Pacific Economic Cooperation and Trade in Textiles and Clothing
The Hong Kong Centre for Economic Research, School of Economics and Finance, the University of Hong Kong

- Presentation (Paper presented in Session 1 : Emergence of the New Blocs : GATT, Uruguay Round, MFA and Trade Blocs at the 24th World Knitting Congress on Facing a new Economic Order at the Hong Kong Convention and Exhibition Centre, 31 October - 3 November, 1993)

PACIFIC ECONOMIC COOPERATION AND

TRADE IN TEXTILES AND CLOTHING

Yue Chim Richard Wong

Hong Kong Centre for Economic Research
School of Economics and Finance
The University of Hong Kong
Tel.: (852) 2547-8313 Fax.: (852) 2548-6319
Email : rycwong@econ.hku.hk

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Summary

The rapid growth of East Asian exports in the 1980s led to rising trade tensions. Trading partners, especially in the USA and Europe, tended to overlook the substantial growth of East Asia's imports (especially raw materials and capital equipment), focusing only on its capture of market shares in products for which US and EC manufacturers no longer held a comparative advantage. There is considerable interest in economic regionalism, raising concern about the division of the world economy into discriminatory trade blocs.

In most economies around the Pacific, there is wide appreciation of the region's overwhelming interest in the maintenance of an open world trading system based on the non-discrimination principle of the GATT. Among initiatives for bilateral and regional trade liberalization in recent years, the Asia Pacific Economic Cooperation (APEC) forum offers perhaps the best prospect of cooperative promotion of these objectives. APEC, established in 1989, already includes fifteen economies from both sides of the Pacific accounting for over half of world production. APECs guiding principles stipulate that cooperation should be outward looking, building consensus on a gradually broader range of economic issues.

This paper proposes four pragmatic options in areas for useful cooperation:

Improving market access by reducing barriers to trade, such as the heavy protection of some parts of Northeast Asian agriculture, of processed minerals, of services, and of textiles and some other manufactures in major OECD countries.

Reducing uncertainty about future market access: for example, agreement to streamline dispute settlement procedures could reduce resort to arbitrary or discriminatory measures to deal with trade tensions.

Reducing physical bottlenecks, such as shortfalls in infrastructure, ranging from harbours to telecommunications, which impede trade in goods and also in services such as tourism.

Harmonizing domestic legislation and rules, such as those relating to safety, quality and environmental standards.

It will not be easy to realize the economic gains from non-discriminatory trade liberalization. But progress should be possible in some sectors where complementarity among APEC economies is obvious. Regional initiatives will need to be non-discriminatory in order to avoid creating needless divisions in the world trading system.

Preferential or discriminatory trading arrangements that fragment the multilateral world trading system constitute a threat to the Pacific region's economic prosperity. In contrast, this paper recommends an evolutionary approach: seeks early consensus on less contentious issues in order to build the sense of trust required for more effective future cooperation among economies on both sides of the Pacific, without discrimination against economies outside the region.

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In discussing textile and clothing trade policy issues, economists often focus on the Multi-Fibre Agreement (MFA). However, the MFA has not produced a water tight regime. Textile and clothing production and trade have changed through product and process innovation, new management styles, and the ever-changing tastes of consumers. The MFA restrictions have effected these innovative changes, but the policy issues need to be discussed in this context of industrial change.

Throughout the 1980s the Asian-Pacific region (and especially East Asian countries) has achieved rapid economic growth accompanied by drastic changes in industrial production and trade. In the textile and clothing industry, exporting countries display the `flying geese' pattern. The first-tier exporter, Japan, had retreated by the mid-1970s. The second-tier exporters, the East Asian newly industrializing economies (NIES, consisting of South Korea, Taiwan and Hong Kong), are now being replaced by the third-tier, ASEAN and Chinese exporters. The drastic changes in production and trade have resulted from the spread of modern textile and clothing production techniques in response to changing comparative advantage. This has been caused by increased labour costs and exchange rate alignment in the first and second-tier exporters, but it has also been affected by the trade policies of industrial importer countries.

The textile and clothing industry trade has been tightly managed under the MFA, and individual trade flows have been restricted by quota allocation under the MFA. At the current GATT Uruguay Round negotiations the major contracting parties agreed, in the Dunkel text of December 1991, on the gradual phasing out of the MFA restrictions over ten years. Whether and when this will actually happen is still uncertain. How will textile and clothing industry trade develop depends not only on the future of the MFA restrictions. An examination of the situation of this industry exemplifies important trade policy issues arising from the rapidly changing industrial structure in the Asian-Pacific region.

Pacific economic co-operation

The remarkable recent growth of most East Asian economies, and of their trade with each other and with North America, has been extensively documented. Asia Pacific economies now account for over half of world GDP. Close to 65 per cent of their trade is with each other; put differently, the 19 per cent share of world trade that takes place among the APEC economies is similar to the 17 per cent share of world trade among the twelve members of the European Community.

Until quite recently, this growth of production and trade among a very diverse group of economies has taken place with almost no inter-governmental regional institutions, contrasting sharply with the European experience. Spectacular trade growth has sometimes occurred between economies whose political leaders have no diplomatic channels of communication (e.g. China's recently burgeoning trade with Taiwan and South Korea).

Against this background, there is some scepticism about recent initiatives for inter-governmental cooperation in the Pacific. Is such cooperation just a makework junket? Could regional economic cooperation actually prove harmful, by getting in the way of a successful trend, or even cut across prospects for an open global trading system? To answer these questions, it is useful to assess why governments in the Pacific region have invested so much recent effort in cooperative initiatives.

Motives for Pacific economic cooperation

The conservative motive for co-operation - to sustain the recent trend towards mutually beneficial interdependence - has been important. The success of East Asian economies has been based on good economic management and high saving rates which allowed these economies to invest massively in human and physical capital, leading to spectacular and sustained increases in productivity. Success has also stemmed from their ability and willingness to take advantage of changing international market opportunities. But, perhaps most importantly, their growth has been sustained by the relatively open multilateral trading system during recent decades.

While the system of international trade under the General Agreement on Tariffs and Trade (GATT) is deficient in several important respects, it has made it possible for Japan and other Western Pacific economies to exploit their comparative advantage. Success in exporting, initially light manufactures, followed by an increasingly sophisticated range of goods and services, has been the key to the growing prosperity of these economies.

Rising trade tensions

The rapid growth in East Asian exports led to rising trade tensions during the 1980s. East Asia's trading partners tended to overlook the very substantial matching growth of imports, especially of raw materials and capital equipment. Attention tended to focus on the capture of market share by East Asian exporters and the pressure this placed on sectors where North American and European economies no longer held comparative advantage. These economies and, until recently, Australia tended to react defensively, often imposing selective import restrictions or demanding `voluntary' export restraints. Trade tensions across the Pacific have also been exacerbated by high and persistent US trade deficits. Although overwhelmingly due to macroeconomic imbalances rather than East Asia's remaining trade barriers, the deficits provided the excuse for threats of retaliation by the USA, using the `Super 301' section of the 1988 US trade legislation.

