The impact of liberalizing preferential rules of origin on trade and upgrading in the clothing industry: A review of the evidence.

Louise CURRAN, Toulouse Business School.

1. Introduction

Preferential trading Arrangements (PTAs) have the potential to distort trade flows. To a large degree, that is the objective. If there was no trade reaction to such regimes, there would be little point in establishing them. However, the extent to which trade actually reacts to preferential access provision depends on several factors, most obviously the supply potential of the exporting partner and the market demand in the importing partner. In the case of preferential market access for developing countries to developed markets, the former factor is crucial. In other words, the effectiveness of such trade regimes in stimulating the beneficiaries’ exports clearly depends on their domestic industrial base. However it also depends on the way in which the market access is structured and, especially, on whether there is an implicit assumption of the existence of a functioning supply chain. This latter factor is dependent on the rules of origin (RoO) which govern preferential trade. There is growing evidence that this ‘fine print’ of trade policy, has a strong influence on the extent to which PTAs actually increase trade, especially in relatively poor, underdeveloped economies.

The objective of this paper is to bring together the existing evidence on RoO and their impact on trade and investment and supplement it with up to date analysis of trade flows and the current state of play. Although several researchers have made heroic efforts (Augier, Gasiorek and Lai-Tong, 2004; Fox, Powers and Winston, 2007; Cadot, Djiofack and De Melo, 2008; Gasiorek et al, 2010), modeling the impact of RoO on trade is far more difficult than modelling the impact of ad valorem tariffs. There remains, therefore, substantial uncertainty about actual, as opposed to theoretical, effects. However, there have been several more qualitative studies looking at the effects on supply chains of these rules, which provide further evidence of their actual impacts. This paper seeks to bring together this substantial body of research in order to summarize the current state of knowledge on the issue and implications for policy.

Where the importance of RoO is most clearly seen, is when the rules change. There are now several ‘real world’ examples of changes in RoO which we can draw on, to better understand their impacts. Several qualitative studies of such examples have also looked beyond the trade figures, at issues of investment, employment and sustainability. This research gives us a more rounded view of the impacts of such change on development. We will look in detail at several examples, in both the EU and the US, concentrating on the clothing sector, a sector often highlighted as being subject to particularly onerous RoO (Harris, 2009; Gasiorek et al, 2010). We will analyse cases where change seems to have made a difference to trade and explore, through trade data and the increasingly detailed qualitative fieldwork now available, what we know about how change has impacted on domestic industry in the affected countries. Finally we will draw some conclusions and what these findings mean for policymakers in the countries providing preferences, as well as in preference receiving countries.

2. The debate on the most appropriate RoO
When a country provides market access to another country, this access is conditional on the product being made in the latter country. The concept of being ‘made in’ a given country is more complex than might appear at first sight and has been further complicated by the expansion of Global Value Chains (GVCs) in recent decades. The exact definition is provided in the so-called ‘Rules of Origin’ (RoO) applied to the market access. These often run to many pages of detail and have attracted a great deal of criticism from NGOs like Oxfam (2004) and development oriented international institutions such as UNCTAD (2010) and the World Bank (Brenton, 2003). These criticisms center on the fact that to qualify for preferential access to key world markets, developing countries need to conform to certain requirements, many of which require a functioning domestic supply chain. A recent European Commission paper on the subject acknowledged three key criticisms of its RoO: the fact that more stringent rules of origin tend to correlate with low utilization of preferences, the tendency to develop product specific rules which can be very complicated and the fact that compliance with the requirements is both costly and burdensome for exporters and importers (CEC, 2012: 27).

The clothing sector is one where criticisms have been particularly strong and indeed utilisation rates of preferences have historically been low in the EU (Curran, Nilsson and Frontini, 2007). This is linked to the nature of the textiles and clothing value chain, where the down-stream, higher value added (textiles) end of the chain is more capital intensive and therefore less developed in many developing countries, particularly the Least Developed Countries (LDCs), where investment capital tends to be scarce (Inama, 2011; Oxfam, 2004; Brenton and Manchin, 2003; Frederick and Staritz, 2012). The RoO for garments in the EU market usually require them to be made up from cloth that is, either domestically sourced, or sourced in the country or region providing the preferences. This requirement is known as ‘double transformation’: transformation of yarn into textiles and then from textiles into clothing.

Critics consider that these requirements have restricted the utility of preferences to certain LDC exporters (Oxfam, 2004; Faber and Orbie, 2009). A study undertaken for the European Commission indicated that this rule required local value added to be between 55-70% in most product categories (Scheffer, 2006), a level that many LDCs could not reach. In the US market, the situation is even more restrictive. Most preferential clothing exporters need to conform to the ‘yarn forward’ rule, which requires, not only that clothing be made from domestically woven (or knitted) textiles, but also that the textiles be woven (or knitted) from yarn that is domestically spun from fibre. This is effectively triple transformation (Frederick, Bair and Gereffi, 2014).

The effect of these restrictions differs between the woven and knitwear sectors. Woven textiles production is considerably more capital intensive than knitted fabric production, both in terms of the complexity of the machinery and the turnover required to justify investment. Knitting machines can be quite small, simple and cheap. They can also also knit fabric to predefined dimensions that require little further processing – knit to fit – further reducing the complexity of the production process. This observation holds for much of the most heavily traded knitted goods like t-shirts and jumpers. It is not universal however and some knitted fabric is knitted on complex expensive machines and cut and made up in a similar manner to woven goods. Overall, however, double or triple transformation ROO are less restrictive for knitwear than for clothing and indeed analysis of preference utilization confirms this – higher rates are found in knitwear, at least in the EU (Curran et al, 2007).
Historically, the result of such restrictions has often been limited preference utilisation. In 2003 only 60% of Bangladeshi exports to the EU, most of which are clothing, qualified for the preferences to which, in theory, they should have been entitled (Curran, Nilsson and Frontini, 2007). More recent figures indicated that preference utilization improved over time, with 75% of EU imports from LDCs, most of which come from Bangladesh, using preferences in 2006 (Nilsson and Matsson, 2009).

Developmental Non Government Organizations (NGOs) have long called for change. They see the double transformation rule as contrary to the interests of poor countries, most of whom have little local production capacity beyond clothing. Oxfam estimated in 2004 that Bangladesh could only supply 12-15% of the textiles required for its woven clothing industry (Oxfam, 2004) although the World Bank (2012) and Rahman (2011) estimate that the figure to be higher - 25%. Most developmental NGOs and institutions, as well as a majority of academics, concur that RoO which allow the use of higher levels of non-domestic inputs would stimulate more preferential trade.

The reasons why preferences are subject to RoO are multiple. Most obviously, they prevent preferential trade being diverted to other countries, which are not nominally subject to preferences. However developmental arguments for restrictive RoO are often put forward, in that such rules can encourage the development of local industry (Harris, 2009; Rahman, 2011). Thus RoO can be seen as an incentive for upgrading, in the sense that requiring goods to have a certain level of local processing or content in order to qualify for lower or zero tariffs encourages investment in local production capacity. Although some observers see merit in such development-based arguments (Harris, 2009), many are skeptical that strict ROO really encourage supply chain development (Vermulst, 1992; Cadot, Djiofack and de Melo, 2008). Cadot et al (2008) consider that it underestimates the capacity limitations of LDCs and runs counter to the logic of increasingly disintegrated value chains: ‘Forcing backward integration in the host country by imposing rules requiring substantial transformation of goods amounts to preventing the division of labour, i.e. organising and codifying inefficiency.’ (op.cit p.105). As we shall see below, there is rather limited evidence that restrictive RoO encourage upgrading, although there is quite substantial evidence that less restrictive RoO encourage exports.

