many problems that impeded its growth. Among others, organized textile mills bore very high cost mainly due to their large overhead expenditure, rapid increase in power cost etc.

Moreover, international trade in textiles and clothing had, so far, been controlled by the STA, LTA, and several cycles of MFA, all of which imposed quantitative restrictions (in the form of bilateral quotas) on imports from developing countries' export to the different developed importing countries. However, fundamental structural change has taken place in 1995, with the formation of WTO and gradual integration of textile and clothing trade into the GATT framework by systematic liberalization of MFA quotas. According to Kathuria and Bharadwaj (1998), "the dismantling of the quota regime represents both an opportunity as well as a threat for a country like India. An opportunity because markets will no longer be restricted, a threat because markets will no longer be guaranteed by quotas and even the domestic market will be open to competition."

However, recognizing its importance in the economy, the Government of India had attempted to create a congenial atmosphere so that the industry could regain its strength and face the onslaught of global competition in the impending years.

2.2.4 The Export Entitlement Distribution Policy (Quota Policy)

The Export Entitlement Distribution Policy (known as Quota Policy), effective from January, 1994 to December, 1996, aimed at making the system of quotas more transparent and simple and realizing increased unit values from textile and garment quotas encouraged nonquota export of garments. Besides, the Technology Upgradation Fund Scheme (TUFS) was launched in 1999 to enable the textile units to take up modernization of the projects by providing an interest subsidy on borrowings.

Subsequent development, particularly the coming into existence of WTO, necessitated that a fresh look be given to the Textile Policy of 1985 so that the textile sector would become truly competitive in the global context and at the same time would meet the domestic needs. The Government therefore set up an Expert Committee under the Chairmanship of Shri S.R. Sathyam, Retired Secretary, Ministry of Textiles, to review and evaluate the impact of the existing Textile Policy and identify the changes that were necessary, particularly in terms of the new imperatives of international competition. Acknowledging the tremendous impetus provided by the Textile Policy of 1985 to the economy, resulting in compounded annual growth rates of 7.13 % in cloth production, 3.6 % in the per capita availability of fabrics, 13.32 % in the export of textiles, raising the share of textiles to 13 % of value-added domestic manufacturing of the country, and to one third of the export earnings of the country, the Expert Committee submitted its report which, thenceforth, was formulated as New Textile Policy, 2000.

2.2.5 New Textile Policy, 2000

The Expert Committee on Textile Policy under S. Sathyam, set up in 1998, submitted its report to the government in August 1999, which formed the basis for the New Textile Policy. One of the important targets outlined in the Textile Policy, 2000 was to push the value of textile and apparel exports from US\$11 billion to US\$50 billion by 2010 with the share of garments at US\$25 billion.

Salient Features of the New Textile Policy³:

- I. In order to encourage garment exports, a centrally sponsored scheme titled '*Apparel Parks for Exports Scheme*' has been launched for setting up of apparel manufacturing units of international standards at potential growth centers. Under this scheme, nine Apparel Parks are envisaged at *Bangalore (Karnataka)*, *Ludhiana (Punjab)*, *Kanchipuram (Tamil Nadu)*, *Surat (Gujarat)*, *Tiruvananthapuram (Kerala)*, *Tirupur (Tamil Nadu)*, *Tronica City (U.P.)*, *Kanpur (U.P.)*, and *Visakhapatnam (Andhra Pradesh)*. The parks will be equipped with infrastructure and worker training centers in order to attract investment from large-scale apparel producers under the "dereservation" policy.
- II. The decentralized sector activities covering handloom, powerloom, sericulture, handicrafts, and wool constitute an important segment of the industry. During 2002–2003, a cluster-based approach was adopted as an important policy measure for implementing schemes/programs in these sectors.
- III. Jute manufacturing sector also got a boost, by this policy, by the revocation order obtained by the Jute Manufacturers Development Council (JMDC) against an International Patent awarded to a British firm for use of Hessian to cover waste ground.
- IV. Major reforms have taken place on the indirect tax treatment of the Textile sector in 2003–2004, as described below, seeking to remove tax-induced distortions:

First, CENVAT⁴ chain was completed to improve compliance and to reduce the negative influence of taxation on firms' decisions regarding the choice of technology and thereby encourage modernization and global competitiveness.

Second, the excise exemption for power looms was removed except for a few tiny units. Third, the duties on polyester yarns were brought down by 12–24 % and those on fabrics and garments were reduced to 10 %. Besides, weavers/readymade garment manufacturers undertaking job work were relieved from excise formalities and duty payments. Moreover, the customs tariff on specified textile machinery, apparel grade raw wool etc. were cut to 5 %.

³Source of Information: Documents of Ministry of Textiles, Government of India.

⁴CENVAT—Central Value-Added Tax. It was introduced in the budget of 2000–2001 as an Industrial Policy initiative aimed for rationalization of excise duty and reduction of the number of rates of excise duty.

All these developments have helped to set the stage for large-scale investments in the Indian textile industry and improvements in export competitiveness. Subsequently, the budget proposals for 2002–2003 contained welcome steps to eliminate some obvious distortions that had hurt the industry. Within the framework of the new policy, some sector-specific initiatives were also proposed to be taken to emphasize the development of different sectors separately for accelerating the progress of the entire industry as a whole.

