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## Prosperity for all? Real adjustment in the MFA complex after Marrakech

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# Kiel Working Papers

**Kiel Working Paper No. 681**

**Prosperity for All?**

**Real Adjustment in the MFA Complex after Marrakech**

**by**

**Dean Spinanger**

**April 1995**



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## **PROSPERITY FOR ALL?**

### **REAL ADJUSTMENT IN THE MFA COMPLEX AFTER MARRAKECH**

#### **Summary**

More than thirty years after Ludwig Erhard suggested a "breathing spell" for European textile/clothing (T+C) industries "to adjust to new market conditions", the Final Act in Marrakech foresees yet another transitional period before liberalization is achieved.

During the "breathing spell" factors shaping trade/production patterns of MFA products led to production shifts to NON-ICs and concomitantly exports back to ICs. While initially and primarily clothing production - given technological constraints - continued expanding in labor-abundant countries, recent shifts in the production location of textiles underline the erosion of ICs' capital-intensive/high-tech advantages. At the same time, the high-tech equipment demanded for manufacturing MFA products originated - contrary to most other engineering products - ever more from ICs. Since competitiveness of textile machinery firms depends upon interfacing with textile producers, might there be danger of reneging on Marrakech promises? For European producers this danger does not seem imminent as Eastern European manufacturing sites are rapidly evolving.

And the impact of the Final Act on future T+C production/trade patterns? If an EC strategy initially excludes liberalization of highly restricted MFA products, Eastern Europe seems to have a head start, whereas Hong Kong will have to wait. While countries like Hong Kong may still pocket quota rents, early liberalization will help promote more efficient production, hence prosperity.

## **Table of Contents**

I.	Introduction.....	1
II.	The Uruguay Round and the MFA: Background and Relevance .....	2
III.	Behind T+C Production Locations and Trade Flows .....	4
IV.	Doing it East of the Former "Iron Curtain" .....	8
V.	OPT, the Evolving European Economic Area and the MFA after Marrakech .....	11
	References.....	17

## **List of Tables**

Table 1 -	World Merchandise Exports by Products, 1980-1992 .....	3
Table 2 -	Concentration in World T+C Industry Exports: The 80's.....	7
Table A.1 -	Description of 3-Digit SITC (Rev. 2) Categories in Division 65, Textile Yarn, Fabrics, etc.; 84, Articles of Apparel and Clothing Accessories .....	16

## **List of Diagrams**

Diagram 1 -	Working Hours per Unit Output in Spinning and Weaving since 1750 .....	6
Diagram 2 -	Share of Neighboring Countries in Clothing Imports of Major Industrialized Countries.....	10
Diagram 3 -	Structure of Textile/Clothing Imports (per cent) from three Major EU-Suppliers by Quantities and Values - 1990.....	13

## PROSPERITY FOR ALL?

### REAL ADJUSTMENT IN THE MFA COMPLEX AFTER MARRAKECH\*

#### I. Introduction

In 1962, Ludwig Erhard, the German Economics Minister was questioned about the "Textile Agreement ... concluded ... at the GATT conference in Geneva: ... [He felt that the] accord ... reached in the field of textiles inside GATT ..., seems to be a practicable way to help the branches of industry in question in West Europe to gain the breathing spell one must grant them to adjust themselves to new market conditions."<sup>1</sup> More than thirty years later, there is reason to hope that the "breathing spell" is coming to an end: with the completion of the Uruguay Round negotiations in December, 1993, the signing in Marrakech in April, 1994 and the inauguration of the World Trade Organization (WTO) in January, 1995, major steps have been taken towards ensuring that the international division of labor - in the context of this paper especially as concerns Multifibre Agreement (MFA) products - will be shaped by a more efficient allocation of resources.

This paper focuses on the MFA complex<sup>2</sup> in connection with trade and development issues in the post-Marrakech era. It begins by briefly putting the MFA complex into a proper perspective (Section II). It then points out how and why locational advantages within the MFA products have been shifting (Section III), what this might imply vis-à-vis the MFA complex of a major player, the EU, (Section IV) as well as the liberalization commitments embodied in Final Act (Section V).<sup>3</sup>

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\* The author expresses thanks to an anonymous referee and Rolf J. Langhammer for useful comments on draft version.

<sup>1</sup> Far Eastern Economic Review, Feb. 1, 1962, pp. 198-199.

<sup>2</sup> Refers to production and trade of textile and clothing products as well as to textile and clothing machinery.

<sup>3</sup> The paper does not attempt to generate estimates of global welfare changes, or the distribution thereof, evolving from the removal of trade restrictions on textile and clothing (T+C) products. Such computations have been competently carried out elsewhere, even if they may not completely reflect the state-of-the-sector as of Marrakech. See for instance Hamilton [1990]; Trela, Whalley [1990]; OECD [1993]; USITC [1994]. For more views on "quo vadis" MFA see von Schöppenthau [1993].

