

Impact Assessment of Lifting the Multifiber Agreement on the Qualified Industrial Zones

The Multifiber Agreement: Concept and Future Developments

International trade in apparel and textiles is regulated by a system of bilateral tariffs and quotas known as the Multifiber Arrangements or MFA. The Multifiber Agreement (MFA) is a framework agreement that governs the trade in textiles and clothing throughout most the world. The textiles and garment sector will be integrated within the GATT 1994 of WTO in 2005, where quota restrictions will be lifted.

The MFA includes most major industrial and developing countries and covers products made of cotton, synthetic fibers, wool, silk and ramie. Under the MFA, all exports are subject to quotas when total exports from an exporting country reach a certain share of total imports in the country of destination. This discriminatory trade distortion imposed by industrial countries severely affected exports from developing countries. As a result, in 1985 the International Textile and Clothing Bureau was formed to seek an end to the MFA and return trade in textiles and clothing to normal GATT rules .

However, given the long history of trade restrictions it was no easy task, and compromises had to be made in the form of adopting a gradual liberalization approach. On 1 January 1995, the MFA was replaced by the World Trade Organization (WTO) Agreement on Textiles and Clothing (ATC), which sets out a transitional process for the ultimate removal of quotas and the full adoption of textile and clothing products into GATT rules.

The liberalization process takes effect over a 10-year period (1995-2005), with MFA-restricted goods returning to normal GATT rules in three phases. At the start of each phase of integration, importing countries must integrate a specified minimum portion of their textile and apparel imports, based on total trade volume in 1990. The quota growth rate of products remaining under quota is also specified for each phase. In addition, import tariffs are being reduced under this agreement, on both textiles and clothing, and on a wide range of other goods.

The first phase of the liberalization process started on January 1, 1995 with a 16 percent minimum trade integration and an increase of the quota growth rate to 16 percent. The second phase started at the beginning of 1998 with a specified minimum trade integration rate of 17 percent and an increase of the quota growth rate to 25 percent higher than the previous stage rate. The third phase is due to begin in 2002, with targets of 18 percent (integration rate) and 27 percent (quota growth rate). Finally, all remaining products will be integrated at the end of the transition period on January 1, 2005.

The agreement also contains a specific transition safeguard mechanism that can be applied at any stage to products not yet integrated into GATT. Action under the mechanism can be taken against individual exporting countries if it is demonstrated by an importing country that a sharp and substantial increase of imports from an individual country would cause serious damage or threaten its domestic industry. Action can be taken by mutual agreement, following consultation, or unilaterally, but

subject to review by the Textile Monitoring Body¹. Bringing the MFA under GATT rules was a big accomplishment in trade negotiations. Given the distortions that had arisen from the MFA over a wide range of products and countries, it was to be expected that the impact of the changes would be strong. Importing countries stand to benefit from lower import prices due to the abolishment of quota rents. They can source from the most efficient exporters, while resource allocation in importing countries will improve as a result of import competition. Exporting countries may benefit or not, depending mainly on their comparative advantage .

The quota system restricts competition and allows less competitive exporters to export more than their competitive share. These less competitive exporters will lose their market share. Export countries previously limited by the MFA will gain from increased market access. However, exporting countries will face lower prices as a result of increased competition, although production and export will be rationalized, with a move to more efficient sectors .