2.2.6 New National Textile Policy, 2013

The Government of India has constituted an Expert Committee to review the National Textile Policy 2000 and formulate the National Textile Policy 2013. The existing National Textile Policy 2000 was framed about 13 years ago and since then the industry has undergone various changes on the domestic and international fronts. The domestic textile industry has seen large-scale modernization and technological upgradation in the last decade and faces new challenges. In the international trade scenario, while the export quota regime has been removed in 2004, recent trends in the global textile industry offer an enormous opportunity for the Indian industry to enhance its share in world trade with a supportive policy framework. Hence, the government aims to formulate a new improved Textile Policy to address concerns of adequate skilled work force, labor reforms, attracting investments in the textile sector, as well as providing a future road map for the textile and clothing industry. This road map includes provision of 3 % interest subvention, inclusion of new markets like New Zealand, Latvia, Lithuania, and Bulgaria under the Focus Market Scheme, and incremental export incentive scheme. Exporters are encouraged to explore new markets such as Japan, Australia, Israel, Latin America, Africa, Southeast Asia, and the Middle East to reduce dependence on Western markets.

2.3 International Rules for Textile and Apparel Trade

Liberalization of world trade is an intrinsic policy under the General Agreements in Tariff and Trade (GATT). Yet, textiles and clothing have historically been exempted from the purview of GATT disciplines. Actually, by mid-1950s, disruptions in production and trade caused by the World War II began to ease. The import of cotton textile products into the USA grew rapidly, turning its textile trade surplus into a small deficit. Its agricultural policy of price support to cotton, supplemented by a highly restrictive quota on its import, was a contributory factor. The quota on cotton and the double price system forced the US textile industry to pay higher prices domestically compared to the world price of cotton. Technological changes, including the substitution of man-made

fibers for cotton, add to competitive pressure on the industry. Since 1955, the American industry started demanding protection against rising imports and employed various tactics against the low-cost developing countries. On the other side of the Atlantic, however, due to severe balance-of-payments difficulties, European countries had been maintaining import restrictions on the entire range of imports, pursuant to Article XII of GATT, which shielded their textile industries too. As a consequence of relentless pressure from the industry at the beginning of 1960–1961, President J.F. Kennedy announced a “seven point program” of assistance to its domestic textile industry. It included a direction to the Department of State to convene an early conference of principal textile exporting and importing countries to seek an international understanding to provide a basis for trade that will avoid undue disruption of established industries. Accordingly, the US requested the GATT Council to convene a Working Party with a view to arriving at a multilateral solution to potential disruptions in the import markets. The decision that resulted from the deliberations of the Working Party evoked the introduction of a short-term arrangement regarding international trade in Cotton Textiles. Trade in textiles had been regulated since then, first by STA, then by LTA, and then by several cycles of MFA thereafter. Since the history and implications of STA and LTA are profusely available in the literature and those are also beyond the relevant limits of our study, we mention them in brief here and emphasize on subsequent MFAs.

2.3.1 The Short-Term Arrangement (STA)—1961

While technically violating GATT, quotas were first institutionalized in 1961 with the drawing up of the Short-Term Arrangement for international trade in cotton textiles. The arrangement, which covered the period of only one year from October 1, 1961 to September 30, 1962, aimed at an orderly opening of restricted markets to avoid detrimental market disruptions for the importing countries. The definition of “market disruptions” adopted by the contracting parties, entailed the possibility of singling out imports of particular products from particular countries as the disrupting source.

2.3.2 The Long-Term Arrangement (LTA)—1962

The short-term arrangement had actually opened the door for a series of bilaterally negotiated quota restrictions that became the rule in the following Long-Term Arrangement in 1962, which truly replaced the STA. The LTA was agreed to commence on October 1, 1962, and last for 5 years. The LTA was designed to prevent the rapid penetration of imported textiles in the developed markets with a view to avoid serious threat thereof to domestic producers (Khanna 1991).

The LTA was initially signed by the governments of 19 exporting and importing countries and was subsequently renewed in 1967 and 1970 as LTA-2 and LTA-3. It is worth noting that despite these initiatives taken by the developed countries, the 12-year term of LTA witnessed growth in the exports of textile products from LDCs particularly due to changing trends in consumer preferences for noncotton fibers. Consequently, the developed countries tried to bring imports of noncotton textile products under control and such effort was finally succeeded with the signing of MFA (ITCB Document).

2.3.3 Multi-Fibre Arrangement (MFA)—1974

In 1974, LTA was replaced by the MFA, which was renewed twice since then. These agreements, though sanctioned by GATT, were derogations from its rules since they had imposed a system of quota control of South-North trade in textiles over and above the MFN tariff rates. The quota system is specified by the country of origin, country of destination, and product categories. Moreover, although the STA, the LTA, and the MFA provided a framework for negotiations, the quotas themselves were agreed on a bilateral basis, thus violating the GATT principle of nondiscrimination. The existence of the MFA and its precursors had thus led to a situation in which trade in textile sector followed principles totally opposed to those for which the GATT stood (Tussie 1987).

MFA-I

The first MFA was negotiated in 1973 under American advocacy and implemented with effect from January 1, 1974. MFA-I, at its core, was an instrument of forced consensus designed to manage textile trade to the advantage of those countries, which were fast losing international competitiveness in different lines of textile production. Not only that, this agreement also aimed at furthering the economic and social development of developing countries and secure a substantial increase in their export earnings from textile products and to provide for a greater share for them in world trade in these products (MFA-I text; Article 1, Para 3) although in retrospect, MFA-I set the tone for achieving exactly the opposite. The main components of MFA-I were:

- (a) The trading partners should agree to apply safeguard measures only in 'exceptional' circumstances and in accordance with the manner in which this multilateral treaty allowed (MFA-I text; Article 1, Para 5).
- (b) The importing countries could apply safeguard measures only when market disruption was being caused in terms of specific definitions enshrined in Annex A to the agreement. (MFA-I text; Article 3). The determination of a situation of "market disruption" was based on the existence of serious damage to the domestic producers either in terms of sharp and substantial increase in imports of particular products from particular sources or in terms of low price