## **II. The Uruguay Round and the MFA: Background and Relevance**

General speaking, the hope spawned during the signing of the Final Act of the Uruguay Round of Multilateral Trade Negotiations in Marrakech, that a truly multilateral, liberal and enforceable world trading system did not merely result from the simple fact that those who prophesied a failure had been proven wrong. It was, of course, also that the Final Act reached agreement on numerous issues, where considerably less was viewed as achievable early on.<sup>4</sup> In the case of negotiations on textile and clothing (T+C) products, it was no doubt that the massively distorting MFA framework could hardly be maintained, let alone expanded for a longer period of time. Giving credence to this contention that the negotiating countries did indeed become more serious in their intentions to dismantle the MFA, is a not insignificant change in the wording made in the Final Act vis-à-vis the "Dunkel Paper": the word "promote" was replaced by the word "achieve" in describing access to markets for textile and clothing products [GATT, 1993b, Agreement on Textiles and Clothing, Art. 7, paragraph 1].

And in connection with "achieving" market access it was essential to create the institutional and legal framework within the WTO to enforce adherence to the letter of the Final Act. Without such real "teeth" in the Final Act it was seen difficult to counter the ubiquitous and multifaceted attempts to nullify agreed-upon, liberal trade principles, as was so often the case in the area of T+C products.<sup>5</sup>

Hence, at long last the principles of non-discrimination will be applied to trade in T+C products between industrial countries (ICs) and non-industrial countries (NON-ICs),<sup>6</sup> even if

<sup>4</sup> Numerous articles deal with the wide spectrum of areas (e.g. agriculture, services, trade-related investment measures [TRIMs] and trade-related intellectual property rights [TRIPs] now covered by the Final Act; see e.g. Sutherland [1994] for a general statement, a more in-depth article was written by Rom [1994].

<sup>5</sup> Such attempts were not limited to T+C products. Remember, for instance, the strange trips video cassette recorders had to take to Poitiers in order to receive customs clearance in France [see Greenaway, Hindley, 1985, pp. 29-63].

<sup>6</sup> The aggregate "ICs" encompasses the EU, EFTA, North America, Japan, Australia, New Zealand and South Africa. The aggregate "NON-ICs" encompasses all other countries.

this does take place over a ten-year transitional period.<sup>7</sup> It is also a relevant area to focus on given the fact that T+C trade has not been a declining segment of world trade. On the contrary, exports, particularly those from NON-ICs, have been growing faster than average (Table 1). In 1989/90, the value of world exports of textile and clothing products exceeded those of passenger cars and aircraft.

Table 1 - World Merchandise Exports by Products, 1980-1992

	Value <sup>a</sup>	Shares (in per cent)		Annual average change (in per cent) <sup>b</sup>		
		1992	1980	1992	1980-92	1991
All products <sup>c</sup>	3642	100.0	100.0	5.0	1.6	5.9
Agricultural products	444	14.7	12.2	3.3	0.8	6.1
Food	349	11.0	9.6	3.8	3.3	7.3
Raw materials	95	3.7	2.6	1.9	-7.2	2.1
Mining products	446	27.6	12.2	-1.9	-5.1	-2.0
Ores and other minerals	47	2.1	1.3	0.9	-6.7	-3.2
Fuels	331	23.0	9.1	-2.8	-4.8	-1.8
Non-ferrous metals	67	2.5	1.8	2.4	-5.6	-1.7
Manufactures	2653	54.0	72.8	7.6	3.3	7.6
Iron and steel	103	3.8	2.8	2.5	-1.1	-1.2
Chemicals	327	7.0	9.0	7.2	3.1	7.4
Machinery and transport equipment	1359	25.8	37.3	8.3	3.8	8.0
Office and telecom equipment	349	4.2	9.6	12.5	7.6	8.8
Automotive products	361	6.5	9.9	8.8	1.5	10.7
Other machinery	649	15.2	17.8	6.4	3.1	6.2
Textiles	117	2.7	3.2	6.3	4.2	6.9
Clothing	131	2.0	3.6	10.2	9.7	12.0
Other consumer goods	337	5.9	9.3	9.0	2.9	8.8

<sup>a</sup>Bill. US\$. - <sup>b</sup>Bold faced figures designate products with growth rates exceeding manufactures. -

<sup>c</sup>Including unspecified products.

Source: GATT [1993a], Table III.1.

<sup>7</sup> The Act stipulates that textile and clothing products are to be integrated into GATT in 4 stages, based on the volume of imports in 1990. In Stage 1 (beginning as of 1/1/1995), products accounting for 16 per cent of the imports (in volume terms) are integrated into GATT. The respective growth rates of the remaining products are increased during this period by 16 per cent. In Stage 2 (from 37th-84th month), another 17 per cent of MFA products (based on 1990 shares) are integrated and growth rates of remaining products increased by 25 per cent over Stage 1. In Stage 3 (from 85th to 120th month), another 18 per cent of the products must be integrated and the growth rates of remaining products (49 per cent) increased by 27 per cent over Stage 2. In Stage 4 (i.e. immediately following 120th month) the remaining products, i.e. 49 per cent, are integrated, so that all textile and clothing products will have been incorporated into GATT. For specifics see GATT [1993b, Final Act, Agreement on Textiles and Clothing, Article 2]. See also Bagchi [1994] for an initial assessment.

These figures clearly underline the importance of the T+C industry in world trade. For sure, if there is one industry which has served as a motor of industrialization over the centuries and across countries, then it is the textile and clothing industry [see e.g. Deane, 1965, pp. 84-88]. This still holds true today, particularly for the clothing industry. For example: In 1980, Bangladesh gave rise to the impression that it was destined to become a black hole for development assistance. Today, it exports more to the US and EU combined than all of Africa (excluding Mauritius, Tunisia and Morocco) and South America together. Hence, trade and concomitantly development success is quickly possible via the T+C industry because of its relatively high degrees of standardization of technology and thus inter-country "shiftability".