Abolishing the Multifiber Agreement: The Future Threat

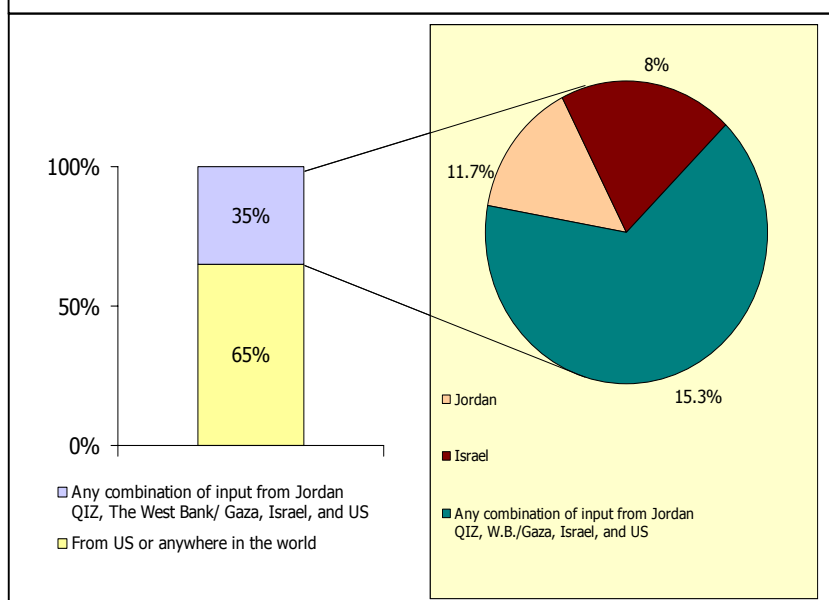
I. Introduction

The Multifiber Agreement that sets quotas for the export of textiles to the US has enabled Jordanian QIZs to compete with exports from China, India, Bangladesh and Pakistan. The QIZ agreement enables the products that are produced in these designated areas to be **exported quota and duty free to the US market**. As a result, exported QIZ products have a **price advantage** against similar products exported to the US market from other countries.

However, for a product to be eligible for duty free entry, it should possess certain requirements. The product should be a new and different article of commerce that has been grown, produced, or manufactured in the zone, and that at least (35%) of the appraised value of the product consists of the cost or value of materials produced plus the direct cost of processing operations performed in the QIZ. A product is qualified under this agreement by one of the following methods:

- At least (11.7%) of the final product must be added by the

Figure (1): Qualifying a product under the QIZ agreement



¹ The Textiles **Monitoring Body** (TMB), established in the Agreement on Textiles and Clothing (ATC), supervises the implementation of all aspects of the Agreement. The TMB consists of a chairman and ten members and has a role of dispute settlement.

Jordanian manufacturer in the QIZ and (8%) by the Israeli manufacturer (7% for high-tech products). The remainder of the (35%) can come from QIZ Jordan, Israel, West Bank/Gaza Strip, or the US. As for the remaining (65%) production expenditure can be from anywhere in the world.

- Jordanian and Israeli manufacturers must each contribute at least (20%) of the total cost of production of the QIZ product.
- QIZ manufacturers are allowed to mix and match between the first and second method in order to qualify their product.

There are eleven QIZ's located throughout Jordan: three located in publicly run industrial estates, seven privately owned industrial estates, and one sub zone. However, only seven QIZs are currently in operation. The QIZs flourished in the Kingdom where by the end of 2002, the total number of QIZ projects reached (62) and total investments in QIZs arrived at a total of (JD383 million).

QIZ Zone	Type	No. of Projects		Investment Capital (JD Million)	
		Existing	Expected	Existing	Expected
Al-Hassan Industrial Estate	Public	15	7	98.5	-
Al-Hussein Ibn Abdalla II Industrial Estate (Al Karak)	Public	3	-	40	-
Ad-Dulayl Industrial Park	Private	11	3	50	20
Al-Tajamouat Industrial City	Private	25	10	150	50
Cyber City	Private	5	3	20	15
Al-Qastal	Private	2	-	16	-
El-Zay sub zone	Private	1	-	7.5	-
Total		62	23	383	85

Source: Jordan Investment Board as in 31/12/2002.

II. The Current Impact of the Multifiber Agreement on the Jordanian QIZs

Abolishing the Multifiber Agreement is a step forward in improving trade accessibility. However, while free trade improves welfare, its benefits are not distributed evenly among concerned parties. Some will gain, and some will lose. This is also the case in the textiles and clothing trade. *Countries with established comparative advantages will benefit from the abolishing of the MFA, while countries that can export because of protection from any source will lose out after liberalization.* This section will explore some indicators reflecting the current effect of the Multifiber Agreement on the Jordanian QIZs as a first step of assessing the phasing out of the agreement on the current, investment type, exports and employment.

The Multifiber Agreement's rules and conditions which employ quota constraints on developing countries points out the current investment attraction for the Jordanian QIZs. The effects of the agreement are seen clearly when analyzing the type of projects located in the Kingdom. Most of the projects operating in the QIZs are specialized in the production of garments products (92%) which by the rules of the agreement endure high level of quota constraints.

