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East Asia

*China's textile and clothing exports in a
changing world economy*

Yongzheng Yang and Chuanshui Zhong

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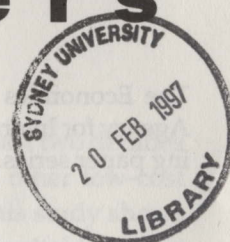
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Published by the National Centre for Development Studies

Printed in Australia by Better Printing Service,
1 Foster Street, Queanbeyan, NSW, 2620.

The Economics Division acknowledges the contribution made by the Australian Agency for International Development (AusAID) towards the publication of this working paper series.

ISBN 0 7315 2327 X

UNIV. OF SYDNEY LIBRARY

ISSN 1038-412X

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China's textile and clothing exports in a changing world economy

abstract

The rapid expansion of China's textile and clothing exports in the past two decades has raised fears that there are not enough export markets left for other low-cost developing economies. Using a global general equilibrium model, this study shows that with rapid economic growth China will increasingly shift to more capital-intensive exports and its reliance on textiles and clothing will decline. Uncertainty surrounding China's World Trade Organisation accession will further encourage export diversification. Slower growth in China will pose less competition to other low-cost exporting economies, but it will prolong the competition, as well as the pressure, for adjustment in industrial economies. It is in the interests of both importing and exporting economies that barriers to world trade in textiles and clothing continue to be reduced after the phasing out of the MFA, in order to accommodate exports from emerging South Asian and other low-cost exporters.

Textile and clothing market competition has become intense at the scale that the market is probably the most protected among manufactured commodities in industrial economies. Although the Multifibre Arrangement (MFA), which has regulated the world textile and clothing market through voluntary export restraints over the past 22 years is to be phased out by the year 2005, tariffs on textiles and clothing remain high in industrial markets. Textile and clothing exports from developing economies are often subject to anti-dumping actions in industrial markets. The question arises whether the world market can accommodate further expansion of textile and clothing exports from developing economies. Despite the protection, import penetration for these commodities is among the highest in industrial markets. Even after the MFA is removed, export expansion may depress world markets, leading to unsatisfying growth in exporting economies.

As the world's largest clothing exporter and second largest textile exporter, China has a particularly important role to play in this global issue. In the 1980s, it was feared that industrial economies would not be able to accommodate China's continued expansion of textile and clothing exports (Whalley 1992). MFA restrictions have indeed become increasingly severe, but China has managed to increase its exports rapidly in

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Textiles and clothing are among the first manufactured products an industrialising economy produces. They played a critical role in the early stage of industrialisation in Britain, parts of North America and Japan, and more recently in the export-oriented growth of the East Asian economies. Hong Kong, Korea and Taiwan relied heavily on textiles and clothing for their exports from the 1950s to the mid-1980s. In the last two decades, several ASEAN economies and China have become large producers and exporters of textiles and clothing. Major South Asian economies, namely those of India, Pakistan, Bangladesh and Sri Lanka, have also emerged as significant textile and clothing exporters in the last few years.

As more economies enter the world textile and clothing market, competition has become intense. At the same time this market is probably the most protected among manufactured commodities in industrial economies. Although the Multifibre Arrangement (MFA),¹ which has regulated the world textile and clothing market through voluntary export restraints over the past 22 years is to be phased out by the year 2005, tariffs on textiles and clothing remain high in industrial markets. Textile and clothing exports from developing economies are often subject to anti-dumping actions in industrial markets. The question arises whether the world market can accommodate further expansion of textile and clothing exports from developing economies. Despite the protection, import penetration for these commodities is among the highest in industrial markets. Even after the MFA is removed, export expansion may depress world markets, leading to immiserising growth in exporting economies.

As the world's largest clothing exporter and second largest textile exporter, China has a particularly important role to play in this global issue. In the 1980s, it was feared that industrial economies would not be able to accommodate China's continued expansion of textile and clothing exports (Whalley 1992). MFA restrictions have indeed become increasingly severe, but China has managed to increase its exports rapidly. In

the fourteen years from 1980 to 1994, China's exports of textiles and clothing increased eightfold. With rapid increases in domestic costs, however, the dominance of the textiles and clothing sector is approaching its peak; China's exports have begun to shift from textiles and clothing and other labour-intensive industries to more capital and technology-intensive products (Garnaut 1996).

While the shift is inevitable as trade theory suggests, the timing of the shift has important policy implications. How much longer can China expand its exports before it loses competitiveness, and what consequences could this have on its textile and clothing sector? Apart from the long-term supply potential, there are several demand factors affecting China's prospects for textile and clothing exports. The phasing out of the MFA would discourage structural adjustment, while the uncertainty surrounding the outcome of China's World Trade Organisation (WTO) membership negotiations tends to encourage adjustment. For China's competitors, especially the latecomers in the world textile and clothing markets (such as the South Asian and some ASEAN economies) the timing of China's shift has major implications for the long-term growth of their exports.

