Review of the Impact of the China Restraint Agreement on the Clothing and Textile Industry in South Africa

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Introduction

Following China's accession to the WTO in 2001, cheap Chinese garments have flooded clothing markets worldwide bringing to fruition the prophecy of Chinese hegemony in a liberalised global clothing market (Kaplinsky 2005; Nordas 2004; and Kaplinsky et al 2006). South Africa's domestic market has, unexceptionally, also been adversely affected by rising Chinese imports evidenced by i) a falling relative contribution of apparel to total manufacturing output and ii) persistent job loss in the sector (Kaplan 2003; Barnes 2004). China has significantly increased its footprint in the South African clothing market over the past decade.

Table 1 shows China's overwhelming dominance in South African imports in the two main clothing categories HS Chapters 61 and 62. The Chinese market share of aggregate South African clothing imports rose steadily from 21.58% in 1996 to 78.49% in 2006 and if Hong Kong is included then its share in 2006 was 81.23%.

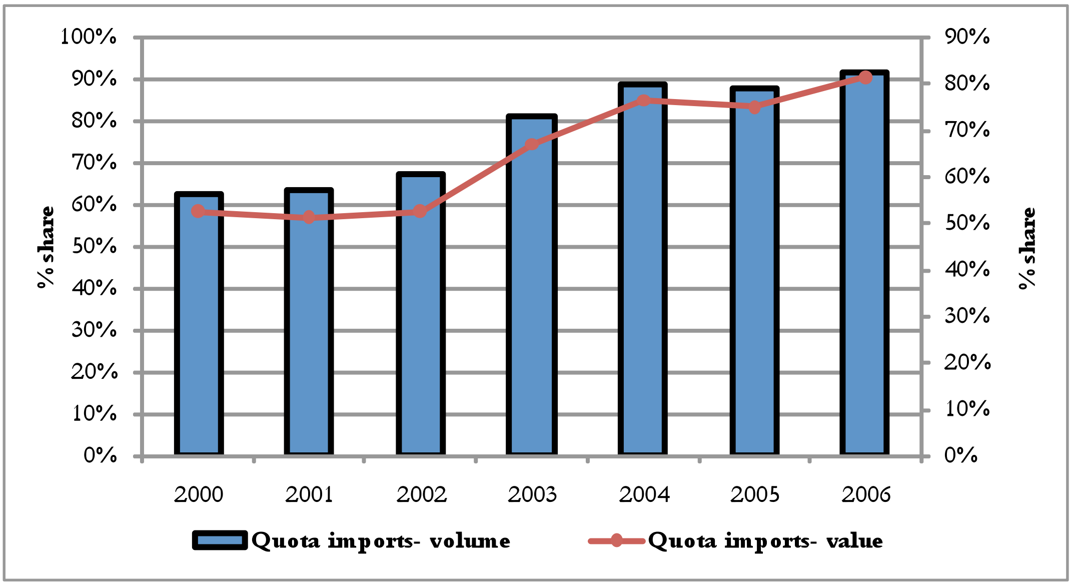
Table 1: Sources of RSA imports of HS61, 62 as share of total clothing imports: 1996-2007

HS61	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
China	25.77	28.40	33.64	38.82	50.42	53.73	58.27	68.81	74.47	75.59	77.13	64.85
India	2.12	3.32	3.41	4.33	4.02	3.30	2.91	4.12	3.81	4.56	3.79	6.21
Mauritius	0.13	0.06	0.11	0.83	1.31	0.41	1.89	1.91	1.42	2.03	3.27	5.74
Hong Kong	9.06	6.48	6.77	5.95	6.93	7.87	7.46	5.47	5.10	3.89	2.77	2.62
Indonesia	1.48	1.26	3.56	3.38	3.58	2.41	2.34	1.61	0.76	0.57	0.61	2.06
Myanmar	0.00	0.00	0.05	0.05	0.00	0.00	0.07	0.03	0.03	0.24	0.46	1.96
HS62	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
China	18.15	17.53	15.35	22.16	48.75	48.55	51.96	64.92	74.25	73.10	79.51	59.29
Hong Kong	8.77	5.34	5.83	7.24	7.44	7.90	5.86	4.50	4.21	3.77	2.71	5.39
India	21.36	25.44	21.25	16.53	14.50	10.48	8.38	7.91	6.42	8.61	4.20	5.22
Malawi	17.51	19.32	26.34	24.34	7.56	11.34	14.92	6.56	3.61	3.20	1.97	2.96
Indonesia	1.10	1.67	2.67	3.75	1.45	1.12	1.74	0.96	0.67	0.96	0.77	2.96
Mauritius	0.10	0.14	0.20	0.17	0.15	0.20	0.45	0.29	0.26	0.52	1.21	2.57
HS61&62	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
China	21.58	22.36	22.73	28.48	49.39	50.68	54.43	66.37	74.34	74.22	78.49	61.88
India	12.70	15.61	14.05	11.91	10.50	7.52	6.24	6.50	5.35	6.92	4.02	5.69
Hong Kong	8.90	5.85	6.21	6.75	7.24	7.89	6.49	4.86	4.58	3.82	2.74	4.10
Mauritius	0.11	0.11	0.16	0.42	0.59	0.29	1.02	0.89	0.74	1.15	2.10	4.05
Indonesia	1.27	1.49	3.03	3.61	2.26	1.66	1.98	1.20	0.89	0.74	1.15	2.54
Bangladesh	0.02	0.06	0.04	0.04	0.10	0.18	0.36	0.44	0.38	0.50	0.74	2.24

Data source: Quantec

Furthermore, almost all of China's recent growth occurred in quota lines. Figure 1 below shows the share of China in total quota imports into South Africa by value (as a line) and volume (as columns). From 2000 to 2006 China increased its value share from 52.52% to 81.35% and its volume share from 62.33% to 87.60%.

Figure 1: Demonstration of China in quota imports by value and volume: 2000-2006



Data source: Clotrade

Indeed, it is argued, South Africa has been more disadvantaged by China's entry into the WTO than most of Sub-Saharan Africa due to the AGOA triple transformation rule, which discriminates its exports to the US more than those of all other Sub-Saharan countries (excl. Mauritius) (Gibbon 2002a; Gibbon 2003; Morris and Kaplinsky 2006; and AGOA 2006). However there is one caveat; whereas increased Chinese import penetration worldwide is generally a consequence of the removal of MFA quotas, this is not applicable to South Africa, where quotas were never in effect. Instead, Chinese imports were triggered by a sudden depreciation in the currency which pressed local retailers to seek alternative (mainly Chinese) suppliers abroad as local suppliers opted to export their product. Moreover, whilst fierce competition from Chinese imports is certainly a contributing factor, it is not considered exclusively to blame for the sector's poor performance. Other factors offered in explanation of falling employment and output levels in the industry include a deteriorating export performance, currency appreciation, inconsistent extension of the Duty Credit Certificate Scheme and difficult labour market conditions (Gibbon 2003 and Edwards et al 2006). However, some leading analysts go further to contend that rising Chinese imports is not a cause, but merely a *symptom* of underlying problems with the sector itself (Barnes et al 2006 and Morris 2007).

The government's response to warnings of imminent industry collapse was a botched Customised Sector Plan and then to negotiate with China to agree quantitative restraints on imports of certain textile and apparel products originating in China. The Memorandum of Understanding signed between South Africa and China in September 2006 (Government Gazette, 2006) established annual quotas through 2008 on - mostly cotton and cotton-rich - made-up garments and fabrics spanning 31, mainly HS61 and 62, tariff lines. The rationale: " To give the sector an opportunity to restructure and become globally competitive…by encouraging local retailers to source from local manufacturers" *(Patel, General Secretary of SACTWU)*. The DTI's explicit aims of the China quota policy were to a) raise employment in the industry and b) rejuvenate domestic production by providing temporary relief from intense Chinese competition (DTI 2006). It aim was to afford further protection to an industry which already nestles behind the highest tariff walls in the economy.[1]

The adoption of this measure was highly controversial, eliciting a vocal and public outcry from industry retailers and clothing manufacturers. The textile sector was muted, but ultimately supportive of the initiative. Disagreements over the lack of consultation with industry players were the focal point of contention. There were also differences over the design, scope, implementation mechanism, and quota allocation. Although the DTI claimed the quotas were instituted on behalf of requests from Clotrade and SACTWU starting in 2004, Clotrade objected strenuously to the proposal when the decision was sprung on the industry in mid 2006. With no movement from the DTI on the original 2004 request, Clotrade had abandoned this as a measure which could be of any use. The clothing manufacturers had instead began successfully to build a business alliance with the domestic retailers and create value chain alignment in the sector as the most effective way of laying the foundation for a sustainable clothing sector in South Africa (Business Alliance 2006). The China quota restraint, in both its mode of implementation and modus operandi, was

[1] Although the average import weighted tariff on apparel has almost halved since 1993, now 40% for clothing and 22% for fabric, it is still 5 times higher than the average for the economy as a whole (Edwards et al 2006)

perceived as a direct attack on the retailers and hence ran counter to these initiatives. In effect the China quota policy became an initiative of SACTWU under the aegis of the DTI.

The expectation that the China quotas will reduce the importation of cheap Chinese goods is predicated on the assumption that Chinese imports will be substituted for locally produced goods and that the South African industry is internationally competitive once Chinese imports are disregarded. The competitiveness issue has increased in complexity over the past decade. Specifically, it is noted that, whilst price is still the primary determinant of competitiveness, it is no longer the sole determinant (Barnes et al 2006; Gereffi 2003; Gereffi and Memedovic 2003). China derives a major competitive advantage from a combination of low wages and high productivity and the production of high-quality and low cost inputs (Kaplinsky 2005 and Barnes et al 2006). However, many other Asian economies, such as Bangladesh, are rapidly developing similarly derived comparative advantage from abundant cheap labour and the availability of cheap high-quality fabric. Since the quotas do not restrict retailers to China in their search for low cost clothing, it is argued (in Hazelhurst 2006b and Barnes et al 2006) that it is not simply South Africa's inefficiency relative to China that is the problem, but rather its inefficiency relative to Asia as a whole.

The South African clothing manufacturing industry is uncompetitive, lacking both skills and technology (Hazelhurst 2006b) whilst having relatively high labour costs (USITC 2004). But the future is not all doom and gloom. The emergence of "lean manufacturing" which requires quick turn-around and short lead times has provided South African firms with something to offer that their Chinese counterparts can't - speed and flexibility. Hence, fast production and proximity to local markets, rather than price and volume, are recognised as the basis on which local firms can compete (Bleby 2006). Getting co-operation along the value chain from retailer to manufacturer is fundamental to this process and great strides have been taken at the industry level - with the exclusion of national government - towards achieving this goal (Bisseker 2006a and Bleby 2006).

It is against this backdrop that the largely unanticipated response of the clothing manufacturers to the DTI's quota decision should be understood. Clotrade, the industry's representative body, gave three reasons for its decision to unreservedly withdraw its support of quotas: i) The quotas came too late since most of the unemployment, which quotas were intended to mitigate, has already and irreversibly, occurred (Brink 2007); ii) The quotas were a threat to the retailer-manufacturer alliance (Bisseker 2006a). Manufacturers are trying to connect with the value chains of which retailers are the drivers; therefore, any industrial policy which is antagonistic to the retailers is self defeating; iii) Many local manufacturers are themselves importers of both fabric and finished garments who would be disadvantaged by quantitative restrictions on certain tariff lines subject to quotas.

Three outcomes are possible at the end of 2008, the scheduled expiration date for the China quotas. There will either be i) more local firms supplying the market with increased employment, indicative of a reinvigorated clothing manufacturing sector which is responsive to the growing internal market; or ii) the same number of local firms with more imported goods and increased employment, where the relative percentage of local to imported goods remains constant but grows as domestic demand expands; or iii) less local firms and decreased employment despite growing internal demand as imports from other countries are substituted for locally produced items. This will portend the collapse of the local industry as local firms fold under the competitive pressures of global competition.

