Risks to the Mexican Textile Industry from trade liberalization effects of the end of the Multi-Fiber Agreement

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1. Introduction

The Mexican textile industry has been suffering a massive loss in global market share in the last few years. Research in this area is needed because of the importance that the manufacturing of textiles and garments has on the Mexican economy; they accounted for 6.5% to the manufacturing contribution to GDP. It is a market that employs a significant amount of labor and accounts for 6.7% of all manufacturing exports. This sector has been described as a crucial sector for developing economies because historically it is the first rung on the ladder of industrialization for developing countries.

The purpose of my paper is to understand the deterioration in the textile sector by focusing on the main international events that have contributed to its demise, namely the end of the Multi-Fiber Agreement. I will do an in-depth analysis of the deterioration in the textile sector; in particular the losses in market share caused by the MFA and based on my findings provide viable recommendations for the private sector. My recommendations will be mainly based on how to make use of Mexican potential to adapt to changes in market conditions. This potential resides in the experience this sector has gained from NAFTA participation, strategic geographical location between North America and Latin America, recent improvements in the industry.

2. Background

2.1 International trade in the textile and garment industry: the end of the Multi-Fiber Agreement

The Multi-Fiber Agreement, a system of quotas for the world's textile and garment sector that has governed international trade in this area for the last forty years, reached its end at the beginning of this year. The end of the quota system was agreed in the 1994 Uruguay round as part of the WTO steps into trade liberalization. The Agreement on Textiles and Clothing (ATC) was implemented in 1995 as a ten year phase out system of the MFA (See Appendix 1). The ATC was mainly controlled by the United States and the European Union, who decided on which the products they would integrate at different stages of the process and left the items of most significance to the end of the phase, "they have… liberali[zed] items not strategically important such as dolls' clothes, parachutes and seat belts".[1] At the same time they used trade barriers, such as rules of origins and anti-dumping to delay the phase out.

The prospect of having trade liberalization in the textile and clothing sector was the reason why many developing countries agreed to have service and intellectual property rights on the Uruguay round and the reason why they signed other WTO agreements. The ATC was seen as working in the interests of developing countries because it opened up access to previously protected markets, but by leaving the most important items to the end the greatest adjustments are happening now.

At present the global market is relocating its textile and garment production concentrating market share in low-wage economies. This effect has been seen in Mexico

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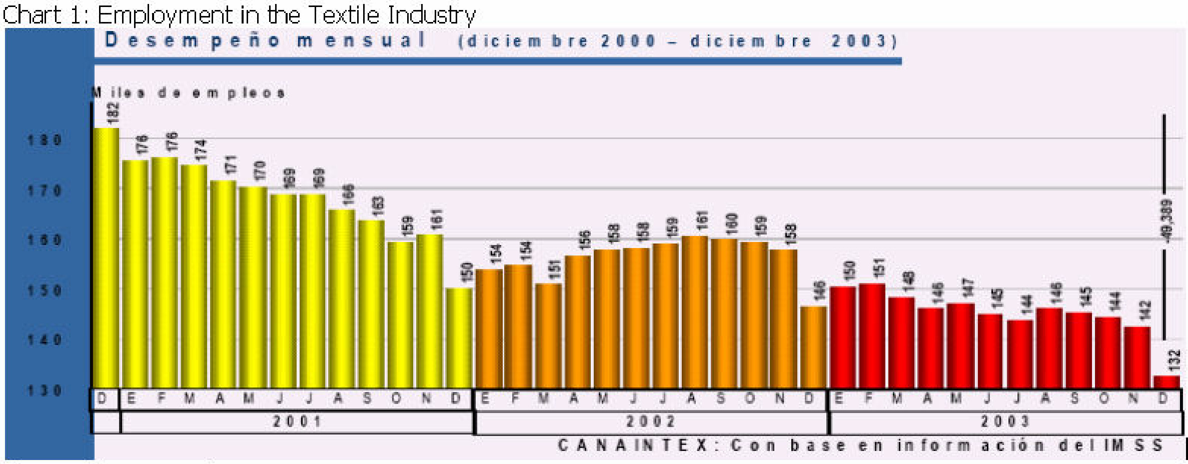
[1] Hale, Angela. "Trade liberalization in the garment industry: who is really benefiting?", *Development in Practice*, Volume 12, Number 1, February 2002, pg. 4

as great export and employment losses in the textile and clothing sector during these last few years, this can be noted in Chart 1. For many developing countries, including Mexico, trade liberalization in this area translates into yielding their market share to economies with greater comparative advantage, like China and India.