- of the imported goods vis-à-vis goods of comparable quality in the domestic market.
- (c) The restraint levels on imports (or exports), though negotiated bilaterally, could not be lower than the actual imports (or exports) during the 12-month period preceding the negotiation.
 - (d) MFA-I envisaged the setting up of a textiles surveillance body (TSB) to examine disputes and make recommendations to the Textile Committee of GATT. However, this condition was not binding.
 - (e) The bilateral agreements must be concluded within the overall framework of MFA-I (MFA-I text; Article 4).
 - (f) The administration of the quotas set under Articles 3 and 4 should facilitate full utilization of quotas among exporters.
 - (g) The coverage of product items was widened to include made-ups, piece goods, yarns, apparels of cotton, wool, man-made fibers, and blends etc. However, handloom fabrics of developing countries or handmade cottage industry products are exempted from this arrangement (MFA-I text; Article 12, Para 3).

At the end of 1977, satisfied with its bilateral arrangements, the USA preferred a simple extension of the MFA. EC, however, adopted a very restrictive stance because EC was slow to devise its common textile policy, as its negotiated agreements were limited to only those products in which it saw that market disruption had actually occurred. As a result of that, during the first years of the MFA, imports into the Community increased substantially and the situation was accentuated by the oil crisis of 1973. Under pressure from its industry, it attempted to gain support for several amendments. The net result was that in MFA extension negotiations, developing countries were forced to accept the harsh reality in terms of more stringent actions, formally embodied into MFA-II (Bagchi 1994).

MFA-II

MFA-II came into force on January 1, 1978 as a result of a protocol signed on December 14, 1977. The participating countries agreed to renew the MFA for a second term on the basis of the conclusions of the Textiles Committee of GATT about the working of MFA-I.

The major change in MFA-II was that a 'reasonable departures' clause was introduced. Under this clause trading partners could mutually agree to depart from the general terms of the MFA in particular elements in particular cases. Thus, in effect, this acted as an escape clause for participants facing undesirable situations. However, these "departures" were regarded to be temporary and the participants were obliged to return to the MFA framework in the "shortest possible time." In a nutshell, this unique clause limited the expansion of LDC imports into developed countries thereby making MFA-II more restrictive than MFA-I. MFA-II was extended for 4 years.

Unhappy experience of the "reasonable departures" clause spurred developing countries to conceive of ways to coordinate and cooperate. A meeting was held in Bogota, Colombia, in November 1980, which affirmed their will to be united. It

emphasized that disciplines of the original MFA must be restored and the provision of “reasonable departures” must be abolished. It also stressed that liberalization in the sector should take place by a gradual return to free trade in conformity with normal GATT rules and practices. Subsequently, a program of cooperation among developing countries’ exporters of textiles and clothing was established, in the form of International Textiles and Clothing Bureau, in 1985, with the objective of eliminating discrimination and protectionism against the developing countries and ensuring the full application of GATT rules to world trade in textiles (Bagchi 1994). On the other hand, MFA was due for second renewal in 1981 and came back as MFA-III in January 1982.

MFA-III

The third MFA (January 1982–July 1986) was negotiated in an atmosphere of increasing concern among developing countries about the undesirable impact on their exports in the past. In the first few months of 1981, the EEC alone brought in over 33 restrictions following the triggering of a device known as the “basket extractor mechanism.” The “basket extractor mechanism” was based on a concept of cumulative market disruption where there was an absolute limit on market penetration from “low cost” sources. Under this mechanism, when nonrestrained imports reach a certain percentage of EEC imports in the preceding year from all sources in that category, a trigger in the mechanism goes off. The EEC can make consultation calls and fix a quota even for such a nonquota category (Khanna 1991). It is worth mentioning here, that seven of these restrictions were concerned to China while three were concerned to India. The severity of these restrictions led to “quota frauds” by which exporters in LDCs, where quotas had been exhausted, rerouted their exports through third countries or under different product categories. The worst sufferers were the newer suppliers who were hardly being allowed to export textile and clothing on a scale commensurate with their needs and potential.

At the conference table in 1981, EEC’s stand was the most protectionists of all. However, just a week before the signing of the extension protocol on December 22, 1981, the USA delegation reversed their liberal position and supported EEC and thereby, MFA-III came into force with the following notable features:

- (a) Safeguard measures would be invoked by importers only if there was market disruption or risk thereof due to imports and these measures would be completely in confirmation to the disciplines mentioned in Annex A of the original MFA text. In this respect, requests for action should be accompanied by relevant factual information on specific items.
- (b) It agreed to cutbacks (in imported amounts or quota) in the form of lower positive growth rates in case of recurrence or exacerbation of market disruption. Such cutbacks would be agreed bilaterally particularly in respect of large suppliers with simultaneous compensatory provisions.
- (c) It also agreed to bilateral solutions being found for problems of market disruption in countries having small markets, exceptionally high levels of imports and/or a correspondingly low level of production.

- (d) It recognized the special problems faced by small suppliers, new entrants, and cotton textile exporters. Moreover, it also agreed to treat textiles and apparel separately for working out import shares and give them favorable treatments in regard to restraints.
- (e) Most importantly, it decided to set up a subcommittee to monitor developments in the autonomous adjustment process in the importing countries on the basis of data provided by participants to the arrangement.

