

# Garments - What happens after 2005?

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*Some observers predict that by 2005-06, major textile and clothing buyers will reduce by half the number of countries they source from. The challenge for countries and companies is to remain an important source for these buyers. This article explores the coming changes in the market and highlights steps governments and exporters can take now to avoid adverse impacts.*

On 31 December 2004, the Agreement on Textiles and Clothing (ATC) will end, and with it the quota system for international trade in textiles and clothing. As a result, trade in these sectors will undergo a fundamental change. By 2005 the sector will have been fully integrated into the WTO General Agreement on Tariffs and Trade (GATT), and all quotas will have disappeared.

Only tariffs should remain as a market entry mechanism. Moreover, WTO members will discuss tariff reductions and ways to reduce tariff peaks, high tariffs and tariff escalations under the Doha Development Agenda. A market currently characterized by artificial comparative advantages and managed trade will realign as market forces become the dominant determinant in the sector. A shift in market fundamentals will considerably affect exports from many developing countries and economies in transition, where national incomes depend to a large extent on exporting garments.

Countries such as Cambodia, Bangladesh and Nepal, with a share of garment exports in total merchandise exports of 85%, 75% and 40% respectively, need to attempt to keep at least part of their present markets or face higher unemployment and deeper poverty. In fact, developing countries risk losing heavily from the final liberalization of trade in textiles and clothing if they are not well prepared for the expected business and market changes. Instead of winning new export markets as they had expected following the Uruguay Round negotiations, many countries risk losing existing markets. These losses, in turn, could undermine commitment to the Doha Development Agenda. Countries and firms must prepare for a new reality in the textiles and clothing trade.

## Winners and losers

While nobody can give a precise picture of the global textiles and clothing market after 2004, there are some indicators of the potential winners and losers

of the quota phase-out. Three important indicators are highlighted below:

- \* **Use of quotas:** Countries which are fully using their quotas in the years preceding 2005 will probably increase their exports after that date. Countries which are not able to fill their present quotas are unlikely to benefit from a market opening. Quota performance monitoring, therefore, is essential. As only Canada, the European Union (EU) and the United States continue to impose quotas - 1,007 between them - this is a feasible task for countries to undertake.

- \* **Exploiting liberalized categories:** The changes stemming from the liberalization of product categories, which followed the third stage of the ATC in January 2002, give a clue to possible developments. At that time, the United States integrated seven product categories into WTO, thereby abolishing quotas and causing trade flows to change tremendously. In all liberalized quota categories, China greatly increased its exports to the US market, in some cases up to several hundred percent. While other countries increased exports in some categories, only China did so across the board, mainly to the detriment of Central American and Caribbean countries, and of some other small producers which lost market share.

- \* **Critical export mass:** Developing countries that are not under quota constraints will face intense competition which they have not experienced before. For developing countries that do not currently have meaningful export quantities, it will become even more difficult to enter or to remain in world markets, and critical mass will become an important issue. Major international buyers are unlikely to source from a country where only a few companies serve the world market.

## New challenges

As the textiles and clothing sector is fully integrated into the WTO/GATT, those countries and companies which adapt first to the challenges of the new market will be better placed to secure their market position. Pure economic performance and well-managed competitive advantages will count more than ever before. The possible shape, drivers and disciplines of the new market are highlighted below:

## Growing markets

Trade will no longer be regulated by quantitative restrictions and, as a result, there will be a large and growing market waiting to be conquered. While competition will intensify and

growth rates might slow down in Europe, North America and Japan, new markets are emerging in higher-income South-East Asian countries as well as in the high and middle-income groups in the larger developing countries. These emerging markets will become important targets for future apparel producers.

## Vanishing markets

In the short to mid-term, Europe and North America will remain the most important garment markets, attracting two-thirds of all world-clothing imports. With the quota phase-out, however, many smaller countries will lose guaranteed markets. Studies by the US Department of Commerce in its report to the Congressional Textile Caucus, showed that major buyers will reduce the number of countries they source from by half in 2005-06 and by another third by 2010. The challenge is to remain an important source for garment buyers.