This paper examines the prospects for China's textile and clothing exports and their implications for other textile and clothing exporters. Both supply and demand-side factors will be taken into account in this study. In the following section, China's textile and clothing exports will be placed in global perspective and changing international comparative advantage will be analysed. Section 3 examines the demand factors associated with the Uruguay Round reforms and China's WTO membership negotiations, and Section 4 analyses the economic and demographic factors which determine China's supply potential in textiles and clothing. In Section 5, simulations will be carried out to project the future path of the textile and clothing sector for China and major textile and clothing exporting economies. The major findings of the paper are summarised in the final section.

Changing international comparative advantage

Table 1 { The rapid growth of China's textile and clothing exports has led to major changes in the world textile and clothing markets (Table 1).² In 1970, China accounted for less than 14 per cent of total textile exports originating in developing economies, and less than 5 per cent of total clothing exports from developing economies. China has since gained a substantial market share, especially since the mid-1970s. By 1988, China's market share had peaked, accounting for 22 per cent of total textile exports originating in developing countries, or 7 per cent of world textile exports. As for clothing exports, China's market share has continued to increase. By 1994, China accounted for 26 per

cent of clothing exports originating in developing countries, or 16 per cent of world clothing exports. In 1994, China overtook Asia's newly industrialising economies (NIEs)—Hong Kong, Republic of Korea and Taiwan—as the world's largest clothing exporter.

Table 1 Textile and clothing exports by developing economies, 1965–94
(percentage of developing economy total)

	1970	1980	1985	1990	1994
Textiles					
China	13.7	17.1	21.8	19.6	21.2
NIEs ^a	22.5	34.7	36.0	39.2	37.5
ASEAN ^b	3.4	7.0	7.3	9.6	11.9
South Asia ^c	35.8	17.5	14.4	13.7	14.3
Latin America	8.2	9.7	7.9	5.3	5.1
Developing economies (US\$ bn)	2.2	14.1	16.7	36.7	55.3
World (US\$ bn)	12.1	54.0	52.3	103.5	126.0
Clothing					
China	4.8	10.1	15.0	15.5	25.6
NIEs ^a	75.8	60.9	54.9	34.1	20.0
ASEAN ^b	2.5	7.4	8.2	13.0	13.3
South Asia ^c	2.9	4.9	6.6	8.2	10.2
Latin America	4.8	6.5	4.0	4.5	6.8
Developing economies (US\$ bn)	1.5	16.4	24.9	55.1	93.1
World (US\$ bn)	5.7	38.6	46.6	102.7	150.3

Note: Data before 1988 are not strictly comparable with those from 1988 onward. This is because pre-1988 export data for China are calculated as the sum of imports from its trade partners, whereas from 1988 onward the data are based on official Chinese statistics. Because of China's large re-exports via Hong Kong, the pre-1988 data presented in the table involve double counting of China's re-exports and include value added to re-exports in Hong Kong.

^a Includes Hong Kong, Republic of Korea and Taiwan.

^b Includes Indonesia, Malaysia, Thailand, Singapore and the Philippines.

^c Includes Bangladesh, India, Nepal, Sri Lanka and Pakistan.

Source: United Nations COMTRADE and the Chinese Customs statistics, extracted from the International Economic Databank, The Australian National University.

Just as China's textile and clothing exports have surged, export growth in the NIEs has slowed. For textiles, the NIEs' share in the world market peaked in the late 1980s and has declined steadily ever since. The NIEs accounted for more than 70 per cent of clothing exports originating in developing economies up to the mid-1970s. By 1994,

however, this market share had fallen to less than 20 per cent. The contrast between textile and clothing exports underlines deep structural change in the NIEs. Because clothing is more labour-intensive than textiles, the NIEs have lost comparative advantage in clothing more rapidly than in textiles and hence a large part of their clothing production has moved overseas, especially to China and ASEAN. Rapid expansion of the clothing sector in China and ASEAN has generated increased demand for textiles from the NIEs. This has helped maintain the growth of NIEs' textile exports.

The dramatic declines in the NIEs' market share have also been concomitant with the export surges in ASEAN and South Asia. Both textile and clothing exports have grown strongly in ASEAN. Between 1970 and 1994, ASEAN's share of textile exports from developing economies nearly doubled, while its share in clothing more than doubled. South Asia was a significant exporter of textiles in the 1950s. Like China, it lost much of its market under the inward-looking policy regimes in the 1950s to the 1980s. With economic reform in recent years, however, South Asia has recaptured part of its lost market. In 1994, South Asia was the third largest textile exporter with its clothing exports catching up to those from the ASEAN economies. With the current rate of growth, South Asian exports are poised to overtake ASEAN exports in the near future.

It is interesting to note that the market share lost by the NIEs has been entirely captured by China, ASEAN and South Asia. This occurred in a period of about two decades, but most of the shift occurred from the mid-1980s when China's exports began to surge. This transition has occurred rather smoothly, with the NIEs successfully shifting away from clothing to more capital-intensive commodities. China is clearly ahead of South Asia in textile and clothing exports; at a similar stage of development to some of the less developed ASEAN economies (Indonesia and the Philippines); but slightly behind the more developed members of ASEAN (Malaysia and Thailand). Vietnam, the newest member of ASEAN, is at a similar stage to South Asia.