With these features it became apparent that MFA-III was opening its door wide for disguised bilateralism to absorb shocks perceived by the importing countries. It was during MFA-III that Indian bilateral agreements with importing countries became highly restrictive in their scopes and coverage. Each bilateral agreement incorporated rigid features on category ceilings, growth rates, carry over, carry forward, and swing provisions. Even where quantitative ceilings were not imposed, there were provisions for consultations and freezing of exports in nonrestrained categories. Each bilateral agreement was unique in its features depending on the perceptions of the negotiating parties about the vital trade interests of the other. As a matter of fact, while EEC resorted to its “basket extractor mechanism,” USA had its overall Group II ceiling and Canada also used a group ceiling over and above individual ceilings on sensitive product categories (Khanna 1991).

Following these developments, at its meeting in Seoul in September 1985, ITCB Council urged the importing countries to honor their commitment to maintain and strengthen the multilateral trading system and to pursue liberalization of trade in the sector including the application of GATT rules. The MFA was due for renewal in July 1986. Separately, preparations were in hand in the GATT for the launching of what later became the Uruguay Round of comprehensive multilateral trade negotiations. ITCB Council meeting, in Beijing, agreed on a common position on main elements for MFA renegotiation. In the context of the new round, it emphasized that current MFA restraints be phased out over an agreed time frame. However, at MFA talks, the USA adopted a very restrictive stance and demanded extension of product coverage to include vegetable fiber and silk-blend products. MFA was renewed a third time for a further 5 years, with some improvements, most significant being the elimination of provision for cutbacks in quotas. However, the new protocol expanded the product coverage as demanded by USA.

MFA-IV

Over the last 12 years, MFA had given sufficient time to the textile and clothing industries in the west to adjust to the changing global environment. Although the apparel (clothing) industry is dependent on the textile industry for its inputs, yet it had grown internationally as an industry distinct from the nonapparel sector. All the MFAs applied uniformly to both the sectors. The fourth renewal of MFA continued to have some undesirable features, in its working procedure, as its tenure was extended to 1991.

According to Tussie (1987), these agreements, though sanctioned by GATT, were derogations from its rules since they imposed a system of quota control of South–North trade of textiles over and above the MFN tariff rates. The quota

system was specified by country of origin, country of destination, and product categories and the quotas themselves were settled on a bilateral basis, which was a violation of the GATT principle of nondiscrimination. In this context, Bagchi (1994) opined that although the developing countries were the main targets of protectionist actions like MFA, yet they went along with the MFA because they had thought that the internationally agreed rules governing such measures were a lesser evil than unbridled arbitrary actions.

Moreover, Misra (1993) asserts that, in order to offset the rising wage costs, textile producers in industrialized countries have gone for highly automated, labor-saving technology in both weaving and spinning. This has neutralized the low wage cost advantage of the developing countries in the production of yarn and fabrics to a considerable extent.

2.4 Consequences of MFA

The MFA had been in effect for more than a quarter of a century and thus it had strongly influenced the international trade of textiles and clothing. Both the importers and exporters, of textile and clothing products all over the world, have been greatly affected and various attempts have been made to estimate the magnitude of the effects of the MFA on developed as well as developing countries. Obviously, the MFA mainly affected the developing countries because the MFA restrictions were discriminately imposed on the exports from LDCs. However, the extent to which the developing countries were harmed by the MFA was a controversial issue.

In this context, Trela and Whalley (1988) estimated the welfare cost of the MFA for the developing countries by using a rigorous general equilibrium framework. They showed, among others, that if the MFA were removed, the developing countries as a whole would gain by more than US\$ 3 billion. Their framework was path breaking although the canvas was restricted. They assumed that every MFA quota was binding. But in many cases, the MFA quotas were not fully utilized and the quota utilization rate was sometimes as low as 10–20 %. The estimation result would be misleading if such underutilized quotas were assumed to be binding.

On the other hand, Goto (1990) developed a simple general equilibrium trade model for the analysis of the MFA, which consisted of two markets (the US and the EC) and six groups of supplying countries. Although the structure of the model is very simple, yet it is powerful for the analysis of various effects of the MFA, including *Trade Suppressing Effect* (i.e., how much the clothing exports from restricted LDCs are suppressed due to MFA), *Trade Diversion Effect* among markets (i.e., how much the clothing imports are increased when one of the destination markets unilaterally lifts restrictions), and the so-called *Spillover Effect* (i.e., how much the unrestricted LDCs benefit from the restrictions on other LDCs). Estimation (simulation) results have suggested that the major beneficiaries of the MFA are the domestic producers in the importing developed countries.

Due to the MFA, the value of shipments of clothing by the US producers is more than US\$3 billion higher (US\$400 million for the EC producers) than otherwise. Different from the spillover to domestic producers in developed countries, the spillover to unrestricted developing countries is much smaller than often alleged. On the other hand, the magnitude of trade suppressing effect on the restricted LDCs (such as Hong Kong and Korea) is much larger than that of spillover. Due to the MFA, the value of the clothing exports from restricted LDCs is suppressed by more than US\$1 billion even in the short run.

In a revised and shortened version of their previous paper (1988), Trela and Whalley (1990) estimated the national and global welfare costs for both developed country tariffs and bilateral quotas on textiles and apparel using applied general equilibrium model, which covers quotas negotiated between three major importing regions and 34 developing exporting countries under the provisions of MFA in mid 1980s (i.e., MFA-III). The analysis, based on 1986 data, have estimated that the annual global gain of elimination of quota restraints would be around US\$23 billion where the gain of the developing countries alone would be US\$8 billion. The results have also suggested that although most of the developing countries may be benefited, yet some would gain relatively more than the others. Actually, the higher income developing countries would gain more in terms of market share due to increased consumption in the developed countries, reduced production in the developed countries, and lower trade among developed countries.

