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COMESA TEXTILE INDUSTRY CAN SURVIVE IN THE POST MFA WORLD

Presentation by Stephen Lande, President, Manchester Trade for
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Manchester Trade is pleased to have been invited by RATES (Regional Agricultural Trade Expansion Support) Program to be a presenter today. The plethora of quality and influential speakers makes it an honor to have been included. COMESA Director General Eratsmus Mwencha, ably represented by Dr. Chungu Mwila, leads a program providing comprehensive market opportunities for textiles and apparel within East and Central Africa. Under the leadership of its export tsar, Madame G.M. Sassore's, ably represented here by David Ashiru, Nigeria is on the verge of becoming one of a select number of countries benefiting from textile concessions. Bill Jackson's is USTR's working level point person on AGOA and is doing an excellent job. Paul Ryberg and African Coalition for Trade not only provides the most comprehensive information on a regular basis on AGOA particularly apparel trade, his quiet work in Washington particularly his support of Rosa Whitaker's AGOA III coalition assures that the voice of African manufacturers are always heard.

I will expand Manchester Trade/Bearing Point's paper prepared under the auspices of the REDSO (Regional Economic Development Support Organization) and the East and Central African Global Competitiveness Trade Hub. The paper, posted on the Hub's website (www.ecatradehub.com/home.index.asp) and included in your packet, is entitled "Impact of the End of MFA Quotas on AGOA Textile Exports from Select COMESA countries". The paper was concluded at the end of last year, at about the time that the MFA phased out. This presentation will supplement the paper by including trade data, anecdotal facts and analysis covering the first three months of 2005-three months after the MFA had expired.

Based on an impressive ability to maintain and even expand its market share in the first three months of this year and a determination by many producers to continue, deepen and expand production in the region, we are now more confident about the future of textile production in the region. Thus this presentation is now entitled "COMESA Textile Industry Can Survive in the Post MFA World". The size of the industry and its contribution to growth in the COMESA region will be determined in large part by developments within the control of the region. This means that part of the fate of the industry is in the hands of national governments and the private sector within the region.

The future of the region's industry will also be determined by developments outside of the region's control such as trade policy decisions in Washington, Brussels and Geneva and decisions by buyers and retailers in importing countries as well as decisions by global investors. This presentation will expand upon these ideas after describing the current situation facing COMESA exports.

The textile chain begins at the farm with cotton cultivation and usually ends with clothing shipments from factories to both domestic and export markets. In the interim, cotton is picked, cleaned and ginned, spun, milled, dyed and otherwise treated, cut and sewn or knitted into garments. Accessories are added usually in the form of buttons, snaps, trim, beads, other decorations etc. The study and my presentation focus on the manufacturing aspects of the chain, spinning, milling (weaving or knitting), knitting to shape, cutting and sewing. Unfortunately, so far the major pursuit in Africa in terms of export has been limited to cutting and sewing, not to the other steps.

AGOA was to accomplish two objectives in the textile areas: 1) to develop a world-class garment sewing industry and 2) to create backward linkages to textile mills. In the first area, it is amazingly successful. In fact, it is the most successful of any preferential program in terms of generating new production, exports and jobs in beneficiary countries. There are many preferential programs most notably Generalized System of Preferences programs offered by the United States, the European Union and other developed countries, a whole plethora of European preferential programs for African, Caribbean and Pacific nations, American programs benefiting the Caribbean Basin Initiative (CBI) and Andean countries and finally programs under the least developed rubric of the WTO. Too put it simply, many attendees would not be in business without AGOA.

No program other than AGOA has seen non-existent production in a number of countries attain world-class competitive levels. Apparel exports from poorer African countries (I do not mean Mauritius and South Africa) to the United States were virtually non-existent in October, 2000 when AGOA started. Today, they account for about one percent of total US imports with significant shares of two widely consumed categories, knit shirts and woven trousers. Less important products are cotton sweaters and woven shirts. Four developing countries were able to establish a significant market position (Lesotho, Madagascar, Kenya and Swaziland) recording double-digit growth during AGOA's initial four years. A number of new suppliers seem ready to enter the market and are currently experiencing double and triple digit growth although from a small base.