Garments which embody the dominant products of the companies investing and operating in the Jordanian QIZs are of increased importance to the Jordanian economy. However, during the last four years the Jordanian exports share of garments products out of the total exports witnessed a boom, where it increased from (3.3%) in 1999 to reach (23%) in the year 2002.

Moreover, given the ever-increasing array of bilateral quota arrangements and the quota free arrangements of the QIZ, the QIZ companies' share of the total exports from the garment products had a sharp increase from the date of inception of the agreement to date. The QIZ products share was (5%) in 1999 and increased to reach (75.7%) in the year 2002.

Moreover, the impact of the Multifiber Agreement on the QIZs will depend largely on the kind of investors currently working in the Kingdom and the reasons behind choosing Jordan as an investment destination, given the fact that most of the investments are of products suffering quota constraints under the agreement. The analysis of the investors' nationalities revealed a high percentage of Asian investors. Asian investors in the QIZ own a total of (31) companies out of the (59) companies working in the field of textiles and garments.

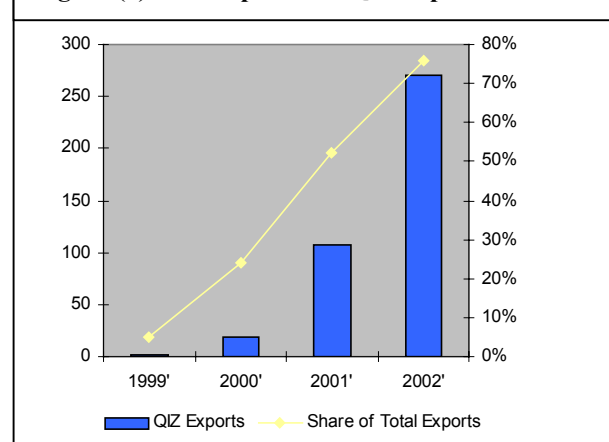
These Asian countries (Hong Kong, Taiwan, Pakistan, Korea, Philippines, Bangladesh, China, India, and Sri Lanka) investing in the Jordanian QIZs depend largely on the textiles and garment sector which represent a high share of these countries exports. The Asian garment companies, being major suppliers to the US garment market are subject to US quota when they produce in their home country. By investing in the Jordanian QIZs, the Asian investors locate their investment in a very attractive gateway and increasing the accessibility of their products to the American market. The companies in the home countries open subsidiaries in the QIZs that are highly dependant on mother companies in terms of marketing, and input supply.

Table (2): Type of projects on the QIZs

Type of Product	No. of Companies	(%)
Knitted and Woven Garments	58	90.5%
Textiles	1	1.6%
Gold	2	3.1%
Plastic Molds	1	1.6%
Bed Sheets	1	1.6%
Printing	1	1.6%
Total	64	100%

Source: Jordan Investment Board

Figure (2): Development of QIZ exports



Source: Department of Statistics, Industrial Development Directorate/MoIT

Table (3): Textiles and clothing exports in some Asian Countries

Country	T&C Exports as % of Total Exports
Bangladesh	84
Pakistan	72
Sri Lanka	54
India	28

Source: WTO Statistics.

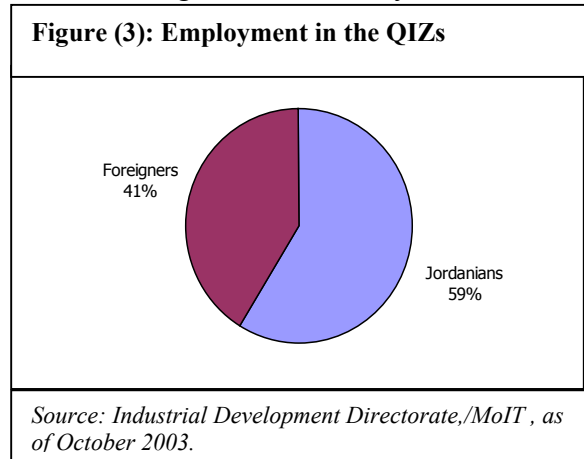
Furthermore, the current effect of the agreement is evident when analyzing the investments coming from the United Arab Emirates. The agreement was a main factor in attracting investors from UAE nationalities due to the fact that, recently USA started applying quota constraints on the textiles and garment products exported by the UAE producers, these new conditions forced the UAE investors to think of Jordan as a place to overcome these constraints. Currently, there are (8) projects in the QIZs where the factories are owned and operated by UAE investors either solely or through partnerships.