The income gaps between China and the NIEs were much larger when China initially began to replace the NIEs in world clothing markets than the current gaps between China and the South Asian economies. This means that South Asia may face stronger competition from China than China did from the NIEs. It also means that, depending on how rapidly China can move away from clothing exports, the world is likely to feel the combined impact of China, South Asia and ASEAN for a considerable time to come.

The demand side³

One of the most important factors determining China's competitiveness in world textile and clothing markets will be the phasing out of the MFA. The Uruguay Round

Agreement on Textiles and Clothing (ATC) represents a major step forward in the liberalisation of world trade in textiles and clothing. It is a transitional agreement and provides a legal framework for the elimination of MFA restrictions over a 10-year period (1 January 1995—1 January 2005). After the transition, the same rules will apply to trade in textiles and clothing as to trade in other manufactured goods. In addition, the ATC also requires that restrictions inconsistent with GATT other than those maintained under the MFA must be either brought into conformity with GATT or eliminated. The ATC also provides for increases in quota growth rates for products remaining under restrictions during the transition period.

The phasing out of the MFA is heavily end loaded, with nearly half of textile and clothing products remaining under quota restrictions until 2004. If importing countries choose to liberalise products which are not restricted by the MFA, there will be little substantive liberalisation before 2005 (Bagchi 1994; Blokker and Deelstra 1995). In the transition process, a special safeguard mechanism similar to the MFA is available for importing countries to impose quantitative restrictions on products yet to be integrated. In the first few months after the entry into effect of the WTO agreements, the United States made 20 'calls' for consultation by invoking the special safeguard provision (UNCTAD 1995a). There is also a fear that even after the special safeguard becomes unavailable after the transition period, importing economies will resort to other protectionist measures as a substitute for the MFA. Anti-dumping and countervailing are likely to be favoured instruments.

As quota acceleration is based on the quota growth rates effective on 31 December 1994, the initial rates of quota growth are critical in determining the extent of quota enlargement. Existing differences in quota growth rates will lead to greater disparities among exporting economies and to increases in the variations in quota volumes for different products. As sensitive products have lower quota growth rates under bilateral agreements, their relative quota volumes in the transitional period will slip behind further, creating greater distortions in resource allocation. The standard deviation of quota volumes across exporters increases by 50 per cent in North America, and 57 per cent in the European Union as a result of quota acceleration (Yang 1996a).

Tariffs on the textile and clothing sector have been much higher than those in other sectors and have been characterised by tariff peaks (above 15 per cent) in industrial markets. Tariffs in developing markets are even higher. Tariffs on textiles and clothing will be reduced as a result of the Uruguay Round, but the extent of reductions in major industrial markets (except Japan) is much lower than in other manufactured commodities. For example, the average tariff reduction by the Quad countries (United States, Canada, the European Union countries and Japan) is only 22 per cent, making textiles and clothing the only sector that did not fulfil the target of one-third reduction (UNCTAD 1995b).

China has been one of the most severely restricted exporters, and its competitiveness in textiles and clothing should improve once the MFA is phased out.⁴ There are, however, uncertainties about improved market access as the removal of MFA quotas on China depends on China's status in the WTO. According to the US and EU legislation implementing the Uruguay Round, non-WTO members may not be able to benefit from the ATC even if they were signatories to the former MFA (UNCTAD 1995b). After 10 years of negotiations on China's WTO membership, it is still uncertain when China is to be admitted to the WTO. There is a danger that China may face increasing discriminatory measures against its exports if it is not a member of the WTO. Mexico, for example, has recently imposed anti-dumping duties of 54–500 per cent on Chinese textiles and clothing (Moore 1995). China has to rely entirely on bilateral efforts to deal with such trade restrictions so long as it is not a WTO member.

The recent change in the rules of origin concerning textile and clothing imports in the United States is likely to have an adverse effect on China's exports. In accordance with Section 334 of the US Uruguay Round Agreement Act (implementation legislation), changes in the rules of origin (effective on 1 July 1996) will affect a broad range of products (T-shirts, pants, and dresses). The new rules will, in most cases, make the country of assembly equivalent to the country of origin, and quotas will be charged against this country. Since China relies heavily on Textile and clothing processing it will be most affected by such a change. While WTO members may have access to compensations in accordance with the WTO agreements (including the ATC), it is unlikely that China will be compensated.

Even if China gained WTO membership in the near future, there exists the possibility that China's exports be subject to discriminatory restrictions under a special safeguard provision which is most likely to be included in the Protocol of Accession of China. As China is considered to be a planned economy with broad government intervention in production and trade, the United States and the European Union have been insisting on the inclusion of a special safeguard provision (in China's Protocol of Accession) that would allow other WTO members to impose quantitative restrictions specifically against China upon the determination of a surge of Chinese imports and serious damage, or threat thereof, to industries in destination markets. Such a mechanism is similar to the safeguard mechanism based on the concept of market disruption contained in the MFA. The proposals by the United States and the European Union on the special safeguard provision also contains a mechanism for third countries to have recourse to such measures on the basis that the imposition of restrictions by other countries has resulted in a diversion and surge of China's exports to their markets.