### **III. Behind T+C Production Locations and Trade Flows<sup>8</sup>**

In Table 1 it can be seen that world clothing exports increased noticeably faster than textile exports. This can be attributed to major differences in production technologies between the two industries. On the one hand, these have turned spinning and weaving production into extremely capital/high-tech intensive processes, out of which factories almost without workers have evolved. The quantum leap achieved over the past decades is portrayed in Diagram 1. Sewing technologies, on the other hand, still have not overcome using many human hands to assist in joining pieces of cloth into an article of apparel.

What occurred on the technology side over the past quarter century (i.e. upstream from clothing production) has accordingly had a major impact on the location of the T+C industry and concomitantly also on the structure of protection. But the technology warp was also reflected in the structure of textile and clothing machinery industry. That is, newer technologies led to a stronger departure from the initial philosophy of textile companies which "often maintained machine departments large enough to stand on their own" [Landes, 1970, p. 184]. Ergo: Textile and clothing industry companies concentrated all the more on producing and selling textiles, rather than constructing machines.<sup>9</sup>

This dichotomy in production technologies has long led to an increasing share of clothing production being shifted to those countries where human hands were in plentiful supply (see Table 2). Already in 1981 did NON-ICs dominate clothing production, with only one IC,

<sup>8</sup> This section draws on material prepared in connection with a World Bank research project dealing with prices of capital equipment (i.e. textile and clothing machinery) in developing countries.

<sup>9</sup> This does not mean that machines are not refined or improved upon by the T+C companies. As a matter of fact in numerous T+C companies it has been pointed out to the author that the production process was particularly efficient due to special adaptations made at the factory.

Italy, number one in just two product groups; by 1990 this had been decreased to one minor group (i.e. accounting for 5 per cent of total clothing exports). Overall NON-ICs continually increased their already sizeable shares and accounted for well over 50 per cent of clothing exports by 1990. In the case of textiles it is still a different story. NON-ICs were the source of less than 40 per cent of world exports in 1990, although they did even more noticeably increase their share (by roughly 50 per cent) vis-à-vis 1981. Whereas only China was a leading NON-IC exporter in but one product group in 1981, by 1990 it (together with Hong Kong) dominated in three groups.

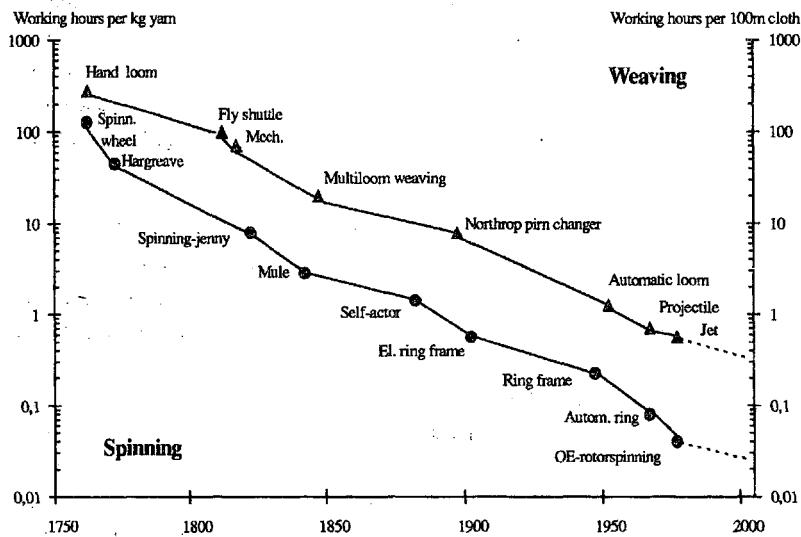
Accompanying these major shifts in textile and clothing production to NON-ICs, was the export of machinery for the T+C industry in the same set of countries. As a matter of fact, by the turn of the decade over 50 per cent of T+C machinery was headed for NON-ICs and thus roughly on par with their share in exports of T+C products. This is definitely the largest shift in demand away from ICs to NON-ICs among all major groups of machinery and transportation equipment exports.<sup>10</sup> By 1990, no other group was concentrated so heavily on NON-IC markets. And where did the T+C machinery exports come from? The production of T+C machinery actually became increasingly concentrated in ICs. Given the fact that among almost all of the other product groups NON-ICs reveal an increase in their share of exports, this is somewhat surprising. That is, why should ICs have become more competitive in producing T+C machinery than NON-ICs?

It can essentially be explained by the extremely high demands placed on tolerances in dealing with textile fibres and yarn. These demands were multifaceted in nature, drawing on a wide spectrum of state-of-the-art technical and scientific knowledge, only - so far - readily accessible in those ICs, where an effective interface with the textile and clothing manufacturing could be established. This interface between the textile industry and the textile machine industry has continued to play an important role, from which both parties profited. It was not only the synergistic effect from approaching the problems from different directions, it was also the ability to test machines under true working conditions before they came on the market.<sup>11</sup> This refers in particular to the textile industry where technical progress has not been restrained nearly as much by the physical properties of the intermediary inputs as in the case of the clothing industry [see Spinanger, 1992, pp. 98-100, and Hoffman, Rush, 1988].

