This PDF is a selection from a published volume from the National Bureau of Economic Research

Volume Title: China's Growing Role in World Trade

Volume Author/Editor: Robert C. Feenstra and Shang-Jin Wei, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-23971-3

Volume URL: http://www.nber.org/books/feen07-1

Conference Date: August 3-4, 2007

Publication Date: March 2010

Chapter Title: Comment on "China's Experience under the Multi-Fiber Arrangement (MFA) and the Agreement on Textiles and Clothing (ATC)"

Chapter Author: Joseph Francois

Chapter URL: http://www.nber.org/chapters/c10466

Chapter pages in book: (387 - 395)

Yang, Y. 1995. China's textile and clothing exports: Challenges in the post-MFA period. *Pacific Economic Papers* 250:6.7–6.12.

Comment Joseph Francois

Introduction

Since its origins in 1947, the multilateral trading system has seen quotas imposed on products ranging from cheese and butter to high definition televisions, steel, and motor vehicles. Quantitative restrictions on international trade flows, and, more broadly speaking, the entire class of nontariff barriers (NTBs), have proven an important feature of the policy landscape. For this reason, estimates of the trade cost-equivalents of NTBs are critical inputs to the assessment of the welfare impact of trade policy, as well as to actual trade negotiations. They also influence the trade patterns at the core of the raft of recent econometric work based on the gravity model (Anderson and van Wincoop 2003 2004).

The launching of the World Trade Organization (WTO) brought with it the dismantling of the single biggest system of quota restrictions to emerge as part of the General Agreement on Tariffs and Trade (GATT)-based trading system—an elaborate system of bilateral quotas on textiles and clothing trade. The process of dismantling these quotas under the Agreement on Textiles and Clothing (ATC) was staged over a ten-year period ending in 2005. In their paper, Brambilla, Klandelwal, and Schott examine the impact of the Multi-Fiber Arrangement (MFA) and ATC on China. They provide a valuable and detailed examination of the utilization of quotas, the impact of quotas, and their expansion on exports during the MFA and ATC, and their role in the surge of exports from China after quotas ended. Their findings fit with other recent estimates (Francois and Woerz 2009; Martin 2004; Andriamananjara, Dean, and Spinanger 2004). While by construction the quotas were increased over time, the technical liberalization of a quota does not guarantee de facto relaxation of implicit trade barriers when the external environment is also changing. In the case of China, quotas on Chinese exports to both the United States and European Union (EU) clearly grew at a rate unable to keep up with the rapid expansion of potential trade due to a mix of both underlying supply and demand growth. As a result, China was more constrained than other countries under the ATC, and, consequently, there was a surge in China's market share when quotas were lifted.

Joseph Francois is a professor of economics with a chair in economic theory at Johannes Kepler Universität Linz.

In my comments, I will focus on two issues. One is the broader context of the ATC phaseout, in terms of its origins and related concerns about quota liberalization on smaller, less-competitive suppliers. The second is the pattern of restrictions on China relative to other major suppliers under the ATC regime.

The ATC and MFA in Context

Like agriculture, the textile and clothing sectors emerged in the early years of the GATT system as politically sensitive sectors. As such, they were treated as special cases within the world trading system, with their own regulatory framework. While technically in violation of the GATT, the quotas were first institutionalized in the beginning of the 1960s with the Short-Term Arrangement (STA) for international trade in cotton textiles. The STA aimed at an orderly opening of restricted markets to avoid (for importing countries) "detrimental market disruptions." The definition of "market disruption" adopted by the Contracting Parties in 1960 entailed the possibility of singling out imports of particular products from particular countries as the disrupting source. This opened the door for a series of bilaterally negotiated quota restrictions that became the rule in the following Long-Term Arrangement (LTA) in 1962. Details on the subsequent evolution of acronyms are provided in table 9C.1.