3. Research on the impact of RoO

There are several econometric studies using US data, which indicate that RoOs do indeed have a measurable impact on trade. Cadot, Estevadeordal and Eisenmann (2005) find evidence that NAFTA RoO, which require the use of US or local fabric in order to qualify for tariff free access to that market, created a captive market for US made intermediate goods amongst Mexican garment producers. Similarly, Gelb (2005) found evidence that US textiles exports increased significantly when use of US fabric was required to qualify for preferential access and fell when third country fabric was accepted. Analysis by the USITC suggested that important welfare gains could be made in the US from liberalising RoO and allowing textile sourcing purely on the basis of relative competitiveness (Fox et al, 2007).

Analysis of ‘real life’ examples of changes in the RoO lends support to the idea that more liberal RoO – specifically those that allow the use of third country fabric (TCF) – tend to be associated with an increase in clothing exports. In 2000 the US launched a new system of trade preferences for Africa under the African Growth and Opportunity Act (AGOA). AGOA extended US trade preferences in the clothing sector to ‘lesser developed countries’ and allowed the use of TCF (i.e. single transformation).
Lall (2005) sees these preferences as vital to the evolution of Lesotho’s clothing industry. Brenton and Ozden (2006) found that the new access rules increased exports significantly from the countries covered, although from a very low base. Frazer and Van Biesebroeck (2007) came to similar conclusions. De Melo and Portugal-Pérez (2008) compared developments in the EU and US markets, where RoO were different and concluded that the more liberal RoO in AGOA were associated with an increase of 300% in exports of the top seven beneficiaries and an increasing diversification of those exports.

Rules of origin have also been seen to have a direct effect on clothing GVCs in Jordan. In 2012 US imports from Jordan were over $1bn, more than all AGOA exporters together. There is clear evidence that this trade is heavily influenced by the trade regime – the so called Qualified Industrial Zones (QIZs) - under which Jordan had tariff free access to the US market even when using TCF. Recent research on the impacts of this regime indicates that it has stimulated trade, but also investment, mainly from firms in East Asia and has been accompanied by significant increases in textile imports (Al Azmeh and Nadvi, 2013).

Finally, during the negotiation of the Central American Free Trade Agreement (CAFTA) Nicaragua negotiated a specific quota of exports to the US market subject to single transformation, known as tariff preference levels (TPLs). Although temporary and subject to quite complex arrangements, these TPLs resulted in impressive growth in Nicaraguan clothing exports to the US, as well as growth in textiles inputs, especially from Asian sources. This latter trend contrasts with other members of CAFTA and Mexico, subject to more restrictive RoO, which tend to source their textiles from regional sources, especially the US. Indeed Azmeh (2015) charts a clear parallel trend in US clothing imports from CAFTA and their exports of textiles to the same countries. In spite of export growth, however, Nicaragua remained highly dependent on a limited range of products and uncertainty around its future market access has held back investment (Frederick et al, 2014).

Although there is now extensive evidence, outlined above, that RoO have impacted on US trade in the textiles and clothing sector, there has been relatively little academic work done on the issue in the context of the other key world consumer market - the EU. Augier, Gasiorek and Lai-Tong (2004) found that the EU RoO within the Mediterranean Partnership resulted in both trade suppression and trade diversion. The implication of the work of De Melo and Portugal-Pérez (2008) is that restrictive RoO were holding back EU imports from African LDCs. An analysis of preference utilization for the EU’s preferential access scheme, indicated that restrictive RoO were indeed having negative impacts on trade (Gasiorek et al, 2010). The index of restrictiveness used to gauge the impact of different types of RoO in this study rated the RoO in textiles as particularly onerous.

Until recently, the EU RoO in clothing were fairly uniform across trade regimes and it was therefore difficult to say with certainty that they had an impact. However, in 2011, following an extensive debate (Harris, 2009), the rules were relaxed for LDCs, allowing them to benefit from zero tariffs under the Everything But Arms (EBA) tariff free access scheme, even for clothing made up from textiles imported from a third country. The impact of this scheme on exports from certain LDCs was significant and will be analysed below. Curran and Nadvi (2015) note a large impact on clothing exports from Bangladesh, in particular in the woven sector.

However the expansion of exports to the preference provider is not an end in itself. As outlined in a recent report, the EU, along with most preference providers, sees trade as a route towards economic
development (CEC, 2012). Thus increased trade should, it is hoped, have positive social and economic impacts. There are two factors which are important to the overall impact of increased clothing exports on the economy of the beneficiary country, which are also vital to gauging the potential effect on upgrading and economic development more generally. The first reflects the historic arguments for restrictive RoO i.e. that they encourage the development of indigenous industrial supply capacity. If the industrial development based arguments for restrictive RoO are correct, we would expect negative impacts on the textiles sectors in the countries where RoO change has stimulated clothing exports, as imported textiles replace local sourcing. However, such negative impacts can only occur if there is an existing domestic textile industry. Nevertheless, depending on how much inputs are imported, the net value-added to the local economy will be lower than the gross export figures indicate, perhaps significantly so.

Another factor which impacts on the extent to which increased exports contribute to indigenous development is the level of foreign direct investment (FDI) involved. Of course FDI can be a very effective means of upgrading local industry through learning and technology transfer effects. However, in their work in Jordan, Azmeh and Nadvi (2013) found little evidence that foreign owned factories were embedded in the local economy, with even the labour force largely imported from South Asia. Their findings indicate that there is reason to question the extent to which the new regime has stimulated sustainable industrial development in Jordan, although it has certainly stimulated trade. In addition, FDI can be very footloose in the relatively low capital intensive clothing sector, as evidenced by the experience of Lesotho after world clothing trade was liberalized from quotas in 2005, when rapid factory closures meant 13,000 jobs were lost (Staritz and Morris, 2013a). It is therefore important to incorporate some assessment of the extent to which increases in clothing exports are related to increases in FDI, in any evaluation of the impacts of policy change.

4. Methodology

This paper will seek to shed light on the question of the extent to which RoO impact on trade and development, through an analysis of the evolution of clothing trade on the US and EU markets, focusing on the interactions between preferential access and trade flows. We analyse trade in more detail for the key suppliers subject to TCF provisions on both markets. We analyse clothing exports (both knitted and woven goods) and textile imports, in order to gauge the impact on the overall value chain in the selected countries. Within the textile sector, we differentiate between imports of finished textiles (woven or knitted), which are mainly inputs to clothing production and imports of raw and treated fibers, which are mainly inputs to yarn production.

Previous research has looked at imports in the whole textile sector (SITC 65 in the UN categorization) (Azmeh, 2015) of countries subject to TCF. However, SITC65 includes all intermediates – textiles, yarn and fibres. As the key objective of a double or triple processing ROO is to impose certain processing stages on exporters, it is useful to look at these stages separately. Confounding all textiles inputs means we may misunderstand trends, as imports of inputs to the domestic textiles industry may be as important, or more so, as finished textile imports. Other studies have looked only at imports of knitted and woven fabric (Frederick et al, 2014). However this also may underplay the extent of local textile production activity.

Much of the analysis will be done using trade data from the TradeMap database of the International Trade Centre (ITC) in Geneva. We analyse trade from 2001, as the database reports consistent data...
from that date. In addition this allows us to compare trade before and after the removal of the quota system that had constrained global trade for decades under the Multifibres Agreement (MFA). For EU trade we use the EU27 configuration, which does not include Croatia, as for the majority of the period covered, the country was not an EU member. We focus on extra-EU trade, so we remove intra-EU trade from our total trade figures.