The objectives of this report are to:

- analyse the impact of quotas on output and employment so far;
- assess how successful import restrictions have been in terms of achieving the stated policy objectives of the DTI;
- reconcile these outcomes with those forecast by industry;
- evaluate the effectiveness of quotas as an economic policy tool, drawing on the experiences of the US which invoked similar restrictions, and the economic justification for their continued existence in South Africa.

Section 1 introduces the issues and situates China in an historical and current trade context. Section 2 reviews the impact of safeguards on imports into the United States for lessons on the likely impact of quotas on employment and output in South Africa. Section 3 outlines the industry's predictions and forecasts for the outcome of quotas and establishes guidelines for discussion. The report then deals with 2007 and 2008 separately. Section 4 analyses trade flows in imports in the two main clothing Chapters HS61 and HS62, focusing on quantitative and qualitative changes in trade flows as well as trading partners and comparing import activity in non quota and quota lines. The principle objective of this Section is to investigate whether quotas led to import diversion. This continues in Section 5 with an investigation into the beneficiaries of import diversion. Section 6 reports on supply chain disruption from quotas and motivations for their occurrence. Section 7 looks at the impact of quotas on employment to establish empirically what employment trends have been since the imposition of quotas. Section 8 deals with the impact of quotas on price. Section 9 discusses the evidence from the second year of quotas in 2008. Section 10 evaluates the evidence from a 2008 survey of clothing firms on the effectiveness of quotas as an intervention. Section 11 evaluates the justification for quotas in the light of the above. Section 12 concludes.

The report draws on primary quota literature and macro-economic trade and statistical data. Qualitative evidence and quantitative information was obtained from various sources including i) interviews conducted with 15 clothing and 5 textiles manufacturing firms in the Western Cape and KZN in 2007; ii) a survey of 50 clothing manufacturing firms in 2008; iii) telephonic, e-mail and personal interviews with 5 retailers and v) consultation with key experts.

1. An historical perspective on China

The clothing industry is characterised by global value chains, where the manufacturing process is segmented into a series of individual components, which are allocated to foreign suppliers on the basis of comparative advantage. Skill intensive tasks concentrate in developed countries, while low-skilled labour-intensive tasks are outsourced to developing countries with low labour costs. The Multifibre Agreement (MFA) was designed to protect the high value-added segments of the value chain in developed countries. As such, the MFA was a quota-based preferential trade agreement and limited exports of certain countries to the United

States and major trade destinations across Europe, affording a high level of protection to clothing industries in developed countries whilst muting the participation of non-preferred trading partners such as China. Indeed, until 2005, China's presence in the global clothing market was effectively mitigated by quotas, since it had to either buy quota or invest in manufacturing plant in countries which had excess quota.

Unsurprisingly, the decision to liberalise following China's Accession to the WTO in 2001 was very controversial because of the contribution that the clothing and textile sectors make to employment in developed countries (Nordas 2004). Following a protracted phase-down period, quota restrictions were finally lifted in January 2005, although this final step was not completely unchecked. The end of the MFA contained a safeguard measure, which gave the US, EU and Japan the right to erect short term emergency barriers against Chinese imports under certain proviso.

Since 2005, China's participation in the global clothing market has accelerated (See Table 2: China's share of world exports of clothing and textiles (US$ million)Table 2). China is currently the world's largest exporter of garments with over 40% (Hong Kong included) share of global clothing trade.

Table 2: China's share of world exports of clothing and textiles (US$ million)

Exports Clothing										1990-2004 % change	% World Total	
Country	1980	1990	1995	2000	2002	2003	2004	2005	2006		1990	2006
China	1,625	9,669	24,049	36,071	41,302	52,061	61,856	74,163	95388	984%	8.9%	30.6%
Hong Kong	4,976	15,406	21,297	24,214	22,343	23,152	25,097	27,292	28391	63%	14.2%	9.1%
World	40,590	108,129	158,353	197,498	202,310	225,940	258,097	277,971	311,410	188%	100%	100%
Exports Textiles												
China		7219		16135			33428	41050	48683	574%	6.9%	22.3%
Hong Kong		8213		13441			14296	13830	13910	69%	7.9%	6.4%
World		104354		158579			195541	205135	218594	109%	100%	100%

(WTO 2007; Morris and Einhorn 2008)

China's clothing exports to the world grew from \$9.7 billion in 1990 to \$115 billion in 2007, an increase of 1092% (WTO).

An analysis of China's exports into European Union (EU) following the termination of the MFA clearly demonstrates its penetration into this region (Table 3).

Table 4: Percentage change in imports from China into the European Union

	% Change	T-shirts	Pullovers	Mens Trousers	Blouses	Womens Coats	Bras	Socks & Pantihose
Q1'05/Q1'04	Vol %	164%	-534%	413%	186%	184%	139%	63%
	Price%	-26%	-47%	-16%	-24%	-18%	-15%	-22%

Morris and Sedowski 2006

China's comparative advantage is attributed to a number of factors, including a dexterous, dedicated, coordinated, non-militant and low-cost labour force[2]; a stable but undervalued currency; and diligent investment in new manufacturing technologies (Kipling 2008)[3]. Although labour costs are not the lowest relative to many Asian and SSA competitor countries, labour is not the unique factor in sourcing decisions (Morris 2007), with labour productivity (which is especially high in China), quality and cost of fabric, lead times and services offered to apparel importers or brands, import tariff rates and the cost of freight also playing an important role (Emerging Textiles 2008b). China's dominance was further enhanced by active participation by government in the development process. A combination of low interest, non-repayable loans and cash export incentives, coupled with an undervalued currency gave China a comparative advantage which WTO-compliant countries could not match (Kipling 2008)[4].

The lynchpin of China's success lies ultimately with its industrial policies. China prioritized unemployment and job creation and structured a development plan aimed solely at achieving this purpose. The plan had four legs: i) identifying labour intensive and mutually beneficial industries (clothing, footwear, luggage and toys) with complementary skills (stitching) and markets; ii) if the industry was export oriented, industries were developed by a port; iii) skills and people were concentrated to encourage specialization, reinforced through specialised education systems which

[2] Morris 2007 notes that, contrary to popular opinion, low wages are not the most significant factor as Chinese wages are significantly higher than other producer countries in SE Asia or in SSA. A recent research report reveals that there are seven Asian countries that are now offering lower labour costs than China. Labour is not the unique factor in sourcing decisions - labour productivity, quality/cost of fabric, lead times and services offered , import tariff rate and the cost of freight also rank in import decisions (Emergingtextiles 2008).
[3] Interview 15 July 2008.
[4] Interview at Clotrade on 15 July 2008.

were developed; iv) a critical mass of clothing firms was achieved[5] off the back of which a viable textiles industry was developed and thereafter, in similar fashion, a clothing machine equipment manufacturing industry.

As China achieved a critical mass, scale economies and productivity gains were accompanied by a simultaneous fall in prices. Table 4 (above) demonstrates the consistent fall in prices and rise in volumes into the EU across garment categories between 2004 and 2005. Imports into the United States show a similar trend; the Dollar value of imports rose by 69.93% between 2004 and 2005 whilst the square metre equivalent rose by 97.99% (Morris 2007). This price deflation lies at the heart of the China story. This impact has two aspects: First, the competitiveness aspect which is concerned with the pressure that imports have applied on the competitiveness of local producers forcing them to radically upgrade to meet new price, quality and reliability demands[6] (Barnes and Esselaar 2005 and Morris 2007). Second, the welfare aspect which is concerned with the impact of imports on employment in the local clothing industry and on the general standard of living of the masses of consumers. This topic has important policy implications and will be revisited and expanded in detail in later sections. The discussion proceeds with an overview of at the impact of safeguards on the US garment industry.

2. Lessons from Safeguards in the United States[7]

In January 2006, the US government initiated safeguards on a range of textile and apparel products deemed "quota-free" since China's accession into the WTO (http://www.fda.gov/oia/Agreements). The decision to proceed with safeguards culminated two years of investigation and consultation by the USITC into allegations that items in the restricted categories were being imported from China into the US in such increased quantities, or under such conditions, so as to cause, or threaten to cause, market disruption to the domestic producers operating in the US of like or directly competitive products (USITC 2004). Safeguards prescribe that imports are

[5] Kipling 2008 stresses that the critical point here is the recognition that clothing and textiles is a *numbers* game where *volumes* count. Consequently, the initial part of development focused solely on achieving a critical mass of clothing firms with up to 50% of all textile inputs imported in 2004. Currently China has 16 million employees in clothing and only 4 million in fabric. In South Africa these ratios are reversed.

[6] As one retailer puts it: "If local can make wanted product at the right price we purchase local. If not, we go off-shore." Local industry either adapts to the new market conditions or loses out.

[7] The imposition of safeguards resulted from the post MFA impact of Chinese imports in 2005... The surge in imports from China to South Africa started in 2002 and had totally different causes (Morris and Einhorn 2008).

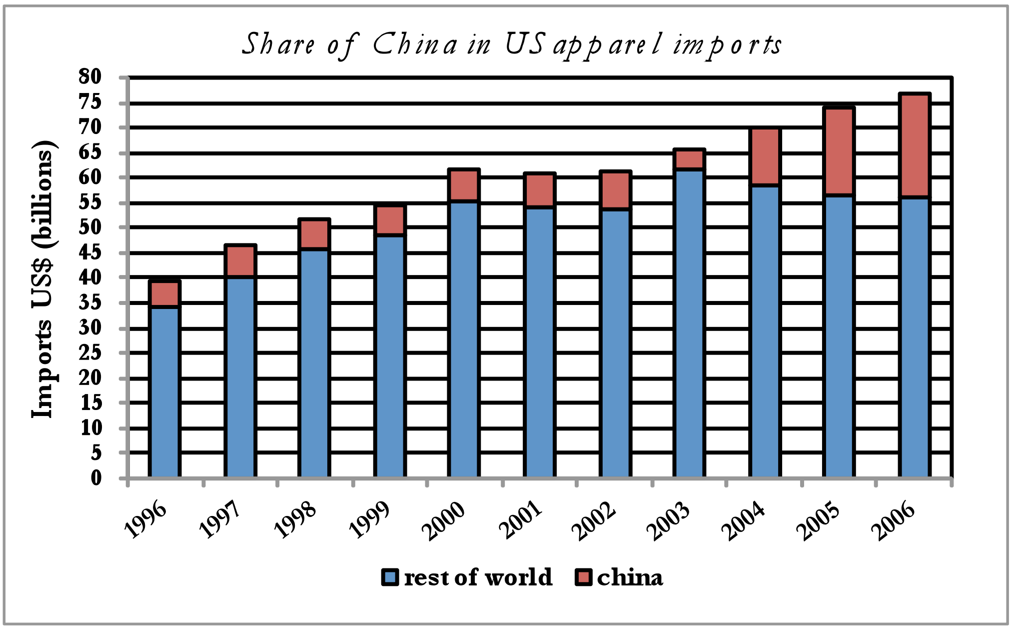
restricted to a maximum of 7.5% above the previous year's quantity (USITC 2004). This move was unprecedented and ran very much against the spirit of liberalised trade, which motivated the dissolution of the MFA. The relief afforded by safeguards was intended as temporary (until 2008) and for the purpose of providing time for the industry to adjust to import competition. Safeguard quotas were supposed to i) reduce reliance on imports to meet domestic demand by rejuvenating local manufacturing output and ii) improve employment levels in the sector which have fallen consistently since January 2001.

The evidence to date is contraindicative to these outcomes. Safeguards have led to i) **import diversion**, ii) **suppression of domestic prices** and iii) migration to higher value-added garments with the implication of **downgrading** in the local supply chain.

2.1 Import diversion and round-tripping

In their immediate wake, safeguards did successfully reduce imports from China into the United States, which fell by 14.64% and 10.67% in volume and value terms for the first six months of 2006. Almost all of the decreases occurred in restricted categories. Chinas share in total imports fell accordingly as shown in Figure 2 below. What is more, aggregate US imports fell in both volume and value terms by - 2.36% and 0.46% respectively in the first six months after imposition of the new restrictions.