As expected, the effect of the Multifiber Agreement was evident on the type of products manufactured and exported from the QIZs, where about (89%) of the products exported to the USA market (mainly from the QIZs) are concentrated in six product categories possessing high levels of quota constraints. These products are characterized with tariff rates that have a very low minimum tariff edge. This analysis revealed clearly that the type of investors operating in the QIZs were mainly concerned with quota levels rather than the tariff reductions granted by the QIZ agreement.

Table (4): The type of products exported to the USA market mainly from the QIZs						
Category HS Code	Share of Category out of Garments Total Exports to USA (2002)	Product HS Code	Product Description	Product Share out of the Total Garments Exports to USA (2002)	American Normal Tariff Rate	No. of Countries Investing in the QIZ and Suffer from Binding Quotas in the Product
61	7%	6107.11	Men's or boys' underpants and briefs, of cotton, knitted or crocheted.	5.3%	7.4%	6
62	93%	6203.19	Men's or boys' suits, of other textile materials, not knitted or crocheted.	10.2%	4.2%-21%	10
		6203.39	Men's or boys' jackets and blazers, of other textile materials, not knitted or crocheted.	17.2%	1.6%-27.5%	5
		6203.49	Men's or boys' trousers, bib and brace overalls, breeches and shorts, of other textile materials, not knitted or crocheted.	28.1%	0.3%-28.1%	12
		6205.10	Men's or boys' shirts, of wool or fine animal hair, not knitted or crocheted.	14.0%	5.3%-17.8%	3
		6205.9	Men's or boys' shirts, of other textile materials, not knitted or crocheted.	14.5%	1.7%-7.1%	12
Total	JD291.8 Million			89.3%		

Source: Department of Statistics, US Customs Department

Moreover, an important element in the production chain of the garments industry is the labor force. However, the Jordanian work opportunities resulting from the QIZs are considerably affected by the agreement in terms of the attraction of investment from countries characterized with low cost and high productive labor. The investors are bringing their workers from their home country. Currently, the QIZ companies are employing (26,552) workers, out of which (41%) are workers coming from Far Eastern countries according to the official sources.



III. The Impact of Abolishing the Multifiber Agreement on the Jordanian QIZs

It is necessary to recognize that as the remaining restrictions of the Multifiber Agreement are removed during the third and fourth stages, which began in the year 2002, exporters will face greatly increased competition in international markets. Further, the benefits of the removal of restrictions are not likely to be evenly distributed among exporting countries.

The competitive position of countries currently subject to quota restrictions will determine whether the removal of these restrictions will be advantageous to them. Those whose industries have sharpened their competitive edge by adopting up-to-date technology may benefit fully from this removal. Other exporting countries, particularly those that are not able to use up their full quotas, may draw only marginal benefits unless they immediately take steps to assist their industries in becoming more competitive. Countries that are not currently subject to restrictions on import markets will also have to prepare themselves to meet increased competition from countries whose exports are currently restrained. However, Jordan as a country not subject to quota constraints and its investments in the field of garments that is driven by the Multifiber Agreement, is expected to suffer from the abolishment of the agreement.

The effects of abolishing the agreement will severely affect the investments currently operating in the Jordanian QIZ. However, as most of the investments currently operating in the QIZ are by investors moving from their home countries as a result of the quota constraints, and yet didn't benefit from the associated tariff reductions granted by the QIZ agreement, the abolishment of the Multifiber Agreement will result in these investments moving back to their home countries. This will give rise to the following sever consequences:

- The investments that are currently operating in the QIZs and owned by the Jordanian investors will face huge competition, many of the Jordanian investors are working with subcontract orders and depend mainly on the Asian huge investments in Jordan and on their mother companies back in their countries. Moving the Asian investments away to the mother country, will affect the Jordanian investments that were clustered around them, and thus some of these

investments that depend largely on the subcontracting will face a lack of orders and may close down.