Chart 1: Employment in the Textile Industry



Source: Bancomext

2.2 Description of the textile and garment industry

Clothing Sector

The clothing sector is divided into two major markets; the high-quality fashion market and the mass production segment characterized by lower-quality and/or standard products. Depending on what segment we focus on, we can describe the clothing sector as being an unskilled labor-intensive, low wage, industry or a dynamic and innovative one, relying on modern technology with well paid skilled workers and a high degree of flexibility.

Since the competitive advantage of firms in the high-quality fashion market relies upon their ability to capture tastes and trends, firms are largely located in developed countries and often limited to geographical areas. Manufacturers for the segment targeting mass production are largely found in developing countries, often in export processing zones. The role of the retailers has become increasingly important in the supply chain for this segment; retailers not only have incredible market power on the consumer market but also buying power from the manufacturing sector. Multinational retailing chains that have developed their own brands and source their clothing directly from suppliers have drastically increased their market power on this sector. It has been calculated that during the 1990's "retailers accounted for half of total garment imports in the EU"[2].

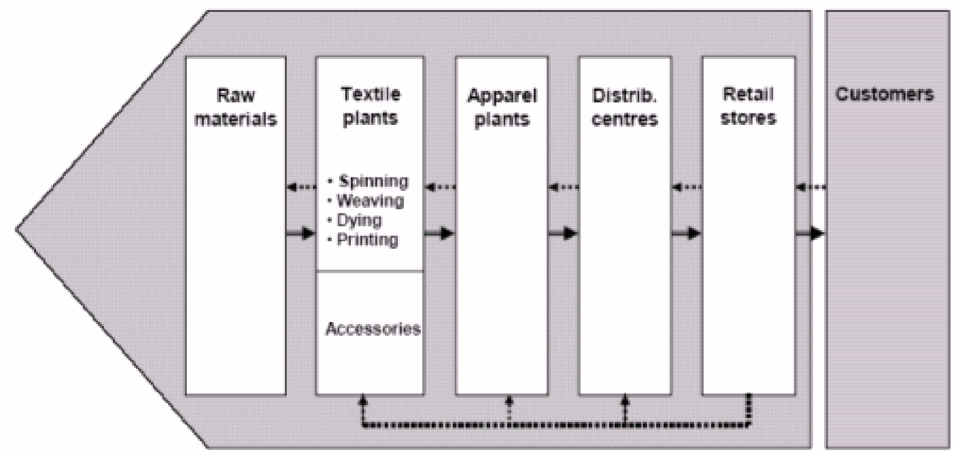
Textile Sector

The textile industry is more capital intensive than clothing. It is divided in areas such as spinning, weaving, and finishing, and most of the time this can be done in one same plant. The textile industry is less flexible in terms of adjusting to consumer tastes than the clothing and retail sectors because lead time is needed and the capital intensity of the industry results in relatively large minimum orders.

The textiles and clothing sectors can be seen as a production network divided into specialized activities with a high degree of demand driven supply chain as can be seen in the following chart where the dotted lines represent the flow of information, while the solid line represent the flow of goods.

[2] Kyvik Nordas, Hildegunn. "The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing", *World Trade Organization.* Pg 9.

Chart 2: Supply Chain in the Textile and Clothing Industries



Source: WTO

As the import share if inputs in the textile and garment sector are quite high, it has been difficult for developing economies to create backward linkages to their local economies. Nonetheless, this sector remains an important job creator in developing economies. Many countries, such as Mexico, have been able to "upgrade their clothing sectors by moving from assembly of imported cut fabrics and accessories to full-package production over time"[3]. Full-package production uses national inputs on nationally established assembly lines and exports a product completely produced in one same country, it strengthens the fiber-textiles and garment confections production chain.

2.3 The Mexican Case

In 2001, 78% of the industries belonging to the textile and garment industries were small retailers and family owned businesses specialized in one product with an average of one hundred workers, see Chart 3. Most of these companies are vertically integrated; they produce their own fiber and woven fabrics and are technologically

[3] Kyvik Nordas, Hildegunn. "The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing", *World Trade Organization. Pg 3*

equipped to do their own bleaching, dying, printing and other finishing. The Mexican textile industry encompasses a variety of firms ranging from the fabrication of natural, artificial and synthetic fibers, threads and weavings.