Figure 2: Chinas share of US apparel imports: 1997-2006



Data source: Otexa Own calculations

The impact of safeguards in the immediate aftermath of their imposition primarily stemmed from the uncertainty surrounding the process of their implementation. The Memorandum of Understanding (MOU) was only signed in mid-November 2005. So for most of 2005, the safeguards were applied on a piecemeal basis because the visa system was not yet in place. Hence firms had no guarantee that they would actually receive ordered product. Firms operate with extended lead times of about six months from date of placing their orders. So, although the firms placing orders would have guaranteed access to quota, in order to ensure guaranteed access to actual product, many of them had already switched to alternative country suppliers. There was virtually no growth in U.S. imports (2005-06) for safeguard items.

Furthermore the quotas were not fully utilized in 2006. However, once a stable system was in place, in 2007 (Jan-Nov), U.S. imports in the quota categories from China actually increased by 12 percent.[8] This was because the MOU created stability that made it "safe" to increase sourcing again from China. However firms did not shift all their sourcing of quota product back to China. Once started import diversion also stabilized, confirming predictions by some pundits that the sourcing of imports from alternative low cost countries to China, mainly in response to limitations on Chinese products[9], is likely to be a **permanent phenomenon** rather than a knee-jerk reaction by US importers (Emerging Textiles 2007a). Vietnam, for example, has gradually strengthened its foothold in the US apparel import market since safeguards were initiated[10]. Shipments from this region surged 34.44% in US$ and 35.27% in volume terms compared with same period in 2006[11] (Emerging Textiles 2007a). At the end of 2007, Vietnam lay in third place (behind Mexico) with a 5.90% market share equivalent to US$4.36 billion. Shipments from Bangladesh also surged. In 2007 its import share was 4.20% (US$3.10 billion). (Emerging Textiles 2008a; OTEXA 2008)

Total imports from China fell 15% in December 2007, which may indicate a sourcing shift in the near term. Interviews with the large U.S. apparel importers reveal that

[8] Quota utilisation was much higher in 2007 than 2006, indicating some reversion to Chinese sourcing. In some categories - fill rates were up as much as 18% - 25% on the previous year. (Emergingtextiles 2007)
[9] Although a rapidly rising Yaun and increasing production costs are also having an impact.
[10] This also involves a relocation of some Chinese clothing companies to Vietnam.
[11] Imports from Vietnam have continued to show robust growth in the first half of 2008, up 25% on the comparable 2007 period (OTEXA 2008).

they actively seek alternatives to China to balance risks and costs[12]. This is corroborated by recent announcements from some large trading houses about a potential sourcing shift from China to other origins (Emerging Textiles 2008a).

Table 5: U.S. General Imports from China in Square Meters, millions 2004 -2007

	2004	2005	2006	YTD Nov/2006	YTD Nov/2007
Total all products	11,662.2	16,763.0	18,613.5	17,111.7	19,879.2
Subtotal safeguard categories	4,913.9	7,322.4	7,367.8	6,755.6	7,574.7
Subtotal non-safeguard categories	6,748.4	9,440.6	11,245.7	10,356.1	12,304.5
		39.9%	19.1%	-7.9%	18.8%

Source: USITC personal communication

The initial beneficiaries of the 2006 US safeguards were Bangladesh, Vietnam, Indonesia and Cambodia. January to June 2006 saw volume increases on the comparable 2005 period of 19.62%, 27.40%, 19.92% and 31.22%, and value increases of 26.54%, 30.40%, 27.37% and 29.93% respectively. In addition, round-tripping was evidenced by rebound shipments through Hong Kong and Macau which increased by 24.66% and 43.98%, and 24.22% and 45.86%, in volume and value terms respectively (Emerging Textiles 2006). However, some of these trends were not sustained for the whole year (Table 6) below. Bangladesh, for instance, saw full year net volume and value increases of 3.44% and 6.49%. Volume and value changes for other countries for the same period were recorded as follows: Indonesia (5.04% and 8.47%), India (3.28% and -0.53%), Cambodia (2.84% and 13.53%) and El Salvador (12.24% and 5.57%) (OTEXA 2008). Imports from Hong Kong and Macau for the year fell by 31.56% and 14.27% in volume, and 31.74% and 14.61% in value terms, which confirms suspicions of transshipment activity through them.

Table 6: Top ten US imports of apparel in 2007 (sorted on value)

Country	Volume imports (SME millions)		% change '06-'07	Value imports (US$ millions)		% change '06-'07	Market share (%)
	2006	2007		2006	2007		
World	**22,539.24**	**23,332.11**	**3.52**	**71,629.83**	**73,922.59**	**3.20**	**100%**
China	**6,506.08**	**8,033.59**	**23.48**	**18,517.64**	**22,745.02**	**22.83**	**30.77**
Mexico	1,477.17	1,210.46	-18.06	5,297.11	4,523.37	-14.61	6.12

[12] We are grateful for input and the data in Table 2 from Robert Koopman and Kimberlie Freund of the USITC. In 2005 Nathan and Associates interviewed the main US retailers in respect of sourcing from AGOA exporters as an alternative to China. The importance of spreading risk in their sourcing decisions was a clear critical success factor (Kaplinsky and Morris 2006). This is also confirmed in personal discussion with the USITC.

Vietnam	947.37	1,273.67	34.44	3,222.05	4,358.51	35.27	5.90
Indonesia	1,013.16	1,064.25	5.04	3,670.30	3,981.07	8.47	5.39
India	840.30	867.89	3.28	3,186.89	3,169.93	-0.53	4.29
Bangladesh	1,306.92	1,351.83	3.44	2,914.09	3,103.35	6.49	4.20
Cambodia	842.72	866.62	2.84	2,135.89	2,424.94	13.53	3.28
Hong Kong	523.34	358.20	-31.56	2,810.98	2,034.78	-16.45	2.75
Thailand	566.39	522.97	-7.67	1,839.71	1,766.31	-3.99	2.39
Philippines	589.01	457.90	-22.26	2,002.47	1,722.22	-13.99	2.33

Data Source: OTEXA

Despite quotas, China continued to grow its volume and value share of aggregate US apparel imports - currently 34.43% (8.03 billion SME) and 30.77% (US$22.74 billion) respectively - albeit at a decelerating rate. Value imports from China in all categories grew by 36% in the third quarter of 2006 and 46% in the first half of 2007. When averaged across the entire 2006-2007 period, the net change in imports was 23.48% and 22.38% in volume and value terms respectively.[13] Aggregate US apparel imports increased by 3.52% and 3.20% in value and volume terms respectively. Furthermore, imports from China in restricted categories continued rising throughout the quota period.

Table 7 demonstrates China's performance in restricted categories between 2006 and 2007.

Table 7: China's performance in quota categories: 2006-2007

Category		'06-'07 Volume Change (%)	'06-'07 Value change (%)
332/432/632	Socks	50.95	53.94
338/339	Cotton knit shirts	41.20	53.56
340/640	M/B woven shirts	68.50	88.40
347/348	Cotton trousers	30.29	39.43
349/649	Brassieres	20.37	4.63
352/652	Underwear	66.63	76.56

[13] Whilst a detailed analysis is beyond the scope of this paper, preliminary data for the first half of 2008 suggests that this situation has changed quite dramatically in the first half of 2008. Imports from China fell by 6.55% (volume) and 4.63% (value) on comparable 2007 figures. Furthermore, China lost US market share in 8 of 13 quota categories in the same period (OTEXA 2008).

359/659	Swimwear	15.73	10.42
443	Wool suits	-1.37	6.50
638/639	MMF knit shirts	27.74	34.78
345/645/646	Sweaters	73.24	92.59
647	MMF trousers	35.04	29.38
847	Silk & veg trousers	-13.96	-17.13

Data source: OTEXA

2.2 Price inflation and product downgrading

The second outcome of quantitative restrictions on imports into the US is a shift in the direction of higher value-added higher quality products, evidenced by an increase in the unit value of imports. This happens because importers striving to maximise profits drop low-margin items first when forced to reduce consignments (Edwards et al. 2007, Morris and Einhorn 2008). The corollary to this is that domestic manufacturers are forced toward low-cost, basic items whilst importers fill the demand at the high end of the market.

In the first half of 2006, unit values of apparel imports into the US rose by 1.95% in aggregate whilst those from China rose by 4.65% (Emerging Textiles 2007b). However, for the full 2006-2007 period, the results are mixed. In aggregate, unit values of imports fell by -0.31% as did those from China by -0.53%. However, a detailed analysis of unit values in quota categories broadly confirms the theory of price inflation (Table 8).

Table 8: Changes in unit values in US quota categories: 2006-2007

		Aggregate imports		**China imports**	
		Unit value 2007	'06-'07 change (%)	Unit value 2007	'06-'07 change (%)
332/432/632	Socks	1.38	-5.05	1.28	1.98
338	Cotton knit shirts	5.51	1.67	10.79	12.63
340/640	M/B woven shirts	3.56	4.14	3.53	11.81
347/348	Cotton trousers	4.60	-3.22	5.36	7.01
349/649	Brassieres	9.80	-4.14	7.83	-13.07
352/652	Underwear	1.22	-1.10	1.35	5.96
359/659	Swimwear	1.42	-0.59	1.24	1.46
443	Wool suits	22.47	4.17	10.89	7.97
638	MMF knit shirts	2.63	10.95	3.68	2.05

345/645/646	Sweaters	2.58	3.49	2.61	11.17
647	MMF trousers	3.77	0.38	5.34	-4.19
847	Silk & veg trousers	4.47	-1.97	4.20	-3.68

Source: Emerging Textiles 2008c

In nine of the thirteen quota categories, unit values from China increased between 2006 and 2007; in the most sensitive categories (those with high fill rates), such as woven shirts, cotton trousers and sweaters, these increases were up 12.8%. In the remaining three quota categories, unit values from China fell by between 4 and 13% for the comparable period (OTEXA 2008). Unit values from China across all quota categories included in the calculation increased by 3.43%[14] compared with a 0.73% increase in aggregate values between 2006 and 2007.[15] Where unit values from China have fallen, for instance in the case of brassieres, this may be due to excess supply in China from U.S. buyers switching to alternative sources as a result of safeguards, in this case, Bangladesh.

In addition, aggregate price increases were evident for most emerging supplier countries as well. Full year increases of between a half and 10% were recorded for eight of the nine alternative sourcing locations, such as Mexico (4.21%), Bangladesh (2.96%), Indonesia (3.26%) and Vietnam (0.62%) as well as Cambodia (10.40%) (OTEXA 2008). This implies that US manufacturers are being generally forced toward production of basic, low unit value items.

CASE STUDY: Restrictions on Imports of "Baby Socks" from China into USA

Objections against quantitative restrictions on imports of certain baby socks and booties in terms of quotas on hosiery (category 332/432/632) prompted an investigation by the USITC into the probable effect of their removal. The report concluded that the removal of BSB1 - socks with bulky embellishments which preclude them from being worn as footwear - from the quota would likely have a negligible effect on the level of imports of baby socks and booties from China on total US imports of baby socks and booties and on domestic producers of baby socks and booties. This is because the product imported under this definition constituted a product for which there was no US production. With respect to BSB2 - socks with embellishments - the commission upheld the restrictions despite significant anecdotal evidence that the quotas had simply led to higher unit prices

[14] No part categories were included in the calculation due to lack of information.
[15] A detailed analysis is beyond the scope of the current report but preliminary data released by OTEXA suggests that this trend of rising prices is escalating.

with no increase in domestic orders. This is because importers had either procured additional quota early when quota costs were at their highest or switched to higher cost foreign suppliers including South Korea, Taiwan and Cambodia. Import restraints therefore remain despite evidence that i) increased costs associated with purchasing quota or changing suppliers are passed onto consumers and ii) any domestic loss in sales of BSB2 would likely affect sales of other baby socks since BSB2 are mostly sold as part of an assortment that includes other baby socks even though they alone account for a relatively small share of total imports of baby socks.

The above case study demonstrates the **inherent problem with interventions that paint with a broad brush**. Firstly, the quota net may be cast too wide with the result that it catches products that do not require restrictions but whose limitation **disrupts the local market**. Government officials are often incapable of appreciating the broader supply chain effects of restrictions on product categories. More importantly, it also demonstrates that quotas may not altruistically benefit local manufacturers but will more likely lead to **supplier substitution** where the product is sourced from alternative foreign locations at a higher cost.