<sup>10</sup> A total of 43 three-digit SITC groups in SITC category 7 were analyzed. As can be seen in Table 1, machinery and transportation equipment accounted for over 50 per cent of manufacturing exports in 1992.

<sup>11</sup> Furthermore, as touched on above, improvements on machines made by T+C companies were often eventually incorporated into later models produced by T+C machinery companies. An appropriate theoretical treatment of the issue can be found in Harthoff [1991].

Diagram 1 - Working Hours per Unit Output in Spinning and Weaving since 1750



Source: Adapted from Hartmann [1993, p.66].

It was further accelerated by ever higher quality demands and more rapid fashion changes which implied more effective production controls but also a greater degree of flexibility. Hence, being successful in exporting textile and clothing products to ICs became an increasing function of quality. And the level of quality demanded was often only attainable by employing capital equipment, their embodied technologies and the essential components from ICs. Knowing that countries like India and China do produce considerable amounts of T+C machinery, and given the crucial interface mentioned above, the existence of an inherently competitive T+C industry bears the potential to spawn a future competitive base for exportable T+C machinery.

Table 2 - Concentration in World T+C Industry Exports: The 80's

SITC (Rev.2) groups	Export concentration (per cent) <sup>a</sup>						Share in total SITC 65/84 exports (per cent)		IC import concen- tration (per cent) <sup>b</sup>	
	1981			1990					1981	1990 <sup>d</sup>
	Top 4	Top XC <sup>c</sup>	NON- ICs	Top 4	Top XC <sup>c</sup>	NON- ICs	80/81	88/89	1981	1990 <sup>d</sup>
651	44.6	14.5 G	23.1	38.4	15.2 G	34.1	26.7	24.5	68.1	69.3*
652	42.1	12.2 G	35.5	44.7	12.3 C	47.0	13.5	14.2	61.5	54.0**
653	60.6	30.0 J	23.1	50.6	14.9 G	38.6	19.4	19.6	49.7	52.5*
654	53.3	25.2 I	28.3	60.6	29.5 I	32.9	6.6	8.0	77.3	68.4*
655	60.1	21.0 G	16.5	51.9	19.4 H	44.3	4.9	4.8	65.5	52.1*
656	55.3	21.5 A	16.1	44.8	16.0 F	25.6	2.6	2.5	59.0	68.1*
657	49.2	17.6 G	14.8	43.4	18.4 G	20.7	9.2	10.4	71.9	67.6*
658	36.2	10.0 C	39.5	39.5	17.7 C	53.6	7.5	7.7	63.7	75.8**
659	52.6	25.0 B	33.1	50.0	27.0 B	36.8	9.6	8.4	82.8	87.6*
842	48.0	14.8 H	51.8	40.5	14.1 H	56.6	21.3	15.6	84.5	87.9*
843	46.5	19.0 H	47.3	46.1	16.4 H	55.2	23.2	24.7	87.8	83.4*
844	58.3	24.8 K	74.5	46.0	21.4 H	72.9	6.7	7.0	83.4	83.5
845	56.7	22.8 I	44.0	52.8	16.5 H	58.6	23.9	25.8	90.7	89.7*
846	40.6	16.0 H	47.8	33.9	14.0 H	57.7	11.0	11.4	87.9	85.2*
847	52.0	22.3 I	35.1	54.7	24.1 I	46.1	4.5	5.0	77.6	81.5**

<sup>a</sup> Per cent share in total world exports of given group. In case of NON-ICs data refer to 1980/81 and 1988/89. - <sup>b</sup> Per cent share of IC imports in total world imports of given group. - <sup>c</sup> XC = exporting country. Letters behind shares designate following countries: A = Austria; B = Belgium; C = China; F = France; G = Germany; H = Hong Kong; I = Italy; J = Japan; K = Korea. - <sup>d</sup> The underlined figures designate a decrease in IC's demand of world imports; those with a "\*" designate an increase (at least 1 percentage point) in DC's share of world exports; a "o" indicate an increase in share of "Top 4".

Source: Own calculations based on UNCTAD [1992], Tables 4.3A and 4.3B as well as UN [1992], Vol. 2, respective tables. See Appendix-Table A.1 for description of groups.

Herein lies the "obvious" potential for strategic trade policies [see e.g. Brown, Julius, 1993], as the disappearance of the textile industry in ICs would mean that the above mentioned key interface with textile producers would also disappear. Would industrial countries' governments attempt such a policy by delaying the dismantling of the MFA restrictions as long as possible in order to preserve the high-tech T+C machinery industry? In doing this, they would obviously have to renege on their Marrakech signatures. Given the past track record of restrictions on T+C imports and particularly in light of the phasing-out timetable for MFA products (see footnote 6), such a step is not inconceivable. However, the market already seems to be generating other solutions. Major European T+C machinery companies have begun to invest in production facilities in both India and China, two countries where an interface with the textile industry could be coupled with the high-tech inputs from home countries. But for European producers, there is also another, market-oriented option rapidly opening up and this interfaces even better with meeting changes in the demand for clothing products, namely doing it with countries next-door.