Chart 3: Sizes of firms in the Textile and Garment Industries in 2001

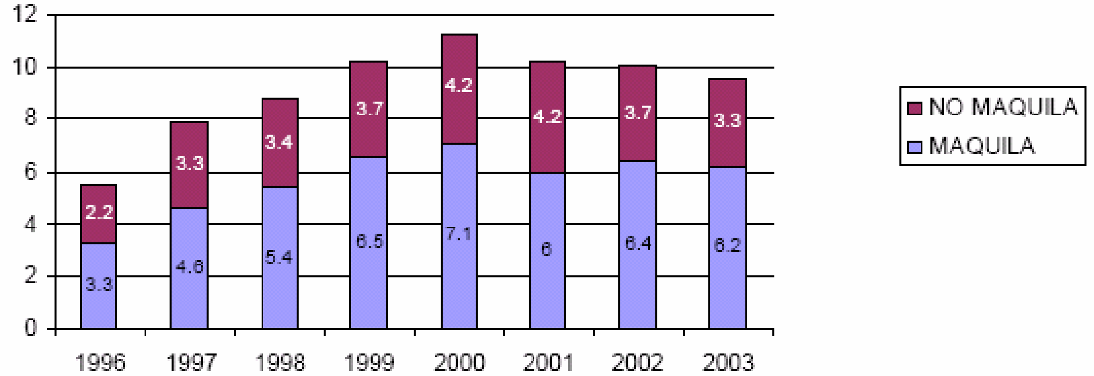
Tamaño de la empresa	Número de establecimientos		
	Sector textil	Sector confección	Textil y confección
Micro	2,129	11,263	13,392
Pequeña	455	1,481	1,936
Mediana	353	995	1,348
Grande	68	258	326
Total	3,005	13,997	17,002

Fuente: Economía SIEM
* No se cuenta con información del tamaño de las empresas de los años 2002 y 2003
Source: Bancomext

Over the past five years, investment in modernization and expansion has been significant in the sector, mainly by companies exporting to the United States. The vast majority of these textile inputs are used by maquiladoras and then re-exported to the U.S. as finished garments (See Appendix 2). Mexico is strong in the production of fibers and the cutting, assembly and exports of garments, however it cannot produce all of the required quality fabric for apparel and thus, the country still relies heavily on textiles imports (See Appendix 3). The creation of a commodity chain that uses Mexican textiles as main input and has the capacity to deliver full-package product is key to subsistence.

Mexico has a comparative advantage over other countries due to its proximity to the U.S. market. After signing NAFTA Mexico's exports in the textile and garment industry increased from 1,894 million USD in 1994 to 9,214 million USD in 2002, as seen in Chart 4.

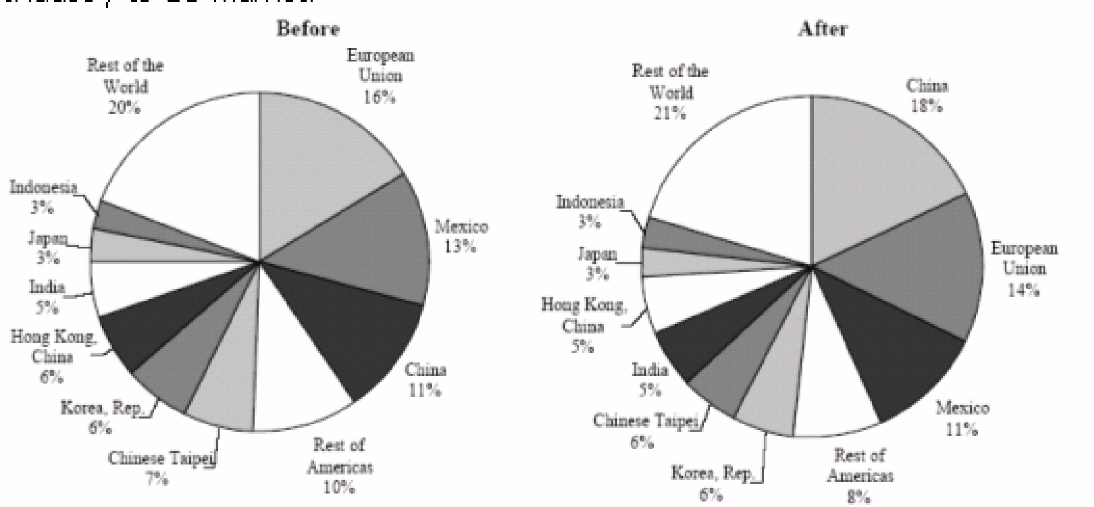
Chart 4: Mexican Garment and Textiles exports in the maquila and non-maquila sectors in millions of dollars.