Another defensive response to intensive competition has been a widespread drift away from non-discriminatory multilateralism towards discriminatory, bilateral or regional, solutions to trade problems. The EC's movement towards a unified market by the end of 1992 has been followed by the US-Canada Free Trade Area (FTA), which may lead towards a wider FTA including a progressively greater part of Latin America. Several other FTA options were under consideration in the late 1980s. These initiatives were designed to be consistent with Article XXIV of the GATT but they represent marked departures from the fundamental GATT principle of non-discrimination and inevitably imply some diversion of trade from optimal sources and directions.

The difficulties encountered in the Uruguay Round of trade negotiations, combined with the trend towards selective import restrictions and discriminatory FTAs, constitute a serious threat to the open global trading system and therefore to East Asian economies which rely heavily on global markets. East Asia's leaders are aware that, prior to the Uruguay Round, they had not played a significant part in shaping the GATT-based trading system. None of them acting alone, not even Japan, can have much influence on the evolution of rules for world trade. To forge alliances to preserve and gradually enhance rules providing for a stable open global environment for trade and investment is another important motive for economic cooperation in the Pacific region.

Beyond trade in goods

The widening range of economic transactions in the Pacific region has also exposed the multiplicity of impediments that increase the cost of such transactions, sometimes prohibitively. ***An important objective of economic cooperation is to reduce such barriers, not just to trade but to travel, payments, and capital and labour movements.***

By the end of the Uruguay Round, GATT rules should cover, at least in principle, trade in all goods and services. But even the Uruguay Round has hardly begun to consider the obstacles to international trade, investment and payments that are imposed by divergences in the domestic policies of trading partners. Some of these are being addressed by sectoral bodies such as the International Telecommunications Union. However, as in GATT negotiations, it is difficult to reach consensus when over 100 governments are involved. Issues such as the physical impediments to trade (e.g. inadequate or incompatible port facilities or air traffic control systems) are much more conveniently addressed by the groups of economies that trade intensively with each other. Therefore, whatever the final outcome of the Uruguay Round (which continues at the time of writing), interest in closer, more effective cooperation will remain strong in the Pacific, building on bilateral, sub-regional as well as region-wide efforts.

The self-confidence generated by the spectacular economic growth of most regional economies in the past few decades provides a promising basis for further fruitful cooperation during the 1990s. There are, nevertheless, substantial risks. While the security environment has been transformed with the break-up of the USSR, threats to security remain, including the potential development of nuclear weapons by North Korea. The trust required for effective region-wide economic cooperation could also be severely damaged if any future US political leadership succumbed to the substantial pressure to adopt the isolationist and protectionist policies advocated by some influential politicians.

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Recent developments

Since 1989, there have been many new initiatives for closer economic cooperation and integration around the Pacific. The diversity of these initiatives, in terms of issues addressed and partners involved, reflects the diversity of the region itself.

APEC

Possibly the most significant recent region-wide initiative has been the ministerial-level Asia Pacific Economic Co-operation (APEC) forum, launched in Australia in November 1989. APEC has evolved from the work of the Pacific Economic Cooperation Council (PECC), which began in 1980, and a close working relationship has been forged between them. Both are designed to improve information about trade and investment links in the region, with task forces and working groups set up to identify common regional economic interests in fields ranging from trade policy, human resource development and technology transfer to energy and telecommunications.

APEC's guiding principles stipulate that co-operation should be outward looking, building consensus on a gradually broader range of economic issues. Regional trade liberalization is to be promoted, provided it is consistent with GATT principles and not to the detriment of other economies. APEC participants include the six members of ASEAN, New Zealand, Australia, China, Hong Kong, Taiwan, South Korea, Japan, Canada and the USA. Participation is to be open -ended, based on the strength of economic linkages; Mexico is the likely next participant. Since 1991, PECC has broadened its coverage even further, to include Russia, Mexico, Peru and Chile. The Pacific Islands are represented by the South Pacific Forum as observers in both APEC and PECC.

ASEAN

At the sub-regional level, a late 1990 proposal by Malaysia for an East Asian Economic Group received a mixed reception and has been steered, by ASEAN, to an East Asian Economic Caucus within the APEC framework. The Singapore Summit of ASEAN in January 1992 marked a new phase of economic cooperation in Southeast Asia. The ASEAN Free Trade Area (AFTA), which is to evolve over the next fifteen years, will include provision for a Common External Preferential Tariff (CEPT) scheme. In addition, the Framework Agreement for AFTA provides for cooperation in sectors such as minerals and energy, transport and communications, technology transfer, human resource development, finance and banking. The scope of the new proposals is considerably more ambitious than anything contemplated up to the late 1980s.

Other regional initiatives

The emerging `growth triangle', linking Singapore to the Malaysian State of Johore and the nearby Riau islands of Indonesia, including Batam, is based on less formal understandings about the rights of investors and the provision of infrastructure to link the three economies. The rapidly increasing integration of Hong Kong, Taiwan and South China is a vivid example of sub-regional integration driven by economic logic rather than inter-governmental agreements.

Recent developments in bilateral economic cooperation in the Pacific region include the 1990 Structural Impediments Initiative (SII) discussions between the USA and Japan. Both participants agreed to review some of their domestic economic policies in order to reduce impediments to trade and investment between them; and to do so in such a way as to avoid cutting across the interests of other economies. The terms of the Sll included undertakings by Japan to expand public sector infrastructure investment and to liberalize its retail distribution system. The USA *inter alia* undertook to improve savings and educational standards. In contrast, an agreement made during President Bush's January 1992 visit to Japan to increase purchases of automotive components from the USA paid no regard to the interests of other suppliers and could damage them substantially.

The last few years have also seen a further development of the Closer Economic Relations (CER) arrangements between Australia and New Zealand, substantially unifying those two markets, and stimulating two-way trade while reducing barriers to trade with the rest of the world. An even greater acceleration of trade took place during the last three years between South Korea and mainland China, leading to informal cooperation and the establishment of `unofficial' trade promotion offices.

Next steps

The challenge facing policy makers in the region is to build on all these regional, sub-regional and bilateral initiatives, consistently with the region's overriding interest in a more open global trading system. ***The key to success will be to avoid divisive or discriminatory options, focusing instead on non-discriminatory, confidence-building steps*** such as:

enhanced exchange of information about trading patterns;

increased transparency of trade and investment policies;

reducing uncertainty in international transactions;

harmonization and/or mutual recognition of policies, regulations and standards;

non-discriminatory lowering of tariffs and barriers to labour and capital movements.

There are grounds for optimism about moves along these lines. Cooperative initiatives are taking place against a background of substantial unilateral steps by almost all East Asian nations to deregulate their economic systems and to liberalize their trade policies. Japan, Australia and New

Zealand have been at the forefront of all OECD economies in terms of the scope of structural reform. The Newly Industrialized Economies (NIES) of Asia and most ASEAN economies have substantially liberalized their trade regimes. China's rapid growth during the 1980s was made possible by essential economic reform. Russia and Vietnam have also embarked on de-regulation. Mexico's advance to a less regulated, more open system of economic management has encouraged similar moves throughout much of Latin America.