#### IV. Doing it East of the Former "Iron Curtain"

Within the context of the MFA complex interfacing with one's neighbors is all the more feasible the greater the development (i.e. per capita income) differentials are. Among members of the EU such a division of labor has evolved, for instance, between Germany (as a textile manufacturer/exporter) and Portugal (as a clothing manufacturer/exporter). But of even greater interest in this respect have been the ties Germany has spawned with its neighbors east of the former "iron curtain", the Central and Eastern European Countries (CEECs). Not only are the development differentials greater, but the economic distances shorter and hence the communication costs lower. Interfacing with these countries, in particular over the last decade with Yugoslavia, was eased by regulations permitting offshore processing trade (OPT), which was in addition to MFA quotas.<sup>12</sup> When the new European landscape evolved toward the end of the 80's, as the CEECs began to reform their economies, trade became more significantly redirected. Furthermore, it seems to be shaping production/trade patterns ever more for the coming, final decade of the MFA's fading away. A similar pattern can be determined for the United States vis-à-vis countries "south of the border",<sup>13</sup> where large development differentials also prevail. All these trends can be seen in Diagram 2 with Germany, followed by Italy, leading the European countries and the US far ahead of all of them.

But Germany is an exception in the EU, as it accounts for almost 70 per cent of the EU's OPT clothing imports, as opposed to roughly 45 per cent of total extra-EU clothing imports.<sup>14</sup> Vis-à-vis Eastern Europe its share even approaches 75 per cent down from over 80 per cent just 3 years earlier. Italy, on the other hand, although very rapidly expanding its OPT imports, just slightly exceeds 3 per cent overall or rather 4 per cent from Eastern Europe. The potential of the CEECs as production platforms for OPT has thus hardly been tapped by Europe's largest clothing manufacturer and exporter despite the fact that Mediterranean Rim countries have been used as production platforms (particularly by France) for years. Given the fact that rapidly changing fashions, quick turn-around times and higher quality products are driving demand, being next-door endows these countries on the Rim of the EU with an

<sup>12</sup> By 1985 Yugoslavia was Germany's third largest clothing supplier (behind Italy and Hong Kong). It accounted for over 50 per cent more than MFA countries (4.8 per cent) and 20 per cent more than imports from all other Eastern European countries (6.4 per cent). However, the war in former Yugoslavia reduced its shares in Germany's imports by over 50 per cent between 1990 and 1992 (i.e. from 8.6 per cent to 3.9 per cent).

<sup>13</sup> Imports from these countries were no doubt also induced by the Caribbean Basin Initiative (CBI) and more recently by the coming of North American Free Trade Association (NAFTA).

<sup>14</sup> All figures - unless elsewhere stated - refer to 1992.

advantage that the successful exporters in the Far East will have difficulty compensating. This is all the more the case in those countries where quota rents could be captured.

Given this constellation the medium-term adjustment process for the MFA complex in Europe would seem to be facing relatively positive prospects. To the extent that these countries do gain the access to the EU they have been promised, then restructuring in the T+C industry could be all the more easily effected. And how will the T+C machinery producers fare?

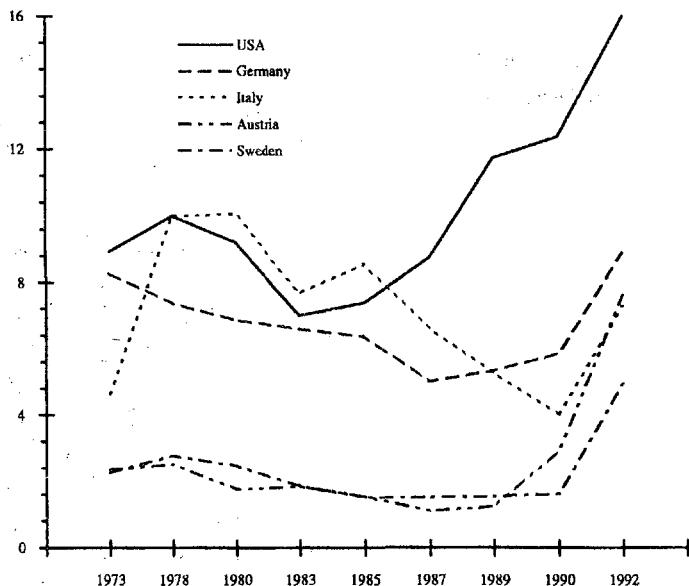
As a matter of fact, the three major European producers of T+C machinery (i.e., Germany, Italy and Switzerland) heavily concentrated their shipments on the European and American T+C industry in the past, with NON-ICs accounting for about a third of exports only. Japan, however, had already begun the process of winding down its domestic T+C industry and was able to use its locational advantage to supply and interface with the fast growing Asian NON-ICs.<sup>15</sup> Japan was hence able to strengthen its dominant position as the world's largest supplier of machinery for the clothing industry, it almost caught up with Germany in spinning and overtook both Switzerland and Germany in weaving/knitting equipment, etc. Only in the area of finishing equipment (the smallest category in value terms) was Japan not able to make significant inroads and it is here where Germany has been able to maintain its hold. Since it is the finishing process which puts the quality and value added into fabrics and yarn, it can be contended that the German textile industry - the world's largest exporter - has profited from this close interface.<sup>16</sup>

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<sup>15</sup> The differential is even more pronounced if the growth rate of T+C machinery exports to Asian countries is compared with that to European countries (over the period 1983-91: 23.0 per cent vs. 13.1 per cent. Japan's exports throughout the decade and across all categories is almost diametrically opposed to the other 3 major suppliers which usually exhibited a strong IC concentration, whereas Japan's overall shares of T+C machinery exports destined for DCs averaged 60 per cent and exceeded 70 per cent in 1991, the shares of the other 3 suppliers were usually 50 per cent lower even if somewhat higher in the second half of the period.