Source: Bancomext

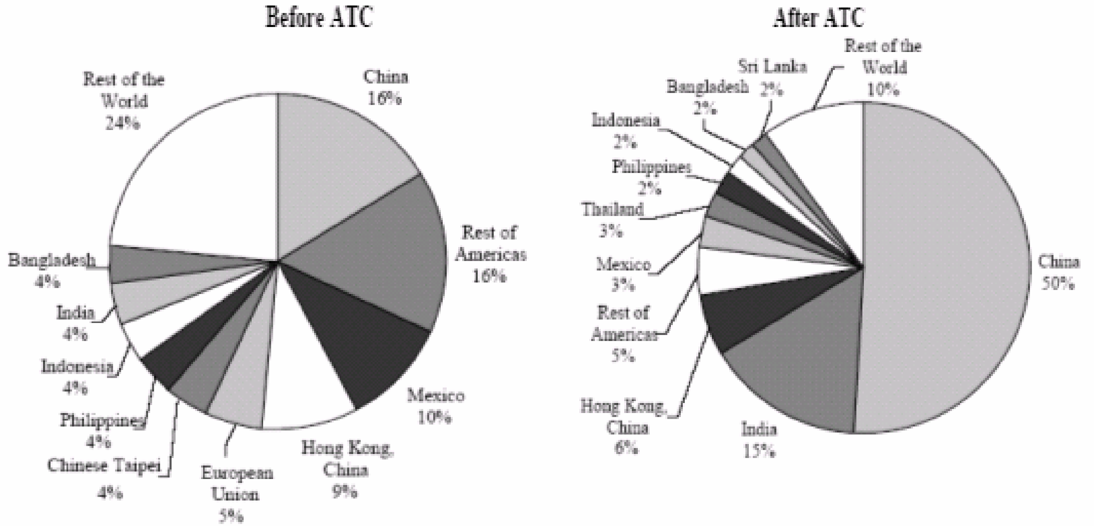
Mexico has also maintained its place as one of the main suppliers of both garments and textiles to the U.S. market, but with the incorporation of China and India to the world market along with the end of the MFA Mexico's place is being jeopardized; see Chart 5 and Chart 6.

Chart 5: Impact of the entry of China and India along with ATC effects in Textile Industry to US market.



Source: WTO

Chart 6: Impact of the entry of China and India along with ATC effects in Garment Industry to US market.



Source: WTO

As mentioned earlier, the textile sector in Mexico is mainly composed of small scale producers their ability to compete at a global scale is almost non-existent, thus a network that uses Mexican textiles as main inputs is detrimental to the survival and future growth of this sector. Also, as the global market relocates to low-wage economies, there is increasing pressure from U.S. clothing importers and portions of the US textile industry advocating for allowing CAFTA countries to assemble fabric from Canada and Mexico and then exporting it duty-free to the US, thus, affecting the manufacturing of textiles and clothing in Mexico.

2.4 China vs. Mexico

Asia is emerging as one of the world powers in textile manufacturing. Three out of the nine countries with higher exports in textiles and garments are Asian and only two out of the nine countries with higher imports in textiles are Asian. China is expected to establish itself as one of the main providers in the textile and garment sector in the next few years to come, its exports in the textile sector will occupy 47% of the world market by 2010.

The greatest threat to Mexico comes from China and Hong Kong, with lower labor costs. In spite of this, Mexico still has a comparative advantage in terms of labor and production costs when compared with other countries in the Americas. When compared against China, Mexico still has several key factors that give the country an advantage as can be seen in Chart 7.