The growth was able to take place because country quotas implemented by developed countries, particularly the United States, against China and other competitive Far East suppliers, limited more competitive exporters. Before AGOA, export production had spread to about thirty countries as buyers had scurried around the world to find suppliers to fill demand gap created by limitations on more efficient suppliers. Governments whose countries were subject to quotas were able to generate revenue for themselves by selling the right to ship while still being able to fill their quota allocations in developed country markets. Producers in such countries also moved up to more sophisticated production in order to maximize revenue. This created space for new suppliers to enter the low-priced or less expensive segment of the market.

The introduction of AGOA in the year 2000 allowed African suppliers to take advantage of this situation, especially least developed countries. The duty preference for apparel incorporating third country fabrics allowed Africa to use its low cost labor to cut and sew fabrics from the most competitively priced suppliers and benefit from a sixteen to thirty-four percent tariff duty-preference market. AGOA beneficiaries were now able to fill the void created by the absence of more competitive suppliers in the low-end of the market.

The second objective may have been attained as well—supply linkages through creation of a vibrant textile milling sector--had not the end of the MFA occurred. The basic provision of AGOA designed to promote the development of textile mills was the phase out after four (extended to seven) years of duty-free treatment for less developed AGOA beneficiaries of their right to export duty-free apparel incorporating third country fabric into its duty-free exports to the United States. It was hoped that this provision's phase-out, would induce African garment makers to switch its source of supply from third country to African (and is some cases American) spun yarn and woven or knitted fabrics. This was to occur through new investments creating world-class African textile mills. Garment exporters no longer benefiting from duty-free treatment for incorporating third country fabrics would be able to continue to exports apparel from third country fabrics and yarns thereby creating backward linkages where none had existed.

Initially, there was little movement towards internal fabric production to feed garment mills producing for exports. The fact was that whereas apparel assembly operations cost approximately 2 to 4 million dollars, a textile mill cost ten to fifteen times as much. An integrated textile mill needs yarn spinning, fabric sewing or weaving and a finishing houses—is much more expensive than the sewing machines and cutting machines--the major capital investment in a garment manufacturing. Whereas apparel mills could be set up in free trade zones often located close to ocean going seaports, textile mills had to be located inland close to the source of cotton, power and water resources. By operating in free trade zones, apparel manufacturing was largely isolated from local problems—the same could not be said for textile mills.

The basic demand for garments whether shirts, sweaters, bottoms, suit jackets, outerwear, socks, etc. does not change. Most garment producers can handle different fabrics on their existing machines. The industry meets competition through introducing more sophisticated sewing and cutting machines, upgrading skills of operators and adding information systems to more closely link producing units to buyers and sales outlets,

Demand for the output of different types of textile mills do change and individual textile mills cannot respond to the challenges. The type of fixed investment required for textile mills is much less adaptable to changes in fashions and buyer's preferences than apparel manufacturers. Fashion whims often result in some fabrics increasing in popularity whereas other fabrics fall out of favor. Textile mills cannot easily move between producing man-made fiber and cotton fabrics, between producing knitted and woven fabrics, between producing lighter shirting and blouse fabrics and heavier bottoms, between producing denim and other types of fabrics. If finishing requirements change—complete finishing houses can find no demand for their operations

As long as African garment producers could incorporate yarns and fabrics at the lowest cost existing in the world, there was no reason to invest in textile mills. Even as the initial deadline for the termination of duty-free treatment for apparel incorporating third country fabrics approached in 2003-4, there was still little inducement to invest. Many believed that faced with the deadline, the United States would simply extend it so as not to endanger the competitiveness of the burgeoning garment industry. This is exactly what happened in 2004 with the passage of a new AGOA bill when the third country fabric provision was extended for an additional three years ending September 30, 2007. Less well noticed was the allowable amount for entry under the tariff rate quota for this item would be halved in the year starting ending September 30, 2006.

Even this limited extension proved difficult to attain. US political leaders agreed reluctantly to the extension, sending definitive signals that this would be the last such extension for apparel incorporating third country yarns and fabrics. Also, there was a strong belief that for AGOA to be really successful in transforming the cotton-textile sector, the third country fabric provision could not be renewed. The few investors in textile mill facilities, particularly in southern Africa and in Mauritius and existing producers in South Africa hoping to supply low cost producers were able to reach US lawmakers and trade officials. They argued that having made an investment based on the ending of the third country fabric provision, they felt betrayed. USTR Ambassador Robert Zoellick and the powerful chairman of the Ways and Means Committee, Bill Thomas, although agreeing to the extension, both stated that this would be the last renewal of the third country fabric provision.