There is little doubt that such a mechanism would be applied mostly against China's most dynamic exports of labour-intensive products, such as textiles and clothing.

Furthermore, such a mechanism would be open to use by any member of the WTO, whether developed or developing. Therefore, there is a real possibility that even if China gains early accession to the WTO, it may continue to face discriminatory restrictions.

Anti-dumping legislation is another source of concern for China. By using a third country or reference price in the determination of dumping margins, the actual costs of China's exports are virtually disregarded. Between the late 1980s and 1994, the EU alone has brought at least 179 anti-dumping measures or proceedings against China (*Agence Europe*, 7 November 1994).

Regionalism and the spread of preferential trade agreements is another concern for China. In the textile sector, several recent developments will further affect China: the formation of the North American Free Trade Area (NAFTA); the enlargement of the EU to include Austria, Sweden and Norway; the EU's preferential agreement with Turkey (a rapidly expanding exporter of textiles and clothing) which eliminated all the quota restrictions effective on 1 January 1996; and the EU's preferential agreements with Central and Eastern European economies, eliminating all quota restrictions on them by 1 January 1998 (ITCB 1995). Sweden abolished MFA quotas in 1991, but its accession to the EU means that this market is under quota restriction again.

Another important recent development is Japan's intention to impose quantitative restrictions on China's textile and clothing exports. Japan has never before imposed MFA restrictions on developing exporters. Japan was a large exporter of both textiles and clothing before the 1970s, but has since turned into a large net importer of clothing and a relatively small net exporter of textiles. Rising import competition in the domestic market has led to intensive structural adjustment in Japan's textile industry in the past decade (Yamawaki 1989).

Increasing restrictions in the US and EU markets have led to rapid diversification and diversion of Chinese exports to the Japanese market. China's share in Japan's total imports of textiles and clothing has risen dramatically in recent years. It has increased from 25 per cent in 1992 to 32 per cent in 1994 for textiles, and from 43 per cent in 1992 to 54 per cent in 1994 for clothing (WTO 1995). As a result, Japan became China's largest industrial market for textile and clothing exports in 1994.

Rising import competition has aroused increasing calls from Japan's textile industry for import restrictions. Beginning in October 1994, at the request of the Japanese Government, several rounds of consultations were held between China and Japan on possible 'voluntary export restraints' on a range of textile products by China. On 9 November 1995, the Japanese Government decided that restrictions would not be imposed *for the time being* due to a decline in China's exports of these products to Japan during the period under investigation.

This development could have far-reaching implications for China. It means that new 'grey area' agreements against China could spread. South Africa has been negotiating a voluntary export restraint agreement with China, and both Korea and Taiwan have attempted to enter into negotiations with China on voluntary restraints on Chinese exports (Reuters Electronic News, 29 January 1996). The WTO is yet to deal with such arrangements involving non-WTO members.

The supply side

Whether China will continue its rapid growth of textile and clothing exports depends not only on the demand conditions, but also on its supply potential. There are two major factors which will determine the long-term growth of China's textile and clothing exports. The first is the success of continuing economic reforms. In neo-classical analysis, reforms will only have one-off effects, and will not accelerate the long-term growth rate of the economy. A growing body of literature has suggested, however, that openness may boost long-term growth rates (Edwards 1993).

The second major factor is the shift in comparative advantage in the world textile and clothing sector. Because textiles and, in particular, clothing are labour intensive⁵, China's comparative advantage in textiles and clothing largely lies in its abundant supply of unskilled labour. China was, however, unable to exploit this comparative advantage in the pre-reform era. It is only since the reform that China's trade pattern has increasingly conformed with its comparative advantage, leading to the rapid growth of labour-intensive exports, including textiles and clothing (Zhang 1993).

In the early years of reform, the state textile and clothing sector played a dominant role in exports. Since the mid-1980s non-state enterprises, especially township and village enterprises, have become increasingly dynamic. During the period 1986-94, rural textile output grew at 19 per cent per annum, and rural clothing output at 27 per cent, while the output of the urban sector (to which the state sector belongs and dominates) grew at an annual rate of 3 per cent for textiles and 11 per cent for clothing (Yang 1996b).

The non-state sector has outperformed the state sector in virtually all industries, but the contrast between the two sectors in the textile and clothing industries is probably greater than in most other industries. Non-state enterprises normally produce textiles and clothing at a lower price than state enterprises because labour costs are lower. Labour redundancy in state enterprises is a major contributor to high labour costs. In addition, non-state enterprises are more flexible in production and marketing, and are therefore more competitive than state enterprises.

As the result of the strong growth of the non-state sectors, the rural sector's share in national textile and clothing output has increased dramatically. In 1986, rural

township and village enterprises accounted for less than 20 per cent of total textile output and 30 per cent of clothing output. By 1992, the respective shares had climbed to 35 and 50 per cent. It should be noted that these percentages do not fully take into account output by other private rural enterprises. In terms of incremental output, the contribution of the rural sector is even greater. Between 1986 and 1992, township and village enterprises accounted for 61 to 75 per cent of the total incremental output (Yang 1996b).

