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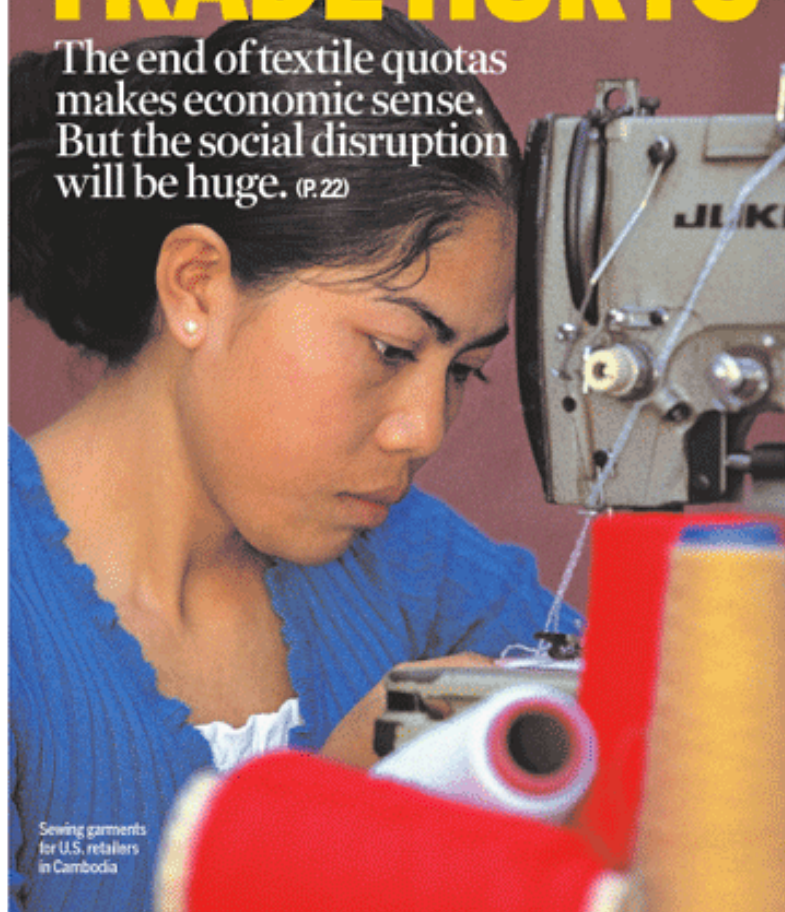
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The end of textile quotas
makes economic sense.
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will be huge. (P. 22)



Sewing garments
for U.S. retailers
in Cambodia

DECEMBER 15, 2003

ASIAN COVER STORY

Where Free Trade Hurts

Thirty million jobs could disappear with the end of apparel quotas

By Cambodia's modest standards, Tuch Phearom is a success story. For the past four years she has been sewing sweaters, a job that now earns her as much as \$80 per month, including overtime. The money has helped her family build a new wooden house that sits on stilts, leaving room for the chickens, pigs, and cattle to sleep and forage below. And her wages have allowed her father to expand the plot of land he farms to 4.5 hectares.

The winds of global commerce, though, may soon blow right through Tuch's humble prosperity. The U.S. and Europe next year are set to remove a 30-year-old regime of strict import quotas on clothing and textiles, which could put Tuch and the 1,300 other workers at the Thai-Pore Garment Manufacturing Co. Ltd. out on the street. The reason: Once the quotas are lifted, a handful of countries -- most notably China -- are expected to quickly dominate the clothing industry worldwide, using their low wages, modern factories, and good infrastructure to put outfits like Thai-Pore out of business. "I'm worried my family will have nothing," says the 24-year-old Tuch. Adds her boss, managing director Roger Tan: "China is a major, major threat."

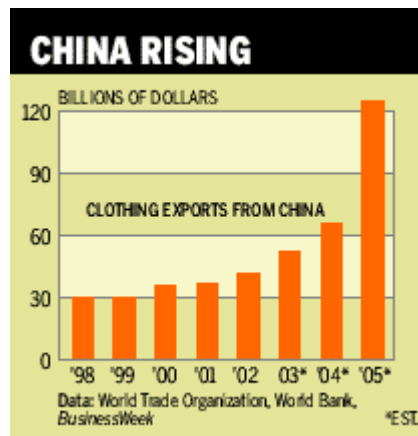
It's not just a threat to Cambodia. From the Dominican Republic to Bangladesh, some 30 million workers in dozens of developing countries could see their jobs suddenly evaporate. Under a 1974 global pact called the Multi-Fiber Arrangement (MFA), 47 nations each gets a share of the European and U.S. markets for clothing and textiles. Cambodia, for instance, this year can export to the U.S. 1,721,232 cotton pillowcases, 72 silk dresses, 1,136,229 knit shirts, and 37,896 playsuits -- in all, \$1.4 billion worth of clothing and textiles. The original idea of the quotas was to afford some protection to the declining textile industries of the developed countries. The reality was different: With quotas effectively guaranteeing market access, manufacturers sprang up in such unlikely places as Jamaica and Sri Lanka, which before the quotas had no significant textile industry.