By the start of the 1970s, it had become apparent that the multiplicity of makeshift arrangements protecting the textile and clothing industries had to be replaced. Resulting negotiations led to the MFA, which went into effect in 1974. Over time, its product coverage was extended from cotton to noncotton textiles and clothing. The final MFA (known as MFA IV) was extended several times, leading in the end to the ATC in 1995. Like the preceding arrangements, the MFA provided rules for the imposition of quotas, either through bilateral agreements or unilateral actions, whenever actual or perceived surges of imports caused market disruption. (Baughman et al. 1997; Krishna and Tan 1997). This included the threat of a surge. In the years leading up to the Uruguay Round Agreements, six developed participants actively applied quotas under the MFA—the EU, the United States, Canada, Norway, Finland, and Austria. These were applied almost exclusively on imports from developing countries. Sweden liberalized its textile and clothing regime in 1991 and actually managed to withdraw from the MFA. Sadly, Sweden was forced to rejoin this regime when it joined the EU. Two other developed-country participants, Japan and Switzerland, did not impose MFA quotas, but instead restricted themselves to "signaling" a readiness to apply quotas by the act of being signatories to the MFA agreement, combined with (active) import surveillance. As shown by Winters (1994), import surveillance can, at least in concentrated industries, induce a fall in import levels as producers are trying to forestall explicit quotas. The restrictiveness of the applied MFA quotas, and subsequent ATC quotas, var-

Table 9C.1 A parade of acronyms: the evolution of quotas

Year	Overview of events
1955–57	U.S.–Japan dispute leads to a 5-year agreement limiting textile exports
1958	United Kingdom imposes "voluntary" limitation on cotton textile and clothing products with Hong Kong by threatening to otherwise impose quotas at levels lower than prevailing volumes.
1959	United Kingdom signs restraint agreements with India and Pakistan.
1960	General Agreement on Tariffs and Trade Contracting Parties recognize the problem of "market disruption" to serve as an "excuse" for establishing future nontariff barriers.
1961	**STA:** The Short-Term Arrangement (STA) is agreed.
1962	**LTA1:** The Long-Term Arrangement (LTA) is agreed, to commence October 1, 1962, and last for five years.
1963–65	United States tries and fails to establish agreement on trade in wool products
1966	The United Kingdom implements a global quota scheme in violation of the LTA. The LTA provides only for product-specific restraints.
1967	**LTA2:** Agreement is reached to extend the LTA for three years.
1969–71	United States negotiates voluntary export restraints with Asian suppliers on wool and man-made fibers.
1970	**LTA3:** Agreement is reached to extend the LTA for three years. It was later extended three months more, to fill the gap until the Multi-Fiber Arrangement (MFA) came into effect.
1973	**MFA I:** The MFA is agreed, to commence January 1, 1974, and to last for four years.
1977	The European Economic Community and the United States negotiates bilateral agreements with developing countries prior to agreeing to extension of the MFA.
1977	**MFA II:** The MFA is extended for four years.
1981	**MFA III:** The MFA is renewed for five years. The United States, under pressure from increased imports resulting from dollar appreciation, negotiates tough quotas.
1986	**MFA IV:** The MFA is extended for 5 years, to conclude with the expected end of the Uruguay Round (UR).
1991	**MFA IV+:** The MFA is extended pending outcome of the UR negotiations.
1993	The UR draft final act provides for a 10-year phase-out of all MFA and other quotas on textiles in the Agreement on Textiles and Clothing (ATC). MFA extends until UR comes into force. ATC allows credit for liberalization in products that are not actually restricted.
1995	**ATC1:** 1st ATC tranche liberalized 16% of 1990 imports.
1998	**ATC2:** 2nd ATC tranche liberalized 17% of 1990 imports.
2001	**ATC3:** 3rd ATC tranche liberalized 18% of 1990 imports.
2005	**ATC4:** 4th ATC tranche liberalized 49% of 1990 imports.
	Déjà vu all over again: United States and European Union reimpose quotas on China.

Source: Based on an update of Francois, Glismann, and Spinanger (2000), from Francois and Woerz (2009).

ied from product to product and from supplier to supplier. Norway dropped the use of binding quotas with the shift from MFA to ATC.

The Ministerial Declaration at Punta Del Este in 1986 that launched the Uruguay Round stated that the "Negotiations in the area of textiles and clothing shall aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened GATT rules and disciplines." In plain English, this was a promise to developing countries that MFA quotas were finally going to be eliminated. Indeed, this promise was critical to convincing developing countries to sign on at the creation of the then new WTO. The Uruguay Round of GATT negotiations launched at Punta Del Este led to the ATC in 1995. The ATC was the institutional embodiment of the promise to end quotas in an orderly process. Indeed, it was flagged as a major showpiece in the Uruguay Round Agreements and an important source of trade-based income gains linked to the introduction of the WTO (Harrison, Rutherford, and Tarr 1995; Francois, McDonald, and Nordström 1995; Hertel et al. 1995). By design, the agreement mapped a gradual phaseout of the quota restrictions carried over from the MFA regime on a ten-year timetable leading to full elimination.