The non-state sector has also outperformed the state sector in production for export. In 1988, township and village enterprises alone accounted for about half of China's total clothing exports, and 16 per cent of textile exports. By 1991, clothing exports had climbed to 78 per cent and textile exports to 25 per cent. Clothing exports further increased to 90 per cent in 1992. Non-state sectors have become the most important exporters for most light manufactured products in recent years (Ministry of Agriculture 1995).

Most of China's textile and clothing exports are produced in the coastal region, with Guangdong, Jiangsu, Shanghai, Fujian and Shandong in the lead. After rapid economic growth over the past one and half decades, shortages in unskilled labour have begun to emerge in some of these areas, drawing large migration from inland areas despite government restrictions on migration. At the same time, rental costs for land are also increasing and exerting pressure for production facilities to move west. The soaring costs have led to diversification of production activities. In the last three years, the shares of textiles and clothing in total rural industrial output have shown a declining trend (China State Statistical Bureau 1993, 1994, 1995).

Given great variations in labour costs in different parts of China, it will take a considerable time for an overall labour shortage in China to emerge. The large pools of unemployed and underemployed in most rural areas will provide virtually unlimited labour resources on which the coastal areas can draw. Policies aimed at reducing the costs of migration from the west to the east will enable China to use these vast human resources. Household registration has been a major constraint on internal migration, although the system now has less sway over the rural population. A number of other policies have also hindered effective use of migrant resources in urban areas: migrants are seldom eligible for public housing, medical care, and education; there are still restrictions on employment of rural migrants in state enterprises; regulations are also imposed on where migrants may live in urban areas; and some cities collect tolls on migrants.

An alternative policy for tapping China's human resources is to further improve infrastructure in inland areas. This will not only reduce migration costs if farmers choose to migrate east, but also provide the necessary conditions for indigenous industries to thrive should would-be migrants decide to remain in the west. This may

also attract entrepreneurs to inland regions. This trickle-down effect is likely to reduce the east-west income inequality which has been growing since the beginning of economic reform in the late 1970s.

With rapid growth, capital accumulation will continue. It is likely that capital accumulation will be more rapid than growth in income. This will be achieved through attracting more foreign investment and/or increased savings, as in the recent past. In the last 18 years, China's savings rate has exceeded 35 per cent in most years. The inflow of foreign investment, especially foreign direct investment, has accelerated in recent years, reaching US\$33 billion in 1995 (Ministry of Foreign Trade and Economic Cooperation 1995)

Table 2 summarises growth projections of factors of production, GDP and population for China and other economies over the period 1992–2005. These projections are prepared for the simulation exercises in the following section and are adopted from Hertel et al. (1995). A much higher growth in the labour force is assumed in this study. While population growth is slowing down because of the effects of the one-child family policy, China can draw on its vast pool of surplus labour which includes large numbers of unemployed and underemployed in both urban and rural areas. Taking this into account, China's effective labour force is projected to grow by 36 per cent⁶ between 1992 and 2005 (or 2.4 per cent per annum). This makes China's effective labour force grow as fast as that of South Asia, although its population growth is substantially slower (Table 2).

China is projected to have the most rapid capital accumulation and GDP growth over the period 1992–2005. This reflects the strong growth performance in the past decade and an optimistic assumption about the stability of the economy in the future. The inferred 9 per cent annual growth is not unrealistic if China continues with its reform programs. Nevertheless, we will explore the implications of a slower growth scenario for China. Rapid capital accumulation means that China will become increasingly capital-abundant and labour-scarce. Land resources are assumed to be constant over the period of projection. Thus, increases in agricultural output will be achieved solely through the growth of capital and labour and improvements in productivity.

Prospects for export growth

In this section, a 10x10 version⁷ of the Global Trade Analysis Project (GTAP) model⁸ is used to project the growth path of the world economy, with particular attention to the textile and clothing sector. The projections essentially involve exogenously augmenting factor uses, GDP and population using the magnitudes shown in Table 2. As GDP forecasts are imposed, economy-wide technological change variables in the model are

endogenised to make up the gaps between GDP growth and factor accumulation. Alternatively, GDP growth can be endogenously determined if economy-wide

Table 2 Projected annual changes in factor endowments and real GDP, 1992–2005 (per cent)

	Population	Labour	Capital	Real GDP
Australasia	0.7	0.6	2.1	2.5
North America	0.7	0.9	2.8	2.7
EU	0.2	0.2	1.3	2.2
Japan	0.3	-0.2	3.3	2.6
NIEs	0.9	0.9	6.3	6.3
ASEAN	1.6	2.2	6.8	6.8
China	1.3	2.4	9.3	8.9
South Asia	1.8	2.4	7.1	5.2
Latin America	1.7	2.2	1.2	3.6
Rest of the world	1.3	2.4	2.5	2.5

Source: Based on Hertel, T., Martin, W., Yanagishima, K. and Dimaranan, B., 1995. 'Liberalising manufactures trade in a changing world economy', paper presented at the conference The Uruguay Round and the Developing Economies, the World Bank, Washington, DC, January 26–27 1995. Also see the text.

technological change, along with factor uses, is exogenous. It should be noted, however, that GDP does not grow at the same rate across sectors in either approaches, even though only the economy-wide GDP growth or technological change is projected. Because of variations in factor intensity among sectors, different rates of factor accumulation means that GDP growth differs among sectors. In addition, consumer preferences are not homogenous, so the growth of demand for various products differs as income rises. Following Gehlhar (1995), the magnitudes of trade elasticities in the GTAP model are doubled in the projection simulations.