Significant trade barriers still remain. The bans on rice imports by Japan and Korea, for example, continue to impose considerable costs on consumers in those countries. These barriers, as well as a large number of `informal' resistances to imports by several Asian economies, are continuing to exacerbate trade tensions across the Pacific. Despite these problems, the dominant trend in East Asia -- most spectacularly by China since the late 1970s - has been one of `opening to the outside world'.

Scope for cooperation

Choices about matters on which to cooperate, and with whom, need to be considered concurrently. Given the diversity of the region, any Pacific economy wishing to reach understandings on a comprehensive range of issues would have to deal with just one or two economies at a time. But if issues can be broken up into discrete components a region-wide consensus on some well-defined matters may be possible.

A strategy for future cooperation that insisted on agreement on a comprehensive set of issues would create a risk that bilateral or sub-regional groupings might form, but would then prove difficult to link with each other. For example, if Australia decided that it would engage in economic cooperation only with economies prepared to reach understandings on *all* of the topics covered by the CER agreement with New Zealand, it would not easily find new partners. It would be no less risky to adopt a strategy whereby Pacific regional cooperation had to proceed at the pace of those least interested. Fifteen APEC participants have agreed, in principle, to look for areas of cooperation involving all of them. They have already agreed to exchange information about trade patterns and to standardize, and provide for full electronic interchange of, trade documentation.

A pragmatic approach

Fortunately, there is no need to follow either of these rather restrictive strategies. The following paragraphs outline what could prove to be a pragmatic, evolutionary approach to effective and reasonably broad-based regional cooperation. It aims to tackle four kinds of impediments to economic transactions in the region:

- **Market access barriers:** including the heavy protection of some aspects of agriculture in North East Asia and North America, and the protection of textiles and clothing producers by Australia and North America.

- **Uncertainty about future market access:** the increasing resort to arbitrary and discriminatory measures to deal with losses of market share to imports and the recent threats of unilateral trade retaliation, mostly aimed at East Asia, have increased uncertainty about regional trade prospects.

- **Physical bottlenecks:** shortfalls in infrastructure (ranging from harbours to tele-communications) are serious impediments to trade in the most rapidly growing parts of the region, including coastal China, Indonesia and Thailand.

- **Differences in domestic rules and legislation:** divergent standards relating to safety, quality and environmental matters and different approaches to commercial legislation can introduce distortions to regional trade and investment.

Market access barriers are well defined, but often intractable. The GATT has grappled with them for four decades. The protectionist sentiments that generate trade distortions are, all too often, also well entrenched within the APEC region. In order to develop the momentum of substantive regional cooperation, APEC's trade liberalization agenda should cover a wider range of trade problems than those imposed by tariffs or quotas.

Reducing physical impediments

Reducing physical impediments to trade may be a pragmatic starting-point, since the potential for mutual benefit is readily appreciated. Exchange of information about patterns and trends in trade and tourism can pinpoint the investments needed to avoid infrastructure bottlenecks. Harmonization, or mutual recognition, of standards and procedures can also lead to more efficient use of infrastructure capacity. Analysis by APEC working groups, such as those dealing with human resource development, energy, transport, telecommunications, tourism and environment, is directed to this end; each can draw on the accumulated analysis of sectoral policy issues by the corresponding working groups of the PECC. For example, the use of existing transport infrastructure will be improved by APEC's project to achieve total electronic exchange of trade documentation by the end of the decade. It may take a long time before APEC can agree on reducing any customs duties; meanwhile, progress can be made on standardizing customs documentation and clearance procedures.

More generally, the relevant working groups of APEC could review the range of standards that are being adopted by the EC. The EC's basic principle of mutual recognition of standards could also prove useful in the Asia Pacific. That experience can point to products or processes where broad-based agreement may be relatively easy to achieve. Product labelling and safety standards, for example, could be considered at an early stage. Reaching agreement on environmental standards would almost certainly prove more sensitive; uniform standards may in any case not be appropriate for a group of economies with very different degrees of industrialization and population densities. But it may be possible to agree to share modem techniques for reducing the environmental side effects of some production processes; the dissemination of clean coal technology for power generation is already under consideration by APEC.

Harmonization of legislation and regulations

The harmonization of legislation and regulations affecting international transactions in the region will need to grapple with the sometimes radical differences in legal frameworks, compounded by the frequent lack of a clear definition of administrative rules. However, a potentially productive start could be made on rules influencing investment. For example, a common approach to defining the basic rights and responsibilities of foreign investors could avoid the laborious negotiation of scores of bilateral investment protection agreements. A more ambitious objective would be to work towards a more uniform approach to tax concessions offered to investors, avoiding wasteful and distorting `competition' for investment through subsidization.

The substantial harmonization of competition policies between Australia and New Zealand has led to agreement that anti- dumping action will no longer be taken by either partner against exports from the other. This example suggests that progressively closer harmonization of competition policies by a broader group of economies could be encouraged by a corresponding reduction in the scope for anti-dumping actions against those who participate in such harmonization. Such a trade-off could reduce an important source of uncertainty facing exporters in the Asia Pacific region.

Dispute settlement

Another useful step toward reducing uncertainty in regional trade would be for APEC participants to agree to adhere strictly to the new procedures and timetables for dispute settlement that are likely to form part of any final Uruguay Round outcome. It may also be useful to consider wider access to the dispute settlement mechanism which may be included in the proposed North American Free Trade Agreement (NAFTA). A streamlined region-wide approach to dispute settlement should reduce resort to unilateral retaliation to resolve trade disputes.

Building consensus

The foregoing list is by no means exhaustive, but indicates the pragmatic trade liberalization agenda that APEC could begin to consider. The issues considered so far have some important common features:

In each case, there is scope for breaking down broad sets of issues into manageable policy options and grading them from less contentious to more difficult.

Progress can be made on each separate issue, without any conflict with GATT principles and without detriment to others outside the region.

Non-participants would not be disadvantaged, but neither would they get an obvious `free ride': the benefits of an enhanced dispute settlement process within APEC, for example, would be of advantage to others only if they also agreed to adopt such better standards of behaviour.

Progress could be made on individual issues by some APEC participants, ahead of others. Agreements on (say) product labelling standards among some subgroup of APEC participants need not be to the detriment of others, provided that the standards were well-defined (or `transparent'). Non-participants to the original understandings could then choose to adopt the same standards informally, possibly leading to subsequent, more formal endorsement.

The preferable approach to tackling the above agenda would be to initiate discussions among all APEC participants. However, there is no reason to discourage or prevent progress by subgroups within APEC on the issues discussed so far, provided that provision is made for others to join a broadening consensus on particular issues over time. In other words, there is a substantive agenda on which progress need not be restricted to the `lowest common denominator' among participants. ASEAN has adopted such a strategy in the AFTA Framework Agreement: ASEAN-wide discussions are to start on many facets of economic cooperation. At the same time, the agreement provides explicitly for some members reaching agreements on some matters earlier than others. There is an underlying assumption that the nature of agreement reached among some of ASEAN would be designed to facilitate subsequent endorsement by the other members. Moreover, the emphasis in the agreement on maintaining and strengthening ASEAN's economic linkages with its other trading partners suggests that agreements on some substantive issues could be broadened to include some other regional economies.