- Moreover, moving the investments away will affect the current export value, since most of the Jordanian exports are currently going through the QIZs. The share of the exports outside the agreement reached about (24.3%), even these exports will face huge competition especially when recognizing that our export markets are not diversified and include mainly the USA, Israel and Europe. The American and European markets are heavily regulated by the quota constraints, while the exports to Israel are mainly due to subcontracting work due to Jordan's comparative advantage relative to Israel in the labor cost. Abolishing the agreement will cause severe competition from countries with lower labor costs and higher productivity which will affect the competitiveness of the Jordanian products.
- Furthermore, due to over reliance on a few markets and standard low value added products, the threat of Jordanian producers losing their market share in export destinations is high. Losing the export markets, which the Jordanian QIZ producers depend largely on, will affect the employment level, whereby many of the current employees will lose their jobs.
- To sum up the above effects, it is obvious that Jordan will be heavily impacted by the abolishment of the Multifiber Agreement. This negative impact is mainly due to the over reliance on quota free incentives granted by the QIZ agreement to Jordan which currently positively affected the QIZ investments and the textiles and clothing sector at large. However, concentrating on this sector for easily attracting investments while dismantling other incentives and not considering it as a short term strategy were the biggest Jordanian drawbacks that if remedy actions are not taken quickly, will cause a serious economic quandary.

Box (1): Some competitive low cost countries

China emerged as a low-wage producer and penetrated the labor-intensive market. Unit costs in China were only US\$0.3 for textiles and US\$0.24 for clothing. Indonesia had the same unit cost as China in textiles and even lower for clothing. India also established itself as a low cost country, although slightly higher than China.

Abolishing the Multifiber Agreement: Policy Recommendations to Confront the Challenge

Formulating the policy recommendations for Jordan to adapt in order to assist the textiles and clothing sector to overcome the effects of abolishing the Multifiber Agreement will depend largely on the understanding of the current status of the investments, products and export destinations. Jordanian Government therefore will have to use the remaining transition period to implement certain actions that will help in facing this threat. For Jordan, this should be two folds. Firstly, the government should have on its priority agenda, a set of actions on how to sustain the current investments in the sector that were attracted to Jordan during the past years. Secondly, huge efforts are needed to upgrade the local investments to meet the international standards and increase competitiveness.

Furthermore, the Jordanian government should rely heavily on the incentives granted for the country by the agreements signed by the world two largest markets the USA and Europe. However, a campaign amongst existing foreign investments currently working in Jordan is found essential to make them divert from low tariff low value added products into high tariff, high value added products.

In addition, investment promotion missions aiming at attracting new investments should explore new opportunities existing in the Jordanian market depending mainly on the effective tariff reductions and the investment climate available. Targets should depend on careful studies that target long term, high value added investments.

Adapting such strategy will require working heavily in the field of making our workforce more competitive in terms of skills and productivity. The investors working in Jordan should find available a very skilled labor force capable of meeting their expectations. The sector skilled and productive labor will maintain an edge for Jordan amongst the giant exporters coming from the Far Eastern low wage cost countries.

Upgrading the skill level and productivity of workers will have a very high impact in reducing the cost and improving the quality of the sector's output. Moreover, the government should reduce the input cost through negotiating the reduction of the Israeli percentage in the QIZ product eligibility requirements, while trying to improve the implementation of the Jordan-EU Trade Agreement through bilateral agreements with other MEDA countries and the effective sourcing of European inputs and making them available to the industry. Additionally, working out a proposal for Jordanian-European QIZ underlining a new formula for fulfilling the rules of origin may work as a very efficient tool for conquering the impact of abolishing the Multifiber Agreement on Jordanian manufacturers.

At the industry level, textile and clothing industries in Jordan should prepare themselves to meet heightened competition resulting from the abolishing of the agreement in their export markets. They should modernize their technology, rationalize production methods, and carry out market research to identify the textile products in which they can compete effectively in international markets on the basis of quality and price.

Traditionally, many enterprises have concentrated on markets in developed countries and especially on the USA, Israel and Europe. In adopting programs and strategies for export development in the post-MFA period, the vast potential that now exists for increased trade with other developing countries especially within the region should also be adequately taken into account. A number of countries have unilaterally reduced under the WTO Agreement, the high tariffs that they previously applied to imports of textile products. Ideally, demand for textile products in these countries will expand as they make further progress in economic development and as their per capita incomes rise.