Chart 7: Mexico vs. China

Factor competitivo	China	México
Costos de mano de obra	■	
Costos en electricidad	■	
Base de distribuidor doméstico	■	
Promoción gubernamental	■	
Incentivos tributarios gubernamentales	■	
Zonas de procesamiento de exportaciones		■
Costos de transportación		■
Mano de obra calificada / productividad		■
Costos de telecomunicaciones		■
Transferencia tecnológica		■
Flexibilidad en manufactura		■
Protección intelectual		■
Transparencia en reglas		■
Tratados de libre comercio		■
Proximidad geográfica a EUA / Zona TLCAN		■
Disponibilidad de agua		■

Source: Bancomext

Taking all of the previous information into consideration we can note that in order to keep the Mexican textile industry from shrinking, high-value added products, full-package production and market diversification is detrimental to the subsistence of the industry.

3. Policy Recommendations

The textile and garment industry is a highly competitive market. During the last few years newly entrants to the market like African economies, Pakistan, Turkey, India and Dominican Republic have driven prices down due to oversupply of their products. This factor has been further exacerbated with China's overproduction. In spite of this, Mexico still has the potential to adapt to the new market trends given its NAFTA experience and key factors, as those from Chart 7, that give it comparative advantage against other countries.

Mexico is highly competitive when compared with other countries in the region; it has a strategic position between Central America, the Caribbean region and the North American markets of Canada and the US. Central America has started to develop their first assembly lines and this not necessarily posses a threat to Mexican labor if it is flexible enough to adapt to new market trends faster and separate itself by establishing quality standards. Focusing on Guatemala, El Salvador and Honduras we can see that since they are importers of textiles, Mexico has the potential to supply textiles for this market given its geographical proximity and its superiority in terms of infrastructure, as long as investment is encouraged in this sector.

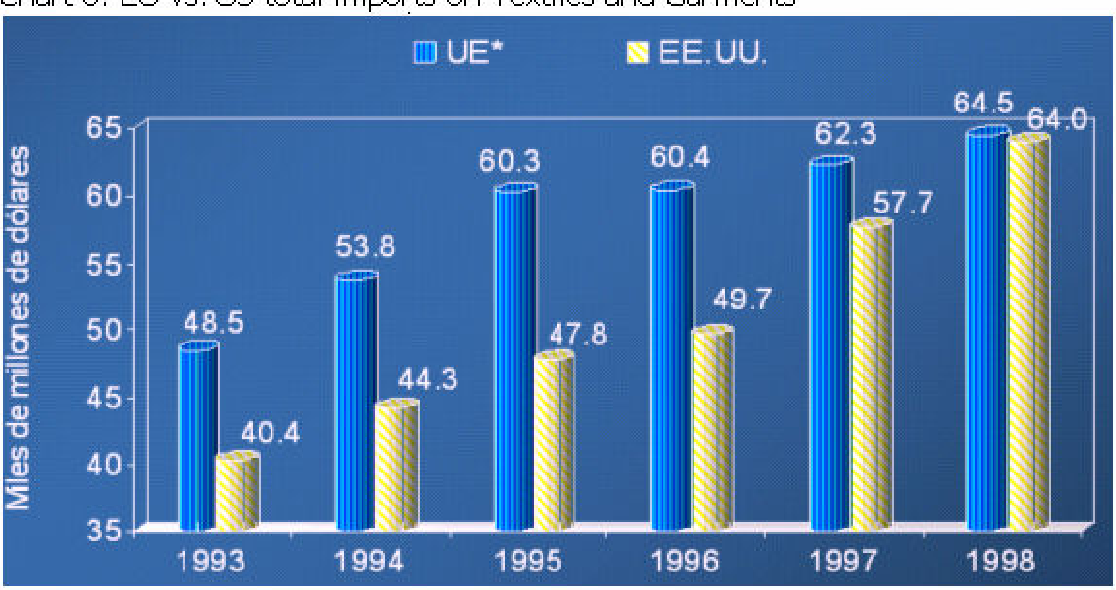
By belonging to NAFTA we have seen that Mexico has been greatly favored, compared to NAFTA nations Mexico has a comparative and absolute advantage in labor costs, improvements in infrastructure and its ability to provide "full package" production, give Mexico a powerful tool for future trade within the region.