Many felt with this policy in place, a regional textile industry would develop. A few garment producers in Namibia, Swaziland and Mozambique as well as Mauritius had invested in such facilities and more could follow. South African producers also eyed the AGOA market. Ethiopia has laid out ambitious plans to modernize and privatize its textile mills. Nigerian factories producing narrow coarse printed fabrics for the ethnic market established plants to produce wider dimensioned apparel type fabrics.

This rosy scenario has now changed. One negative factor was appreciation of local currencies particularly in southern Africa contrasted with the continued undervalued on of Chinese currency. However, a more significant reason was the realization that the MFA would end and there would be no permanent replacement for it. There was concern that production that had emigrated to Africa and other alternative suppliers to MFA limited countries would now float back to the Far East especially if duty-free treatment was removed for apparel incorporating third country fabrics.

The post MFA world will be challenging for COMESA exporters even without the phase out of duty-free treatment for apparel incorporating third country fabrics.

1. COMESA suppliers will have to compete against increased amounts of competitively priced apparel available from countries previously limited by MFA quantitative restrictions

2. Those countries, previously restrained by quotas, now with unlimited access will no longer have an incentive to stay out of lower-priced garment sector--major market niche currently occupied by Kenya, Madagascar and Uganda.

3. The elimination of quota charges will likely lower prices in very competitive Far East countries newly freed from restraints since quota charges are expected to disappear. .

4. With buyers reducing the number of countries where they purchase apparel and looking for integrated production, COMESA suppliers will be challenged to be included among them.

5. Newly unrestrained suppliers will be freed from paperwork requirements, AGOA suppliers will not.

The short-term future is fairly positive for COMESA apparel exports meaning the period ending September 30, 2005. During the first three months of 2005, COMESA exports have been maintained and even expanded. Due to uncertainty about the future, buyers continue to purchase from LDC suppliers. Kenya and Madagascar increased their shipments by 18 and 13 percent respectively compared to the last quarter of 2004. I will not go into greater statistical detail here since time for this presentation is limited and the next panel includes a statistical presentation by Paul Ryberg.

Through the first three months of 2005, China is the only country to have experienced significant growth in the US market. According to US statistics, Chinese imports into the United States increased by 50 percent compared to the comparative period in 2004 when China was under control. Triple digit increases of 320 and 170 percent respectively were noted in the woven cotton trousers and knit cotton shirts, the leading exports from African LDCs. Now that Chinese exports are restrained, these surges should be reversed. We expect however that other competitive Asian suppliers will increase their share now that China is restrained. This will maintain pressure on African exporters to grow or for that matter even to maintain their exports.

Fortunately, for Africa, it now appears certain that the United States will institute restraints on Chinese exports or China will impose effective voluntary restraints. Two of the three petitions self-initiated by the US Government to limit Chinese exports covered categories composing 85 percent of African LDC exports to the United States—Category 347/348 (cotton trousers) and category 338/339 (cotton knit blouses and shirts.) China also grew in other categories exported from Africa, specifically Category 340/360 (cotton and miff non-knit shirts) and Category 345/645/646 (cotton and mmf sweaters.) which are subject of industry petitions. Such restrictions could be in place as early as late this month with the outside expectation seeing a delay in implementation until June or July.

The only way such limitations can be avoided is if China enters a voluntary agreement with the United States. China has offered to limit its own exports through a system of export taxes which, depending on its level, would have a similar effect to the former system of quota charges. China is reportedly considering imposing an export tax of 50 cents per apparel item that could be sufficient to drive US importers to purchase low cost products from sources other than China. The incidence of a flat tax on low cost goods is much higher on low than on high-end priced products. This could mean that China would stay out of the low priced garments currently occupied by African exporters.

We have not seen any significant increase in exports from other sources. If restraints as expected are implemented against China, Africa will then be challenged to maintain its export levels from such newly freed suppliers as Bangladesh, India, Pakistan and Turkey.

We expect that African LDCs will continue to maintain its exports at current levels. However, profit margins will be under pressure as the newly unrestrained suppliers drive down prices in the absence of quota charges. We favor steps to decrease production costs in COMESA countries particularly through reductions in power and short-term financing costs, but do not expect these reductions to offset price reductions in garments exports.