In projecting the world economy to 2005, two scenarios are first considered. In the first scenario, no policy changes take place. This means that all trade restrictions, including the restraints of MFA quotas, remain constant. The purpose of this experiment is not to provide realistic projections for the world economy, or for the textile and clothing sector in particular. Rather, it is intended to capture the structural change that would result purely from changing factor endowments. In the second scenario, changes in trade policies resulting from the Uruguay Round of trade liberalisation is taken into account. Thus, the growth of the world economy is driven both by factor accumulation and trade liberalisation.

In the 'no policy change' scenario, factor uses and GDP growth are exogenous, while economy-wide total factor productivity is endogenously determined. In the trade liberalisation scenario, the total factor productivity estimates from the first scenario are exogenously imposed, while GDP is determined endogenously. This effectively assumes that trade liberalisation does not affect productivity, but does contribute to GDP growth by improving the efficiency of resource allocation. The same approach has been adopted by Tyers and Yang (1996).

For the second scenario, the estimates of tariff cuts and agricultural liberalisation resulting from the Uruguay Round are based on GATT (1993 and 1994) and UNCTAD (1995a). Essentially, for industrial economies domestic support for agriculture is reduced by 20 per cent, and export subsidies and tariffs (equivalent quantitative restrictions) by 36 per cent. Tariffs on textiles and clothing are reduced by 18 per cent in North America, 16 per cent in the EU (15 per cent for imports from developing economies), and 33 per cent in Japan. For developing economies, domestic support for agriculture is cut by 15 per cent, export subsidies by 24 per cent, and tariffs by 26 per cent. Tariff reductions in developing economies are two-thirds of industrial economy liberalisation.

Simulation results show that without trade liberalisation, China's textile and clothing production tends to grow more slowly than the economy as a whole (Table 3). In general, more capital-intensive sectors tend to grow more rapidly than labour-intensive sectors. In the NIEs, textile production also grows less rapidly than GDP, but clothing production grows slightly more rapidly than GDP. It should be noted that this latter result may be biased because the model does not take into account foreign direct investment. In the last decade or so, many clothing production factories in the NIEs have moved to China. Had this investment movement been incorporated in the model, clothing production in the NIEs would not have grown so strongly in the projection, while China's clothing output would have expanded more rapidly.

In the ASEAN economies, output growth in textiles and clothing outstrips overall production growth, and in the case of clothing by a significant margin. Similar to China, the growth of the textile and clothing sector in South Asia lags behind overall economic growth. In the projection, South Asia's labour force increases rapidly, reflecting population growth in the region. However, capital accumulation is projected to grow even more rapidly, leading to stronger growth of sectors which are relatively more intensive in capital. Compared with China, however, South Asia's structural change towards more capital-intensive sectors is less pronounced.

Trade liberalisation accelerates output growth in China's textiles and clothing (the second scenario). However, even with trade liberalisation, textile output still grows much less rapidly than GDP, while the growth of clothing production exceeds overall

economic growth. In contrast, trade liberalisation boosts textile production in the NIEs while leading to less rapid growth of clothing production. Increased competition from

Table 3 Projected annual changes in real output and trade in selected developing economies, 1992–2005: central scenario (per cent)^a

	China	NIEs	ASEAN	South Asia	Latin America
Output					
Textiles	5.3 (5.9)	5.2 (6.6)	7.6 (10.8)	4.3 (5.6)	2.4 (2.1)
Clothing	6.4 (10.8)	6.6 (4.9)	9.1 (15.8)	4.7 (8.8)	3.4 (2.8)
GDP	8.9 (9.1)	6.3 (6.4)	6.8 (7.0)	5.2 (5.3)	3.6 (3.6)
Exports					
Textiles	4.0 (5.8)	5.7 (8.2)	7.5 (9.3)	3.8 (7.6)	1.2 (2.4)
Clothing	5.6 (12.5)	6.4 (3.3)	10.4 (19.6)	4.2 (12.6)	-0.7 (-4.6)
All exports	6.0 (7.5)	4.3 (4.8)	6.6 (7.5)	4.7 (6.5)	0.6 (1.6)
Imports					
Textiles	5.6 (8.7)	4.7 (4.5)	6.3 (10.9)	4.4 (7.0)	2.7 (3.5)
Clothing	7.9 (12.6)	5.6 (5.3)	7.0 (11.8)	5.5 (8.5)	4.5 (6.3)
All imports	7.9 (9.3)	5.3 (5.6)	6.1 (6.9)	3.2 (4.4)	2.9 (3.7)

^a Numbers without parentheses are results from the scenario without trade liberalisation, and those in parentheses are results from the scenario with trade liberalisation.