Parallel discussions of issues, such as harmonization or mutual recognition of certain standards or policies by ASEAN and by APEC working groups could well lead to some quite broadly-based (possibly APEC-wide) agreements during the 1990s. Such a process could then develop the sense of trust and common purpose required to tackle the wider and currently more contentious issues of cooperation.

Improving market access

Considerable mutual benefit could also be derived from the reduction of traditional market access barriers such as tariffs and quotas. ***The remaining barriers to trade in the region, e.g. in agriculture, textiles, clothing and processed minerals, tend, perversely, to be highest where there is most complementarity in terms of resource endowments and cost structures***.

These barriers stand in the way of the efficient location of production around the region and preclude potential gains from greater specialization. By far the greatest share of benefits from further nondiscriminatory liberalization by the Asia Pacific region would accrue to the region itself, a conclusion that has been validated by experience. Liberalization and deregulation contributed to the spectacular growth of trade by APEC economies during the 1980s; no attempt was made to discriminate against the rest of the world, but the relative proximity, complementarity and dynamism of Asia Pacific economies ensured that much the largest part - 76 per cent - of trade growth from 1980 to 1990 was among APEC participants.

The politics of liberalization

Market-opening measures everywhere face the political cost of reducing the protection of internationally uncompetitive sectors. The long-term benefits outweigh the short-term costs of adjustment, but the gains are delayed and widely spread while the costs are concentrated and immediate. To counter this strong resistance to trade liberalization, governments often seek to outflank the vested interests of protected sectors by negotiating for the simultaneous reduction of trade barriers by others, thereby offering immediate offsetting gains to some efficient export sectors.

The political pain involved in liberalization also tempts negotiators to keep trade barriers as bargaining counters, offering to liberalize market access for only those trading partners which are also lowering some of their barriers. There is great reluctance to allow other economies to `free-ride' on the liberalization that might be negotiated among a limited (e.g. regional) group of economies. Such reluctance leads, all too often, to preferential or discriminatory trading arrangements which are contrary to GATT's fundamental principle of nondiscrimination.

Most Pacific economies have accepted that the long-term economy-wide benefits of liberalization outweigh any short-term costs. The spectacular recent success of East Asian economies, in contrast to the highly protectionist economies of South Asia, the former USSR and Eastern Europe, vindicates this strategy. By acting unilaterally they have accepted, sensibly, that, in addition to their own long-term benefits, all other economies stand to gain; they have not allowed dog-in-the-manger concerns over gains by others to preclude relatively larger gains to themselves.

Liberalization priorities

The same logic could be extended to nondiscriminatory liberalization by groups of economies - once again they would achieve gains that were relatively greater than those accruing to the rest of the world. It is therefore useful to consider whether Pacific economies could identify sectors in which nondiscriminatory trade liberalization might prove possible, at a pace faster than is feasible in the Uruguay Round. Appreciation of the difficulties involved in gaining support for such initiatives suggests a search for sectors where:

complementarity among regional economies is evident;

the net gains from liberalization can be estimated;

the original reasons for protection have been weakened by changes in circumstances; and where natural resource endowments and transport costs limit effective competition from outside the region.

Processed minerals

A potential candidate for early liberalization might be trade in processed minerals, including steel products. Import barriers to coal and other basic raw materials tend to be quite low, but to rise with the degree of processing. This tends to give a high degree of effective protection to processing in particular countries, distorting the economically efficient location of additional or replacement capacity for activities such as steel or aluminium production. The original reasons for the domestic processing of imported minerals by Japan, for example, are now essentially obsolete. Employment in these industries is now an even more trivial part of the work-force, while the high cost of industrial land and the considerably greater cost of meeting more rigorous environmental standards have reduced interest in such industries. The same considerations are increasingly relevant in South Korea and Taiwan. It is becoming clearer that the economy-wide benefits that would be generated by reducing costs to other industries would greatly outweigh the adjustment costs of phasing out aspects of mineral processing. The biggest gains from liberalization would accrue to the resource-poor industrial economies of the region by reducing the costs of inputs to industry; resource-abundant economies such as Australia, Canada and Indonesia would also benefit.

Another option would be for all APEC participants to remove any barriers to trade in tropical products that may remain after the Uruguay Round. As in the case of minerals, not only would consumers benefit, but the region would be likely to seize most of the new trade opportunities created by liberalization.

Textiles

Rapid liberalization of trade in textiles and clothing would have considerable benefits for regional consumers: directly for the labour-abundant participants in APEC, such as Indonesia and China, as well as indirectly for efficient raw material producers like Australia. The Uruguay Round outcome is expected to phase out the trade-distorting Multi Fibre Arrangements by a gradual liberalization of all quota limits. But only marginal increases in access are likely to be agreed upon for the next five years. APEC could contribute substantially to regional growth by agreeing to increase quota limits more rapidly than the minimum pace agreed upon in Geneva. However, it will be very difficult to overcome the resistance of textile producer lobbies in some industrialized economies.

Services

It may also prove difficult to promote rapid regional trade liberalization in services, where trade policy issues are less well understood and where the relative weakness of trade data precludes detailed quantitative analysis of the potential benefits and costs of liberalization. The Uruguay Round should lead to an agreement in principle for all trade in services to be brought ultimately under GATT rules, but applying these principles to particular sectors will be a task for the rest of the 1990s APEC could accelerate this process by developing sectoral codes for some services of particular interest, such as telecommunications and transport. APEC could then promote the GATT-wide adoption of such codes or consider adopting them within the region, pending wider acceptance.

These examples suggest that options for the non-discriminatory trade liberalization of products can also be graded in terms of the likely difficulty in several trading partners reaching agreement. As discussed in the previous section, the absolute benefits from liberalization would be greater if all Pacific economies lowered particular trade barriers at the same time. However, so long as all trade liberalization is on a non-discriminatory basis, no economy would be disadvantaged if some moved faster than others.

Avoiding discriminatory trade blocs

In Seoul 1991, President Roh Tae Woo declared in his keynote address to the Third APEC Ministerial Meeting that, "confrontations over ideologies and systems have by and large ended, and a new world order based on economic capabilities is about to emerge ... The world's future and the destiny of mankind will largely depend on whether the new order fosters exclusive and self-centred regional economic blocs or whether it develops in the direction of promoting openness and cooperation among the regional economies".

The strong commitment to open regionalism and strong support for the GATT-based non-discriminatory global trading system is an important feature of the APEC forum. APEC participants can give effect to this commitment directly by the joint pursuit of liberalizing proposals in GATT-based trade negotiations. They can also do so indirectly, by setting positive examples of non-discriminatory ways to reduce obstacles to international trade and investment, without detriment to other economies, possibly by following up some of the options discussed above. But APEC is a new regional forum and, for the foreseeable future, most trade negotiations in the Pacific will not be APEC-wide but on a bilateral or sub-regional basis. Care will therefore be needed to ensure that decisions taken in the course of such negotiations do not destroy prospects for subsequent region-wide liberalization by creating tensions and divisions among groups of regional economies. To quote from President Roh's speech again:

> "In view of the vastness and diversities of the Asia-Pacific, the appearance of sub-regional groups may perhaps be inevitable for purposes of increased economic efficiency. Sub-regional groups, however, must also seek to develop in harmony with the open and cooperative order of the region ... Asia-Pacific Cooperation should not, in any case, develop into a competing relationship between East Asia and North America. On the contrary, it should play a central role for the promotion of a harmonious and balanced development of trans-Pacific relations."