Though the ATC was a response to developing-country demands, a number of developing countries expressed concern from the outset, and some even mounted a rearguard action in the end of the ATC phaseout to try and block final quota elimination. In combination with regional agreements, the quotas had led to a distorted pattern of exports, with high import shares for Eastern European and Mediterranean suppliers in the EU market and likewise for Mexico in the U.S. market. For instance, Spinanger (1999) reports evidence that the EU quotas in textile and clothing prevented diversification of the market across exporting countries based on relative costs. In the case of the EU, these distortions were also intentionally used for a discriminatory trade policy with the aim to spur development in certain countries at the expense of other developing countries. With China more restricted than other suppliers (a fact confirmed by the Brambilla, Khandelwal, and Schott estimates), there was genuine concern that smaller, less-competitive suppliers would be hurt in the competitive shuffle following liberalization.

Related to concerns about smaller exporters, there was also concern that the MFA and ATC had induced too much specialization in unconstrained exporters (for example, Bangladesh). Through the quota system, some small, unconstrained exporters were largely protected from the competition of other, bigger suppliers for a long time. Thus, the quota system might have induced strong and persistent specialization in textiles and clothing in these countries, while in the absence of the quotas the need to diversify into other industries may have been stronger. The worry was that removal of the quotas against all suppliers would suddenly make such a failure all too obvious (Spinanger 1999).

What actually happened? As Brambilla, Khandelwal, and Schott note, we did indeed see a surge in exports from China after the ATC quotas were eliminated. From their detailed analysis, they also report that unit values fell in products where quotas were lifted. China moved to lower prices and higher volumes in liberalized products (consistent with loss of quota rents in export pricing). This is only part of the story, however. Because China's quota growth rates did not keep up with growth in supply conditions in China (where growth was around ten percent a year), let alone the combined impact of income growth (i.e., rising demand) in North America and Europe, the quotas on China were still largely binding when they expired. The outcome was political theater, new quotas on China, and revitalization of managed trade in the sector. I will focus on the pattern of protection against China in the next section.

The Impact of the Quotas

The impact of quantitative restrictions on trade is reflected in per-unit economic rent generated by a binding quota. This is because a binding quota effectively limits the supply of the good in the importing market, resulting in a price markup and giving economic rents to those suppliers who have access to the market (i.e., those who are able to export inside the quota). Because the quotas on textiles and clothing were administered as "voluntary" export restraints by the suppliers, often with the quotas distributed by auction, these rents can alternatively be seen as an implicit tax on exports. For these reasons, the effect of the quotas in the literature is generally expressed as an export tax equivalent (ETE). In their paper, Brambilla, Khandelwal, and Schott use ETEs to focus in detail on how quotas impacted China. I will focus here on how, at the same time, these quotas had a broadly more restrictive impact on China than on other suppliers, again in terms of ETEs. To do this, I will make some comparisons based on ETEs for a wider set of countries, though at a more aggregate level.

Table 9C.2 reports information on the top five suppliers in textiles and clothing for the quota using importers: Canada, the United States, and the EU. Because China ranged among the top suppliers for all quota users in 2001, the evolution of the Chinese ETEs as implied by the quotas can be read from table 9C.2. The tariff and ETE estimates in table 9C.2 come from Francois and Woerz (2009). Other data come from Martin (2004) and the World Bank's *World Development Indicators* database. Canada was the quota user most compliant with the ATC among all three. The reduction in price wedges for China was especially impressive. During the life of the ATC, the ETE was reduced to zero from an estimated 30.4 percent of export price for clothing. Indeed, with most suppliers, liberalization was substantial in Canada, if not complete, even if some high barriers remained, mostly against minor suppliers (for instance, Jamaica, Qatar, and Morocco).