In conclusion, whilst safeguards have at best only managed to put the brakes on China's import growth, they have also encouraged importers **to prematurely identify alternative foreign sources of clothing**, the effect of which will endure beyond the restrictions. From an output perspective quantitative restrictions have encouraged importers **toward high unit value items** with accompanying greater margins leaving local manufacturers to satisfy the low value end of demand.

3. South Africa: What the industry said would happen…

Restrictions were imposed on 31 tariff lines with 82 product categories affected: 11 at HS 4, 63 at HS 6 and 8 at HS 8 level. Not all are in the generally recognised clothing categories of Chapters HS61 and HS62, but also in fabrics (HS52, 55 and 60) and one in curtains (HS63). These lines accounted for 65.81% of 2007 aggregate clothing imports. The criteria governing the selection of these exact lines are far from clear. However, Sandrey and Jensen (2007) conclude that since only six of the lines that received quotas showed growth rates that exceeded the growth of clothing imports from China overall, growth alone was not the selection criterion.

At the time of implementation, the industry emphatically rejected the DTI's proposal that quotas would promote employment and encourage firms to commit to and engage in meaningful reform. Instead a series of quite contrary outcomes were anticipated. To put the quotas into context, Clotrade (2007) observed that without making provision for growth in demand, the shortfall between 2006 imports in restricted categories and the 2007 quota implied that 172.9 million garments and 5.6 million kilos of wearing apparel[16] had to be sourced from local manufacturers or alternative countries to China at short notice. If this quantity were produced locally, 60,000 additional jobs would be created, which given the 2006 level of 74 600 employees, meant that the industry would have to double its capacity and rejuvenate the skills pool which has been haemorrhaging since 2003.

Industry stakeholders and experts hypothesized that quotas would:-

- Lead to **import diversion** with no serious net fall in imports: The experience of the United States shows that import restrictions on Chinese goods would not unequivocally lead to substitution for local goods. A more likely occurrence was that retailers would simply secure alternative, and possibly lower cost, foreign suppliers. In the short run at least, it was expected that countries where contracts already existed would benefit, such as India, with suppliers casting an ever widening net toward other Asian countries. Brink (2006) showed that half of the increase in textiles imports between 2000 and 2004 was already from suppliers other than the Chinese.
- Push local manufacturers **down the value chain** to low value-added goods. In order to optimize their competitive advantages of location, flexibility and speed to market, domestic manufacturers were advised to focus production efforts on high end disposable fashion items rather than compete with China in low end mass produced items. However, as observed in the United States, quantitative restrictions imply that importers graduate to high end products to maximize the net worth of their import basket which has the opposite effect of pushing local producers down the value chain (Bisseker 2006b).

[16] In January to December 2006, 345.1 million garments (71% of total unit imports from China) and 9.4 million kilos (48% of total kilo imports from China) were imported in restricted categories. The 2007 quotas in these tariff lines are 172.2 million units and 3.8 million kilograms respectively.

- Encourage **trans-border shipments**, illegal activities and increase the number of imports declared under incorrect codes (Bisseker 2006b). In particular, the overly restrictive nature of the quotas and the short notice for implementation would increase attempts at transshipments and add to the already substantial level of illegal activity evidenced by gross undervaluations of imports (Clotrade 2007a; Sandrey and Van Eeden 2007, Morris and Einhorn 2008). Given the lack of capacity of SARS and the ITAC to monitor border activity and verify rule-of-origin violations, Chinese goods would continue to enter South Africa through other SADC countries (Sandrey 2006).
- Lead to **supply shortages** and supply chain bottlenecks - relating mainly to fabric restrictions, and quota on fabric not domestically produced.
- Be **ineffective** as an intervention to promote the **competitiveness** of the industry. It was argued that promoting systemic competitiveness required encouraging individual firms to upgrade their production capabilities, and facilitating a strategic collaboration between sectors and enterprises.
- **Fail** to create **jobs** and sustainably raise employment in the industry (Edwards and Morris 2007). This is obviously critical as it is a key claimed objective.
- Create welfare problems through **raising the cost of clothing** and reducing the disposable income of the poor (Bisseker 2006b, Hazelhurst 2006a, Morris 2007, Morris and Einhorn 2008).

The discussion that follows is guided by addressing the following key questions:-

1. What has happened to imports in the restricted categories? And, what has happened to imports overall?
2. What has happened to employment since the restrictions were imposed?
3. What has happened to domestic production and domestic demand in the first nine months of this year?
4. What has happened to competitiveness and innovation in local firms? Have firms moved up or been forced further down the value chain?

5. What has happened to price and by inference, what has been the consumer welfare impact of quotas?

4. Comparison of trade in quota and non quota imports

Since the majority of lines subject to restriction fall under the tariff headings for clothing, the following sections limit analysis to trade under the two main tariff headings of HS61 and HS62. The discussion proceeds with an overview of import activity in aggregate imports, and quota and non quota categories. It concludes with analysing the implications for import diversion and local manufacturing.

4.1 Aggregate clothing imports: 2006-2007

Between January and December 2007, total and quota **clothing imports from China fell** by R1,518.53m (28.02%)[17] and R1,937.78m (50.10%) respectively. Table 8 below tracks the progressive decline in imports from China by cumulative quarters during 2007. At the same time, **some countries** which had never featured heavily in the past made **dramatic inroads** into the South African market.

Table 9: Quota imports from China (Rm): 2007 by cumulative quarters

	2006	Q1 2007	Q2 2007	Q3 2007	Q42007
World	**4,741.58**	**682.51**	**1,394.00**	**2,491.35**	**3,595.03**
China	**3,857.47**	**439.32**	**839.48**	**1,421.37**	**1,955.49**
China % 2006	**100%**	**65.03%**	**60.86%**	**57.74%**	**47.74%**
% market share	**81.35%**	**64.37%**	**60.22%**	**57.05%**	**54.39%**
2nd place	India (3.60%)	India (4.70%)	India (5.03%)	India (6.05%)	India (6.37%)
3rd place	Hong Kong (2.48%)	Malawi (3.66%)	Hong Kong (4.53%)	Hong Kong (5.49%)	Hong Kong (5.60%)
4th place	Malawi (2.33%)	Hong Kong (3.51%)	Mauritius (3.12%)	Mauritius (3.37%)	Indonesia (3.56%)
5th place	Mauritius (1.14%)	Mauritius (2.56%)	Malawi (2.99%)	Indonesia (3.12%)	Mauritius (3.48%)
6th place	Italy	Indonesia	Indonesia	Malawi	Malawi

[17] This is the figure according to customs import data. However, numerous arguments are presented in Section 5.2 for adjusting this figure downwards to reflect forward-buying by retailers.

	(0.98%)	(1.75%)	(2.18%)	(2.86%)	(2.91%)
7th place	Zimbabwe (0.89%)	Myanmar (1.38%)	Malaysia (1.79%)	Malaysia (2.10%)	Bangladesh (2.82%)
8th place	Thailand (0.80%)	Italy (1.33%)	Italy (1.61%)	Myanmar (1.76%)	Malaysia (2.52%)
9th place	Indonesia (0.73%)	Malaysia (1.09%)	Myanmar (1.49%)	Bangladesh (1.75%)	Myanmar (2.27%)
10th place	Bangladesh (0.60%)	Bangladesh (0.91%)	Bangladesh (1.31%)	Italy (1.38%)	Italy (1.46%)

Data source: Clotrade Own calculations

4.1.2 Major percentage and monetary gainers

Table 9 (below) shows major percentage and monetary gainers in clothing imports as a whole in 2007. Despite expectations that India would be a major beneficiary of quotas (Clotrade 2007a), it has been consistently outperformed in both percentage and monetary terms by a host of other emerging supplier countries including Mauritius, Indonesia, Malaysia and Vietnam[18]. Cambodia, Sri Lanka, Zimbabwe and Bangladesh have achieved also gains of approximately 100% or more compared with the same 2006 period[19]. As of December 2007, Malaysia was the principle beneficiary of quotas having achieved more than 1000% growth in value terms and an even more impressive 8000% in volume terms in 2007. Volumes increased from 238,000 units in 2006 to 19.26 million units in 2007 of which 81% (R15.62 million) were under quota (Clotrade 2007b).

Table 10: Major percentage and monetary gainers in aggregate clothing imports

Major Percentage movers			Major value movers		
Rank	**Country**	**% change**	**Rank**	**Country**	**Value change**
	World	**-8.58**		**World**	**-591.91**
	China	**-27.92**		**China**	**-1,512.12**
1.	Madagascar	4823.54	1.	Indonesia	111.96
2.	Malaysia	1092.84	2.	Mauritius	110.71

[18] A recent research report suggests that some of this growth may be due to the establishment of Chinese clothing firms in some of these Asian countries in response to (mainly) US safeguards (Emergingtextiles, 2008).

[19] Some Swaziland firms have coped by taking advantage of the China quotas and switched to exporting to South Africa. However, because Swaziland belongs to the South African Customs Union, the magnitude of these 'imports' do not show up in the South African trade and customs data base.

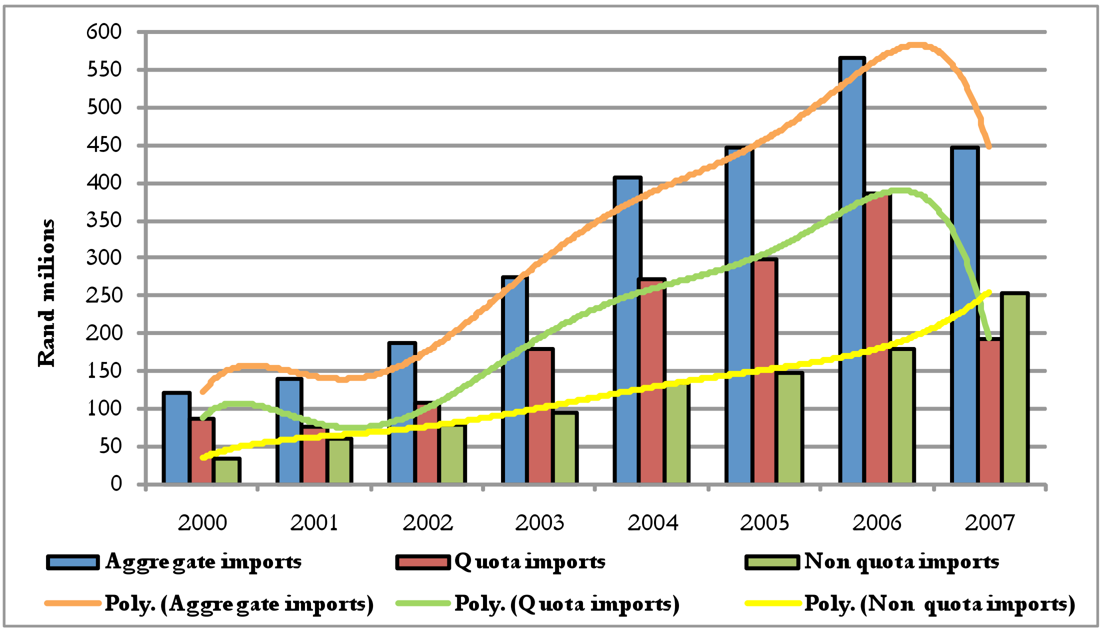
3.	Myanmar	444.17	3.	Malaysia	103.20
4.	Sri Lanka	381.99	4.	Bangladesh	90.67
5.	Macao	374.55	5.	Vietnam	84.44
6.	Vietnam	341.03	6.	India	81.19
7.	Indonesia	232.66	7.	Myanmar	78.55
8	Cambodia	198.99	8.	Hong Kong	69.62
9	Bangladesh	178.35	9.	Thailand	37.74
10	Zimbabwe	85.13	10.	Zimbabwe	37.43
11	Mauritius	76.59	11.	Turkey	27.56
12	Thailand	59.62	12.	Sri Lanka	27.27
13	Turkey	54.99	13.	Madagascar	23.61
14	Tunisia	53.07	14.	Cambodia	23.60
15	Hong Kong	36.86	15.	Macao	12.15
16	Romania	30.40	16.	Italy	8.10
17	India	29.26	17.	Pakistan	6.27
18	Pakistan	24.50	18.	Tunisia	5.71
19	France	16.35	19.	United States	5.35
20.	United States	15.92	20.	Romania	4.65
21.	Italy	10.64	21.	France	4.41
22.	Republic of Korea	9.84	22.	Republic of Korea	0.42
23.	Taiwan	-1.29	23.	Taiwan	-0.26
24.	Philippines	-4.86	24.	Philippines	-0.54
25	Germany	-5.55	25	Germany	-0.75

Source: Quantec

4.2. Quota versus non-quota clothing imports

The analysis here decomposes aggregate imports into imports in quota and non quota lines. The objective is to compare quota lines trade with that in non-quota lines. This will be done in three ways: First, on an aggregate basis. Second, by unit and kilogram categories. Third, by HS categories. These distinctions are prompted a) by the diverse behaviours of unit and kilo imports within quota and non quota cohorts and b) due to the disproportionate share of quota lines in the different clothing Chapters, 28 in Chapter 61 (wovens) compared with 47 in Chapter 62 (knits).