The USA is still the main export market for East Asia, and the US-Japan bilateral economic, relationship is among the most intense in the global, let along the regional, economy. One of the objectives of APEC must be to encourage the two largest Pacific economies to have regard to the interests of their other regional trading partners; APEC provides a `convenient regional framework within which Japan can move towards a position of shared policy leadership with the United States, in buttressing and extending the GATT-based trade regime'.

Open global trade can be promoted through bilateral negotiations. The 1988 US-Australia-Japan beef negotiations, for example, ensure that Japanese consumers benefit from cheaper beef and all producers can compete for their custom. Both the USA and Japan will benefit by implementing their 1990 Structural Impediments Initiative undertakings, but no other economy will be worse off. Provided bilateral or sub-regional trade negotiations lead to such non-discriminatory outcomes, trade liberalization efforts by subgroups such as ASEAN can proceed in step with APEC wide and global economic initiatives. Lee Kuan Yew described this process as `concentric circles of cooperation'.

In contrast, bilateral or sub-regional efforts that lead to outcomes detrimental to the interests of others not directly involved will prove divisive, undermining prospects for region-wide liberalization. The pressure placed by the USA on Japan in early 1992 to agree to raise imports of motor components from the USA, without regard to the interest of other suppliers, was dearly inconsistent with the pursuit of a non-discriminatory global trading system as well as contrary to GATT rules. Preferential FTAs may be consistent with the letter (though not the spirit) of the GATT, but their proliferation in the Pacific region would create quite serious risks for region-wide cooperation.

Discriminatory trade liberalization does create additional trade among the participants and improved growth prospects may create some new trade opportunities for outsiders. But some trade is bound to be diverted from more efficient directions, reducing the *absolute* gains from trade liberalization. The *relative* share of the reduced gains going to participants is increased, but the benefits to non-participants are considerably less and can even be negative. The higher political value often placed on relative as against absolute gains lies behind the conventional trend towards preferential trading arrangements.

The EC has been the most prominent example of post-war regional and preferential trade arrangements legitimized by GATT Article XXIV. The early phase of European economic cooperation was a preferential reduction of market access barriers. But the EC has also demonstrated that free trade in goods leaves plenty of scope for further steps to reduce transaction costs in order to create a genuinely unified EC market. More recent initiatives for close economic relations,' such as the US-Canada FTA and the Australia-New Zealand CER, also provide for a much wider range of agreements than the elimination of barriers to trade in goods. A central feature of the US-Canada agreement is a process for consultation on and resolution of bilateral trade disputes. The CER goes further than any other existing economic cooperation arrangement in reducing obstacles to trade in services and harmonizing competition policy legislation. Similarly, as noted above, ASEAN's next steps towards closer economic cooperation extend well beyond the creation of a system of preferential tariffs.

This broadening of closer economic relations arrangements reflects the substantial changes in the pattern of international transactions that have occurred since the inception of the GATT over forty years ago. At that time, international transactions were dominated by trade in physical goods. Since then, trade in services has expanded much more rapidly, trade in electronically stored information is the fastest growing segment of all trade, and movements of various types of labour and capital are closely associated with most trade in goods and services. Yet, despite the rapidly shrinking relative importance of trade in goods, the setting up of an FTA still tends to be regarded as the natural starting-point for closer economic cooperation between pairs or regional groups of economies. Thus, the US initiative to draw North and South American economies closer together is cast in terms of a network of preferential FTAs.

An important disadvantage of a preferential FTA-based approach is that, for consistency with GATT Article XXIV, a large set of often sensitive issues has to be tackled at the same time. If a preferential FTA is treated as the first phase of closer economic cooperation, trade-related issues cannot be tackled individually, paying regard to their relative sensitivity as well as importance. Since vested interests and protectionist sentiments are most deeply entrenched against free trade in goods, the need to resolve all of these issues simultaneously at the outset may preclude steps to reduce impediments and uncertainties relating to a much wider range of international transactions. It is therefore, not surprising that existing preferential FTAs have been negotiated amongst economies with rather similar structures; similarity in cost structures has meant that only relatively minor reallocation of resources was required, hence less resistance to liberalization.

The EC, European Free Trade Area (EFTA), US-Canada and Australia-New Zealand FTAs all link fairly similar economies. The diversity of economic structures and levels of human resource and technological development within ASEAN have proved serious obstacles to substantive cooperation to date. If concluded, the US-Canada-Mexico FTA would prove a breakthrough in terms of linking economies of quite a different nature. Against that background, it is difficult to envisage FTAs linking many of the remarkably diverse Pacific economies; that is one of the major risks of an FTA-driven strategy for closer cooperation in the Pacific, especially one which envisages an FTA covering much of the Western hemisphere.

The considerable benefit to the world of a more outward-looking Mexican economy and its recent extensive non-discriminatory liberalization suggest that a positive balance of trade creation over diversion may well be attained by linking its economy more closely to its northern neighbours. The balance could be improved further if the USA and Canada both followed Mexico's example by unilaterally lowering some of their own trade barriers. Accession of additional economies to NAFTA is less likely to benefit, rather than damage, the rest of the world economy. The nature of the agreement would inevitably emphasize concerns arising from trade with Latin American economies and reflect Western hemisphere legal structures. Even if NAFTA contained formal accession provisions open to all, in practice Latin American economies would be more likely to join than any East Asian ones, needlessly exacerbating divisions across the Pacific.

Even if a preferential FTA initiative could embrace most economies from both sides of the Pacific, it would still run counter to the Asia Pacific region's overwhelming interest in sustaining and enhancing a global trading system. Such an APEC-wide trade agreement would confront a European trading bloc, with disastrous consequences for the GATT-based system. This is why the new APEC process has unambiguously rejected a discriminatory approach to trade liberalization.

A further disadvantage of discriminatory FTAs is that the broader set of issues discussed above, such as the exchange of information reducing physical bottlenecks, harmonising standards and reducing uncertainties, cannot be tackled simply by a comprehensive set of preferential reductions to barriers to trade in goods. ***The Singapore-Johore-Batam `growth triangle' represents a clear, more imaginative, contrast to the preferential FTA approach to effective sub-regional economic integration***. No discriminatory trade policies are to be involved; in fact, trade policy issues are marginal. Instead, emphasis is placed on reducing physical obstacles to trade through heavy investment in infrastructure and on reducing barriers to investment. The interdependence of these economies will be boosted rapidly, while old-fashioned issues of discrimination against the rest of the world will not arise.

In view of these considerations, it would be highly desirable for the Pacific to adopt a strategy for closer economic cooperation that rules out preferential FTA initiatives beyond finalization of the ones already taken, such as the ASEAN FTA and the linking of Mexico to the USA and Canada through preferential arrangements. This would not end options for closer links between US-Canada-Mexico and other Latin American economies. However, these links should be based on cooperation which does not involve discrimination against non-participants. An early option might be to extend more widely the consultation and trade dispute settlement procedures in NAFTA. This could be done without entering into discriminatory trade policy arrangements.