"Trade Not Aid"

Talk about unintended consequences. Clothing exporters such as Ghana, the Dominican Republic, and Turkey had long protested that quotas were holding back their development. Not so many years ago, each expected to ramp up production dramatically if the quota system were dismantled. The World Bank, meanwhile, estimated that the quota system, by limiting market access, deprived poorer nations of twice what they received in foreign aid. So "trade not aid" became the prescription for Asia, Africa, and South America. In 1995, the U.S. and Europe agreed to begin phasing out their quotas on clothing and textiles as part of the deal that created

the World Trade Organization. Of the 140 categories of clothing covered by the MFA, quotas on about 50 less contentious categories have already been eliminated. By Jan. 1, 2005, the rest are scheduled to disappear, though most products will still face import duties of 16% in the U.S. and 18% in the European Union. Developing nations hailed the agreement.

That was before China was invited to the party. In December, 2001, after 13 years of negotiations, China joined the WTO. Now, as a member of the global trading club, China will be able to compete on an equal footing to sew blazers, blouses, and bedspreads for the fashion-conscious consumers of Europe and America. The grand prize: \$500 billion in global garment trade.



As in so many other areas, China's weight is likely to be felt far beyond its borders. Apparel industry workers in China earn an average of \$73 per month, compared with \$75 in Indonesia, \$102 in the Dominican Republic, and \$300 in Honduras. Moreover, with the help of trading companies in Taiwan and Hong Kong, China can quickly deliver its goods to stores thousands of miles from its shores. Last year, China's exports amounted to 17% of the global clothing market. Once all quotas are lifted, its share is expected to quickly jump to 45%, the World Bank estimates. China now sells the U.S. \$6.5 billion of its \$60 billion in apparel and textile imports. The number may hit \$40 billion by 2010, the World Bank says. China is "the 800-pound gorilla," says Ronald J. Sorini, a former U.S. trade negotiator for textiles.

Making China the Scapegoat

Suddenly, the much-maligned quota system looks like a lifeline. Rather than helping developing nations, the phaseout of quotas creates a Darwinian survival of the fittest -- or, as critics of globalization would have it, a race to the bottom, where wages and benefits are certain to be sacrificed in a frantic effort to retain market share. When quotas on baby clothes and soft luggage ended last year, China's exports of baby clothes to the U.S. leaped 826%, and its soft luggage shipments rose fivefold. In Thailand, the Philippines, Indonesia, and Mexico, production of those products dropped by half. In the Dominican Republic, luggage exports plummeted by 70%, to \$8.2 million.

That kind of competition benefits consumers around the developed world. Prices have already fallen by 30% on dozens of items that went off quota last year, according to industry estimates. And buyers from companies such as the Gap and Nike have been flooding China in search of new suppliers in anticipation of the end of the quota regime. M. Maniwanen, CEO of Indonesia's Busana Apparel Group, got a taste of what life may soon be like when he met in November with officials of Phillips-Van Heusen Corp. (PVH). The Van Heusen team kicked off the discussion by insisting that Busana's prices of \$12 to \$15 for a dozen dress shirts were too steep. "They're taking advantage" of the quota phaseout, says a dispirited Maniwanen. Van Heusen could not be reached for comment.

Still, China is sure to take plenty of heat for the shift. Last year's surge in U.S. imports of three off-quota items from China -- bras, bathrobes, and woven fabric -- has already created a mini-crisis in Beijing's relations with Washington. On Nov. 30, the U.S. announced it would impose emergency "safeguard" quotas on the three categories to give domestic manufacturers some breathing room. China pleads that it needs the clothing industry to absorb legions of workers

from rural areas and those laid off from inefficient state-owned industries. Modernized textile and garment factories could go a long way toward meeting the goal. "China is still a developing country, so for a long time we will need labor-intensive industry," says Cao Xinyu, vice-chairman of the China Chamber of Commerce for Import & Export of Textiles.