Figure 3: Demonstration of World imports in quota and non quota lines: 2000-2007



Data source: Quantec Own calculations

Figure 3: Demonstration of World imports in quota and non quota lines: 2000-2007

Figure 3 (above) shows that between 2000 and 2006, World imports in quota lines steadily increased by 443.50% and 342.49% in value and volume terms respectively. Similarly, World imports in non-quota lines increased by 409.19% and 364.70%, in value and volume terms respectively, during the same period. After 2006, however, the trends in quota and non quota imports diverge; whereas quota imports fall in both value (-24.54%) and volume (-50.07%) terms, non quota imports continued to grow by 26.47% (value) and 26.47% (volume) between 2006 and 2007. The divergence of the value and volume indices 2006 and 2007 indicate rising prices in quota categories and falling prices in non-quota categories. At least some of the divergence is likely due to much hypothesised under-invoicing by importers to avoid duty or misdeclarations under incorrect tariff codes to sidestep quantity restrictions. Ironically, pre-quota this was a problem which was more readily attributed to kilogram imports due to the difficulty associated with monitoring these imports.

Table 11 and Table 13 contain base data for HS61 and HS62 imports for the entire Chapter as well as quota and non-quota categories for Jan–Dec 2007. Comparable 2006 data is also shown, as are percentage changes. Total imports are decomposed under the two main tariff headings for clothing, namely HS61 (knits) and HS62 (wovens). The data is ranked by quota imports expressed in values.

4.2.1 HS Chapter 61

Table 11 introduces the examination, starting with HS61 imports.

Table 11: South African imports of HS61, knitted apparel from Jan-Dec 2007

Country	Total H61 imports		H61 quota imports		H61 non-quota imports	
	Rand (millions)	% change	Rand (millions)	% change	Rand (millions)	% change
World	2939.69	-0.92	919.05	-27.88	2020.64	19.37
China	1906.33	-16.70	481.51	-54.68	1424.82	16.21
India	182.63	62.49	98.71	104.20	83.93	31.02
Mauritius	168.74	73.85	42.53	462.59	126.21	41.01
Myanmar	57.49	325.69	43.57	737.80	13.92	67.59
Malaysia	53.96	979.58	40.44	3109.54	13.52	261.74
Indonesia	60.46	235.72	37.12	319.52	23.34	154.76
Hong Kong	76.91	-6.36	35.42	42.42	41.50	-27.54
Thailand	52.55	75.99	25.86	98.12	26.70	58.81
Bangladesh	55.44	95.68	17.98	129.80	37.47	82.66
Turkey	40.15	78.50	14.09	139.54	26.06	56.88
Vietnam	26.95	99.89	12.10	93.93	14.85	105.02
Malawi	15.90	-76.21	7.84	-77.22	8.06	-75.14
Italy	29.48	-1.25	6.33	-1.33	23.15	-1.22
Sri Lanka	13.16	174.80	4.34	329.28	8.82	133.49
Cambodia	25.79	170.17	4.15	207.50	21.64	164.01
United States	20.45	30.46	3.62	38.12	16.84	28.92
France	12.45	22.90	3.43	30.94	9.02	20.10
Pakistan	13.90	-10.26	1.92	-40.36	11.98	-2.36
Taiwan	10.65	-9.73	1.63	-49.05	9.03	4.85
Portugal	8.26	92.95	1.24	59.85	7.02	100.28
Madagascar	12.67	2654.15	0.46	2621.47	12.21	2655.39
Zimbabwe	2.49	32.05	0.22	-47.14	2.28	53.98

Data source: Quantec   Own calculations

In 2007, total HS61 imports from China fell by 16.70%. Global HS61 imports also fell, although by only a marginal 0.92%. In value terms, this constituted a fall of R27.38m and R382.23m in World and Chinese imports respectively. In contrast, India and Mauritius showed sizeable percentage increases of 62.49% and 73.85%, or alternatively, of R70.24m and R71.68m in value terms respectively. The largest percentage gainers were Madagascar (2654.15%), Malaysia (979.58%), Myanmar (325.69%), Cambodia (170.17%), Indonesia (235.72%), Vietnam (99.89%) and Sri Lanka (174.80%) although all off a low base. These countries were also the greatest gainers in value terms; Malaysia (48.96m); Myanmar (43.98m); Indonesia (42.45m); Bangladesh (27.11m) and Thailand (22.69m). The greatest losers in value terms were Malawi (-50.95m), United Kingdom (-5.24m) and Hong Kong (-5.22m). These countries were also the greatest percentage losers; Malawi (-76.21%); Hong Kong (-6.36%), United Kingdom (-42.59%).along with Pakistan (-10.26%), Germany (-17.07% and Korea (-12.35%) off a lower base.

Quota imports

In the quota lines of HS61, overall imports fell by 27.88% as did imports from China in these lines by 54.68%. This translates into a fall in value terms of R355.31m and R580.97m for the World and China respectively. Conversely, imports from India (104.20%), Malaysia (3109.54%), Myanmar (737.80%), Indonesia (319.52%) and Mauritius (462.59%), increased significantly as did those from Sri Lanka (329.28%), Vietnam (93.93%), Turkey (139.54), Cambodia (207.50%) and Madagascar (2621.47%) off a lower base. In value terms, India saw the greatest gain of R50.37m, followed by Malaysia (R39.18m), Myanmar (R38.37m), Mauritius (R34.97m), Indonesia (R28.27m) and Thailand (R12.81m). The greatest loser in value terms was Malawi (-R26.58m), also the greatest percentage loser (-77.22%), along with Zimbabwe (-47.14%), United Kingdom (-46.65%), Pakistan (-40.36%) and Germany (-38.54%).

Non-quota imports

In non-quota lines of HS61, overall imports increased by 19.37% as did imports from China in these lines by 16.21%. Positive value increases were also registered by all other major import countries, but generally lower than increases in quota lines. Mauritius, Madagascar and Vietnam are the exceptions. The only countries to experience decreases in imports in both value and percentage terms were Malawi (-75.14%; -R24.36m), Hong Kong (-27.54%; -R15.77m), United Kingdom (-41.34%;-R3.96m) and Germany (-11.73%; R0.38m). The increase in Hong Kong imports in quota lines coupled with the fall in non quota lines may evidence much anticipated "round-tripping" or 'trans-shipment' where imports from China are funneled through Hong Kong into South Africa.

Table 11 below shows country rankings for comparable 2006 and 2007 periods

Table 11: Leading suppliers of South African imports of HS61, knitted apparel 2006-2007

Total H61 imports		H61 quota imports		H61 non-quota imports	
2006	**2007**	**2006**	**2007**	**2006**	2007
1. China	1. China	1. China	1. China	1. China	1. China
2. India	2. India	2. India	2. India	2. Mauritius	2. Mauritius
3. Mauritius	3. Mauritius	3. Malawi	3. Myanmar	3. India	3. India
4. Hong Kong	4. Hong Kong	4. Hong Kong	4. Mauritius	4. Hong Kong	4. Hong Kong
5. Malawi	5. Indonesia	5. Thailand	5. Malaysia	5. Malawi	5. Bangladesh
6. Thailand	6. Myanmar	6. Indonesia	6. Indonesia	6. Italy	6. Thailand
7. Italy	7. Bangladesh	7. Bangladesh	7. Hong Kong	7. Bangladesh	7. Turkey
8. Bangladesh	8. Malaysia	8. Mauritius	8. Thailand	8. Thailand	8. Indonesia
9. Turkey	9. Thailand	9. Italy	9. Bangladesh	9. Turkey	9. Italy
10.Indonesia	10 Turkey	10. Vietnam	10. Turkey	10. US	10. Cambodia

4.2.2 HS Chapter 62

The data in Table 13 shows a similar pattern. Although the value of imports in both clothing Chapters are comparable for the Jan to Dec 2007 period, 2939.69(HS61) versus 3368.41(HS62), there is a big difference in the relative shares of quota and non quota lines in the respective Chapters. Imports in HS62 are heavily concentrated in quota categories. During 2006, quota lines comprised 86.84% of total HS62 imports. During 2007 this was reduced but to a still high 79.44%.

Table 13: South African imports of HS62, woven apparel from Jan-Dec 2007

Country	Total H62 imports		H62 quota imports		H62 non-quota imports	
	Rand (millions)	% change	Rand (millions)	% change	Rand (millions)	% change

World	3368.41	-14.35	2675.98	-22.82	692.43	48.68
China	1997.11	-36.13	1473.98	-47.26%	523.14	57.56
Hong Kong	181.55	70.13	165.74	79.09	15.82	11.61
India	175.98	6.63	130.15	6.55	45.86	6.68
Malawi	99.69	28.54	96.60	27.11	5.25	22.57
Indonesia	66.61	280.83	90.99	254.49	9.57	98.78%
Bangladesh	86.06	282.45	83.54	307.05	2.53	22.66
Mauritius	86.52	82.18	82.53	78.24	4.00	202.23
Zimbabwe	78.91	87.50	78.78	88.12	1.09	28.06
Vietnam	82.25	629.31	76.22	736.13	6.35	124.84
Malaysia	58.68	1220.19	50.04	1928.94	8.64	336.79
Italy	54.81	18.30	46.21	15.03	8.60	39.62
Thailand	48.48	45.01	38.96	57.60	9.53	9.28
Myanmar	38.74	826.88	38.02	989.10	0.73	5.53
Turkey	37.54	35.85	32.19	70.71	5.35	-39.04
Sri Lanka	21.24	804.36	19.68	849.75	1.57	465.43
Pakistan	17.97	77.75	15.41	150.69	2.56	-35.31
France	18.93	12.41	14.74	1.33	4.20	82.27
Romania	15.86	40.08	13.11	19.05	2.76	769.13
United States	18.52	3.23	11.85	-3.89	6.67	18.86
Tunisia	11.01	49.35	10.62	45.66	0.39	388.68
Cambodia	9.67	317.89	9.12	351.81	0.56	87.44
Madagascar	11.42	38822.76	8.82	61964.33	2.61	17114.36

Data source: Quantec Own calculations

Total Chapter 62 imports

Overall imports in HS62 fell by 14.35% with those from China down by an even larger 36.13%. These percentages translate into significant value decreases of R1, 129.89bn and R564.53bn for China and the World respectively. These values are notably larger than those for Chapter H61. Conversely, imports from India and Hong Kong, the second and third largest suppliers were up by 6.63% and 70.13% respectively (almost all in quota lines), as were imports from all other major suppliers (also mainly in quota lines). The increase for Hong Kong was contrary to the experience of HS61 but not unexpected given that quota is a more important factor in HS62. Major percentage gainers included Zimbabwe (87.505), Mauritius (82.18%), Indonesia (230.83%) and Bangladesh (282.45%) as well as Vietnam (629.31%), Myanmar (826.88%), Malaysia (1220.19%), Sri Lanka (804.26%) albeit off a lower base. Although off an even lower base, Madagascar's gains of 38,822.76% are impressive. In value terms, the major gainers were Vietnam (70.98m), Indonesia (69.51m), Bangladesh (63.56m), Malaysia (54.24m), Mauritius (39.03m), Myanmar (34.47) and Zimbabwe (36.83m).