Dean (1990) tested two hypotheses regarding the impact of restrictions under the MFA as imposed on the developing countries' exports of textile and clothing to US market. The first hypothesis was that the MFA restraints have been a binding constraint on a country's sales to the US. The empirical findings based on pooled data on eight small Asian exporters over the period of 1975–1984 corroborated the fact that MFA was indeed a binding constraint for them and that the importance of cost competitiveness for export success diminishes as the scope of restrictions on a country increases. The second hypothesis was that the MFA encouraged smaller exporters by restricting exports of major sellers. This hypothesis was also justified (i.e., tightening restrictions on "big three" like Hong Kong, Taiwan, and Korea diverted export demand toward small exporters thereby increased their market shares) for those periods when the smaller countries' own quotas had grown more rapidly than the overall US market. However, the study also revealed that a controlled country's share in importing regions grew, on an average 56 % more slowly than the share of an uncontrolled country.

Yang (1994) had estimated (by simulations using a world clothing and textile trade model and a new set of estimates of tariff equivalents) the welfare cost of the prevalence of MFA regime and it stemmed to about US\$7.3 billion a year during mid-1980s. Most of the costs seemed to have been borne by established developing country exporters and major developed importers. However, relatively new and emerging exporters have also to bear some losses not only because of having small quotas but also because world prices for clothing and textiles were depressed by the MFA. This was particularly true for countries having a large portion of their exports destined for non-MFA markets.

The inferences drawn by the aforesaid studies were confirmed when Martin and Supachasalai (1990) estimated that the developing countries lose US\$2 billion annually due to the MFA quota restrictions on clothing alone. Similar results came from many other studies like that of UNCTAD (1986), Kirmani et al. (1984) etc.

While most economists conclude that almost all developing countries have suffered substantially because of the MFA, others such as Cable (1990) expressed serious doubt on this conclusion claiming that actually many exporting countries with underutilized quota capacity got benefit from the MFA because they could take advantage of higher prices in restricted importing countries without limiting their exports.

In a recent paper by Whalley (2006), it has been argued that a more vigorous effect of the MFA had been its generation of quota hopping foreign investment; moving production away from newly constrained to temporarily unconstrained countries and inefficiently proliferating clothing industries in more countries than would have been the case in the absence of the MFA. As a consequence, MFA elimination would be a major negative for the more marginal infrastructure and distance-constrained suppliers (such as Nepal) as global production would become more concentrated in a smaller number of core supplying countries.

On the basis of this review, one could possibly summarize that the system of MFA had been generally regarded as an economically inefficient system since it had always protected the domestic textile industries of the importers that were uncompetitive and acted as an obstacle to increased exports from developing countries (EXIM Bank 1995). Actually the MFA, in its first phase, functioned fairly satisfactorily in the observance of its rules. The Apple-cart was, however, rudely upset in 1977 when the EC insisted on throwing overboard all the MFA obligations while retaining unfettered rights to take such restrictive actions as it pleased. As a result, MFA lost its original balance and became more and more restrictive which led to the disenchantment of the developing countries with the MFA. They assembled at Bogota in 1980 and decided to push jointly for a gradual return of the textile trade to the rules of the GATT. Subsequently, they established their own organization—the International Textiles and Clothing Bureau (ITCB)—with the objective of eliminating discrimination and protectionism against the developing countries and ensuring the full application of GATT rules to world trade in textiles. In September 1986, the Uruguay Round was launched. The ITCB countries succeeded in placing textiles on the agenda for negotiations despite noncooperation of majority of the developed importing countries.

2.5 GATT Integration of Textile Trade

These undesirable features of the MFA regime in textiles were sufficient to seek an early return to the GATT regime. Unfortunately, MFA-IV was continued till 1991 along with its restrictive features.

In September 1986, when the Uruguay Round was launched, the ITCB countries succeeded in putting textiles on the agenda for negotiations whereas,

importing countries continued to stall progress in textile negotiations in that Round. At its mid-term review in Montreal, textile remains unresolved, alongside three other areas. The issue was settled in Geneva in April 1989 with the agreement that modalities of negotiations should cover the phase-out of MFA restrictions, and that the process of integration should commence following the conclusion of the Round and should be progressive in character.

In December 1991, Director General of GATT, in his capacity as Chairman of the Uruguay Round Trade Negotiations Committee (TNC), presented a Draft Final Act containing all agreements negotiated in the Round, including the ATC. Though based on ITCB framework proposal, the economic content of the agreement was significantly diluted. He announced that any change should require consensus among all participants.

The Ministerial Declaration at Punta Del Este that launched the Uruguay Round of Trade Negotiations of the GATT stated that the “Negotiations in the area of textiles and clothing shall aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened GATT rules and disciplines.” In other words, this was a promise to the developing countries that the quotas on textiles and clothing were finally going to be eliminated. This Round of GATT negotiation, thereby, led to the ATC in 1995, the institutional shape given to the promise to end quotas in an orderly process. The ATC featured mechanisms for the gradual expansion of quotas and deliberate graduation of whole product categories from the regime. The agreement was flagged as a major showpiece in the Uruguay Round Agreements, and an important source of trade-based income gains linked to the introduction of the WTO (Harrison et al. 1995; Francois et al. 1995).