Another challenge is the fifty percent reduction in the TRQ for AGOA Year VII starting October 1, 2006 and its termination-starting year VIII. Current statistics indicate that African imports may pierce the TRQ and lose duty-free access for exports incorporating third country yarns and fabrics sometime during the summer of 2007.[1] There will not be sufficient competitive textile mill production to allow African garment producers to switch to African formed yarns and fabrics and production will flow back to the Far East unless the legislation is amended.

This expectation will be devastating to African apparel exporters that year. There will be a rush to the border to avoid paying MFN duties. However, after the rush, there will a serious reduction in orders and shipments as buyers become concerned that the TRQ will be filled before their products enter and thus will be subject to full duty assessment. They will shun Africa for the important Christmas season. The absence of African world class textile mills means that garment exporters could not maintain their shipments by substitution regional for third country fabrics and yarns in their production.

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[1] For the current AGOA Year V ending September 30, 2005, the amount of the TRQ is 536 million SME. This amount would be projected to increase by 12 percent to about 600 million SME for AGOA Year VI. If global imports would increase by another 12 percent in the following year, the TRQ world be increased to 672 million SME for AGOA Year VII beginning October 1, 2006. The recent imposition of restraints on Chinese exports probably means that this figure will not be attained. However, even if it were, since current legislation mandates a fifty reduction in the TRQ, the TRQ for AGOA Year VII would be only 336 million SME, significantly below current African TRQ imports. African TRQ imports for the first six months of the current AGOA year amounted to about 200 million SME. If we project this for the remainder of the year, the total would be 400 million SME. For the TRQ not to fill sometime during AGOA year 2007, imports from Africa will have to decline from current levels by 16 percent. Such a decline would be disastrous to AGOA and hopefully remedial measures would be taken before then.

We therefore expect lost orders as buyers return to established Far East suppliers. Without the continuation of African duty preferences, at least in the short term, buyers will find more competitively priced production in such newly liberalized locations as Bangladesh, Central America, Egypt, India, Jordan Pakistan and Turkey as well as still restrained Vietnam and unrestrained Cambodia.

A longer-term concern is the possible reduction of preferential margins in Africa emanating from duty reductions for suppliers that compete with AGOA.

1. It is not clear whether MFN duties on apparel will be reduced in the current Doha Round of Multilateral Trade Negotiations. Economic development theory does not favor foregoing MFN tariff reductions in order to maintain preferences. The harm to overall world efficiency more than offset any temporary disadvantage to preference receiving countries. However, developing African countries have argued that given the fact that the DOHA is a development round, some consideration should be shown to their textile and apparel exports.

2. The United States continues to expand its network of free trade agreements. Although no agreement allows for unlimited duty-free treatment for apparel incorporating third country fabrics, many contain provisions providing limited duty-free entry for such exports. CAFTA allows for duty-free entry for unlimited quantities of certain apparel (brassieres, boxer shorts, and nightwear) incorporating third country fabrics. CAFTA and US-Morocco contains provisions allowing Nicaragua, Costa Rica and Morocco, limited amounts of duty-free entry for apparel incorporating third country fabrics and yarns. Such provisions can be included in additional FTAs currently being negotiated with such competitive countries as Thailand and possibly Egypt.

3. The United States has recently granted so-called QIZ (Qualified Investment Zone) access to Egypt. Under this provision, Egypt can ship unlimited quantities of apparel incorporating third country yarns and fabrics provided such garments incorporate a minimal quantity of Israeli inputs and are produced in one of three large qualified producing zones.

Manchester Trade remains confident about the future of AGOA including the textile and apparel areas.

1. We expect the competitive threat of China to be contained through three developments.
    A. The expected imposition of restraints will provide short-term relief. However, we would emphasize that this is only a band-aid that will be in effect for no more than three years. It may be in effect for a shorter period of time. First, the restraints are only allowed to be in effect for one year unless renewed. There is no assurance that even if implemented, they will be renewed for a second or third year.

In addition, China has indicated that it may challenge the restraints under WTO rules. Even if Chinese efforts are successful, WTO procedures are too slow to dissuade imposition of the initial restraint any time during the first post-AGOA calendar year. However, a successful case could dissuade the US from implementing protection for the second or third year.

B. We expect the Chinese Renminbi to be revalued by at least 40 percent in the short term. Even a smaller revaluation will have a positive effect.

C. We expect China to move up the value ladder focusing on higher priced more styled apparel leaving exports of this category opened to low-priced exports from Africa.