Quota imports

In HS62 quota lines, overall imports are down by 22.82% and China's by a significant 47.26%. These figures are similar to that of HS61 but the values are higher; -R791.23 m and -R1321.01m for the World and China respectively. Imports from India in these lines rose by a mere 6.55%. Comparatively, Hong Kong, South Africa's third largest import partner in this Chapter in 2006 saw strong growth of 79.09% or R73.19m in monetary terms. Other gainers in value terms included Vietnam (R67.11m), Indonesia (R65.32m), Bangladesh (R63.01m), Malaysia (R47.57m), Zimbabwe (R36.90m), Mauritius (R36.23m) and Myanmar (R34.53m). In percentage terms, Mauritius (78.24%), Zimbabwe (88.12%) and Malawi (27.11%) were the major gainers. However, consistent with previous analysis, large percentage gains, although off a low base came from Malaysia (1928.94%), Vietnam (736.13%), Myanmar (989.10%), Indonesia (254.49%) and Bangladesh (307.05%). Once again, Madagascar's gain of 61,964.33% albeit off a very low base is noteworthy. One of the greatest loser in both percentage and value terms behind China was Mozambique (-62.97% or R7.96m).

Non-quota imports

Perhaps the most important change of all was recorded in non-quota HS62 imports. Overall values increased by nearly 50% (48.68%), a considerably larger percentage increase than HS61 (19.37%), although once again the values are lower. In value terms, imports in non quota lines rose by R226.70m (versus R327.93m HS61). China showed a similar increase in these lines of 57.56% or R191.12m, which marks an obvious shift toward non quota line imports. If this growth is sustained, imports in non quota lines from China could potentially offset its loss of quota imports in HS62. Non quota imports for all other major suppliers increased between 5 - 25%, except Indonesia and Mauritius which saw a respective rise of 94.16% and 235.06%.

Table 13 below shows country rankings for comparable 2006 and 2007 periods

Table 13: Leading suppliers of South African imports of HS62, knitted apparel 2006 & 2007

Total H62 imports		H62 quota imports		H62 non-quota imports	
2006	**2007**	**2006**	**2007**	**2006**	2007
1. China	1. China	1. China	1. China	1. China	1. China
2. India	2. Hong Kong	2. India	2. Hong Kong	2. India	2. India
3. Hong Kong	3. India	3. Hong Kong	3. India	3. Hong Kong	3. Hong Kong
4. Malawi	4. Malawi	4. Malawi	4. Malawi	4. Turkey	4. Thailand
5. Mauritius	5. Indonesia	5. Mauritius	5. Indonesia	5. Thailand	5. Malaysia
6. Italy	6. Mauritius	6. Zimbabwe	6. Bangladesh	6. Italy	6. Indonesia
7. Zimbabwe	7. Bangladesh	7. Italy	7. Mauritius	7. United States	7. Italy
8. Thailand	8. Vietnam	8. Indonesia	8. Zimbabwe	8. Indonesia	8. United States
9. Indonesia	9. Zimbabwe	9. Thailand	9. Vietnam	9. Taiwan	9.Vietnam
10.Turkey	10 Malaysia	10. Bangladesh	10. Malaysia	10. Pakistan	10. Turkey

4.2.3 Ratio of quota to non-quota imports

Data from Table 11 and Table 13 are reproduced in Table 14 as ratios of quota imports to non quota imports allowing changes in the composition of total imports to be easily identified.

Table 14: Ratio of HS61 and HS62 quota to non-quota line imports

Country	Chapter HS61		Chapter HS62	
	2006	2007	2006	2007
World	0.75	0.45	*6.86*	*3.58*
China	0.87	0.34	*7.32*	*2.48*
India	0.75	1.18	4.96	4.85
Myanmar	0.63	3.13	5.06	34.60
Mauritius	0.08	0.34	*45.31*	*22.86*
Malaysia	0.34	2.99	1.16	5.73
Hong Kong	0.43	0.85	6.30	9.44
Indonesia	0.97	1.59	5.27	9.42
Thailand	0.78	0.97	2.78	4.04
Turkey	0.35	0.54	2.12	5.24

Vietnam	0.86	0.81	3.12	11.96
Bangladesh	0.38	0.48	9.95	33.03
Malawi	1.06	0.97	17.12	18.00
Italy	0.27	0.27	*6.37*	*5.37*
Sri Lanka	0.27	0.49	6.53	10.86
France	0.35	0.38	*6.30*	*3.39*
Cambodia	0.16	0.19	6.77	16.38
Zimbabwe	0.28	0.10	48.26	71.13
Pakistan	0.26	0.16	1.37	5.64

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Non-quota imports, which have always dominated imports in HS61, increased their share to 68.74% from 57.05% the previous year. Quota imports comprised 31.26% of aggregate imports in HS61, down from 42.95% in 2006. At an aggregate level, the ratio of quota imports to non quota imports fell from 0.75:1 to 0.45:1, confirming the slight overall shift away from quota line and toward non-quota line imports identified above and a shift of similar magnitude in the same direction for China. In 2007 imports in non quota lines made up 74.74% of all HS61 imports from China compared with 53.57% in 2006 (not shown). The percentage share in aggregate imports of quota lines from China fell to 25.26% in 2007 from 46.43% in 2006. Comparatively, India, Mauritius, Myanmar and Indonesia increased their ratio of quota to non quota imports.

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As mentioned previously, quota imports comprised 78.18% of total imports in this Chapter in 2007, down from 87.28% in 2006. However, despite the minority share of imports in non quota lines - 21.82% - this was double the 2006 figure of 12.72%. The fall in the ratio from 6.86:1 to 3.58:1 confirms that in 2007, HS62 quota imports have fallen relative to HS62 non-quota imports. At an individual country level, the shift toward non-quota imports is particularly evident for China where the ratio of restricted to non-restricted imports has fallen from 7.32:1 to 2.48:1. That is, for unit every non quota imports, there were only 2.48 units of quota imports in 2007 which is less than half the 7.32 units for 2006. As a percentage share in total HS62 imports from China, non-quota imports increased from 12.02% to 28.71% (not shown) in 2007. Another country which showed a significant shift in this direction i.e. toward non-quota lines was Mauritius. In 2007 only 22.86 units of quota imports were imported from this region for every unit of non quota imports, almost half of the 45.31 units in 2006. Interestingly, most European Union countries i.e. Romania, UK, Italy and France as well as the US also showed a marked shift away from quota line imports in 2007.

The opposite trend is apparent for most other individual countries i.e. there was a majority shift *toward* quota lines demonstrated by an increase in percentage share of quota imports in individual country aggregate imports. This is especially evident for the emerging Asian countries; Malaysia (53.67% to 85.14%), Vietnam (75.72% to 92.28%), Pakistan (57.84% to 84.95%), Thailand (73.52% to 80.16%), Cambodia (87.12% to 94.24%) and Bangladesh (90.87% to 97.06%) but also for Hong Kong, Madagascar, and Zimbabwe. Hong Kong increased its share of quota line imports to 90.42% and Madagascar its share 77.18% compared with 48.40% in 2006 (not shown). As discussed, this raises questions about the possibility of trans-shipments. Increases from Zimbabwe are difficult to explain in general (Sandrey and Van Eeden 2007). The migration toward imports in restricted categories by Vietnam, Indonesia, Bangladesh, Pakistan, Sri Lanka and Thailand is consistent with findings from studies in the US that these countries are able to successfully take advantage of quota restrictions to their benefit. Imports in restricted categories comprise a large share of total imports from these countries and play a significant role in their overall export performance. Clearly this is evidence that **South African Chinese quotas, as in the US, is leading to significant import diversion as predicted**.

4.2.3 Trade in quota and non-quota imports from the perspective of China

Figure 4 shows quota imports in millions of Rands (in columns on the left hand scale) and China's share of these imports (as a line on the right hand scale).
Figure 6 shows aggregate imports in millions of Rands (in columns) and China's percentage share of these imports (as a line). Two things are evident:

i) the dramatic decline in quota imports into South Africa from a high of R4,754.29m in 2006 to R3,587.62m in 2007 is matched by an equally dramatic fall in the percentage of China in these imports from 81.35% in 2006 to 53.80% in 2007 (

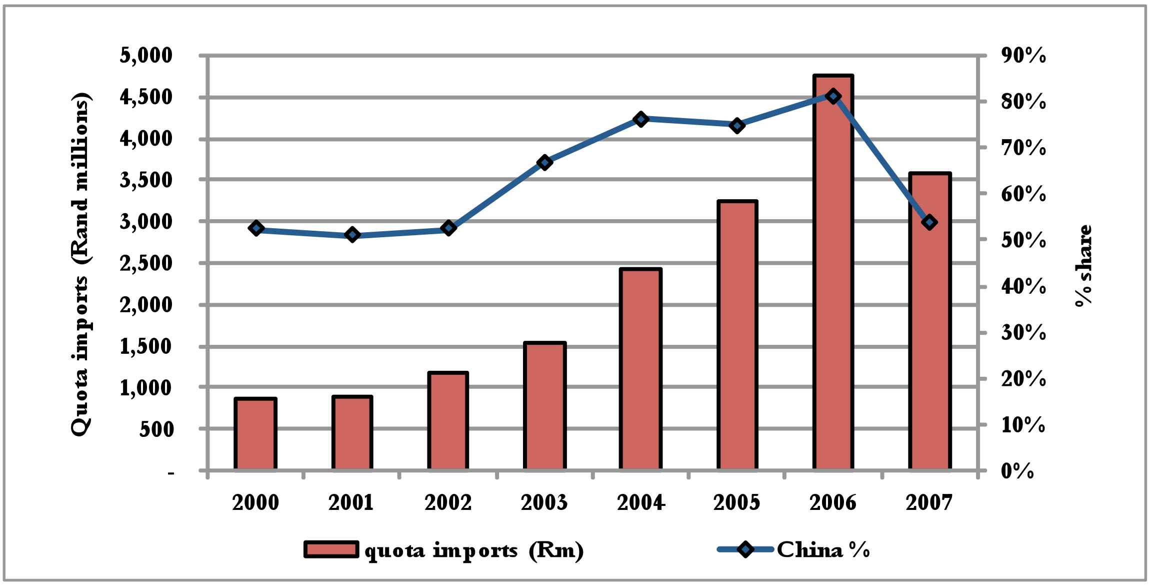
ii)

iii)

iv) Figure 4); and

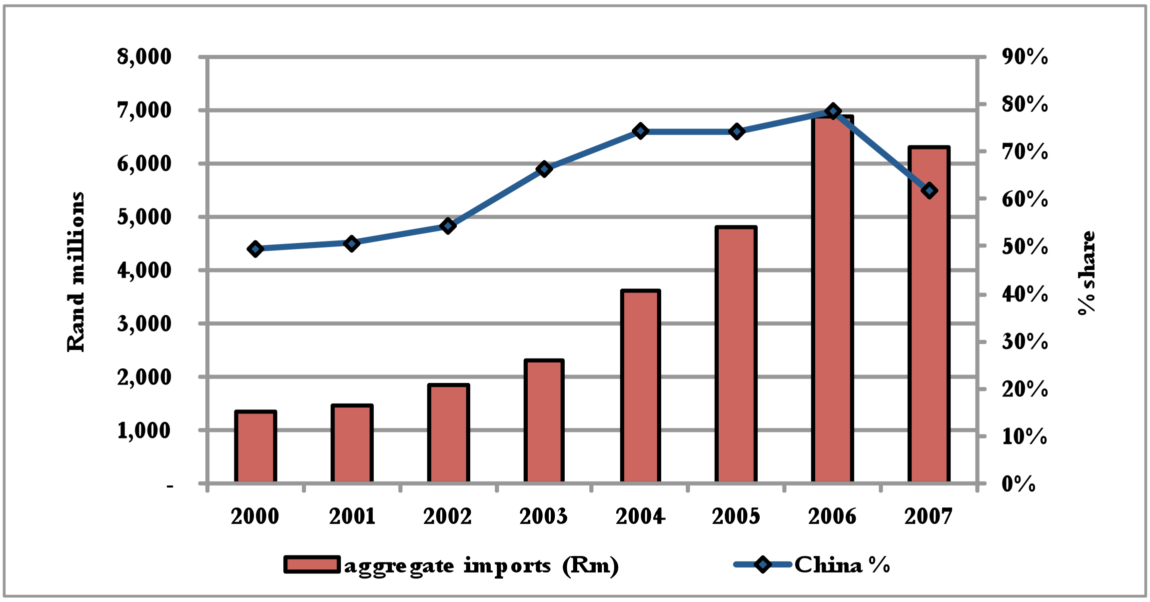
v) whilst aggregate imports into South Africa declined from R6,902.78m in 2006 to R6,304.87m in 2007, so too did China's share in these imports from 78.5% in 2006 to 61.86% in 2007. As far as quotas on clothing are concerned, if the objective was to reduce China's participation in quota imports and overall imports, this analysis suggests that quotas have to some extent achieved this.