2.6 Agreement on Textiles and Clothing (ATC)

2.6.1 Product Coverage of ATC

In order to understand the Agreement on Textiles and Clothing in its pure form, we must first understand what is meant by textiles and clothing defined in the Annex to the agreement. Textile and clothing products are defined at the six-digit level of the Harmonized Commodity Description and Coding System (HS), available in Section XI (textiles and textile articles) of the HS nomenclature. Among the products covered are silk (Chapter 50), wool, fine/coarse animal hair, horsehair yarn and fabric (Chapter 51), cotton (Chapter 52), other vegetable textile fibers, paper yarn and woven fabrics (Chapter 53), man-made filaments (Chapter 54), man-made staple fibers (Chapter 55), felt and nonwoven wadding, yarns, twine and cordage (Chapter 56), carpets and other textile floor coverings (Chapter 57), special woven fabrics, tufted textile fabrics, lace and tapestries (Chapter 58), impregnated, coated, cover /laminated textile fabrics (Chapter 59), knitted or crocheted fabrics (Chapter 60), articles of apparel and clothing accessories, knitted or crocheted

(Chapter 61), articles of apparel and clothing accessories, not knitted or crocheted (Chapter 62) and other made-up textile articles, sets and worn clothing (Chapter 63). Selected products from Chapters 30 to 49 and 64 to 96 are also included. In a nutshell, therefore, the coverage of the ATC was fairly broad (Debroy 1996).

2.6.2 Monitoring and Implementing ATC

In order to oversee the implementation of the agreement, a Textiles Monitoring Body was established (Article 8.1) and existing restrictions were required to be notified to the TMB. The restrictions notified would necessarily constitute the totality of such restrictions applied by the respective members on the day before the entry into force of the WTO agreement. No new restriction, in terms of product or member, should be introduced except under the stipulated provisions of this agreement. Restrictions not notified within 60 days of the date of entry into force of the WTO agreements would be terminated forthwith (Article 2.4).

2.6.3 Transitional Phase-Out of MFA Quotas

The phasing out of MFA quotas and the integration of textiles and clothing into the GATT framework did not take place overnight. There was a 10-year period of transition, subdivided into subperiods of 3, 4, and 3 years, respectively (Article 1.1).

STAGE I

On the date of entry into force of the WTO agreement, each member was required to integrate into GATT 1994, products, which accounted for not less than 16 % of the total volume of the member's 1990 imports. The products to be integrated should encompass products from each of the following four scheduled groups, viz. (i) tops and yarns, (ii) fabrics, (iii) made-up textile products, and (iv) clothing (Article 2.6).

Accordingly, 16 % of textiles and clothing trade was liberalized on January 1, 1995. However, this does not mean that 16 % of textiles and clothing exports that face quotas were liberalized in 1995. Since the coverage was universal, it had been proposed that, if less than 16 % of textiles and clothing exports of a country were under coverage of the MFA during that time, there would be no liberalization. Actually, the importing countries were required to identify the products earmarked for early liberalization, therefore, those products were initially chosen for which the importing country did not have any quota at that time.

STAGE II

On the first day of the 37th month that the WTO agreement was in effect, products, which accounted for not less than 17 % of the total volume of the member's

1990 imports', would be integrated (Article 2.8). Together with the earlier 16 %, this means a cumulative liberalization of 33 % on January 1, 1998.

STAGE III

On the first day of the 85th month that the WTO agreement was in effect, products which accounted for not less than 18 % of the total volume of the member's 1990 imports' would be integrated (Article 2.8). Together with the earlier figure of 33 %, this means a cumulative liberalization of 51 % on January 1, 2002.

STAGE IV

The remaining 49 % was left to be integrated at the end of the period. On the first day of the 121st month that the WTO agreement was in effect, the textiles and clothing sector would be fully integrated into GATT, i.e., the entire liberalization process was proposed to come to an end by January 1, 2005.

It is worth mentioning that in both the consecutive liberalization stages, i.e., in stages III and IV, the products brought to be integrated must cover the above-mentioned four groups viz. tops and yarns, fabrics, made-up textiles, and clothing. Subject to this caveat, the products that would be integrated depended upon the importing country, with the additional stipulation that the integrated products must be the same for every WTO member. Table 2.3 summarizes the stages of integration.

It is very important to note here that as the importing countries were free to choose the products to be integrated at each stage of liberalization (so long as the products were picked up from each of the four mentioned categories of WTO), it was quite natural that very little liberalization could take place in the earlier years of the transitional period. The manner, in which MFA quota phase-out has been implemented, leaves the economists to call it considerably 'back-loaded', and on a large number of products of interest of developing countries, the quotas remained in place till 31 December 2004. Moreover, back-to-back anti-dumping investigations, and investigations against products already under quota have revealed that the actual attitude of the developed countries have not yet changed toward the deregulation of the textile and apparel trade worldwide (Verma 2002).

Table 2.3 The 10-year schedule for integrating textile trade

Stage	Period	Integration share (in %)	Actual growth rate of quotas
Stage I	Jan 1, 1995–Dec 31, 1997	16 (total 16)	1.16 (for each unit growth, e.g., from 3 to 3.48 %)
Stage II	Jan 1, 1998–Dec 31, 2001	17 (total 33)	1.25 (for each 1 % growth, i.e., from 3.48 to 4.35 %)
Stage III	Jan 1, 2002–Dec 31, 2004	18 (total 51)	1.27 (for each 1 % growth, i.e. from 4.35 to 5.52 %)
Stage IV	Jan 1, 2005	49 (total 100)	Full integration

Source WTO (<http://www.wto.org>)

2.6.4 Additional Safeguards Outside ATC

In addition to back-loading of liberalization, an additional area of concern related to the implementation of the ATC and associated Uruguay Round MFN tariff reductions has been the scope for preference erosion, especially for the least developed African countries. Virtually, all the African countries have entered into contractual preference arrangements with the EU, and obtain preferential treatment for certain exports in the USA and Japan, as well as in other selected developed country markets.