Source: Simulations of the GTAP model.

China and other more efficient producers reduces the expansion of clothing exports while increased demand for textiles in China and other more efficient producers help boost textile production in the NIEs. Regardless of trade liberalisation, ASEAN's textile and clothing production grows more rapidly than its GDP, but with trade liberalisation, the growth of textile and clothing production exceeds GDP growth by a substantial margin. While textile and clothing output in South Asia grows more slowly than GDP without trade liberalisation, it increases more rapidly than GDP with trade liberalisation.

Export growth shows similar trends (Table 3). Without trade liberalisation, China's textile and clothing exports tend to grow less rapidly than overall exports, but even with trade liberalisation, textile exports grow considerably less rapidly than overall exports. Without trade liberalisation, textile and clothing exports in the NIEs tend to grow more rapidly than overall exports, but with trade liberalisation, clothing exports grow less rapidly than overall exports, while textile exports grow even more rapidly. For ASEAN and South Asia, trade liberalisation boosts the exports of both textiles and clothing, leading to more rapid growth of these exports than overall exports.

It is interesting to note the substantial increases in textile imports in China, ASEAN and South Asia over the period 1992–2005 (Table 3). Trade liberalisation accelerates their import growth substantially. This is not only because their tariff cuts are considerable, but also because of induced demand for textiles when their clothing exports expand.

The projections discussed so far are based on the relatively rapid growth of the Chinese economy. There is always uncertainty with such growth forecasts, especially with China, where the continuation of economic reform involves great risks. What would happen if growth slows down in China over the period 1992–2005? In the next simulation, China's growth rate is assumed to be one-third lower than the baseline projection in the first scenario. It is also assumed that capital accumulation is also one-third lower than the baseline projection, while labour employment growth remains the same. These assumptions imply that technological progress in this scenario is slower than under the high growth scenario. As in the second scenario, the Uruguay Round of trade liberalisation is incorporated in the simulation.

With slower growth, both China's production and export growth slow down (to see this, compare the numbers without parentheses in Table 4 with those in parentheses in Table 3). However, the shift from labour-intensive to capital-intensive production will not proceed as rapidly as it would with a faster-paced economic growth scenario. While China's annual real GDP growth rate is reduced by one-third over the period 1992–2005, annual output growth is only reduced by 25 per cent for textiles and 19 per cent for clothing. The growth rate of total exports also falls by 19 per cent. Because textiles and clothing are more labour-intensive than other manufactures on average, their growth rates slow down to a lesser extent, 12 per cent and 14 per cent, respectively. This is clearly a Rybczynski result in an open economy where capital is not perfectly mobile. As labour becomes relatively abundant with slower capital accumulation, labour-intensive activities do not slow down as much as the economy as a whole.

China's slower growth does not, in general, give a large boost to the export growth of textile and clothing exports from other developing economies. The largest impact of China's slower growth is felt by the NIEs, which have more intensive trade ties

with China than other economies. China's slower growth leads to an increase in the growth rate of the NIEs' textile output by nearly one percentage point and that of clothing output by half of a percentage point. ASEAN's output growth increases by about half of a percentage point for both textiles and clothing, while the increase in South Asian textile and clothing output rises by only one-tenth and three-tenths of a percentage point, respectively. The impact on other economies' export growth of China's slower growth is similar to the impact on output growth, except that it has no impact on the NIEs' textile exports. This is because the NIEs export a large proportion of their textiles to China; any export expansion in other markets is offset by the decline in import demand from China.

Table 4 Projected annual changes in the textile and clothing industries in selected developing economies, 1992–2005: slower China growth (per cent)^a

	Output		Exports	
	Textiles	Clothing	Textiles	Clothing
China	4.4 (-17.3)	8.8 (-21.2)	5.1 (-8.8)	10.7 (-19.2)
NIEs	6.7 (1.6)	5.4 (7.3)	8.2 (0.1)	3.9 (8.2)
ASEAN	11.3 (5.5)	16.4 (8.1)	9.6 (3.3)	20.4 (9.4)
South Asia	5.7 (0.7)	9.1 (3.7)	7.6 (-0.2)	13.1 (5.8)
Latin America	2.2 (0.2)	2.8 (0.6)	2.4 (0.2)	-4.1 (7.6)

Note: Numbers in the parenthesis are the comparative static effects of slower China growth for 2005.

Source: Simulations of the GTAP model.

Table 4 also presents the impact of China's slower growth in a comparatively static manner (see the numbers in parentheses). These numbers indicate the percentage changes in the 2005 level of output and exports that result from China's slower growth as compared with higher growth. In general, the impact on clothing of China's slower growth is larger than on textiles despite smaller reductions (as a result of slower GDP growth) in the annual growth rates of clothing production and exports. This is because with higher growth in the clothing sector these reductions translate into larger falls in the levels of clothing output and exports by 2005. For example, slower GDP growth

would lower China's clothing output in 2005 by 21 per cent, and exports by 19 per cent, while the reductions in textile output and exports would be only 17 per cent and 9 per cent, respectively.