These considerations pose an important policy choice for the USA. It can continue to implement a strategy based on the old preferential FTA concept, linking it to more Latin American economies in ways which are `GATT-legal', but which discriminate against the rest of the Pacific. However, such a course would be increasingly difficult to reconcile with assurances that East Asian economies are not being damaged. Even if East Asia were not clearly disadvantaged in net terms, it would hardly be conducive to economic cooperation across the Pacific. If US strategy for such cooperation remained focused on preferential trading arrangements in its own hemisphere, possibly accompanied by continued threats of retaliation against East Asian exporters, interest in an East Asian economic bloc might well revive. At worst, this could lead to the emergence of three defensive trading blocs dominating the world economy.

On the other hand, if APEC participants, including the USA, adopted a strategy of forging links with other economies in nondiscriminatory, confidence-building ways, it would be possible to launch APEC-wide initiatives to which East Asian as well as Latin American economies could respond, simultaneously and positively Although APEC does not yet include any Latin American economies, they could be given the opportunity to participate in any non-discriminatory APEC agreements on specific issues which began to reduce impediments to international economic transactions in the Pacific region.

The way forward

I have sought to suggest that there is a substantive agenda for non-discriminatory trade liberalization in the Pacific region. Relatively non-controversial steps such as the exchange of information and harmonization of customs documentation, can build the sense of cohesion and trust required to tackle harder issues such as reducing market access barriers.

Tackling substantive economic issues in carefully graduated steps could enhance the effectiveness of APEC during the 1990s, set a positive example of open regionalism, reduce the risk of fragmentation of the world economy into rival trading blocs, and allow APEC to begin to set priorities for future negotiations to improve the global trading system.

Changes in the production and trade structure of textiles and clothing

It is useful to start with a statistical overview of the performance of the East Asian textile and clothing trade in recent years. Table 1 shows the performance of the four country groups in three textile and clothing industry product categories. Since they are measured in export and import values, they reflect price increases and exaggerate the contribution of high-valued products. But they show changes in the relative size of the second-tier versus third-tier exporters.

East Asian NIEs dominate both export and import in the three product groups. This partly reflects an interlinkage of the textile and clothing trades, in which textiles and clothing are inputs to clothing production, as Hong Kong imports fabrics and exports clothing. The third tier groups, ASEAN and China, have been catching up with the NIEs to different degrees in the three product groups. As regards cotton fabrics, ASEAN countries exported about a third of the amount exported by the NIEs, whereas China exported almost the same. As regards synthetic fabrics, both ASEAN and Chinese exports were only 20 per cent of the NIEs'. Their relative size did not change much between 1985 and 1990. However, in clothing exports both ASEAN and China doubled their relative size between 1985 and 1990. ASEAN's clothing exports increased from 16 per cent to 34 per cent and China's increased from 15 per cent to 29 per cent of those of the NIEs.

Japan, while surviving as a competitive exporter of synthetic fabrics, has turned into a big net importer of clothing. The catching-up with the second-tier by the third-tier groups is also evidenced in their export performance in individual markets. Table 2 shows changes in exports of woven outer garments to the two major markets (the United States and the European Community) by NIEs, ASEAN and China. All three groups increased their exports (partly because of price increases), but the increase by ASEAN was most evident, followed by China.

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Causes of change

What are the factors underlying these changes? Changes in trade shares reflect changes in comparative advantage in textile and clothing production. In other words, Japan and the NIEs have been losing comparative advantage in production, with ASEAN and China gaining. There are two determinants of comparative advantage in production, one of which is obvious to economists while the other is often ignored. One determinant is labour cost, since the industry is labour-intensive, especially in the sewing and finishing processes of clothing production. The other determinant is the producer's ability to keep up with ever-changing and more demanding consumer taste. The market continually seeks for textiles and clothing of better quality and designs.

Availability of material inputs affects the textile and clothing industry's comparative advantage only in a limited way. Local availability of raw cotton and wool often provides producers with standard yarn and fabric at a competitive price, but quality cotton and woollen fabrics are often made of imported raw materials. Materials for synthetic textiles and clothing are petroleum products and available everywhere. Fabrics for clothing production are nowadays actively traded internationally (see Table 1).

Table 1

Changes in textile exports and imports in East Asian countries : 1985-90 ($ million)

Country		Cotton fabrics		Synthetic fabrics		Clothing	
		Export	Import	Export	Import	Export	Import
Japan	1985	666	279	2283	116	377	625
	1990	873	495	2345	340	203	3584
NIEs[a]	1985	757	257	2464	1504	5,999	613
	1990	1781	1476	6702	3741	11,123	3117
ASEAN	1985	249	304	490	619	942	156
	1990	557	829	1309	1500	3,826	393
China	1985	994	62	496	431	906	8
	1990	1602	312	1095	834	3,181	17

[a]NIEs here refers to South Korea, Taiwan and Hong Kong.
Source : Compiled from UN Commodity Trade Statistics.

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Throughout the 1980s, when the East Asian countries continued rapid growth and enjoyed rising living standards, labour costs soared and acute labour shortages emerged in Japan and the NIES. Simple labour-intensive textile and clothing production became costly and difficult. Exchange rate alignment in the latter half of the 1980s affected all manufacturing production in Japan and the NIEs and accelerated the erosion of their competitive edge in textile and clothing production. Japanese and NIE producers have been shifting domestic production abroad, mainly to ASEAN countries and China, to take advantage of lower labour costs in these countries.

According to a survey by a Japanese general trading company, processing costs (marking, cutting, sewing and finishing) of men's white shirts were 80 in South Korea, (Japan = 100) 40 in Thailand, 25 in China and Indonesia in December 1992. Only Korea can provide quality fabrics locally for production and export of shirts. In the other countries, good quality fabrics are not generally available and are supplied by Japan, therefore the cost differences between them are narrow.

The relocation of clothing production from first- and second-tier producers to the third-tier groups takes a variety of forms: foreign direct investment (FDI) with 100 per cent equity ownership; joint venture investment with local producers and distributors; subcontracted production by local producers and so on. In all cases the design, fabrics and other materials (even for marked and cut garments) and the processing technology are provided by the parent companies. Sewing machines and other assembly equipment are provided through counter-trade under which the initial cost of machines and equipment is recouped by exporting processed products later.

Japanese general trading companies often take charge of export materials and machines, and import processed products. Their clothing imports are not `spot imports' but `planned imports' in the sense that their production is based on market orders and their sale is assured. Cheap clothing made of local fabric is imported by other trading companies and retailers and sold as spot imports, but this is generally a `volume zone' product (sold in great volume at low prices, often as bargain sales at supermarkets). Clothing under planned imports belongs to the category of `better zone' products (higher price products for which design, fashion, colour, finish, quick supply, and other non-price elements of competitiveness matter).