<sup>16</sup> For an in-depth analysis of Germany's T+C industry see Spinanger, Piatti [1994].

Diagram 2 - Share of Neighboring Countries<sup>a</sup> in Clothing Imports<sup>b</sup> of Major Industrialized Countries



<sup>a</sup> For US per cent share from Caribbean countries and Mexico in total clothing imports; for all other countries per cent share from CEECs (excluding Yugoslavia) in total clothing imports. - <sup>b</sup> SITC 84 (Rev. 3).

Source: Own calculations based on special UNCTAD tabulations. OECD trade statistics [var. issues] and EUROSTAT CD-ROM [30/4/93].

Given such tendencies it can be assumed that they would reinforce regional trade patterns shaped by proximity to markets (i.e. low transaction costs). Although on the one hand modern global telecommunications systems and efficient transportation links have reduced or even eliminated some natural trade barriers, on the other hand, capital equipment exports for an industry being driven ever faster by rapidly changing fashions as well as shorter lead-times, places high demands on service and repair networks. The costs of maintaining such operations far afield can be assumed to be all the larger, the less the industry tends to be conveniently concentrated in easily accessible urban locations. The consequences of such a constellation are trade patterns clustered around the dominant suppliers with geographically peripheral, marginal and/or new buyers being subjected all the more to different purchasing conditions.

But - as noted above - new adjustment requirements have emerged for European firms in the MFA complex and now it is the demand outside of Western Europe which has to be tapped if T+C machinery producers are to survive. New clients must be sought and "wooed".<sup>17</sup> But obviously, "wooing" only works if the machines to be sold can be used to produce textiles which can also be sold. Given the technological constraints placed on the core production process in the clothing industry (i.e. sewing) as well as the decreasing advantages of ICs in the manufacturing of yarn and fabrics, shifting T+C industry production to CEECs is the ideal path.

In other words: for Germany and Italy tapping the CEECs will boost the competitiveness of their high value-added clothing industry. Accordingly their textile industries will profit all the more the longer they can take advantage of OPT, i.e., as long as effective tariff rates on clothing products from these countries are lower.<sup>18</sup> Likewise, their T+C machinery industries can maintain their close interface with textile producers while at the same time gearing up production facilities in countries like China and India.

## V. OPT, the Evolving European Economic Area and the MFA after Marrakech

As plausible as the above conclusions may sound, protectionist tendencies in the EU following the signing of the Uruguay Round agreements still threaten to turn them into fiction. The bone of contention was the long-pending revision of the EC regulation embodying the framework within which the OPT is carried out (i.e. No. 636/82). It was not only Greece, Portugal and Spain, who felt that their own textile and clothing industries were being threatened, but also the EU's largest producer and exporter of clothing, namely Italy.

<sup>17</sup> An article describing a T+C machinery fair in Indonesia contained excerpts from a discussion with a representative from one of the four largest flat knitting machinery producers. See Sung [1993, p. 32]: "Mr. Andreas Mayer of Stoll ... said that [in the past] clients had to woo machine makers in order to purchase a machine. The delivery time was about two years long 4-5 years ago and even longer before that. Now clients want their orders filled immediately. The tables have turned and machine makers are now wooing the buyers instead."

<sup>18</sup> Given the fact that tariffs are only applied to the value added produced outside the EU customs area, the effective rate on the total EU import value could be 50-70 per cent lower. Based on 1992 US OPT statistics, the dutiable value in percent of total import value ranged from 32 per cent for men's/boy's trousers to 50 per cent for women's/girl's coats and jackets. On average for clothing products it amounted to 37 per cent [see USITC, 1994a, p. B-25, but also Table 1-7]. In light of the EU free trade agreements with CEECs, production platforms in Eastern Europe will tend to become even more attractive.

Hence, revised OPT regulations were approved by these countries only under far more restrictive terms.<sup>19</sup>