## Declining prices

US textile and clothing import prices have fallen continuously since 1996, as is the case in Europe, Japan and many other markets. In an oversupplied, liberalized market, this trend is likely to continue, potentially bringing about a deterioration in developing countries' terms of trade.

## Patchwork agreements

In response to the ATC, major buying countries have granted specific concessions that provide selected countries with comparative advantages. This tendency has resulted in a regionalization of trade in textiles and clothing and a complex patchwork of international trade agreements. This makes it very difficult for clothing-exporting small and medium-sized enterprises (SMEs) from developing countries to determine their competitiveness vis-à-vis that of major competitors. As quotas are phased out, there may be more concessions granted than before, rendering trade even more complicated.

## Anti-dumping

There is likely to be a rise in anti-dumping and countervailing duty cases, which will pose a real threat to successful developing country exporters. The use of anti-dumping measures could sharply reduce the benefits of liberalization as they are non-transparent and unpredictable. Just the announcement of possible anti-dumping investigations can make buyers hesitant to place future export orders because of uncertainty over whether



A library picture of garment workers in a factory in the Katunayake export promotion zone. The quota system ends on 31 December 2004. Will Sri Lanka remain a major source for international buyers of garments when the quota system ends?

## barrier?

Textile and garment manufacturers from developing countries are increasingly confronted with the need to adapt to eco-labelling requirements. Eco-labelling schemes currently serve primarily as a marketing tool, and products with eco-labels tend to target niche markets. However, there is concern that access to developed markets will be significantly reduced due to consumer boycotts of non-labelled goods and aggressive advertising by protectionist domestic industries. Overall, more transparency is needed to ensure that eco-labels do not become a new market access barrier.

While developing countries and academics are expressing this fear, US and EU industry lobbyists are calling for their explicit use as, they feel, many products are simply dumped on the market. For case studies on how anti-dumping cases have affected developing countries' textiles and garment exports, visit the web site of the International Textiles and Clothing Bureau (<http://www.itcb.org>).

## Customs checks

Textile and clothing manufacturers are subject to random checks by customs officials, to ensure that transshipment activities are not taking place. If a company cannot provide the required information, customs will automatically ban this company from exporting to the US or EU. It is expected that until 2005 'product verification visits' will increase. In addition, increased security requirements for imports after 11 September 2001 may have a negative effect on exports from developing countries.

## Ethical standards

There is widespread concern about child labour in the marketplace. Western non-governmental organizations, the media and labour unions advocate for 'sweatshop-free' sourcing of clothing, by creating awareness among the major consuming groups. They are putting pressure on international buyers to source 'ethically correct' manufacturers. Major buyers and retail groups have reacted to these pressures by introducing corporate codes of conduct. Such ethical sourcing standards are applied to all their developing country manufacturers, and even sub-contractors. Large international buyers apply these rules strictly, as they cannot afford negative publicity.

## Eco-labels a new

## Preparing for new markets

It seems possible that the changes in the textile and clothing sectors will bring more risks and challenges than new opportunities, particularly for smaller exporters in developing countries and economies in transition. Comprehensive preparation is a must to manage these risks and take action to secure existing or additional markets.

- \* **Develop an action plan:** Countries need to develop a strategic approach on how to tackle the challenges highlighted. A partnership between private and public sector players is critical to develop effective responses. While the government needs to set up an enabling environment, the business sector needs to develop the supply response to market requirements. Together, they need to develop a monitoring system for trade in textiles and clothing that is attuned to the changing economy. To continue as an interesting source for international buyers, a 'critical country mass' is necessary. No single company in any country can play this role.

- \* **Use business advocacy:** The textile and clothing quota phase-out needs to be viewed in light of the Doha Development Agenda. WTO members are due to conclude the round at

the same time as quotas are due to disappear. As such, the Doha deliberations will impact on trade in textiles and clothing. The Uruguay Round and the implementation of the ATC demonstrated that the textile and clothing business needs to take an active part in channeling its views and concerns to governments, so that negotiations serve the interests of the business community. While quotas will disappear, countries need to ensure that one set of trade barriers is not replaced with another. Moreover, developing countries and WTO newcomers from transition economies need to ensure that a public-private partnership is in place for the Doha Development Agenda if they are to avoid the disappointment they experienced with the ATC.