The impact of China's slower growth on output and export levels in other economies is much smaller. The largest percentage increase in output and exports in 2005 is observed in ASEAN, followed by the NIEs. The impact on South Asia is significant for clothing only.

Policy implications

Historically, most developing economies have established some capacity in modern textile and clothing industries. Because textile and clothing production is labour-intensive and requires relatively simple technology, many developing economies have chosen these industries as a spearhead for export expansion. China has been able to tap into its huge production capacity and abundant labour resources since it commenced economic reform.

The MFA has not stopped China from utilising its comparative advantage, nor does it seem to have prevented the relocation of world textile and clothing production from high-cost to low-cost economies. If MFA quotas on China are phased out, as they will be for other developing economies, China's textile and clothing exports will receive a temporary boost in the next decade or so. On the other hand, the likely inclusion of a special safeguard provision in China's protocol of accession to the WTO will encourage export diversification. The special safeguard may prove to be more discouraging for Chinese textile and clothing exports than the MFA in the past. Under the MFA all major exporters are restricted, while the special safeguard provision targets China alone.

China is large and labour costs vary greatly from region to region. This means that textile and clothing exports will remain competitive and important for some time to come in the future, as long as production is able to move to lower cost areas or labour can freely move to the coastal areas. As China continues on a high growth path it will experience structural change and move up the technological ladder to more capital-intensive industries. Even with the rapid growth of the labour force resulting from greater labour mobility and utilisation of surplus labour, China's reliance on textiles and clothing will diminish over time. China's diversification will give South Asia and some ASEAN economies greater opportunities for export expansion. In the past, these economies' export growth has accelerated at the same time as China's exports were expanding rapidly and replaced the NIEs as the prime supplier to the world market.

Export expansion in South Asia and ASEAN has also largely resulted from improved supply conditions. With the slowing down of China's textile and clothing export growth, these economies should be able to continue to increase their exports. The removal of the MFA will further encourage their textile and clothing exports.

The fear that China's high growth will prevent other low-cost textile and clothing economies from export expansion is therefore unfounded. A slower growth of the Chinese economy over the next decade or so would give other economies only slightly greater opportunities for textile and clothing exports. However, slower economic growth for China also means that structural adjustment there will occur less rapidly, and hence China will compete with other economies for a longer time period in the future. Prolonged concentration in labour-intensive exports by China will also increase the pressure for adjustment in industrial economies.

Past experience suggests that the world has adjusted reasonably well to China's expansion of textile and clothing exports. If textiles and clothing from China can be absorbed by the world market, there is a greater chance that other commodities will be accommodated in the future. As China diversifies its exports, few commodities will be likely to cause the extent of structural adjustment that has been entailed by textiles and clothing. But the world market must accommodate other low-cost exporters, such as South Asia, which in terms of population is of similar size to China. The conclusion of the Agreement on Textiles and Clothing shows that industrial economies are accepting, albeit reluctantly, the potential challenge from South Asia and other low-cost exporters. It is important, however, that industrial economies continue to liberalise their textile and clothing imports after the MFA is phased out. If the history of the MFA is any guide, continued protection will only slow structural adjustment in the world economy, to the detriment of both importing and exporting economies.

Notes

The views expressed in this paper are the authors' own and do not necessarily represent those of the Chinese Ministry of Trade and Economic Cooperation, with which Chuanshui Zhong is affiliated.

¹ See Keesing and Wolf (1980), Cline (1987) and Blokker (1989) for extensive analyses of the MFA.

² See Anderson (1992) for a broader review of changing comparative advantage in world fibre, textile and clothing markets.

³ For extensive discussions of the demand side issues, see Zhong and Yang (1996).

- ⁴ See Trela and Whalley (1990) and Yang (1994) for assessments of the effect of MFA abolition on China and other economies.
- ⁵ According to the database maintained at the Centre for Global Trade Analysis of Purdue University, labour accounts for 42 per cent of value added in China's textile industry, and 52 per cent of value added in the clothing industry. In contrast, the value-added share of labour in other manufacturing industries averages 37 per cent. Similar patterns are observed for other Asian economies.
- ⁶ According to the Economic Intelligence Unit (EIU, Electronic Publishing, 6 December 1995), 20 per cent of China's labour force is surplus. If the labour force grows by another 18 per cent by the year 2005, the incremental labour force available to China by the year 2005 will be 38 per cent higher than the current level. Assuming three-quarters of this extra labour will be absorbed by the year 2005, the increase in the current productive labour force will be 36 per cent [$75\% \times 38\% / (1-20\%)$]. This is equivalent to reducing China's unemployment rate to 8 per cent by the year 2005 ($25\% \times 38\% / 118\%$).
- ⁷ See Table 2 for the 10 regions in the model. The 10 commodities are: (1) agriculture, (2) mining, (3) processed food, (4) textiles, (5) clothing, (6) iron and steel, (7) transport equipment, (8) machinery and equipment, (9) other manufactures, and (10) services.
- ⁸ GTAP is a multi-sector and multi-region global general equilibrium model. It was developed under the Global Trade Analysis Project led by Thomas Hertel of Purdue University. Interested readers are referred to Hertel (forthcoming) for details of the model.

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