It should be noted that sometimes the declared imports or exports of certain developing countries are clearly underreported. We see this, for example, when there are sudden large increases in the later years of data provided, when TradeMap uses mirror data instead of the country’s own declarations, or when declared imports into the key consumer market are higher than the country’s declared exports to the world. In cases like this, we have used declared exports/imports from key partner countries which regularly and consistently report trade over the period – thus we essentially construct mirror data for the whole period. This inevitably results in underreporting of certain flows (although they are generally higher than the country’s own declarations), but we can be more confident that the trends are correct.

On the issue of FDI, the situation is still more complex. Many of the poorest developing countries do not provide regular statistical declarations to the key international bodies. Although this is also the case for trade, in the latter case we can use mirror data. In the case of FDI this is much less likely to be feasible. Even developed countries often declare total FDI flows either by destination or by sector, but not both simultaneously. In analyzing the extent to which FDI is linked to trade growth, we therefore need to largely rely on existing field work by other researchers.

5. Results

5.1. US market overview

Table 1 provides an overview of the key suppliers to the US market in the knitted and woven clothing sectors. It also indicates which suppliers benefit from preferential market access to the US, mostly through Free Trade Agreements (FTAs) and finally whether the ROO of this preferential access allow the use of third country fabric (TCF). In both this table and Table 2 for the EU we use the preferential status of the country in 2014. As these trade regimes change quite regularly, this status may not have been constant over the period covered.

It is immediately obvious that, although many of the top suppliers benefit from some form of market access, others do not. Most notably neither China nor Vietnam have any preferential access to the US market (although Vietnam is in negotiations with the US), yet together they represent almost half of total US imports in both sub-sectors. Both third suppliers are in a similar position (Indonesia and Bangladesh). Thus the first conclusion we can draw from these figures is that preferential access is far from being the most important factor in the sourcing decisions of clothing buyers.

However, as we move down the list, preferential suppliers become more important, especially in knitwear, where there are four regional suppliers under NAFTA or the CAFTA-DR FTA in the top 10 suppliers. In woven goods there is only one – Mexico - although other preferential suppliers are more important in the second half of the table. In terms of the key focus of this paper, the capacity to use TCF doesn’t seem to be a key factor in overall sourcing – Nicaragua is the key beneficiary in knitwear, with only a 2,4% market share, while Egypt is the most important suppliers using TCF in woven goods, with only a 1,2% market share. Thus TCF provisions may seem rather marginal to clothing
sourcing. However, if we look at growth rates, a more interesting picture emerges. The huge growth rates registered in Vietnam over the 14 years covered is a reflection of the fact that, prior to the normalization of trade relations with the US in December 2001, their exports did not benefit from most favoured nation (MFN) status and thus attracted significantly higher tariffs than other trade partners. China also registers very high growth for a similar reason – prior to entry into the World Trade Organisation (WTO) in 2001, they also attracted tariffs that were higher than MFN rates.

<table>
<thead>
<tr>
<th></th>
<th>Knitwear</th>
<th>Woven clothing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total imports</strong></td>
<td>Change (01-14)</td>
<td>Import share</td>
</tr>
<tr>
<td>China</td>
<td>24097,5</td>
<td>12,0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>323,6</td>
<td>5,9</td>
</tr>
<tr>
<td>Honduras</td>
<td>24,6</td>
<td>4,7</td>
</tr>
<tr>
<td>Cambodia</td>
<td>356,3</td>
<td>4,2</td>
</tr>
<tr>
<td>El Salvador</td>
<td>37,9</td>
<td>3,6</td>
</tr>
<tr>
<td>India</td>
<td>189,6</td>
<td>3,4</td>
</tr>
<tr>
<td>Mexico</td>
<td>-59,9</td>
<td>2,9</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>143,4</td>
<td>2,7</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>1045,1</td>
<td>2,4</td>
</tr>
<tr>
<td>Guatemala</td>
<td>23,2</td>
<td>2,3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>49,1</td>
<td>2,2</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>127,6</td>
<td>2,1</td>
</tr>
<tr>
<td>Jordan</td>
<td>572,0</td>
<td>1,8</td>
</tr>
<tr>
<td>Thailand</td>
<td>-28,0</td>
<td>1,6</td>
</tr>
<tr>
<td>Philippines</td>
<td>-9,7</td>
<td>1,4</td>
</tr>
<tr>
<td>Haiti</td>
<td>238,1</td>
<td>1,4</td>
</tr>
<tr>
<td>Peru</td>
<td>67,2</td>
<td>1,3</td>
</tr>
<tr>
<td>Italy</td>
<td>-12,8</td>
<td>0,9</td>
</tr>
<tr>
<td>Dominican Rep.</td>
<td>-45,3</td>
<td>0,9</td>
</tr>
</tbody>
</table>

Source – ITC TradeMap and author’s calculations

If we disregard these exceptional growth rates, in knitwear, we can see that the highest growth in the sector have been seen in Nicaragua and Jordan, both benefitting from TCF. The other TCF beneficiary, Haiti\(^1\), experienced slightly lower, but still very high (+238%) growth. If we compare Nicaragua with Guatemala, a rather similar sized country with similar market share, we see that the latter has failed to develop its exports while the former has multiplied them by a factor of ten. It seems reasonable to suggest that this divergence in performance is linked to TCF provisions.

The woven sector has been less dynamic, in general, than knitwear, with only 19% nominal growth over the period compared to 67% in knitwear. Given that IMF figures indicate that US inflation averaged 2,3% annually over the period, this amounts to a contraction in the real value of imports of woven goods. In this difficult market context, the highest growth rates outside of Vietnam were registered by Jordan (+371%). Besides China and Bangladesh, which both have no preferential market access but are highly competitive in the sector, the next most important growth was registered by Egypt – subject to similar market access to Jordan. In addition, Nicaragua registered healthy growth rates during a period when its neighbors in Central America universally experienced a contraction in exports. This was most significant in volume terms in Mexico. Although they remain the fourth most important supplier to the market, their exports almost halved in nominal terms over

---

\(^1\) Haiti can benefit from TCF provisions, with some restrictions, under the HOPE Act.
the period. In addition, Haiti, which is not in the table, as only 22th supplier to the US with 0.6% market share, has multiplied their exports by a factor of four.

In terms of any differential effect of preferential access between the two sub-sectors, we note a greater number of preferential suppliers in the top ten suppliers to the knitwear market, compared to woven goods, where most key suppliers have no special preferences. This is consistent with the standard RoO in knitwear being less difficult to fulfil than in woven goods. As outlined above, knitting is less capital intensive than weaving. Although in the case of the US, the requirement for triple transformation, would call for, not only a domestic knitting industry, but also a spinning industry, in order to produce goods from fibre. Given that all of the suppliers in question are within the Central American region, importing raw materials from the US would also be a feasible option to comply with RoOs. Indeed, as indicated above, academic studies indicate that this practice is widespread (Cadot et al, 2005; Gelb, 2005; Azmeh, 2015).

From this brief overview, we can conclude that preferential market access seems to be a rather marginal factor in clothing sourcing for the US market. Several preferential suppliers, most notably Mexico, have seen their exports fall over the period, in spite of being subject to theoretically quite significant tariff advantages. The performance of those preferential suppliers subject to TCF has been substantially better than average. Thus preferential access, combined with liberal RoO, does seem to have enabled certain relatively small suppliers to augment their US market share, often in quite difficult market conditions. Thus there does seem to be an affect from such trade regimes, even if the volume of trade covered is often rather low.