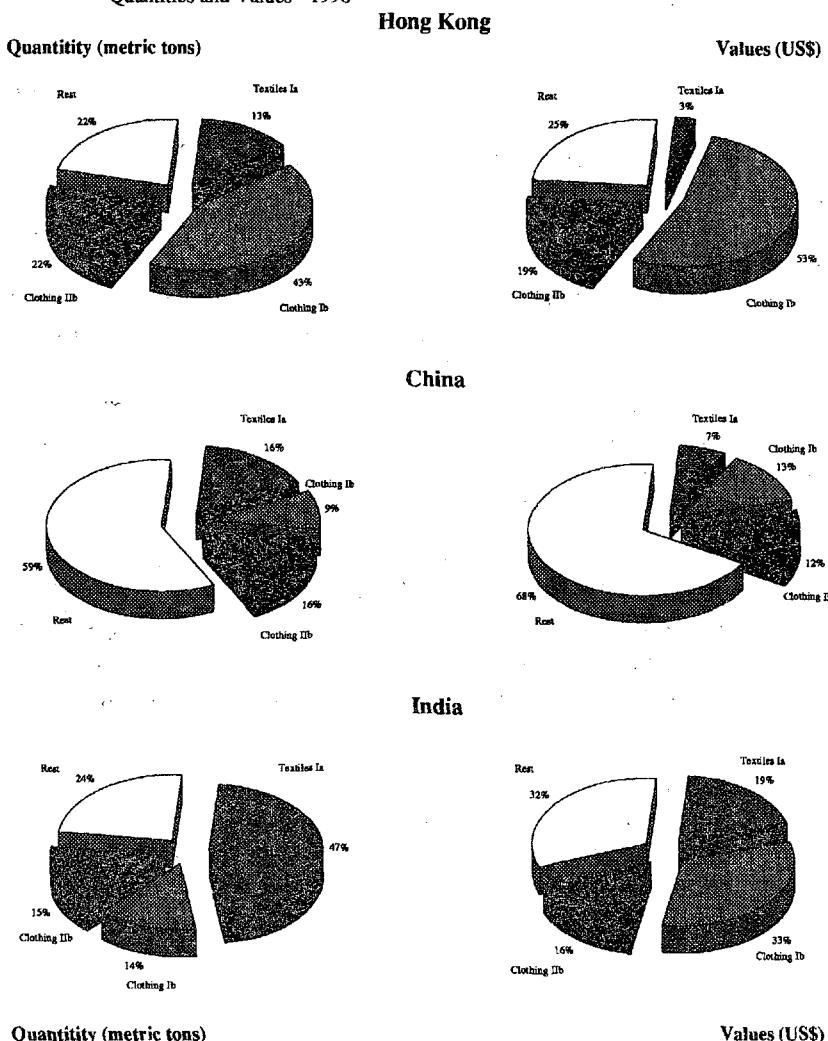
Needless to say the thrust of more restrictive OPT regulations would have primarily shifted the adjustment burden onto Germany's T+C trade with Eastern European countries. To underline the dynamics behind Germany's move into the East: By 1992 Germany was exporting more textiles to CEECs (that is, to be mainly turned into clothing) than to EFTA, the USA, Canada and Japan combined. Three years earlier the latter exceeded the former by 75 per cent. The significant savings in labor costs plus the high level of labor skills accessible in the neighboring Eastern European countries made this option particularly attractive for high-quality, fashion-oriented products. Hence, OPT, together with rapidly moving into up-market niches, have become essential ingredients in survival strategies of Germany's textile and clothing industry complex. That German clothing manufacturing has indeed been successful in following this strategy can be gathered from its outperforming Italy in major EU and other export markets. Furthermore, the fact that it achieved particularly strong growth in the highly fashion-oriented Italian market (where German clothing exports increased twice as fast as those to total EU), underlines what could be called the German rag-trade miracle. After all, who would have thought 10 years ago that Germany would be increasing its clothing export share in world markets by 10 per cent, while Italy was losing over 10 per cent and Hong Kong more than 30 per cent.

The logical question is, if Germany has successfully tapped the OPT potential, also preserving thereby an effective interrelationship with the T+C machinery industry, to have high-quality EU-textile products sewn into fashionable clothes (primarily) just to the east of EU borders, why should Italy - also with a viable T+C machinery industry - want to limit access to an obvious advantageous option with considerable potential left to be tapped? Despite Italy's initial insistence on stricter OPT regulations it could be shown in Diagram 2 that it was actually already following Germany's path to the Eastern European countries. Hence, by December of 1994 agreement was finally reached on a new EC OPT regulation (No. 3036/94) which contained enough liberal elements so as to enable the above-postulated interface between the T+C industry and the T+C machinery industry to evolve. This interface is bound to be strengthened knowing that trade barriers between the EU and Eastern

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<sup>19</sup> Despite the existence of a common external tariff regulation, Regulation 636/82, was differently interpreted by the various EU countries. Whereas Germany permitted OPT for almost any type of manufacturing/trading company Italy limited it specifically to manufacturing companies and made it dependent upon turnover (i.e. OPT allowed in an amount equal to 30 per cent of calculated turnover). See, for instance, Döpfer [1994].

Diagram 3 - Structure<sup>a</sup> of Textile / Clothing Imports (per cent) from Three Major EU-Suppliers by Quantities and Values - 1990



<sup>a</sup> Ia and Ib include the most sensitive EU textile / clothing import categories (cover cat. no's 1-8); clothing IIb (next sensitive group) encompasses the three largest categories.

Source: Own calculations based on Eurostat, External Trade (CN), CD-ROM (30/4/93).

European countries are due to be eliminated - even for T+C products - over the coming years in creating the European Economic Area. Can the prosperity engendered thereby be considered to be a positive side-effect of the MFA?