While there was a clear pattern toward liberalization for imports to the EU, the degree of liberalization was more limited than in the Canadian

Table 9C.2 **Top 5 import suppliers**

	2001 import share	2001 tariff	ETEs as % of export price	
			1996	2004
EU15: textiles				
Turkey	14.0	0.0		
China	9.1	8.2	18.6***	14.0***
India	8.1	7.5	6.6***	2.0***
United States	4.7	6.4		
Pakistan	4.6	0.0	13.1***	3.2***
All	100.0	1.8	1.8	0.7
EU15: clothing				
China	17.1	10.6	48.5**	19.4***
Turkey	8.5	0.0		
Romania	6.6	0.0		
Tunisia	6.2	0.0		
India	5.8	8.5	19.3***	
All	100.0	3.2	13.1	3.6
United States: textiles				
Mexico	12.7	0.1		
European Union	10.9	8.5		
China	10.2	7.4	6.5***	7.2***
Canada	7.7	0.0		
Pakistan	5.4	9.0	5.2***	
All	100.0	7.9	3.8	3.5
United States: clothing				
China	13.3	9.8	43.3***	48.1***
Mexico	12.1	0.1		
Hong Kong	6.9	11.5		
European Union	4.5	10.1		
Indonesia	4.3	12.7		
All	100.0	9.9	10.2	14.5
Canada: textiles				
United States	54.2	0.0		
European Union	8.7	9.4		
China	7.4	13.5	5.9***	
Korea, Republic of	4.4	10.3		
India	3.6	10.9	0.1	
All	100.0	5.2	0.5	0.0
Canada: clothing				
China	27.4	15.6	30.4***	
United States	12.0	0.0		
European Union	8.0	16.3		
India	7.8	17.7		
Hong Kong	6.4	17.9		
All	100.0	14.5	11.6	0.1

Source: Francois and Woerz (2009).
Note: ETEs = export tax equivalents
***Estimated bilateral ETEs significant at the 1 percent level.
**Estimated bilateral ETEs significant at the 5 percent level.

case. Although trade with China became more liberalized, the degree of protection remained high at the end of the ATC. Table 9C.2 shows the fall in protection against China. However, the tariff equivalents at the end of the ATC remained substantial. The removal of the quota system by 2005 thus implied a substantial surge in imports from China. Indeed, as Brambilla, Khandelwal, and Schott note, in 2004 and 2005, we saw a tremendous increases in China's market share in the EU market, leading to a reimposition of quotas by the middle of 2005.

Most interesting is the experience with the United States. The ETEs for China actually went up. The observed backloading of trade liberalization vis-à-vis China should not be surprising and cannot be ascribed purely to noncompliance with the ATC. Nor is it the case that China was alone. China's experience was instead a consequence, in part, of the design of the system. From table 9C.2, U.S. protection against restricted suppliers went up for fifteen WTO exporters of textiles. Only four WTO suppliers—Cambodia, Macedonia, Brazil, and Pakistan—faced falling export tax equivalents during the ATC in the U.S. market. For clothing, three suppliers—Uruguay, Cambodia, and India—saw a fall in their ETEs, while nine suppliers faced increasing price distortions—Turkey, Bulgaria, China, Poland, Hungary, Slovakia, Romania, and the Czech Republic.

In the case of China, the spike in U.S. quotas follows from the interaction of several factors. The first factor is the failure of quota growth to keep up with growth in potential trade. This is illustrated in table 9C.3, which highlights the strong expansion of the Chinese economy and, thus, the huge increase in export potential over the life of the ATC. This growth well surpassed quota growth rates. While the Chinese quotas on the U.S. market increased by 33 percent in textiles and 41 percent in clothing between 1994 and 2004, Chinese gross domestic product (GDP) rose by 170 percent over the same period. With a cumulative growth of 61 percent, U.S. GDP growth—as a proxy for the growth of import demand—itself outstripped the rate of quota expansion. Another factor in spiking ETEs was the ability to "borrow forward" on quotas. This meant that, for example, in late 2000, importers could borrow against 2001 quota limits. Obviously, by late 2004, there were no more quotas to borrow against, contributing to the late surge in U.S. ETEs as the system, by construction, became increasingly restrictive.