Industrial adjustment of textile and clothing industry in Japan

Industrial country producers facing increased import competition resulting from the change in comparative advantage have three adjustment options:

automate, upgrade and respond quickly to market changes in order to compensate for increased labour costs and thus survive at home;

relocate production abroad in order to take advantage of cheaper labour costs and either import back home or export to third countries; or quit the industry and switch to another business.

In Japan all three options are pursued by textile and clothing producers. Import competition has been stiff in Japan since the mid 1980s. The import to consumption ratio of all textile and clothing products (in terms of yarn equivalent) increased from 16.3 per cent in 1980 to 41.4 per cent in 1991. Imports rose by around 25 per cent annually from all NIEs as well as from China during the period 1987-89. However, since 1990, imports from NIEs have stagnated while imports from China have continued to grow by 40 per cent annually. China now supplies 40.2 per cent of all textile and clothing industry imports to Japan, while the three NIEs combined supply only 23.1 per cent. By individual commodity, China supplied 56 per cent of Japan's cotton fabric imports, 56 per cent of woven underwear and knitted sweaters, 53 per cent of woven outer garments, 50 per cent of knitted underwear and so on.

Import competition is stiffest in grey cotton fabric of low-count yarn, volume zone knitted products, and cloth-bleached towels of low-count yarn. Japan's domestic production decreased by 46 per cent, 35 per cent, and 21 per cent respectively for these three products between 1986 and 1991. The producers are mostly small and medium sized firms. Without superior technology, funds and personnel for overseas operation, they were unable to take the upgrading or relocating options, and therefore many of them quit business when their owners reached retirement age. The number of textile and clothing firms declined by 21,000 (14 per cent) and their employees by 70,000 between 1984 and 1989.

In contrast, new synthetic fabrics and differentiated traditional textiles and clothing (such as quality fabrics and fashion sweaters) survived and maintained both their domestic production and exports. Synthetic fabrics are made of new fibres with complicated cross sections, but have a natural feel. Asian producers have so far not been able to imitate the Japanese dyeing and weaving techniques. Automation and computer-aided equipment have reduced labour input and also made possible quick production responses to market changes, but this first option is available only to those firms which invest in R&D and modern equipment.

In clothing production there is only limited room for innovation at home. Many clothing firms, therefore, have adopted the relocation option, as mentioned above. But this option is not available to all clothing manufacturers facing increasing labour costs and labour shortages, who have to keep a competitive edge in design, processing, and marketing so as to maintain their product quality and sell to the difficult Japanese customer.

This industrial adjustment reflects the responses of textile and clothing producers to changes in the industry and the market. What role did government play in this adjustment process? ***The Japanese Ministry of International Trade and Industry (MITI) has not resorted to MFA restrictions on imports of textile and clothing products.*** It occasionally negotiates voluntary export restraints with the Korean and Chinese governments for some textile and clothing products, but their restrictive effects cannot be compared with the MFA restrictions imposed by the United States and the European Community. ***This is the reason why import competition has intensified and adjustments have had to be made by the textile and clothing producers***.

MITI's adjustment assistance has focused on efforts by small and medium textile and clothing industry firms such as modernization of equipment, linkaged production units (i.e. inter-firm cooperation for joint R&D, dyeing and other facilities etc.), textile and clothing resource centres (i.e. joint facilities for collecting technology and marketing information), and institutes for fashion industries (for training textile and clothing industry experts). It has also subsidized the joint development of the fully automatic sewing system (1982-9) which has already been introduced to some clothing manufacturers. MITI also continues the system of registering spinning and weaving machines (begun in 1967) and occasionally introduces programs for the purchase and scrap of `excessive capacity'. The effectiveness of these adjustment programs was often questioned, however, and it was finally decided that the system should be abolished in October 1995 and that voluntary adjustment be encouraged. In addition, MITI assists FDls by small- and medium-sized firms by means of preferential financing and trade and investment insurance. Tariff exemption for outward processing (like the US Trade Act 807) has long been enacted but is seldom utilized because of strict application requirements. Fabrics have to be marked and cut within Japan and only sewing and finishing are to be undertaken abroad, a regulation which was introduced earlier so as to restrict outward processing of metal products.

Towards the end of the 1980s, NIE producers faced similar pressure to adjust. These economies enjoyed high growth but their textile and clothing industry producers suffered from wage increases and labour shortages. The erosion of their competitive edge was accelerated with the appreciation of their currencies by 25-30 per cent. Adjustment efforts similar to Japan's are observed in the NIEs, but with a different emphasis in each economy. Hong Kong producers have fostered fashion and design capability so as to upgrade their clothing production, while Korean producers are more inclined to modernize their equipment than to promote R&D.

Impact of the MFA restrictions

Nowadays world trade in textiles and clothing is severely constrained under the managed trade scheme, the MFA. This unique regime was introduced in 1974 as a temporary measure for a four-year period in order to give importing countries breathing time for adjustment while ensuring for exporting countries orderly expansion of exports by at least 6 per cent per annum. There are two types of restrictions under the MFA. Article Three provides a safeguard measure in the presence of market disruption regarding specific products. It enables importing countries to request consultation with an exporting country or countries to limit exports to a fixed level for a twelve month period. Article Four enables importing and exporting countries to conclude bilateral agreements in order to eliminate market disruption in importing countries and disruption to the textile and clothing trade of exporting countries.

The major importing countries, such as the United States and the European Community, have mostly applied Article Four and have concluded bilateral agreements with individual exporting countries on the base level and growth rates of imports of individual textile and clothing industry products. They have thus established a managed trade network, instead of resorting to the Article Three safeguard to deal with actual market disruption.

Contrary to the assurance of generous implementation of Article Four, the MFA restrictions have tended to be strengthened in terms of coverage and implementation. The MFA was extended four times: MFA2 for 1978-82, MFA3 for 1982-87, MFA4 for 1987-91 and again to the end of 1993 owing to the delayed conclusion of the current Uruguay Round. Quotas have been expanded by barely 1 per cent, in line with the growth of domestic demand. Neither carry-forward nor transfer between product groups has been permitted. Contrary to its original intention, the MFA has subjected textile and clothing trade to tight management for the past nineteen years.

Japan has been in a unique position. Japan participated in the first MFA negotiations as an exporting country and its exports were restricted by the United States under a bilateral agreement. However, as exports stagnated and imports increased in the past decade, domestic producers have begun to demand protection against increasing imports and Japan's policy stance has changed into that of an importing country. Although the Japanese government pledges to resort to MFA restrictions in case of disruptive imports, it has managed to avoid this so far even though it participates as an importing country in the current textile and clothing negotiation.

The impact of the MFA has been given diverse evaluations. The MFA restrictions have provided domestic producers with rent in the form of restricted competition with imports, higher product prices, but often greater sales values. An awkward transaction pattern has emerged under the MFA restrictions. Individual exporting countries allocate their country's export quotas to a particular importing country among individual exporting firms who can increase exports only to the extent of their quotas. When some firms have not exported to the full extent of their quotas, unused quotas are redistributed among other exporting firms. Because of inevitable time lags in administration and redistribution, this practice has tended to leave some quotas unused by the end of the year. The export quota system under Article Four has tended to depress competition among exporters by restricting exports of efficient firms while benefiting less efficient firms. The export price is thus raised and the higher price constitutes a rent (additional income) to some exporters.