It is interesting to note that there are no AGOA suppliers amongst the top twenty in either sub-sector. In spite of the extensive vaunting of the benefits of AGOA from academics and developmental organisations, its impact on total trade has been low. The first AGOA supplier in woven goods in 2014 was Mauritius (23rd supplier to the market, with 0.5% market share) and in knitwear it was Lesotho (26th supplier to the market, with 0.4% market share). Given the often limited supply capacity of these countries, this fact is perhaps not surprising. As we will see below even small market share increases can have important local effects in small economies. However it is clear that the impact of liberalised RoO on Asian LDC trade is potentially far more significant indeed the heated debates around the RoO to be applied to any potential US market access accorded to Vietnam under the Trans Pacific Partnership (TPP) bear witness to the concerns of other suppliers and domestic US industry about the potential of Asian low cost suppliers to displace other actors in the market (Frederick et al, 2014).

5.2. EU market overview

Equivalent figures are provided in Table 2 for the EU market. Here we note an even stronger concentration (54% of the market in both sub-sectors) in the top two suppliers – China once more and Bangladesh. However, preferences seem to play a much more important role in sourcing choices than in the US, with the majority of suppliers (12 in each case) subject to preferences in both sub-sectors. FTA access and EBA are the key preferences used. The only significant recipient of GSP plus

---

2 For this table we considered suppliers subject to preferences under the Generalised System of Preferences (GSP) as not subject to preferences, as the small reduction in tariffs accorded (from 12% to 9.6%) is not considered sufficient to significantly impact on sourcing choices.
is Pakistan, who in any case was only accorded this status in 2014\(^3\). In both sectors the key preferential suppliers are EBA countries and neighboring countries with FTAs.

If we look at growth rates, it is clear that both Bangladesh and Cambodia have significantly outperformed other suppliers in knitwear, with only Serbia (a neighbouring country with special access under its accession process) and Vietnam performing similarly. Looking at the countries with low or negative growth rates (Hong Kong, Thailand, Indonesia), these have no preferential access to the market, although Tunisia, Morocco and Egypt also had lower growth rates than the market average in spite of free access to the EU market.

The case of Mauritius is curious, as, in spite of preferential access under, initially the Cotonou Agreement and laterally an FTA, which includes TCF provisions, the country has seen major falls in its knitwear exports (as well as in woven goods). This seems likely to be linked to reductions in its competitiveness over time and the loss of the guaranteed market share that the previous MFA quota regime provided (Curran, 2008). Even before the quota regime ended, employment in the Mauritian industry was falling and several companies relocated to Madagascar to take advantage of lower labour costs and more secure market access (Joomun, 2006; Staritz and Morris, 2012a). The interim Economic Partnership Agreement (EPA) with the EU which Mauritius has concluded together with several other countries in East and Southern Africa, is not an FTA as such, but an interim arrangement which may not result in full, long term market access. This could partly explain the failure of trade to pick up after its conclusion, although Nicaragua’s market access is also temporary and yet it has substantially stimulated trade.

In woven goods, like in the US, the market has been less dynamic than in knitwear, although growth rates are still significantly higher than in the US. Two of the three highest growth rates are seen in LDCs benefiting from EBA. The other country with high growth rates, Egypt has free access to the EU market and, as we will see below, is a textiles producer, reducing the difficulties created by ROO restrictions. Other suppliers which outperformed the market growth were China, Pakistan, Vietnam and India. Of these only Pakistan had significant preferences and not for the whole period covered.

In terms of the ROO, the key supplier which seems to have benefitted from the TCF provisions, instituted in 2011, is Bangladesh, although Cambodia has also seen impressive growth and is a key supplier, especially in knitwear. Madagascar has seen less impressive growth rates, although this could be linked to internal political problems, which led to its suspension from AGOA trade preferences, although not those of the EU. Myanmar was only re-accorded preferences in 2013, having been suspended from LDC market access following the coup in 1997. In 2014 alone exports of woven clothing increased by 60%, bringing this source into the top twenty.

Overall, we see that preferences do seem to be a significant factor in sourcing decisions in the EU market. Most of the key suppliers, with the exception of China, those on the Indian sub-continent and Vietnam, benefit from zero tariffs on their exports, providing they use domestic or EU fabric. Given the proximity to the EU of most of these producers, the latter possibility is probably feasible, especially given the historic practice of exporting EU textiles to neighbouring countries for making up

---

\(^3\) GSP plus provides duty free access to the EU market with double transformation ROO. Pakistan’s access to the EU market has varied over the years. They had similar duty free access under a previous regime, between 2001-2005, but lost it following a challenge to the EU’s scheme by India in WTO.
under Outward Processed Traffic (OPT) regimes (Smith et al, 2008). However, only LDCs and certain EPA regimes have TCF provisions. Of these only those provided to LDCs can be seen to have affected trade, quite substantially in the case of Bangladesh and Cambodia.

<table>
<thead>
<tr>
<th>Change</th>
<th>Knitwear</th>
<th>Woven clothing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market share</td>
<td>Preference</td>
<td>TCF</td>
</tr>
<tr>
<td>China</td>
<td>502,5</td>
<td>36,4</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>618,7</td>
<td>17,7</td>
</tr>
<tr>
<td>Turkey</td>
<td>158,6</td>
<td>14,9</td>
</tr>
<tr>
<td>India</td>
<td>277,9</td>
<td>6,4</td>
</tr>
<tr>
<td>Cambodia</td>
<td>839,6</td>
<td>4,6</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>275,9</td>
<td>2,4</td>
</tr>
<tr>
<td>Pakistan*</td>
<td>352,5</td>
<td>2,0</td>
</tr>
<tr>
<td>Morocco</td>
<td>44,3</td>
<td>1,9</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>702,3</td>
<td>1,7</td>
</tr>
<tr>
<td>Tunisia</td>
<td>44,5</td>
<td>1,5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>13,5</td>
<td>1,5</td>
</tr>
<tr>
<td>Thailand</td>
<td>-3,4</td>
<td>0,9</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>-57,5</td>
<td>0,8</td>
</tr>
<tr>
<td>Croatia**</td>
<td>121,0</td>
<td>0,8</td>
</tr>
<tr>
<td>Egypt</td>
<td>60,7</td>
<td>0,5</td>
</tr>
<tr>
<td>Mauritius</td>
<td>-30,8</td>
<td>0,5</td>
</tr>
<tr>
<td>USA</td>
<td>66,2</td>
<td>0,5</td>
</tr>
<tr>
<td>Serbia ***</td>
<td>671,7</td>
<td>0,5</td>
</tr>
<tr>
<td>Madagascar</td>
<td>42,3</td>
<td>0,3</td>
</tr>
<tr>
<td>Switzerland</td>
<td>64,4</td>
<td>0,3</td>
</tr>
</tbody>
</table>

* GSP plus since 2014  
** Croatia became an EU Member in 2013 prior to that there was an FTA  
*** includes Montenegro until 2005  
# Ukraine has unilateral trade preferences since April 2014 and is in the process of implementing an agreed FTA  
## Myanmar has had EBA benefits since 2013 when trade sanctions were lifted.

Source – ITC TradeMap and author’s calculations

5.3. The evolution of trade in key clothing exporters benefitting from TCF provisions

As discussed above, the extent to which clothing exports can be considered to bring wider value added to the economy depends, to a large extent, on whether their production is embedded within local value chains, as opposed to relying on imported inputs. Of course clothing production, as such, provides important employment opportunities, especially for women. However, the economic effects of clothing exports would obviously be greater if the whole supply chain were developed in the country in question. We wanted to look into the extent to which the increases in exports which certain countries have experienced in recent years can be seen to be linked to increase imports of intermediate goods, implying that much of the value chain for the goods assembled in the exporting country may be based elsewhere.