Consequently, there has been a concern that implementation of the market access results of the Uruguay Round would diminish rather than augment their trade and economic prospects. It follows, instead, from the fact that at the beginning of the ATC phase-out, some countries and regions faced much greater restrictions than others. The lower income suppliers in India and elsewhere in South Asia, in particular, faced negative preferences, in the sense that they faced greater effective restrictions than suppliers from East Asia and elsewhere. The distributional effect of the MFA restrictions was thus to discriminate between developing countries, and against suppliers like India and Pakistan. In fact, some developing countries were favored by preferential access, at the expense of other developing countries. MFA and ATC have been effectively serving as negative preference systems, helping some developing country suppliers at the expense of others (Francois and Woerz 2005).

The ATC, contained in the Final Act of the Uruguay Round of GATT negotiations, was designed to govern the future trade in textile products when the WTO was established on January 1, 1995. It was no longer a separate instrument like the MFA, which the countries might join as and when they wished. It was applicable to all the WTO members because of the Uruguay Round being a single undertaking with universal application of all its constituent agreements (Bagchi 1994).

2.7 China's WTO Accession and Its Follow-Ups

Not until January 1995 did the ATC come into force that attempted to reverse decades of protection in these sectors. The ATC sets out the framework and procedures to phase-out the MFA and eliminate the entire quota system eventually by 2005. This should have a huge positive impact on developing countries, which have been restricted on exporting their textile products for an extended period of time. China, as the largest textile and clothing exporter in the world, would thus have a tremendous opportunity to boost its textile and clothing exports, thanks to its entry to the WTO in 2001. However, newly released safeguard measures by the USA against China's textile exports, which came into effect on May 21, 2003, have led to renewed worries (Liu and Sun 2004).

There is a great possibility that China's full integration into WTO could be effectively held up, because China's WTO accession agreement includes a unique,

China-specific safeguard mechanism allowing a WTO member to restrain increasing imports from China if such imports disrupt its home market. This is widely regarded as a “wild card” against Chinese imports and a powerful example of possible measures that can be taken in future to erect new trade barriers against China. “Specific Contingent Protection” rules were included in China’s protocol of WTO accession. These permit other WTO members to keep protectionist pressure up against China for 15 years. They cover special anti-surge clauses for textile and clothing products (4 years), general anti-surge clauses (12 years), and treatment of China as a “non-market economy” in anti-dumping cases (15 years) (Francois and Woerz 2005).

As a natural consequence of the enhanced competitiveness of China’s indigenous textile industry, its textile and clothing exports grew overwhelmingly in the liberalized world market, *vis-à-vis* others. Viewing this unprecedented surge in imports from China, the trade ministers of the developed countries’ panicked, conducted rushed meetings, which eventually led to the reimposition of quotas on China by late 2005. The ability of the USA and the EU to press China on new quota limits can be interpreted in the perspective of the above-mentioned “contingent protection” options.

2.8 Implications for Developing Countries

While enormously welcome, the prospective abolition of these quotas may not necessarily generate automatic benefits to individual countries. Developing countries have to invest a large amount of their negotiating capital into securing the developed countries’ agreement to abolish these quotas. Thus, the outcome for any individual country depends heavily on its policy response. Countries that take the opportunity to unload their trade by using appropriate policies and thereby improve their export competitiveness are likely to increase their gains from quota abolition. Actually different projections are put forward regarding the prospective gains or losses for the developing countries in this changing global context.

Before discussing the resultant implications we should keep in mind that when the ATC was negotiated in 1994, China was outside the WTO/GATT. China’s accession to WTO was accomplished in December 2001; 7 years after the ATC was agreed. As a matter of fact, expectations among larger Asian suppliers such as India, Indonesia, Pakistan, Bangladesh, and others were initially high for the post-MFA period, but had to be revised once China’s accession to the WTO was at hand. In addition, other trade restraints like tariff and anti-dumping duties remained in place; and key importers such as the US and EU had entered into preferential arrangements with regional suppliers as part of regional trade agreements, quite separate from the MFA. This included Mexico for the USA and Turkey for the EU, who had seen sharp growth in exports under these arrangements.

Whalley (2006), in his well-known paper has rightly asserted that Asian exporters, as a broadly defined group, are expected to gain market share in the USA and

the EU both from MFA abolition and the weakening of preferences to non-Asian suppliers, but individual country effects are anticipated to vary. He has elaborately discussed individual country effects depending on country-specific factors in the liberalized scenario. Bangladesh was already free of restraint in EU markets prior to MFA abolition and is thought likely to lose EU market share to new quota-free imports from elsewhere. Vietnam remains under restraints, post-MFA, as a non-WTO member. Cambodia, for instance, is a rapidly growing supplier but at an early stage of industrialization. The export-growth rates of the aforesaid countries are thought probably to fall a little under MFA elimination. In contrast, Philippines as a long-standing MFA participant with established MFA quota and higher cost structure is likely to be affected heavily. India shipped more heavily to the USA and EU, so quota removal would impact a larger fraction of her exports.

Not only that, the impact of quantitative restrictions on trade is also reflected in per-unit economic rent generated by a binding quota. This is because a binding quota effectively limits the supply of the good in the importing market, resulting in a price markup and giving economic rents to those suppliers who have access to the market (i.e., who are able to export within quantity fixed by the quota). Since the quotas on textiles and clothing are administered as “Voluntary Export Restraints” by the suppliers, often with the quotas distributed by auction, these rents can alternatively be seen as an implicit tax on exports. For these reasons, the quotas in the literature are generally expressed as export tax equivalents or ETEs. Kathuria and Bharadwaj (1998) give details of individual ETEs calculated for each quota category.