And what does the gradual disappearance of the MFA over the next 10 years imply in context of the above issues? The proposed structure and time schedule for winding down the MFA and integrating T+C products into GATT rules (see footnote 6) is straightforward, but not without a potential protectionistic pitfall. With only 51 per cent of MFA products incorporated into GATT after 10 years, but the remaining 49 per cent to be removed - all at once that point in time, this could fuel a new round of protectionism, particularly if the structural adjustment process is creating employment problems particularly difficult to absorb. Such a reaction is all the more likely since the Final Act does not stipulate the inclusion of highly sensitive products at any time *throughout* the 10-year phase-out period.<sup>20</sup> Since it is the importing country (e.g., the EU) which dictates the structure of the phase-out, ensuring thereby only that products from four groupings<sup>21</sup> are included, it can decide to maintain quotas on as many highly sensitive products over the ten year period.

Given the initial proposals submitted by the EU, the USA and other countries for the liberalization of the first 16 per cent of T+C imports, it has become obvious that such a strategy is indeed being followed. The EU, for instance, is liberalizing imports of doll's clothing as well as used clothing. Viewing the structure of EU T+C imports from three major supplier it can be easily seen that Hong Kong's T+C products are heavily weighted in highly sensitive clothing products, whereas 60 per cent of China's products are in non-sensitive areas (Diagram 3).

A closer examination of the specific MFA products being liberalized by the EC in the first round (i.e. 16 per cent of 1990 non-EC MFA imports by weight), shows that there is a highly significant positive correlation between the structure of intra-EU trade and the structure of EU imports from Eastern European countries. However, the structure of intra-EU trade is not

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<sup>20</sup> If the liberalization of the most sensitive products is indeed postponed until the end of the 10 years, those responsible for enacting trade policy hopefully have learned from past lessons which clearly show how expensive protection can be [Wolf et al., 1984]. If protection nonetheless surfaces, then it is up to the forcefulness of the WTO to ensure that at least the letter of the Final Act is adhered to.

<sup>21</sup> The groupings are tops/yarns, fabrics, made-up textile products and apparel. The four groups are not of equal importance within the MFA and no stipulation is made vis-à-vis how much from each group must be included.

correlated at all with the structure of EU imports from major East-Asian T+C producers.<sup>22</sup> In other words, the first tranche of liberalized products is much more in line with products already being imported from Eastern European countries than with those from East Asian countries.

Whether this means that the Eastern European countries have established market positions which they can more easily expand as a result of the liberalization remains to be answered. Likewise remaining to be answered is the question whether the non-liberalization of sensitive T+C products, that is products where countries like Hong Kong have been profiting from quota rents over the past years, means that they will continue to be able to profit from such quota rents. Knowing that such rents are not insignificant they could help in promoting structural adjustment before quotas are eliminated.<sup>23</sup> Should restructuring in a country like Hong Kong be viewed as moving quickly into more up-market clothing products, this could prove to be a risky venture. Already products imported from Eastern European countries (e.g. woven cotton shirts) reveal higher unit values than those sourced in Hong Kong.

To conclude: assuming that recent trends in the EU T+C trade patterns continue, the liberalization of MFA products, together with the establishing of a European Economic Area will not only help spawn prosperity via a rapid expansion of the T+C industry in Eastern European countries, it will also assist German and Italian T+C machinery producers in maintaining their key interface with textile producers - an interface which has had an important synergetic impact on the EU MFA complex.<sup>24</sup>

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<sup>22</sup> Pearson correlation coefficients were calculated from the shares of each of the 54 product groups (based on 1990 quantities) in the notification submitted by the EU to the GATT containing the list of products to be liberalized. The correlation between intra-EU import shares and shares of imports from Eastern European countries was 0.69 (significant at 1 per cent level); the correlation between intra-EU import shares and shares of imports from East Asian countries (i.e. Hong Kong, Korea and Taiwan) was an insignificant -0.02.

<sup>23</sup> To the extent that exporters merely pocket the rents, without worrying about the period after they lose their quota "protection", the final liberalization phase could well induce a major shock. That is, it has been noted by major German buyers of clothing products in Hong Kong that they would shift a major portion of their demand to other countries with considerably lower prices, once quotas are removed [see e.g. Spinanger, 1994].

<sup>24</sup> Unanswered remains the question about the impact of a possible quantum leap in technology in the clothing industry, turning it into a capital intensive industry, like the textile industry over the past decades. This author, however, attaches a very low degree of probability to such developments occurring over the course of the next ten years.

Table A.1 - Description of 3-Digit SITC (Rev.2) Categories in Divisions 65, Textile Yarn, Fabrics, etc.; 84, Articles of Apparel and Clothing Accessories

Divisions/ Categories	Description
<b>65</b>	<b>Textile Yarn, Fabrics, Made-up Articles, N.E.S. and Related Products</b>
651	Textile yarn
652	Cotton fabrics, woven
653	Fabrics, woven, of man-made fibres
654	Textile fabrics, woven, other than cotton man-made fibres
655	Knitted or crocheted fabrics
656	Tulle, lace, embroidery, and small wares
657	Special textile fabrics and related products
658	Made-up articles, wholly or chiefly of textile materials
659	Floor coverings
<b>84</b>	<b>Articles of Apparel and Clothing Accessories</b>
842	Outer garments, men's, of textile fabrics
843	Outer garments, women's, of textile fabrics
844	Under garments of textile fabrics
845	Outer garments and other articles, knitted
846	Under garments, knitted or crocheted
847	Clothing accessories of textile fabrics

Source: UNCTAD [1992] notes following Tables 4.3 and 4.4.

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