2. We are concerned about the impending halving and then termination of duty-free entry for apparel incorporating third country fabrics and yarns. Our concern is motivated by the absence of sufficient capacity to spin and to form world call yarns and fabrics in Africa.

However, although the immediate outlook is very negative for an extension, it should not be ruled out. Much depends on COMESA member's ability to present a well-reasoned argument for the continuation of some special access for apparel incorporating third country fabrics. However, any such extension must be supported by both textile and apparel producers in the region and contain effective incentives for the establishment of a competitive world class milling industry. In fact, any AGOA third country provision should provide a bonus for exporters of garment incorporating third country materials. Duty-free treatment should be denied to garment exporters that could have obtained regional instead of third country fabrics and remained competitive.

We would emphasize that there is no active discussion of any extension of third country fabrics. The speaker is in no way affiliated with the United States government. The above is only the speaker's personal opinion and should not be read as any official endorsement of any extension of the third country provision or an official prediction of its possibility.

3. Given the investment required to establish textile mills, long-term financing and other forms of support should be made available to potential investors. In addition, attention should be paid to government assistance to lowering power and inland transportation costs.

4. National governments and private sectors in COMESA countries, together with donor entities, must work together to establish a five year plan for mobilizing capital for building of textile mills, developing infrastructure to support such mills and carrying out studies on requirements to upgrade cotton production and rehabilitate existing or developing new textile mills. Specifically, donor entities should focus on supporting Ethiopian and Ugandan efforts to develop world-class cotton and textile mills. Free trade zones with existing apparel capacity should focus private sector efforts on developing captive and independent mills to supply current garment makers.

5. Given the emergence of unrestrained competitors, government should support garment makers through providing technical assistance to AGOA producers to upgrade their human skills particularly through upgrading sewing and machine maintenance, enhance managerial performance and improve system engineering. Although not as important a production component as for milling, attention should be paid to power costs.

   It is worth noting that our analysis showed that AGOA duty-free garment exports from COMESA LDC exporters could be competitive in the post MFA world if one increased their output per sewing machine. This is not a problem of plant and machine obsolescence. It represents poor training of local labor, particularly systems engineers, managers, operators and technicians. We strongly recommend that a training institute, perhaps modeled on the successful Mauritian experience, be established on a COMESA-wide or on the member state level. In addition, a comprehensive system of government support for plant-level training should be developed in each exporting country.

6. Negotiations under the Doha Development Round (DDR) of multilateral trade negotiations and consultations with multilateral development banks (MDBs) should provide technical assistance for improving the quality and lowering the price of African cotton, both in its raw form and incorporated into clothing.

7. Fashion and marketing advice should be provided to develop an outlet for machine made ethnic fabrics and made-up goods recently designated for duty-free entry under Preference Group 9.

8. For apparel, Governments must assist the private sector in meeting the competition of a post-MFA world. We suggest that countries develop a consistent policy of incentives for apparel production[2], assure the appropriate enabling environment, and provide training resources and working capital at low interest rates.

[2] WTO rules for subsidies are more lenient for poorer countries. COMESA governments should be aware of such rules so as to design WTO consistent programs.

9. There should be an emphasis on maximizing AGOA benefits by such "AGOA SMART" activities as incorporating third country fabrics in short supply, producing wool sweaters, export in categories with the highest duty savings, such as high valued items and apparel incorporating man-made fibers or organically-grown cotton.

10. The COMESA Secretariat should compile and disseminated a list of best practices in the textile and apparel sectors. Kenya has been successful in developing free trade zones. Mauritius can be a valuable resource in training, diversification, developing product niches given its successful experience in these areas.

11. Countries with unblemished records and appropriate certifications for observing labor rights will be desired locations. Each COMESA manufacturer should have his work place certified by an organization acceptable to his buyer.

12, The COMESA Secretariat should work with national governments and USAID to become a clearinghouse for information about the region's comparative advantage and publicize the advantages of working in the region.

13. Consideration should be given to establishing a special short-term rebate for apparel manufacturers, buyers and retailers who incorporate regional yarns and fabrics in their apparel exports.

14, The private sector in the countries visited must intensify efforts to develop alliances with non-African players in global textile trade, alliances that will increase the comfort level of Americans in doing business with COMESA suppliers. US suppliers desire for integrated production can be met through such alliances.