Mexico also has to focus more on Canada. It occupies just 4.1% of the Canadian market share and ranks sixth as provider of textiles. The main exports to Canada are basic mass production products, by promoting the Mexican capability of producing specialized products and providing "full package" production it has the potential to gain more from the high-quality fashion Canadian market share, which has more value added.

In the U.S. case, discount stores are the main retailers of garments; in 2002 they occupied more than 51% of the market. Specialized stores occupied 27% of the market in the same year; departmental stores occupied 22%. Given the high consumer market share of these sectors Mexican producers need to make use of commercialization channels to promote their products amongst them (See Appendix 4).

Mexico has to recognize as well the potential in European markets. As can be seen in Chart 8, Europe is much bigger market than the U.S. In spite of the distance between the Mexican and the European market, there is a need for Mexico to increase communication with this blooming world market and focus on creating complete collections for private brands.

Chart 8: EU vs. US total imports on Textiles and Garments



Source: Bancomext

The proposed strategy is for Mexican producers to focus on market segments that provide R&D analysis in which design and quality are more important than price; keep on developing and promoting the production of "full package" and the supply to private brands as well as promoting the production of garments with high added value that are trendy for the high-end sector of the market. All of these proposals come with the need to develop a cost structure that is flexible, competitive and most importantly that is able to adapt to market changes. Flexibility to market changes in terms of trends and logistics is detrimental in the high fashion industry segment.

Conclusion

In conclusion, the Mexican textile industry needs to rely on the Mexican garment industry to further increase its gains of production. By creating a "full package" production Mexico has a lot to gain when compared to any country in the region. Mexico also needs to diversify its market exports away from the U.S., with the entry of China and Hong Kong to the world industry, production in the next few years would likely go down. New markets can be found in Central America, Europe and Canada. Mexico's producers need to differentiate themselves from Chinese production and promote high-quality end products, using Mexican inputs.

The end of the MFA means that free trade is guaranteed in the textile and garment industry around the world, with the prospects of an agreement like the FTAA being signed sometimes in the future, the Mexican textile and garment industry has nothing to fear as long as it focuses on the policy recommendations mentioned above.

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Appendices

Appendix 1: The Agreement on Textiles and Clothing

A new multinational agreement on trade in textiles and clothing was introduced as part of the GATT Uruguay Round in 1986. The aim was to bring rules on textiles and clothing trade into line with the free-trade policies of the newly established WTO. The ATC provides a framework for phasing out the Multifibre Arrangement (MFA).

Since 1974, world trade in textiles and garments has been governed by the MFA. This provided the basis on which industrialised countries have been able to restrict imports from developing countries. Every year countries agree quotas—the quantities of specified items that can be traded between them. The exporting country then allocates licences to firms to export a certain proportion of each quota.

The ATC is an agreement to phase out the MFA over a period of ten years, beginning in 1995. It applies to all WTO members, whether or not they were signatories to the MFA.

Timetable for the phase-out

The main provision of the agreement is a timetable leading to complete integration at the end of a ten-year transition period, i.e. by 2005.

The agreement provides a list of all the products to be integrated. There are two aspects to this process:

1. *Progressive integration of products*

Integration is required to take place in four stages. Each stage must include products for each of four groups:

- tops and yarns
- fabrics
- made-up textile products
- clothing.

The choice of items within these groups is left to importing countries.

2. *Progressive raising of quotas*

At each of the first three stages of integration there has to be an annual increase in the quota level of those products still under the MFA.

Other provision in the ATC

Several articles in the Agreement have affected implementation of the phase-out. They were the result of strong lobbying by the USA and EU and include:

1. *Transitional Safeguard Measures (Article 6)*

Article 6 continues to permit the application of MFA-type safeguard actions. The provisions are intended to prevent a sudden rise in imports of specific products causing serious damage to the importer's domestic industry. Unlike general WTO safeguard measures, these measures can be directed at specific countries. In order for them to be introduced there has to be evidence of significant damage.

2. *Reciprocal market access*

Article 7 links the integration process to increased access to developing countries' markets. The EU and USA want greater access to overseas markets for textiles and for up-market clothing. This was seen as the price developing countries had to pay for the phase-out of the MFA.

3. *False origins*

The ATC requires developing countries to demonstrate that they have adopted effective measures to prevent trans-shipments or false declaration of origin. Importing countries can impose sanctions (e.g. reduce quotas) in the event of evidence of malpractice.