- \* **Reinforce sector associations:** As 2005 approaches, middle-level support will become increasingly important. Despite the disappearance of quotas, textile and clothing trade will become both complex and cumbersome. To ensure practical responses, textile and garment manufacturers' associations, in agreement with the government, will be required to assume more responsibilities such as fulfilling labour standards; taking over quota administration; and operation of bonded warehouses.

- \* **Understand the competition:** Enterprises need to develop a mechanism to compare performance with competitors in other countries.

- \* **One of the difficulties of the quota regime is that many manufacturers have no comparison with competitors. Many companies - especially SMEs in developing countries - lack a clear understanding of their ability to compete successfully in a quota-free world.**

- \* **Develop sourcing strategies:** Improved value chain management can reduce costs and increase flexibility. A wide sourcing base can increase flexibility when it comes to

securing fabrics from the cheapest source with the quality and design the buyer expects. Such flexibility will be a critical competitive factor in the future. By optimizing the supply chain, lead time will also be reduced. While sourcing decisions are micro in nature, governments can facilitate sourcing by supporting regional trade initiatives. Regional cooperation to strengthen supply chains create two distinct advantages: firstly, regional sourcing allows shorter delivery times; and, secondly, such cooperation enables countries to take maximum advantage of preferential market access schemes which now prioritize regional and country groupings. Some developing countries have sought to develop their own fabric industry through backward integration rather than improve value chain management, an aspiration that seems unrealistic at a time when investment for new domestic fabric industries is rarely forthcoming.

- \* **Increase productivity:** Investment in human capital and machinery can increase productivity and lead to reduced costs and prices.

Training institutions and schemes, which exist in many textile and clothing producing developing countries, need to enhance their training capacities to improve craftsmanship.

- \* **Develop new products and markets:** Avoid mass markets and target niche markets with value-added products. Everybody wants to sell T-shirts to the United States as it is a large and 'easy' market. However, competition in such 'easy' markets is high and prices are low. To avoid this, design and fashion skills need to be developed to target niche markets with value-added products.

- \* **Develop 'e-applications':** E-applications can be employed not only to sell, but also to exchange information across electronic networks at any stage of the supply chain. E-applications facilitate sourcing and supply chain management; production planning; design and forward integration, including Internet sales. The main goal of e-applications is to increase flexibility and to shorten the overall value chain, thus reducing lead-time. A shift to e-applications also highlights that a company is both competitive and willing to adjust to the demands of the market.

During an expert group meeting at the ITC Executive Forum 2002, industrialists and government officials from a range of textile and clothing producing developing countries, agreed that the challenges of this sector needed to be addressed urgently to sustain future exports, especially from least developed countries and smaller developing countries. They elaborated on possible solutions, as outlined in this article, forming ITC's new comprehensive textiles and clothing approach. ITC, therefore, is following a holistic sector approach as required by developing country textile and garment manufacturers who want to stay in business after 2005.

## How ITC can help

Responding to the new challenges, ITC has redesigned its technical assistance

approach in the textiles and clothing sector. The new approach will include industry-level briefings on the phasing-out of the quota system and the competitiveness challenges ahead, combined with a broader programme of advisory and training services targeting sectoral competitiveness. ITC will assist with developing country-specific action plans, following the value chain approach. Countries can implement the action plans by themselves or within the framework of technical assistance projects. The action plans will contain market-oriented performance benchmarking, sourcing and supply chain solutions, market development measures and actions to increase productivity, develop design talent and fashion orientation, as well as tailored e-applications.

To help SMEs in the garment sector to compare their competitive performance with that of other companies, ITC has developed an online benchmarking tool, THE FIT. This tool compares a firm's performance against a group of national and international firms, on a confidential basis. By identifying their relative strengths and weaknesses, THE FIT helps participating enterprises prioritize areas of action to improve their competitiveness. In 2002, ITC assisted Cambodia, Lesotho, Malawi and Nepal in elaborating country action plans. These were developed in partnership with all relevant national stakeholders from the public and private sector. The action plans are ready to be implemented and the countries are presently looking for development partners interested in financing activities.

This year, ITC will help Cuba, El Salvador, Kenya, Madagascar and Mozambique to elaborate their respective country action plans.