Figure 4: Demonstration of China's share in quota imports



Data source: Clotrade

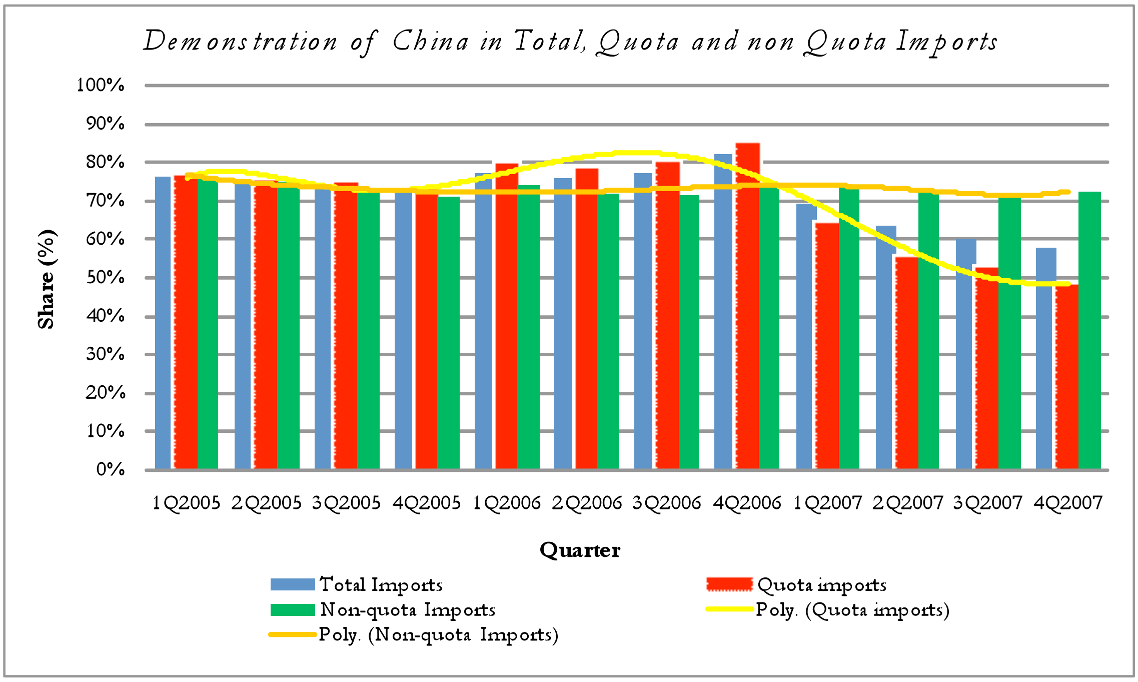
Figure 6: Demonstration of China's share in aggregate imports



Data source: Clotrade

Figure 8 below magnifies the trends elaborated above into quarterly increments between 2005 and 2007. China's share in both quota line and aggregate imports fell sharply between the third quarter of 2006 and the comparable quarter of 2007. However, closer scrutiny of trade flows in quota and non quota imports reveals two other issues that need to be taken into account. Firstly, an **increased** flow of **imports** (identified by Clotrade as between 38-42 million units) in the **last quarter of 2006** as importers hurriedly brought forward 2007 orders and warehoused them instead in South Africa. Secondly, **increased** levels of activity in **non quota line imports** from China in both clothing Chapters.

Figure 8: China's share in aggregate, quota and non quota HS61&62 imports: Q1 2005-Q42007

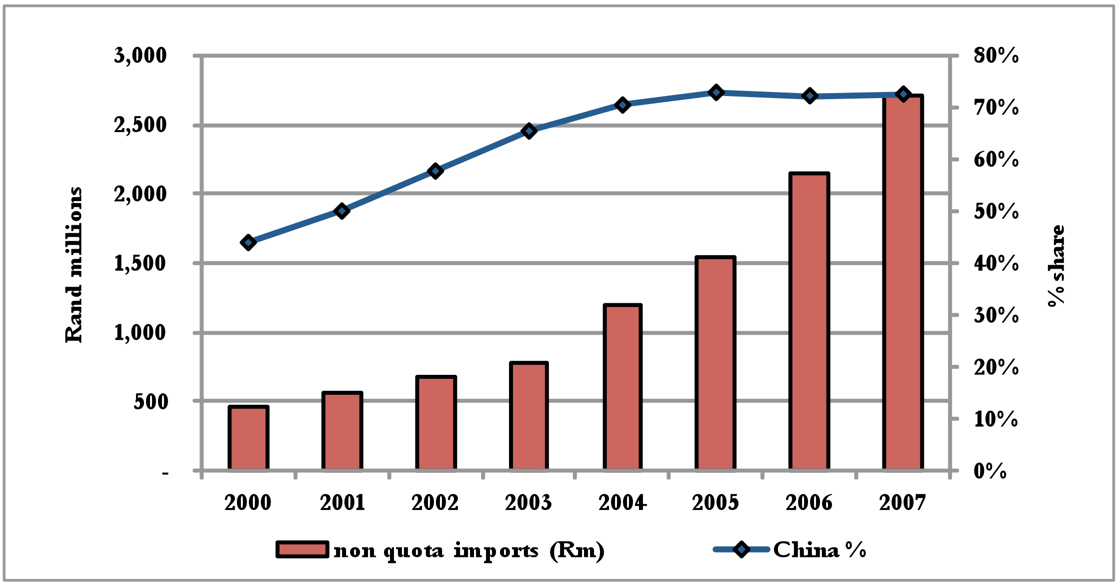


Data source: Quantec Own calculations

Figure 9 has non quota imports in millions of Rands (in columns, on left hand scale) and China's percentage share of these imports (as a line, on right hand scale) and demonstrates;

i) the **sustained growth of non quota imports** into South Africa from 2000 through 2007 and
ii) the simultaneous **qrowth in China's share in these imports**, albeit at a decelerating rate (72.20% in 2006 to 72.52% in 2007). This could potentially compensate China for the loss of quota imports due to quotas and neutralize the effect of selective restrictions.

Figure 9: Demonstration of China's share in non quota imports



Data source: Clotrade

4.3. Section summary

If the objective of quotas was to boost local output, this would require that aggregate imports would, at least, remain constant and at best, fall. This in turn would require that, i) imports from China in non quota categories did not increase whilst imports in quota categories were reduced and, ii) imports from the rest of world in both quota and non quota categories did not increase. Findings in previous sections suggest that these conditions do not hold.

As shown above in
Figure 6, Data source: Clotrade

and
Figure 6, overall imports of clothing have not fallen significantly relative to China. And, although quota line imports from China fell, non quota line imports increased. Furthermore, there has been increased orientation by other major foreign suppliers towards quota line imports. This implies that, in line with expectations by industry and consistent the US experience, **China's share is simply being reallocated with imports being diverted to alternative foreign countries.** The next section investigates precisely who has got China's share.

5. Import diversion: Who has China's slice?

An explicit objective of the China quotas was to reduce imports in the restricted categories. However, the first serious flaw in the DTI's plan was failing to anticipate that shutting out China would simply drive importers towards the proliferation of alternative cheap suppliers (Bisseker 2007b). From a supply perspective, the fact that many companies have either scaled down or completely closed down in the last three years implied that it would be impossible to restore supply capacity at short notice (Clotrade 2007a). It was therefore inevitable and immediately obvious to local manufacturers that importers would simply look elsewhere, encouraged further by an increasingly favorable exchange rate. Table 10 in Section 4.1.2. gave an overview of major gainers in percentage and value terms in aggregate clothing imports i.e. both restricted and unrestricted categories between January and December 2007 periods. China's share of aggregate clothing imports fell by 27.92% or R1512.12m whilst imports for the World fell barely 9%, a monetary value of R591.91m. This implies that some of the imports lost to China were allocated to other foreign countries.

The following section investigates precisely who has taken China's share of clothing imports by comparing current import value and market share for individual countries for 2007. Table 15 below ranks the current twenty five top countries in terms of import share in quota categories. The data is ranked by 2007 sources, expressed in values. Changes in percentage and monetary terms between the comparable 2006 and 2007 periods are also shown.

Table 15: Major players in South African clothing quota categories, 2007

Rank	Country	Imports R millions		% share		% change	Value change R millions
		2006	2007	2006	2007		
0.	The World	4741.58	3595.03	100.00	100.00	-24.18	-1146.54
1.	China	3857.47	1955.49	81.35	54.39	-49.31	-1908.98
2.	India	170.49	228.86	3.60	6.37	34.24	58.37
3.	Hong Kong	117.41	201.15	2.48	5.60	71.32	83.74
4.	Indonesia	34.52	128.11	0.73	3.56	271.16	93.60
5.	Mauritius	53.86	125.06	1.14	3.48	132.19	71.20
6.	Malawi	110.42	104.44	2.33	2.91	-5.42	-5.98
7.	Bangladesh	28.35	101.51	0.60	2.82	258.13	73.17
8.	Malaysia	3.73	90.48	0.08	2.52	2328.13	86.75
9.	Vietnam	15.35	88.32	0.32	2.46	475.4	72.97
10.	Myanmar	8.69	81.59	0.18	0.39	838.74	72.90
11.	Zimbabwe	42.29	79.00	0.89	2.82	86.81	36.71

12.	Thailand	37.77	64.81	0.80	1.80	71.60	27.04
13.	Italy	46.59	52.54	0.98	1.46	12.77	5.95
14.	Turkey	24.74	46.28	0.52	1.29	87.08	21.54
15.	Sri Lanka	3.08	24.01	0.06	0.67	679.13	20.93
16.	France	17.16	18.16	0.36	0.51	5.85	1.00
17.	Pakistan	9.37	17.33	0.20	0.48	84.97	7.96
18.	United States	14.95	15.47	0.32	0.43	3.47	0.52
19.	Romania	13.31	14.72	0.28	0.41	10.61	1.41
20.	Macao	2.63	13.87	0.06	0.39	427.86	11.24
21.	Tunisia	9.08	13.86	0.19	0.39	52.60	4.78
22.	Cambodia	3.37	13.27	0.07	0.37	293.93	9.90
23.	Madagascar	0.03	9.27	0.00	0.26	29,868.87	9.24
24	United Kingdom	10.58	8.46	0.22	0.24	-26.98	-3.12
25	Taiwan	7.16	8.29	0.15	0.23	15.72	1.13

Data source: Quantec Own calculations

The data in Table 15 is reformatted in Table 16 sorted on i) percentage gains and ii) monetary gains between 2006 and 2007. In the first classification (percentage change), the biggest gainers were Hong Kong (71.32%), Mauritius (132.19%), Bangladesh (258.99%) and Zimbabwe (86.81%) followed by Malaysia (2,408.61%), Sri Lanka (682.75%), Vietnam (488.31%) and Indonesia (270.55%) off a lower base. Madagascar, in particular, showed impressive growth of 29,383.07% albeit off a very low base to secure a place in the top 25 supply countries. However, the table does not show the proliferation of countries, which, although off a very low base, have achieved significant percentage gains in quota categories and constitute a vast range of potential supply sources being sampled by importers. For example; Peru (231.91%), Egypt (212.97%), Macedonia (440.13%), Dominican Republic (408.10%), Monaco (841.60%), El Salvador (446.34%), Luxembourg (1,755.49%). And, Mongolia (18,105.425%), Bahrain (3,323.41%), Costa Rica (701.74%), Zambia (795.14%), Tanzania (62,852.66%), Albania (50,470.39%), Cyprus (8,681.38%) and Chile (6,990.43%) albeit off an even lower base.