Source: work by Angela Hale

Appendix 2: The US trading partners' trade with the United States, 2002

	Share of total exports going to USA (per cent)		US share of total imports (per cent)	
	Textiles	Clothing	Textiles	Clothing
Canada	94.2	94.3	50.3	10.4
Mexico	88.2	95.9	77.2	65.4
Dominican Republic	50.2	95.0	38.2	21.7
Honduras	42.8	91.8	32.8	24.7
Bangladesh	19.0	54.3	0.6	2.7
China	9.9	12.6	1.2	0.7
Hong Kong, China	29.9	49.2	1.4	0.5
India	20.0	31.2	2.2	2.2
Indonesia	10.7	50.2	4.0	2.0
Korea, Rep.	13.9	53.4	2.8	1.4
Philippines	44.3	78.0	2.8	6.5
Thailand	23.3	56.5	2.9	3.6
Chinese Taipei	9.1	72.7	5.5	1.2
Italy	5.9	12.1	1.0	0.6

Source: WTO

Appendix 3: Size of the Textile and Garment Industry in Mexico, 2001

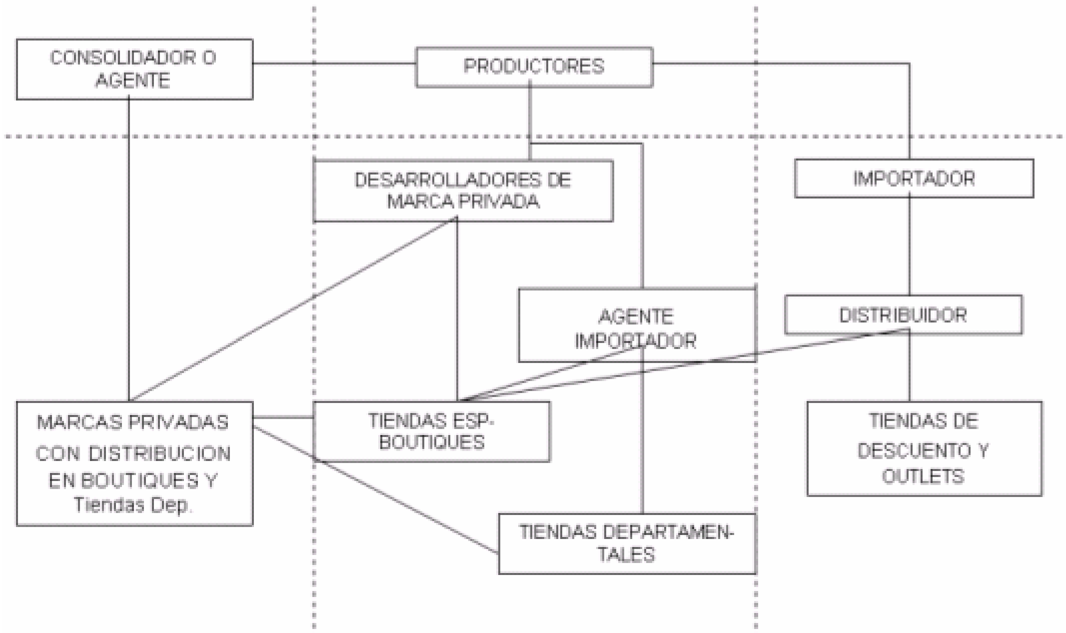
	Exportaciones			Importaciones		
Industria	Rk	MMD	%	Rk	MMD	Balanza
Equipo eléctrico y electrónico	1	43.2	27	1	43.2	.04
Automotriz y autopartes	2	27.9	18	2	27.0	.58
Reactores nucleares, boilers...	3	23.6	15	3	17.0	6.7
Petroquímicos y minerales	4	12.6	8	4	9.9	2.7
Textil y confección	5	10.2*	6	5	9.4	.76
Instrumentos y maquinaria óptica	6	5.0	3	6	5.3	- .28

U$D 10.2 MMD

	MMD	Part.
Textil	$ 1.6	15.7 %
Maquila	$ 0.4	4.0 %
No maquila	$1.2	11.7 %
Confección	$8.6	84.3 %
Maquila	$5.6	55.0 %
No Maquila	$3.0	29.3 %
	10.2	100.0 %

Source: Bancomext

Appendix 4: Commercialization Channels



Source: Bancomext