One of the primary victims of the end of quotas is likely to be the U.S. apparel and textile industry. In the past 12 months, nearly 50,000 U.S. textile and garment jobs were lost, leaving just 780,000 workers in the two sectors. Some expect the U.S. industry to nearly disappear, much as production of toys, bicycles, and consumer-electronics moved offshore with the quiet acquiescence of Washington policymakers years ago. The union representing U.S. textile workers, UNITE, puts the potential job loss from the quota phaseout at 500,000. Even the Bush Administration acknowledges the outcome could be grim. "The industry has been used as a bargaining chip...traded off for benefits elsewhere in the U.S. economy," Grant Aldonas, Under Secretary of Commerce for International Trade, said at a Greater Mt. Airy (N.C.) Chamber of Commerce lunch last year.

Washington is also worried about the destabilizing impact of the end of apparel quotas in the developing world. Last spring, U.S. Trade Representative Robert B. Zoellick ordered a report on the effects of a quota phaseout on poorer nations. His main concern: America's closest neighbors in the Caribbean, Central America, and the Andean nations. Their inefficient industries survive today only because they have guaranteed quotas and can export to the U.S. duty-free as long as they use American-made fabric. But after the study was completed in October, Zoellick refused to release its contents. According to sources familiar with its conclusions, it warns of a devastating effect on many developing economies. Dominican officials say they've been told they will lose more than a third of the country's 119,000 garment workers, while exports will decline by 35%.

The likely losers, meanwhile, are scrambling for ways to fight back. Central American nations, for instance, are desperately trying to negotiate a free-trade deal with the U.S. by Jan. 1. Such a pact would eliminate tariffs on their apparel exports, even when they don't use cloth or yarn made in the U.S. "For us, [a free-trade pact with the U.S.] is a question of life or death," says Jesús Canahuati, president of the Honduran Maquiladora Assn., an industry group representing clothing manufacturers. "It's the only instrument that will permit us to survive." Such a deal, though, may be a hard sell in Washington during an election year.

The situation could be even worse for Vietnam. Clothing is Vietnam's largest export, and its biggest growth industry, employing 2 million workers. As a non-WTO member, Vietnam will continue under quotas even after next year's phaseout -- which won't be an advantage once the country faces full-blown competition with China. While Vietnam's minimum wage of \$28 to \$48 a month is competitive with China's labor rates, its plants are only 60% as efficient as those north of the border, according to U.S. buyers. "We have to bear the huge pressure from competition, especially manufacturers in China, India, Indonesia, and Pakistan," worries Le Quoc An, chairman of the Vietnam Textile Garment Assn.

"No More Handouts"

Cambodia is banking on its adherence to international labor standards to carry it through. With the clothing industry producing 93% of its export earnings, it's highly vulnerable. Since 1999, Cambodia's garment quotas in the U.S. have been determined by its willingness to improve working conditions at its factories. While the requirements have forced many smaller manufacturers to shut down, larger companies quickly realized that they could get additional

quota allowances by treating their workers better, so overall textile employment has increased to 220,000 this year from 96,500 in 1999. Exports have grown by 153% over the same period.



Looming Gloom

A 30-year-old pact that controls global trade in apparel will end in 2004. The shift will eliminate import quotas on clothing and textiles and slash prices in the U.S. and Europe. But it will also devastate developing economies that depend on textile exports.

<p>THE HISTORY To persuade developing nations to beef up intellectual property protection and loosen investment rules, rich nations agreed to phase out import quotas on textiles and apparel.</p>	<p>NEXT YEAR A 10-year process of phasing out European and American import quotas will be completed. Trade in most categories will be liberalized during the year and all quotas will be lifted by Jan. 1, 2005.</p>
<p>THE REASONING Developing nations initially liked the agreement because they have low-cost garment industries and hoped to be able to export more when quotas for WTO members ended.</p>	<p>THE RISE OF CHINA When the deal was struck, China wasn't a WTO member so it didn't stand to benefit. But China joined the group in 2001, and now it is expected to quickly dominate the market.</p>

Data: Business Week

Now some are wondering whether those gains will be lost as factory owners will no longer have the incentive of bigger quotas to provide better conditions for workers. The hope is that factories will realize they can use their labor records as a selling point. Cambodia "has started to realize it might give it an edge over other countries as a way of attracting buyers," says Lejo Sibbel, an official of the International Labour Organization in Phnom Penh. Adds Chea Vichea, president of the Free Trade Union of Workers of the Kingdom of Cambodia, whose 40,000 members account for about 20% of garment workers: "Cambodia has a good reputation with buyers and consumers."

Indonesia, meanwhile, will have a hard time competing on price. Like many other countries, its textile industry is inefficient and has trouble supplying garment makers. The country's 1.2 million workers make as much as \$90 a month -- plus benefits -- stitching clothing for export. But they use mostly Chinese fabrics, so when quotas are lifted Indonesian manufacturers will likely lose out to Chinese companies. Last year, at least 10,000 jobs were lost as eight factories closed and Indonesia's clothing exports plunged 13.2%, to \$3.8 billion. So far this year, 30 more Indonesian garment operations have shut down, according to industry figures.