To do this, we analyse trends in trade from the key exporters to the key market providing preferences with TCF provisions, their exports to the world and their imports to the textile sector. In the latter sector, as indicated above, we differentiate between finished fabrics and inputs to weaving/knitting or spinning. For reasons of space, we chose to concentrate our analysis on the two key suppliers subject to TCF provisions in each market for each sub-sector (knitwear and woven clothing). These are Bangladesh and Cambodia in both sectors for the EU, and Nicaragua in both for...
the US, with Jordan for knitwear and Egypt for woven goods. It should be noted that it is not possible to differentiate between those inputs to textile production or spinning which are subsequently used in knitwear and those used in woven goods. In cases where the key supplier is the same in both sub-sectors, the figures for these two inputs are therefore the same in both graphs.

In the knitwear sector, on the US market, we analyse trade from Nicaragua and Jordan. Trade figures for Nicaragua are shown in Figure 1. We don’t report total exports in the graph as they are essentially the same. The US represented 95% of knitwear exports from Nicaragua in 2014 – a level of dependence that is rare. The graph shows that exports have increased considerably since the TPL provisions and that knitted fabric imports have increased in line with these, although at a slower rate. However our total import figures don’t include Honduras, which is apparently an important supplier. Unfortunately they have not declared recent trade figures to the UN. This difficulty in gauging total knitted fabric inputs to Nicaragua has previously been noted by Frederick et al (2014). It is clear, however, that inputs to the textile industry are virtually non-existent in relative terms ($3m in total in 2014), indicating that there is essentially no local textile processing or knit to fit production in Nicaragua.

![Figure 1 - Nicaraguan trade in knitwear and inputs](image)

Source – ITC TradeMap. Nicaraguan imports calculated from mirror data of main exporters. Honduras does not declare

The trends in trade for Jordan are shown in Figure 2. The date of entry into force of the TCF provisions is not indicated as it predates the graph - 1997 - although figures from Azmeh (2015) indicate that trade only really started to develop in 2001. Again, total exports are not shown, as the graph is essentially the same, with over 90% of exports going to the US. We note a similar situation as for Nicaragua, in terms of the link between exports to the US and knitted fabric imports, although there has been slightly more trade in inputs to the textile industry – particularly yarn, with $45m of imports in 2014. Thus some textile processing is occurring in Jordan. This seems likely to be linked to knit to fit processing, which is relatively common in the production of t-shirts, one of Jordan’s key
exports. In contrast to Nicaragua, Jordan saw major falls in its exports from 2005, although they have picked up again in recent years. This seems likely to be linked to the global financial crisis that in 2007-8 and had quite major impacts on clothing trade (Curran and Zignago, 2010). However, the impacts on Jordan were deeper and its recovery slower, than we observe in the other exporters covered in this paper. Between 2007-2009, US imports of knitwear fell by 12%, but they recovered in 2010 to 2007 levels. Clearly this was not the case for Jordan, whose exports only recovered to 2007 levels in 2014.

![Figure 2 - Jordanian trade in knitwear and inputs](image)

On the EU market, we analyse the evolution of trade for Bangladesh, the key source and Cambodia, a growing supplier. The situation is quite different in these two markets. The trends for Bangladesh are provided in Figure 3. Although Bangladesh is highly dependent on the EU market for exports (82% of exports reported here in 2014), their dependence on their main market is lower than for Nicaragua and Jordan. It is clear that there has been a rapid expansion in total exports, largely fueled by a corresponding increase in exports to the EU market. Although we note an increase in knitted fabric imports in recent years, in particular following the change in ROO in 2011, they remain very low compared to the value of exports, and compared to the situation we observed in Nicaragua and Jordan. Other inputs to the textile sector have increased gradually over the time. Rahman (2011) has noted that value added has historically been higher in Bangladeshi knitwear exports than for woven clothing, due to stronger local production capacities in the intermediate sector.

---

4 The large difference in the value of exports and the value of imported inputs begs the question of where the inputs to the Bangladeshi knitwear sector come from, given that there is little local cotton production. It must be noted that the Bangladeshi trade figures for the important raw cotton sector are poor. Several key exporters, like Iran and Turkmenistan don’t report trade for most years and Uzbekistan hasn’t reported trade since 2011. Thus we can safely assume that raw materials imports are substantially higher than the figures indicate. Unfortunately Bangladesh has not declared trade since 2011, so all data since then is mirror data.
The evolution of trade in Cambodia is shown in Figure 4. Here we note a lower level of dependence on the EU market – just under half of exports reported here. However, we also note a much higher level of dependence on imported fabric, along with virtually no imports to the textile or spinning sectors. Thus the emerging Cambodian knitwear industry seems to be heavily dependent on imported fabrics, with essentially no local textile production activity or knit to fit processing. This situation undoubtedly reduces the impact of the industry in the wider economy and we will return to this point in our later discussion on FDI.
In the woven goods sector, the countries which we will consider in relation to the US market, are Nicaragua and Egypt. The trends for Nicaragua are shown in Figure 5. The graph shows, both a large increase in exports up to 2006 and a very rapid fall after - trade value fell by 42% between 2006-9 compared to 19% for US woven goods imports from all sources. Like Jordan in knitwear, it seems that Nicaraguan woven goods exporters were more heavily hit than other suppliers by the fall in demand on the US market following the financial crisis. This underlines the vulnerability of such suppliers to external shocks, especially given their almost exclusive dependence on one export market.

In terms of the textile value chain, as observed above, imports of inputs to the textile industry are largely non-existent and the country seems to be heavily dependent on imported textiles. Woven textiles imports largely shadow related clothing exports, although they did not fall as precipitously in 2006. Closer analysis of the data indicates that textiles imports from all key sources fell over the 2006-9 period, with the exception of imports from the US which rose by 20%. This is likely to be linked to a very specific element of the TPLs accorded, the so-called ‘one-to-one’ rule, imposed in 2006. This stipulated that for each shipment of trousers made from TCF exported to the US, there must be a matching shipment of trousers made from US textile inputs. The quantity of trousers subject to this rule increased automatically each year, resulting in a captive market for US fabric in Nicaragua (Frederick et al, 2014). This probably explains the continued increase in woven fabric imports from the US, in spite of falling clothing exports.
The trends in trade for Egypt are shown in Figure 6. The context in Egypt is very different to that in all other countries studied here. The country has a long and enduring textile tradition. As discussed in Azmeh (2015) this made it a more natural choice for clothing production than Jordan in the context of the QIZ regime. However, the country has seen less rapid increases in exports to the US, for a variety of reasons, which he explores in more detail. In terms of the trends in the graph, although Egypt’s woven clothing exports to the US shadow total exports, unlike Jordan and Nicaragua, Egypt also exports substantial volumes to other markets. The US market accounted for just over half of exports in 2014.

The other notable feature of the graph is that textile imports are, not only higher than exports to the US, but last year actually exceeded total woven clothing exports. At the same time, the country imported even higher quantities of inputs to the textile sector – both yarns for textile production and fibres for yarn spinning. This counter-intuitive situation where clothing exports values are lower than imports of both finished textiles and inputs to the textile industry, is partly explained by internal demand for textiles for other purposes, not least the production of household textiles and other finished textile products for the export market - worth $333m in 2014. In addition, Egypt exports quite substantial quantities of woven textiles to the world market – worth $280m in 2014. Both of these exports are combined in Figure 6 into the category ‘exports of woven fabric and related’.

Overall, the figures show that the QIZ regime has been much less important to Egyptian textiles and clothing trade than in either Nicaragua or Jordan. This is largely because of the greater diversity in markets served by the industry - both geographical and in terms of products - and the availability of local fabrics, making the need for TCF less important. Azmeh (2015), notes that local fabric availability in Egypt was actually seen as a disadvantage by foreign investors seeking to set up in Jordan or Egypt in response to the QIZ scheme, as they usually had existing approved suppliers (often
in Asia) from whom they wished to continue sourcing. We shall come back to this point when we discuss FDI below.