Some studies have stressed this exporters' gain under the MFA restrictions and suggested that its benefits should be extended to developing economies. However, this depends on whether the exporter is given a quota greater than its capacity. The ASEAN member countries were given quotas greater than their capacity and they increased their shares in the US market under the MFA, while the NIE producers were given smaller quotas than their capacity and their shares in the US market decreased. The allocation of MFA quotas has prompted the substitution of ASEAN textiles and clothing for NIE ones in the US market. The textile and clothing industry of the NIEs has thus been forced to an early maturity. The up-grading of their industrial structure has been accelerated. In contrast, ***China has participated in the MFA since 1983. Since its current quota already restrains its exports to the markets under MFA restrictions, China has increased its exports to such non-MFA markets as Japan instead, so that its exports of women's garments to Japan now exceed its exports to the United States and the European Community*** (Table 2).

Consumers in importing countries bear most of the burden in terms of higher prices and poorer quality, but their complaints are seldom heard in the trade negotiations. In addition, there could be a dynamic loss to the industry as a whole incurred by the MFA restrictions, insofar as they prevent the emergence of new producers and discourage innovative efforts by existing producers.

The GATT textile and clothing study (1984) gave a balanced evaluation of the impact of the MFA restrictions and eventually led to the proposal in the Punta del Este declaration in 1986, to phase them out.

Table 2

Exports of woven garments by East Asian countries
To major markets : 1985-90($million)

From/to		United States	European Community	Japan
NIEs[a]	1985	3345	1049	351
	1990	5153	2912	1399
ASEAN	1985	530	148	9
	1990	1377	1065	188
China	1985	334	123	193
	1990	544	423	686

[a]NIEs here refers to South Korea, Taiwan and Hong Kong.
Source : Compiled from UN Commodity Trade Statistics.

Policy issues in textiles and clothing in the 1990s

Textile and clothing negotiations used to be regarded as one of the most difficult items in the current Uruguay Round because of the severe conflict of interest between developing country exporters and industrial country importers. By the end of 1990, however, textile and clothing negotiators had come to agree on a single way of phasing out the MFA, and this was incorporated into the Dunkel text in December 1991.

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Under the new textile and clothing agreement, all MFA restrictions are to be removed by stages and textile and clothing industry trade integrated into the GATT rules within ten years: items equivalent to 16 per cent of total textile and clothing industry imports in the first year, another 17 per cent in the fourth year, another 18 per cent in the eighth year, and the remainder in the tenth year. In addition, the expansion of quotas remaining under the MFA is to be accelerated. When imports of a remaining MFA item surge and its domestic producers are seriously affected, the transitional safeguard mechanism similar to MFA is applied, whereas the new general safeguard mechanism (improved at the Uruguay Round negotiations) is applied in the case of an import surge for items already integrated in the GATT rules. The latter is applied to all textile and clothing industry items after the transitional period.

Because of the delayed conclusion of the Uruguay Round itself, the current MFA has been extended without any change in restrictions. At this moment it is difficult to foresee when the Uruguay Round will be finally concluded but I expect our political leaders will exercise strong persuasion to conclude the negotiations in a few years' time. On conclusion of the Uruguay Round, the phasing out of the MFA will start and, as the restrictions are gradually removed, the market mechanism will resume operation in textile and clothing production and trade. There may be market disruptions in the process. For these, the general safeguard, in the form of anti-dumping measures (improved at the Uruguay Round negotiations), will be applied more readily than before.

The distortion of the textile and clothing trade cannot be attributed only to policies adopted by industrial countries. The catching-up of the third-tier exporters itself may cause some conflicts. Japanese producers are concerned about the rapid expansion of textile and clothing production capacity in China, Indonesia and Pakistan. They fear that it will add to the existing excess capacity in the region and divert their export pressure to non-MFA markets. Of course these countries have their own reasons to expand their textile and clothing capacity. They all have large populations with low per capita textile and clothing consumption. As their economies grow and per capita incomes increase, their textile and clothing consumption will rise. Their capacity expansion aims to meet the probable increase in domestic consumption. Indeed, increased demand and supply will balance in the domestic aggregate in the long run, but some part of the increased supply may be occasionally diverted to export in response to such pressures as trade deficits and shortage of foreign exchange reserves. The result may be trade conflicts with importing countries.

Japanese textile and clothing producers also complain about high tariffs on textile and clothing imports in these Asian exporting countries. Table 3 compares average tariffs on cotton yarns and fabrics among selected countries. The figures show only unweighted averages and on some sub-items (not included in the table) tariffs are as high as 80-100 per cent. China, Indonesia and Pakistan are all competitive exporters of low-count cotton yarns and fabrics but still maintain their own high tariff walls. These are partly a legacy of the import substitution policy of past years, but they also serve a real purpose as these countries are not yet competitive in some upgraded cotton yarns and fabrics. They maintain high tariffs in order to protect their domestic producers.

Table 3

International comparison of import tarrifs on
Cotton yarn and farbics, 1983 (per cent)

Country	Cotton yarn	Cotton fabrics
Japan	2.8	5.6
European Community	6.0	10.0
United States	7.8	9.0
Canada	12.5	15.0
South Korea	9.0	9.0
China	28.0	48.0
Indonesia	15.0	25.0
Pakistan	40.0	80.0

Note : Unweighted average of different tariffs on sub-items.
Source : Tariff tanles of individual countries.

Clearly, such high tariff protection tends to retard the competitive development of the textile and clothing industries of those countries. ***A competitive edge in textile and clothing production cannot be maintained by relying on cheap labour and large-scale production of `volume zone' products***. As industrialization proceeds, wages will rise, with a twofold impact on the competitive edge of textile and clothing production. First, labour costs will increase, and labour shortage and rising costs will make it difficult to maintain a labour-intensive textile and clothing industry. Second, as per capita income rises, domestic demand itself will increasingly shift to upgraded products, not to more consumption of the volume zone products. If domestic producers cannot meet this shift in home demand, they will eventually be defeated by imports of upgraded products from abroad. The second-tier exporters (the NIEs) have already reached this stage. The current policy of high protection tends to discourage producers from competing with better products and improved technology.

Many Japanese and Hong Kong firms operating in China produce better zone clothing for exports with imported quality fabrics (free of high tariffs on inputs into export production). But costly imported quality fabrics are rarely used for products sold on the Chinese market. Demonstration effects matter in the textile and clothing industry, and foreign firms and products often lead the upgrading of this industry. Eventually quality fabrics will be available at home and this in turn will input into the production of better zone clothing for domestic consumers. But at this stage it is necessary to liberalize imports and stimulate competition for the domestic market. A competitive home market creates a competitive industry. Both China and the ASEAN countries now face pressure for trade liberalization either through joining the GATT or by implementing the new ASEAN Free Trade Agreement. We can expect these third-tier countries to take advantage of these challenges so as to strengthen their textile and clothing industries. In the post Uruguay Round period, sound development of the industry will be based on market competition, occasionally supplemented by a strengthened safeguard mechanism.