More importantly, Francois and Woerz (2005) calculated these ETEs by developing a nonlinear Mixed Complementarity Programming based estimation framework for nontariff barriers to examine the evolution of market access conditions under the ATC in the textile and clothing sectors. Working with a panel of bilateral trade data on textile and clothing, they also introduced the use of Gaussian quadrature for estimating the goodness of fit for regression-based NTB measures based on residual fitting. Among different resultant implications, the evolution of Chinese ETEs as implied by the quotas is most important. Between 1996 and 2003, the ETE of China's export to Canada was reduced to zero from an estimated 6.3 % in textiles and 43.7 % in clothing whereas in the USA, ETEs for China have gone up except a few years. Also against other suppliers, liberalization was substantial in Canada, while in the EU, the degree of liberalization was more limited. Although trade with China grew more open, the degree of protection (in terms of tariff equivalents) remained high at the end of the ATC. The removal of the quota system by 2005 thus implied a substantial surge in imports from China. Consequently, tremendous increases in China's market share in the EU market, eventually led to a reimposition of quotas by the middle of 2005 on China alone. Francois and Woerz also opined that textile and clothing imports of EU from India were no longer restricted by the quotas in 2003. As such, the removal was not expected to show strong direct effects. Again similar to the USA market, imports from Vietnam were also restricted on the EU market at the end of the ATC. Thus, while the EU has moved toward more liberalization in textiles and clothing,

protection remained high against China and Vietnam when the final stage of full liberalization in the ATC was reached. Thus, substantial restructuring among suppliers on the European market was inevitable.

Kathuria et al. (2001) also emphasized that a key set of parameters for any evaluation of the MFA is the magnitude of the implicit export taxes that are imposed on a country's exports of textiles and clothing. These taxes are found to be substantial earlier but ETEs for India have declined well in 1996, though appeared to have increased in 1999 to an average of 40 % in the USA and 20 % in the EU, thereby, imposing substantial barriers to Indian exports.

Heron (2006), in his article also argued that while the ending of the MFA may eventually lead to substantial welfare gains for the South as a whole, these are likely to be highly skewed in favor of a relatively smaller number of very competitive textile producers like China. At the same time, a larger number of (generally smaller) developing countries are likely to find themselves significantly worse off in the post-quota trade environment.

This proposition was also supported by the results obtained in a recent study on the assessment of the impacts of the liberalization of MFA quota regime on South Asian countries by Kar and Kar (2011).

In some other studies in this context, the impact of China's WTO accession was incorporated. While there does not seem to be a consensus opinion on what the impact of the elimination of quotas within ATC might imply, there seems to be a growing concern that the impact of China's accession to WTO will have a massive impact on global textile and clothing exports. Spinanger and Verma (2003) examined the likely impact of China's WTO accession on global trade patterns with special reference to India. Based on a GTAP5 (Global Trade Analysis Project) model, the study concluded that such accession would inevitably give China's exports an additional boost; but India would also be one of the few countries that could expect net gains in market access. The paper also identified some key areas for improving India's competitive stance most of which were related to designing its domestic industry-specific policies and building up of efficient infrastructure.

In short, all the studies evaluating the implications of MFA abolition conclude that South Asia, as a whole, will be a significant beneficiary of such process, but the individual country impacts will depend on the respective country's competitive strength, including the country's comparative advantage and the returns from the domestic reforms, vis-à-vis others.

2.9 Concluding Remarks

It can be generally concluded that the performance of the firms in the Cotton Garment-producing sector of India depends largely on their export performance and the investment carried out in that sector. Therefore, quota removal will encourage the firms to expand their exports, if possible, to improve their overall performance. Alongside the immediate short-term impacts of MFA removal on trade

flows and employment, there are also a number of other broader considerations to be factored in when evaluating the possible impacts of MFA abolition on the Asian economies in the medium to longer term. One issue involves the welfare impacts on Asian countries of removing MFA quota restrictions as against the impacts on trade, since while these restrictions lower export volumes they also have the effect of keeping prices high. It is possible therefore that the welfare gain through export growth of Asian shippers post-MFA may be partially offset by the fall in prices. The sharp fall in prices of Chinese exports in the markets of USA and the EU indicates the importance of the phenomenon.

Yet another issue relates to developments on the tariff front. In addition to MFA quota restriction, clothing has been subject to relatively high tariffs in both USA and EU. MFA abolition does not directly affect these tariff levels, but the WTO Doha Round negotiations may have a significant impact on Asian exporters if formula based multilateral tariff liberalization occurs at the end of the Round.

Moreover, foreign investment has contributed significantly to the expansion of garment exports from many developing countries. In the context of MFA abolition, there is likely to be a greater incentive for garment companies of the industrialized countries to set up production facilities in low-cost developing countries. International subcontracting by large American and European apparel firms, including offshore assembly provisions, played a major role in clothing exports from Korea and Hong Kong. The policy makers of India have felt the importance of inviting more MNCs to diversify the country's production process, which need organized production, strict quality control, and extensive marketing and distribution networks. Recently, with the liberalization of the stringent conditions via domestic policy reforms, there has been increased interest from foreign investors not only for establishing production subsidiaries but also for making marketing and technical collaborations with Indian companies. This issue deserves comprehensive investigation, which is dealt with in chapter four of this book.

With these observations, we conclude our discussion, which, we hope has illuminated some policy aspects of an industry that has the potential to play a very crucial role in the post-liberalization evolution of the Indian economy.

Documents

1. Documents of International Textile and Clothing Bureau (ITCB)
2. Documents of Agreements of Textile and Clothing (ATC).

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