**Figure 6: Egypt’s trade in woven clothing and inputs**

![Graph showing Egypt's trade in woven clothing and inputs]

Source – ITC TradeMap and own calculations. Mirror data from key suppliers/markets.

In the EU market, the two countries considered are as for knitwear – Bangladesh and Cambodia. The figures for Bangladesh are shown in Figure 7. We note that, although trends in total exports shadow exports to the EU, in this sector Bangladesh is less dependent on the EU than in knitwear, with just over 50% of exports going to that market in 2015. In terms of the textile value chain, woven fabric inputs have increased in line with these increases in trade, but remain well below total woven clothing exports. As shown in Figure 3, the increase in exports of clothing does seem to have had some positive impact on demand for imported inputs to the textile sector. Imports of inputs to textile weaving and knitting have increased by 32% in the period since the ROO change in 2011 and inputs to spinning by 10%. Thus, although there has been a strong growth in finished textiles imports since the ROO change, there has also been an increase in imports of inputs to textiles and yarn production, indicating that the local textile industry is also increasing its production. It therefore appears from trade figures that fears that the new ROO would result in the decimation of the local textile industry seem to have been exaggerated. This was also the conclusion of more detailed research by Curran and Nadvi (2015).
Finally, the data for Cambodia is shown in Figure 8. Here we see a major increase (+220%) in woven clothing exports since the change in ROO in 2011, largely due to a rapid increase in EU exports (+450%). As a result Cambodia has become substantially more dependent on the EU market—47% of exports were destined for the EU in 2014 against only 17% in 2001. Indeed, in the past, the country had been mainly oriented towards the US market (Natsuda, Goto and Thoburn, 2010). Woven fabric imports have increased in tandem with general increases, and although textiles inputs are also increasing, they are well below imports of finished textiles, while spinning inputs are virtually non-existent, indicating that there is little local spinning capacity and thus triple transformation (as required by the US market) would be difficult for Cambodian manufacturers to achieve.
In conclusion, the figures analysed here indicate that all of the countries covered have seen increases in their clothing exports to the preference providing country, following changes in the ROO, although these increases have not always been sustainable, especially in the face of external shocks. In addition, in all cases, increased exports are accompanied by increases in imports of the finished textiles – knit or woven – required in the production of the exports in question, although experiences vary. In Bangladesh, there seems to be rather little importing of knitted fabric, in spite of large increases in knitwear exports. At the same time, Egypt has seen its woven fabric imports increase well above its woven clothing exports to the US, although this is related to its diversified use of these fabrics. Apart from in Egypt, we do not observe high levels of imports of inputs to the textile industry, so it seems reasonable to assume that in most cases the industry is relatively small and, in the case of Nicaraguan, Jordan and Cambodia, virtually non-existent. Thus, especially for these sources, the question of the added value of the industry to the wider economy, as well as its embeddedness in that economy, could be questioned and indeed several researchers have posed such questions (Natsuda et al, 2010; Azmeh and Nadvi, 2013; Frederick et al. 2014; Azmeh, 2015). Our analysis tends to confirm such concerns.

Finally, in terms of the differences between the two sectors and the supposed relatively higher restrictiveness of double or single transformation in woven, as opposed to knitted goods, the situation seems to be different in the two markets. In the US, it was knitted goods trade which exploded from Jordan and Nicaragua, following the according of TCF provisions, woven goods imports increased at less impressive rates. In the EU, the opposite was the case. The growth rates in the first four years of effective operation of the TCF provisions5 are provided in Table 3. The contrast between the experiences in the different markets is striking. In the EU we see that the varied growth

---

5 EBA TCF provisions have only been in place since 2011 so we only have four years. The financial crisis hit the US four years after TCF provisions were accorded to Nicaragua and Egypt, certainly biasing growth rates afterwards. For Jordan we use growth rates from 2001 as we do not have comparative data before that and, prior research indicates that this was the year that exports started to rise (Azmeh, 2015).
rates are consistent with what would be expected if the prior regime was indeed more restrictive for woven goods. Previous detailed analysis by Curran and Nadvi (2015) also confirms this trend in relation to the EBA ROO liberalisation. In the US market, the very high levels of growth for knitwear, as opposed to woven goods, under TCF provisions, is curious.

The difference in the trade reaction of the different sub-sectors to the changes in ROO in the different market contexts is probably linked to the differing nature of the default regimes – triple transformation in the US and double transformation in the EU. This means that, a knitwear exporter to the EU, ‘only’ needs to ensure that the fabric or structure from which the final product will be made, is knit domestically. In the US they also need to source the yarn domestically. Thus the liberalisation implied by a TCF rule is considerably higher in the case of knitwear exporters to the US market, than those to the EU market, who may largely have been able to conform to the previous ROO in any case. Thus differences in growth rates in knitwear may be understandable. The differences in growth rates in woven goods are less so, and would require further study to unpack why exports to the US in woven goods in the two key TCF suppliers have not expanded to the same extent as those to the EU, which have similar access? As this is not the key focus of this paper, we will not explore it further here.

<table>
<thead>
<tr>
<th>Table 3: Growth rates in years following TCF provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Woven</td>
</tr>
<tr>
<td>Nicaragua</td>
</tr>
<tr>
<td>Jordan</td>
</tr>
<tr>
<td>Egypt</td>
</tr>
<tr>
<td>Bangladesh</td>
</tr>
<tr>
<td>Cambodia</td>
</tr>
</tbody>
</table>

6. The link between FDI and trade development in the clothing sector

As discussed above, the extent to which a country benefits economically from increased trade is also related to the extent to which the capital invested in the development of the industry is domestic, or from outside sources. FDI can, of course, provide a very positive input to development, but the clothing industry, in particular, has historically been footloose, given to changing production locations as cost factors and trade regimes evolve. In addition, FDI has often been associated with the import of expertise as well as finance, resulting in little upgrading of local knowledge and skills. In its most extreme form, this can even extend to the import of low skilled labour required to produce garments. This has been the experience in Jordan (Azmeh, 2014). Researchers in AGOA countries often find little evidence of upgrading, with most factories primarily involved in basic Cut Make and Trim (CMT) trade and heavily dependent on their headquarters for orders and inputs (Lall, 2005; Phelps et al, 2008; Edwards and Lawrence, 2010).

Seeking to gauge how much the increases trade we have observed in reaction to the shifts in preference provision is linked to FDI is a difficult task. Unfortunately FDI data at sectoral level is limited in most countries. ITC has data on investment in the textiles, clothing and leather sectors only for Bangladesh and Cambodia. These figures indicates that flows into Bangladesh were $282.3m in 2011, up by 10% from the previous year and stocks were $1.4bn. Equivalent figures for Cambodia for 2012 were $142.8m and $1.9bn, with a 28.1% increase since 2010. It is difficult to put these
figures into perspective without a wider comparison, but UNCTAD figures confirm that most investment in the manufacturing sector going into LDCs goes to these two countries and the clothing sector is the key manufacturing sector in both (UNCTAD, 2014).

Although we lack reliable comparative figures, there has been quite extensive field research on several preference receiving countries, which provide insights into the interaction between FDI and trade, as well as the extent to which FDI is ‘embedded’ in the local context and thus likely to result in positive spillovers in other sectors of the economy and/or for skills. Looking firstly at research on the countries in this study, the situation is quite different in each. In Nicaragua, the vast majority of large firms studied by Frederick et al (2014) were foreign owned and the authors’ estimate that half of the largest clothing factories – mainly Korean, Taiwanese or US-owned - could move their production elsewhere if TPL expires. Van Wunnick (2011) has studied the operations of the Taiwanese firm Nien Hsing in Nicaragua and found that they had virtually no supply linkages to the local economy, while most managers and technicians were expatriates. He concludes that the impact on wider industrial development in the country of the company is limited and that their case is representative of other local Asian investments.