That has companies such as Busana searching for another way out. Busana's plan: Quit the garment business, close half of its factories, pay workers \$5 million in severance pay, and start over as a

garment buyer providing a bridge between manufacturers in Asia and retailers in the U.S. "Indonesian garment factories that are running are not making money. They're only surviving," says J. Baskaran, chief financial officer of Busana.

China won't be the only winner. India and Pakistan are also likely to benefit from the lifting of quotas. "There will be no more handouts, and everyone will have to survive by sheer economic competitive advantage," says Abid Farooq, an official of the All Pakistan Textile Mills Assn. Wages in Pakistan are comparable to China's, factories are being upgraded, and both countries grow plenty of cotton and make high-quality synthetic fibers. Pakistan's textile and clothing industry is the country's largest, employing more than a third of all industrial workers. Its \$7 billion in sales abroad this year will account for two-thirds of the country's export earnings.

Under Political Pressure

With so much at stake, Pakistan is gearing up for the shift. Imports of textile machinery -- some of it used equipment from shuttered American plants -- rose from \$160 million in 1999 to \$550 million this year. Over the past four years, the industry has invested \$3 billion to upgrade factories and expand capacity. The goal: to double exports to \$14 billion by 2005. Aziz Memon says he welcomes the challenge. His Karachi-based Kings Apparel Industries Ltd., which employs 2,000 and already ships knit-cotton clothing to Europe and the U.S., has added \$8 million of imported machinery to expand capacity by 45%. "We're going to fight against China" and other rivals, Memon says.

India is in an even stronger position. With its sophisticated, growing middle class, it has already created a sizable domestic market. India claims the world's third-largest cotton production, behind China and the U.S. And Indian exporters have established close ties to major U.S. retailers such as J.C. Penney ([JCP](#)) and Target ([TGT](#)). Optimists in the industry are already getting a jump start on 2005. Welspun India Ltd., the world's fifth-largest towel maker, is doubling capacity at its plant outside Bombay, where a stream of U.S. buyers are placing orders in anticipation of the quota phaseout on towels. "We see ourselves as one of the dominant players," says Rajesh R. Mandawewala, executive director of Welspun.

China, meanwhile, is preparing for its new bounty. Shanghai Three Gun Group Co. Ltd. spent \$36 million on a factory in Shanghai's Pudong district that began producing knit fabric last year. By October the company had exported \$65 million worth of textiles -- up from only \$1 million in 2002. "The phasing out of the quota system should be a new point of growth for us," says a Three Gun official. All over China's textile belt, producers "are adjusting our industrial structure, improving our research and development capabilities, and actively following new trends in fashion," says China Textile International Exchange Center Vice-President Zhao Hong.

Will the Bush Administration yield to pressure from political leaders at home and allies abroad to save their apparel factories? "Politically, it's not going to be possible to do nothing," says Fernando Silva, managing director of Kurt Salmon Associates, a worldwide consultant on strategic planning for consumer product companies. "If nothing is done, we will have a very rapid shift to China and a rash of bankruptcies in the U.S., Mexico, the Caribbean, Central America, and Africa."

U.S. officials concede the pressure is intense. "I have people in my office all the time saying, 'You gotta do something,'" says James C. Leonard III, the U.S. Commerce deputy assistant secretary for textiles, apparel, and consumer goods. "What am I going to do? Everybody agreed to do away with quotas." Still, many are skeptical that the U.S. will let China own the global apparel industry. "There's a bigger risk that when the quotas come off, rich nations will impose anti-dumping penalties and other sanctions against China, particularly if we start seeing widespread unemployment in Central America and the Caribbean," says Nancy Birdsall, president of the Center for Global Development, a Washington think tank.

But China has so many advantages that its rise seems inevitable. "Take anything -- garments or textiles -- and people will say, 'Sorry, China is cheaper than anywhere else,'" says G.K. Ram, general manager of a Kahatex Group factory in Bandung, Indonesia, that churns out apparel for Wal-Mart Stores Inc. ([WMT](#)) and Kmart ([KMRT](#)). Perhaps sooner than most realize, Tuch Phearom and millions like her will be struggling to find new jobs.

By Paul Magnusson in Washington, Frederik Balfour in Phnom Penh, and Michael Shari in Jakarta, with Manjeet Kripalani in Bombay, Dexter Roberts in Beijing, Geri Smith in Mexico City, and Naweem Mangi in Karachi

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