Closing Comments

Careful empirical analysis of quota regimes, like those provided by Brambilla, Khandelwal, and Schott, offer valuable insight regarding the political difficulties that followed the ATC's end days. The ATC embodied commitments to a ten-year, staged reduction in quotas. The process was advertised as orderly, systematic, and transparent. Yet the end of the ATC brought with it sudden surges in imports from China, panicked trade ministers, rushed

Table 9C.3 Cumulative growth: 1994–2004 (%)

	Quota growth					
	textiles		clothing		GDP growth	
	U.S.	EU	U.S.	EU	Per capita	In total
Importer						
United States					49	66
European Union					55	61
Exporter						
Bangladesh	168		168		26	53
China	33	50	41	38	151	171
Hong Kong	37	16	17	22	1	16
India	141	50	116	79	57	84
Indonesia	134	83	133	117	19	35
Korea, Republic of	37	70	12	38	34	44
Pakistan	139	79	150	119	30	63
Sri Lanka	134	204	132	204	43	56
Philippines, The	134	112	119	112	1	21
Thailand	127	116	123	116	–10	–1

Sources: Martin (2004), Eurostat, IFS, and Francois and Woerz (2009).

meetings, and the reimposition of quotas on China by late 2005 in both the United States and EU. This episode is fully consistent with recent estimates of the price impact of quotas. A key implication from the results of this research is that the problem of China's textile and clothing sector integration was basically deferred rather than managed in stages. This was not solely a result of the ATC itself, but was certainly reinforced by insufficient predefined quota expansion rates during a period of outstandingly strong expansion of China's supply potential and demand growth in North America and Europe.

An important underlying question is the extent to which managed trade in textiles and clothing is really a thing of the past. There was a de facto peace clause during the MFA and ATC. Exporters agreed to managed trade, and importers agreed not to support antidumping and countervailing duty investigations. Obviously, this cease fire is over. We may yet see a return to managed trade. In addition, there are now countries outside the original MFA importer club—Korea, Brazil, South Africa, and Mexico, for example—who may themselves succumb to similar pressure to manage trade in these sector as they move up the value added ladder and their own producers fall under rising competitive pressure from importers. The MFA (and ATC) may be dead. However, we cannot assume the political economy fundamentals that drove the creation of the system in the first place really have been put to rest.

References

Anderson, J., and E. van Wincoop. 2003. Gravity with gravitas: A solution to the border puzzle. *American Economic Review* 93 (1):170–92.

———. 2004. Trade costs. *Journal of Economic Literature* 42 (3): 691–751.

Andriamananjara, S., J. Dean, and D. Spinanger. 2004. Trading apparel: Developing countries in 2005. USITC and Kiel Insitut for World Economics. Mimeograph

Baughman, L., R. Mirus, M. Morkre, and D. Spinanger. 1997. Of tyre cords, ties, and tents. *The World Economy* 4:407–34.

Francois, J., H. H. Glismann, and D. Spinanger. 2000. The cost of EU trade protection in textiles and clothing. Kiel Working Paper no. 997. Kiel, Germany: Kiel Institute for the World Economy, August.

Francois, J., B. McDonald, and H. Nordström. 1995. Assessing the Uruguay Round. In *The Uruguay Round and the developing economies,* ed. W. Martin and L. Alan Winters, 117–214. Cambridge, UK: Cambridge University Press.

Francois, J., and J. Woerz. 2009. Non-linear panel estimation of import quotas: The evolution of quota premiums under the ATC. *Journal of International Economics* 78 (2): 181–91.

Harrison, G. W., T. F. Rutherford, and D. G. Tarr. 1995. Quantifying the Uruguay Round. In *The Uruguay Round and the developing economies,* ed. W. Martin and L. A. Winters, 215–84. World Bank Discussion Paper no. 307. Washington, DC: World Bank.

Hertel, T. W., W. Martin, K. Yanagishima, and B. Dimaranan. 1995. Liberalizing manufactures in a changing world economy. In *The Uruguay Round and the developing economies,* ed. W. Martin and L. A. Winters, 73–96. World Bank Discussion Paper no. 307. Washington, DC: World Bank.

Krishna, K., and L. H. Tan. 1997. The multifibre arrangement in practice: Challenging the competitive framework. In *East Asian trade after the Uruguay Round,* ed. D. Robertson, 59–77. Cambridge, UK: Cambridge University Press.

Martin, W. 2004. Implications for Pakistan of abolishing the textile and clothing quotas. Report by the World Bank, April 30. Washington, DC: World Bank.

Spinanger, D. 1999. Textiles beyond the MFA Phase-out. *The World Economy* 22 (June): 455–76.

Winters, L. A. 1994. The EC and protection: The political economy. *European Economic Review* 38 (3–4): 596–603.