In Jordan, research by Azmeh (2014;2015) and Nugent and Abdel-Latif (2010) also sheds doubt on the potential positive economic spillovers from preference related FDI. As in Nicaragua, this work notes very low levels of local sourcing and extensive use of expatriate workers, including in low skill assembly tasks. Between 100-150,000 Asian workers were relocated to Jordan over the period since TCF access was accorded, to work in clothing factories there. Indeed the capacity to import labour on this scale was reported to be one of the key reasons that Jordan was favoured as a production location over Egypt, where there was a limit of 10% on foreign workers in QIZ factories (Azmeh, 2014). Nugent and Abdel-Latif (2010) estimated that only 30% of workers in QIZ factories in Jordan were local. In addition they note that the fact that foreign enterprises can avail of tax-free repatriation of profits, further limits the positive spillovers for Jordan.

As indicated in our own analysis above, the case of Egypt is quite different, not least in the fact that there was an indigenous textile industry present before the QIZ regime was established. However, Nugent and Abdel-Latif (2010) note that the industry has some persistent problems, most notably an inefficient textile production sector dominated by state owned enterprises. Although Azmeh (2015) notes some FDI in the clothing sector from Asia, as well as Turkey, following the QIZ regime change, the extent was lower than in Jordan, although limitations on migrant workers meant that those companies which did move to Egypt, staffed their assembly operations with local workers. Nugent and Abdel-Latif (2010) also note an increase in Turkish FDI. They link this, not only to the QIZs, but also to the Egypt-Turkey FTA which came into force in 2005. Most of this investment is in garment production, rather than in intermediate products, the sector where Egypt is perceived to most need help in upgrading. Given the nature of the QIZ advantages, this preference of investors for clothing production is understandable.

Finally the same author’s note that the difference in timing of the entry into force of QIZ preferences (1998 for Jordan and 2004 for Egypt) had an effect on investment flows. In 1998 the quota system, which had distorted clothing trade for decades under the MFA, was still in place. This provided an added incentive to produce in quota-unrestrained countries like Jordan. By 2004 the quotas had
almost disappeared. Thus the timing of preferences as well as their nature, may effect decisions on FDI.

Field research on FDI in the two Asian LDCs covered here – Bangladesh and Cambodia – is more limited. The figures provided above indicate that the stock of FDI in Cambodia is higher than in Bangladesh. Given that the industry in Cambodia is both smaller and much more recent, we can deduce from this that FDI is more important there. Research confirms this view. Although FDI in Bangladesh is not extensive, it has been important to the development of the sector. Rahman (2011) considers the joint venture between Desh, a local company and Dawoo Corporation of Korea, to be a key event in terms of internationalizing the Bangladeshi industry. However he notes that subsequent development was largely indigenous, partly led by local managers that had learnt their trade in Desh-Dawoo, and estimated that in 2011, 95% of Bangladeshi exports were produced by locally owned firms.

The case of Cambodia is very different. The clothing industry is almost entirely foreign owned, with one estimate putting foreign ownership at 90% of the industry, with 60% owned by firms from China, HK and Taiwan alone (Natsuda et al, 2010). This foreign ownership reduces the potential for upgrading, including skills upgrading, as a large majority of management posts are occupied by ex-pat workers, with one survey finding that only 8% of top managers in Cambodian factories were local (Yamagata, 2006). In addition, foreign ownership means that many key decisions, including on fabric sourcing and design are made elsewhere, with Cambodian factories largely confined to CMT, basic operations (Natsuda et al, 2010). It also makes the country vulnerable to shifts in international buyer preferences. In terms of the recent changes in ROO for LDCs, however, foreign owned Cambodian factories are ideally placed to take advantage of TCF provision, as many foreign owners already have textile production facilities or strong and enduring links with third country producers. Shifting production to Cambodia to take advantage of EU market access was thus relatively easy for such companies. Indeed, as we saw, trade data indicates that there has been a very rapid increase in capacity in the clothing industry.

In addition, to the research detailed above, several researches have explored the impacts of AGOA on investment and added value in Africa. Their findings provide further confirmation of the complexity of the interactions between FDI, trade growth and economic development. For example, the source of FDI has been shown to be important to its impacts on economic development and upgrading of production. Staritz and Morris (2013a) in their work on Lesotho, note a distinct difference between the impacts of Taiwanese companies investing to access AGOA market access and South African companies, investing to access cheap labour for re-export to the home market. The latter were significantly more ‘embedded’ in local industry, resulting in extensive exchanges between the actors in the chain and greater opportunities for upgrading for the clothing companies.

The same authors undertook a similar study in Madagascar (Staritz and Morris, 2013b), where they noted a more diverse range of ownership types, including not just Asian investors, but local entrepreneurs, French ‘diaspora’ investors, most of whom had been in the island for generations and investors from nearby Mauritius. Madagascar is an interesting case, as the country temporarily lost its AGOA preferences in 2009, following a coup. Their research found that French ‘diaspora’ and Mauritian firms were much less badly affected than locally owned or Asian owned companies by the loss of AGOA, as they had links to an alternative market – the EU. Most Asian owned companies left
the island, either after the end of the MFA in 2005 or when AGOA status was rescinded. Thus, in this case, certain types of FDI turned out to be more embedded than others, as well as being more resilient to external shocks than domestically owned companies.

Phelps et al (2008) in their work on Kenya found very similar situation to that observed in Nicaragua, Cambodia and Jordan – an industry dominated by foreign owned companies, mainly Asian, importing essentially all of their textiles and intermediate products, mainly from the home country. This was the case, in spite of there being some local capacity in Kenya, as a result of a history of textiles and clothing production. Like other studies, the author’s note a preponderance of ex-pats in management roles, but also efforts to train local staff and some examples of local workers moving into management positions. In his work in Lesotho, Lall (2005) notes that, although manual labour in foreign owned factories was local, most of the managerial tasks were undertaken by ex-pat workers, limiting the potential for learning and upgrading for local human capital.

The issue of local added value of production is further called into question by research on AGOA exports by Olarreaga and Ozden (2004), who find that most of the rent from the reduction in tariffs is captured by the US importer, rather than by the AGOA exporter. They attribute this to the low bargaining power of the latter. Others have questioned whether some of the clothing exports under AGOA contain any African value added at all. Rotunno, Vézina and Wang (2012) studied AGOA exports at a high level of detail and compared them to Chinese clothing exports to beneficiary countries. They note that Chinese clothing exports to key AGOA beneficiaries mirror very closely those countries’ subsequent exports to the US in the same sectors. The suggestion that transshipment is widespread in AGOA is controversial. However, the potential that such transshipment may make the supposed benefits of such exports even more illusory, means it deserves to be better explored in the literature. Certainly the latter research provides strong evidence that transshipment may be an important factor in some flows.

In the context of AGOA, like in Nicaragua, there have been concerns about the fact that much of the increase in trade is linked to FDI, especially from Asian sources, which may quickly disappear if the preferences are discontinued, or the ROO changed (Phelps et al, 2008; Edwards and Lawrence, 2010). Indeed one research study on the Kenyan experience noted, in relation to a key Asian investment ‘The factory’s existence is highly contingent upon the AGOA agreement and its renegotiation, with an interviewee suggesting that any major deleterious change in this respect would most probably result in complete closure’ Phelps et al, 2008 :79.

Thus, a key factor which limits the capacity of policy initiatives like AGOA and the TPLs to support the development of a sustainable local industry, is their impermanence. This creates uncertainty for investors. The situation is rather different for Jordan, Egypt and the LDCs exporting to the EU. The QIZ provisions are part of a permanent FTA. Thus, theoretically at least, they are permanent. In the case of LDCs like Bangladesh and Cambodia, the EBA preferences are also, theoretically, permanent. Although ROO could change in the future, as they have in the past. Following the 2013 collapse of Rana Plaza in Bangladesh, where over 1000 clothing workers lost their lives, the EU issued a statement indicating ‘The EU is presently considering appropriate action, including through the Generalised System of Preferences (GSP) … in order to incentivise responsible management of supply chains involving developing countries.’ (CEC, 2013). One possibility was to remove preferences or to
revise the ROO. The withdrawal or downgrading of EU preferences has occurred in the past for various reasons in the cases of Myanmar, Belarus and Sri Lanka (Portela and Orbie, 2014).

Following major efforts by the Bangladeshi authorities, the threat of change to their preferences has abated, however these preferences are only accorded as long as Bangladesh (and the other LDCs) remain LDCs. Should their economic development be such that their GDP/capita exceeds the threshold (currently $1,100), they will be ‘graduated’ from LDC status and thus from EBA. Four countries have been graduated from LDC status over the years – Botswana, Cape Verde, Maldives and Samoa. GDP/Capita in Bangladesh is currently $900 and in Cambodia $950. Thus their LDC status is not in imminent danger. In any case, in reality, graduation takes some time to be realized. In 2015 Equatorial Guinea was still an LDC, although the decision to graduate it was made in 2009 and their GDP/capita was $14,320 in 2013 (UNCTAD, 2014). For investors, the preferences of Bangladesh and Cambodia are thus assured for a reasonably long period of time, while Jordan and Egypt’s should remain in place as long as there is not a major change in bilateral relations with the US.

**Conclusions**

The evidence provided in this paper leads us to several key conclusions about the interaction between preferential market access, ROO, FDI and development:

- Although preferential access is not the key factor defining sourcing choices it can be seen to be important, especially in the EU market and for smaller suppliers to the US.
- Suppliers subject to TCF provisions are often relatively minor suppliers on the US market, although on the EU market they are more important. However, they generally show impressive growth rates, well above the market average.
- We observe large variations in the extent to which the key TCF producers appear to be capturing value added within the clothing production chain. The lowest levels of imported inputs are seen in Bangladesh, especially in knitwear. Egypt’s trade structure in the sector is far more complex than the other counties studied, both due to its status as an established textile producer, prior to QIZ and due to the high level of integration of this sector with the global market leading, to high imports and exports at all levels of the value chain. Unpicking the effect of TCF provisions in this context is very difficult. Nicaragua, Jordan and Cambodia seem to import the vast majority of the inputs to their clothing industry, with little local textile processing.
- The same three countries have all been identified in fieldwork as having high levels of foreign ownership in their clothing sectors. Thus FDI in this sector seems to be associated with high levels of imported inputs and thus low local added value and embeddedness. Similar patterns have been identified in other countries subject to TCF provisions through AGOA. In such cases the main impacts on development of such activity would be on employment in the clothing sector. However, as the Jordanian example shows, even workers can sometimes be imported, raising major questions about the extent to which such activity has positive impacts on the economy of the host country.
- The very high variability in levels of exports experienced by Nicaragua and Jordan following the financial crisis in the US, underlined the vulnerability of such countries to external shocks. At the same time, FDI with low levels of embeddedness has been seen to move much more rapidly when faced with policy change than local investment, or investment by companies
with strong local links (Staritz and Morris, 2012b). Thus countries like these, highly reliant on policies of foreign governments and investment decisions of foreign companies, are by definition vulnerable to change.

These conclusions underline the complexity of the task of structuring trade (and indeed investment) regimes in a manner which encourages sustainable economic development. Liberalising ROO does seem to increase exports from some countries, yet these increases are often accompanied by equally rapid increases in imports of intermediate goods, limiting the real added value in the exporting country. In addition, the tendency for many of the factories which exploit this market access to be largely foreign owned, limits the potential for exports to create wider spillover effects in terms of learning and foreign market knowledge. Studies of such FDI tend to find that the branch plants have little autonomy, few links to the final market and are largely staffed by ex-pat workers at technical, managerial and even production levels.

The key example of a country which has exploited TCF access without simultaneously rapidly increasing textile imports, is Bangladesh. This fact is probably not unrelated to the fact that most investment in the local clothing industry is domestic. In addition, a long history of clothing production under restrictive ROOs means that there was an existing textile industry in the country, even if it was small relative to the needs of the industry. Thus increased clothing exports under EBA seem likely to have had real positive long term effects on the Bangladeshi economy. The story is not completely positive, however. The very rapid development of the industry, further to EU preferential market access, has been identified as one of the factors which contributed to the Rana Plaza disaster (Taplin, 2014). Specifically, growing demand called for an increase in capacity, which led to very rapid construction of buildings, several of which were not in conformity with building regulations.

The conclusions of this work for policy makers are not straightforward. The fact that many exporters under the TCF arrangements are foreign companies importing much of the required inputs is not, in itself, a reason to renege on such market access. FDI can be a very positive force for development in countries which often lack local resources. Relying on domestic investment would inevitable reduce the speed and extent of industrial development. Rahman (2011) traces the development of the Bangladeshi export oriented industry back to a joint venture with a Korean company in 1979. Thus the evolution of this industry, through largely indigenous investment took place over 35 years. In the absence of FDI, the clothing industry in Jordan would probably not exist. Yet the real impact of investments which import, not only machinery and inputs, but also labour, is very questionable. In their research on the Jordanian case, Nugent and Abdel-Latif (2010) concluded that the main positive local spillovers were actually in the transport sector, which by definition couldn’t be imported from elsewhere.

The Jordanian case also highlights the interaction between trade regimes and investment regimes. The fact that investors in Jordan had the right to import large numbers of workers and didn’t pay taxes on their profits were policy choices by the domestic government. In Egypt the government resisted pressure to increase the limit on foreign workers in QIZ plants and, although this contributed to lower investment flows to Egypt, those companies that did invest there employ largely local labour (Azmeh, 2014). In the very competitive world of foreign investment seeking, it is certainly tempting for governments to limit restrictions on FDI, however, care needs to be taken to strike a balance.
between a supportive environment for FDI and one where the impacts on the local economy are extremely limited.

In terms of preference providing countries, one could conclude that TCF provisions have failed to provide development opportunities and should be revoked. However, a more nuanced interpretation is that TCF provisions can contribute to development, but care needs to be taken in their structuring, if the results are to be maximized. The combination of the requirement for local sewing up with some local sourcing is one possibility – through a minimum value added requirement. The current ROO in other manufactured sectors require a 30% local content minimum (UNCTAD, 2013). This could be extended to clothing, where, depending on the manufacturing process involved, it would often increase the need for local sourcing.

Some observers call for more radical rethinking of the rules, restructuring them in order to favour greater specialization within developing countries themselves by increasing the ‘cumulation’ possibilities under preferential arrangements (Harris, 2009). Although this approach is said to have produced positive results in Central and Eastern Europe in the late 90s, these were radically different economies to the LDCs. Cumulation possibilities already existed for Bangladesh and Cambodia under the previous regime through their membership of SAARC and ASEAN respectively (UNCTAD, 2013), yet these possibilities seem to have been little used and the rapid increase in exports seen in many countries since the TCF provision implies that fabric from non-regional sources, especially China, is often substantially more competitive. As China is not subject to preferential access in the textiles sector in either the EU or the US, even extensive cumulation provisions, such as those proposed by Harris (2009) risk excluding the most competitive supplier.
References


CEC (2013). Joint Statement by HR/VP Catherine Ashton and EU Trade Commissioner Karel De Gucht following the recent building collapse in Bangladesh. 30 April 2013. Brussels: Commission of the European Communities.