In the second classification (value change), the greatest gainers were Indonesia (R93.60m), Malaysia (R86.75m), Hong Kong (R83.74m), Bangladesh (R73.17m), Vietnam (R72.97m), Myanmar (R72.90m), Mauritius (R71.20m) and India (R58.37m).

In both cases, the data evidences a **growing market share for all of South Africa's major clothing suppliers in contrast with Chinas falling share**.

Table 16: Major percentage and value movers in South African clothing quota categories

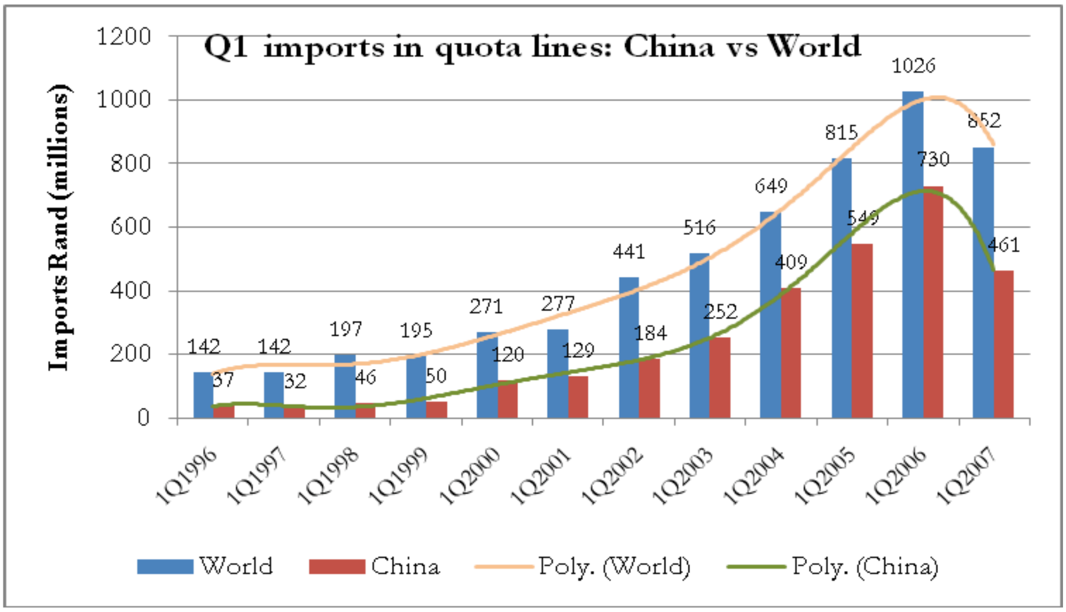
	Imports Rand (millions)		% share		Change '06-'07	
Country	2006	2007	2006	2007	%	Rand (m)
Percentage gainers						
1. Madagascar	0.03	9.27	0.00	0.26	9.24	29,868.87
2. Malaysia	3.73	90.48	0.08	2.52	2,328.13	86.75
3. Myanmar	8.69	81.59	0.18	2.27	838.74	72.90
4. Sri Lanka	3.08	24.01	0.06	0.67	679.13	20.93
5. Vietnam	15.35	88.32	0.32	2.49	475.24	72.97
6. Macao	2.63	13.87	0.06	0.39	427.86	11.24
7. Cambodia	3.37	13.27	0.07	0.37	293.93	9.90
8. Indonesia	34.52	128.11	0.73	3.56	271.26	93.60
9. Bangladesh	28.35	101.51	0.60	2.82	258.13	73.17
10. Mauritius	53.86	125.06	1.14	3.48	132.19	71.20
Value gainers						
1. Indonesia	34.52	128.11	0.73	3.56	271.26	93.60
2. Malaysia	3.73	90.48	0.08	2.52	2,328.13	86.75
3. Hong Kong	117.41	201.15	2.48	5.60	71.32	83.74
4. Bangladesh	28.35	101.51	0.60	2.82	258.13	73.17
5. Vietnam	15.35	88.32	0.32	2.49	475.24	72.97
6. Myanmar	8.69	81.59	0.18	2.27	838.74	72.90
7. Mauritius	53.86	125.06	1.14	3.48	132.19	71.20
8. India	170.49	228.86	3.60	6.37	34.24	58.37
9. Zimbabwe	42.29	79.00	0.89	2.20	86.81	36.71
10. Thailand	37.77	64.81	0.80	1.80	71.60	27.04

Date source: Quantec Own calculations

Imports from China in the categories under quota halved to R1,955.49m in 2007, a fall of R1,908.98 m or -49.31%. However, in the same period, world imports in these categories fell by only half this amount (24.18% in percentage terms and R1,146.54m in value terms) to R3,595.03m (Table 15). This is depicted graphically in Figure 11 which shows that although aggregate imports are trending downwards (represented by poly. (World), the decline is less steep than for imports from China (represented by poly. (China)). This confirms conclusions in previous sections and other studies that **Chinese imports have been virtually replaced by imports from other**

countries with other sources compensating R762.44m for the fall in imports from China.

Figure 11: First quarter imports in quota lines: 1996 – 2007



Source: Adapted from Sandrey and van Eeden 2007

5. Price discrimination from China

Table 17 shows import values from China in the twelve main quota categories during 2007 and the associated change in these values expressed as imports relative to 2006; 2007 import volumes from China and the relative changes against 2006 values; and finally average 2007 import prices and the changes relative to 2006 prices. Imports in these twelve categories comprise 62% and 69% of quota imports from China by volume and value respectively. The units of measurement for the quantities are mainly given in thousands of units (U) although some are given in metric tonnes (kg).

Table 17: Details of South African quota import values, volumes and prices from China

			Value R(m)		Quantity		Average price R/unit	
HS	**Description**	**unit**	**2007**	**change**	**2007**	**change**	**2007**	**change**
	All quota		**1,930.21**	**-50%**	**118,813.28**	**-67%**	**16.25**	**49%**
62034200	M&B trousers. Not knit. Of cotton.	U	295.04	-32%	12,591.73	-49%	23.43	33%
62046200	W&G trousers. Not	U	265.11	-51%	12,202.68	-59%	21.73	21%

	knit. Of cotton							
6111	Babies garments	kg	183.66	-30%	2,195.08	-41%	83.67	19%
6205	M&B shirts. Not knitted or crocheted	U	157.54	-44%	10,408.03	-61%	15.14	44%
6206	W&G blouses. Not knitted or crocheted	U	116.17	-53%	7,673.78	-68%	15.14	47%
6105	M&B shirts. Knitted or crocheted	U	97.62	-51%	5,404.06	-67%	18.06	50%
62034300	M&B trousers. Not knitted. Synthetic fibre	U	85.60	-50%	6,858.93	-58%	12.48	18%
6106	W&G blouses. Knitted or crocheted	U	78.59	-52%	547.33	-62%	11.16	27%
621210	Brassieres	kg	69.05	-47%	547.33	-56%	126.15	21%
6201	M&B overcoats	U	53.34	-22%	1,473.86	-45%	36.19	41%
6202	W&G overcoats	U	50.01	-16%	1,633.58	-54%	30.62	82%
6108	W&G sleepwear	U	41.68	-57%	20,882.65	-59%	2.00	5%

Source: Adapted from Sandrey and Fundira 2008

The average value decline for all imports is 50.10% (50.97% for unit and 43.72% for kilogram categories). For the analysed categories, the value range is from a low 16% (6202) to 68% (6206) for unit imports and from 29.86% to 46.76% for kilogram imports. Due to the different units of measurement, an average volume cannot be calculated across all categories but it is possible at a disaggregated level. The average volume decline for unit imports is 66.42% and 69.34% for kilogram imports. For the analysed categories, the decline ranges from 45.41% to 68.28% for unit imports and from 41.90% to 55.90% for kilogram imports. Average prices increased by an average of 48.93% for all imports (46.00% for unit and 83.69% for kilo categories). The price increases range from 4.53% (6108) to 81.55% (6202).

The above analysis shows that whilst import values from China in quota lines halved during 2007, the accompanying fall in import volumes was significantly more than proportionate and in some cases more than double the fall in import values (6201, 6202). This is reflected in rising average prices across the twelve top quota categories as shown in Table 17 which may hint at price discrimination on behalf of China (Sandrey & Fundira 2008). The price effects of quotas are revisited and dealt with more systematically in their relation to the welfare impact of quotas in later sections.

5.2 Forward purchasing by retailers

A second major oversight by the DTI was the failure to anticipate that a delay in the implementation of quotas would result in **massive buying forward** by retailers to mitigate the effect of restrictions. According to one firm interviewed:

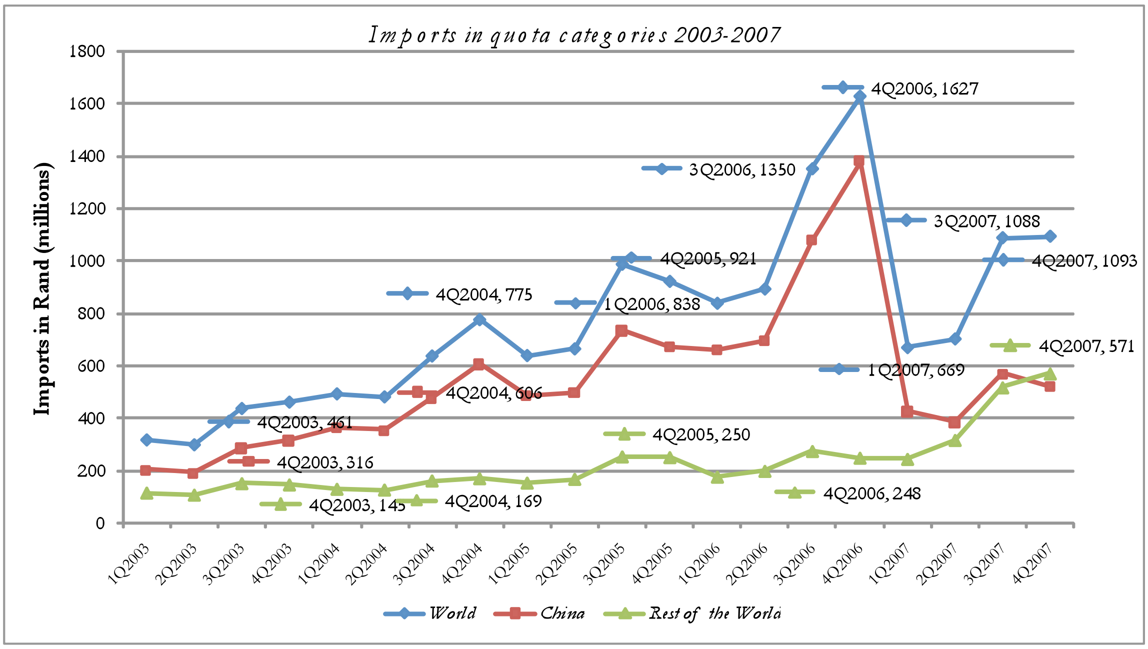
> "There was a total overstocking in the whole retail chain in preparation of quotas. Quota-wise, retailers got what they wanted in terms of a supply base and local business has not been flooded with orders as government anticipated."

Figure 13 below, reproduced from Sandrey and Van Eeden 2007, suggest that retailers did considerably step up their level of activity in anticipation of quotas. A comparative analysis between first and fourth quarter imports in 2006 and 2007 clearly shows the announcement of quotas and their subsequent imposition. The former is characterised by a sharp increase in quota line imports from China in the fourth quarter of 2006 and the latter by a fall in quota line imports in the first two quarters of 2007. Clotrade 2007a estimate that between 38.5 million and 42 million garments from China were brought forward from 2007 for delivery in November/December 2006 to land before the introduction of quota. Given that the shortfall in volume imports from China between June 2006 and June 2007 is 46m units, this implies that the real fall in total Chinese imports may be significantly distorted (inflated). In total, 422.7 million units were imported in 2007, down 22.3% on 543.9m units in 2006. However, imports of products recorded by weight increased from 23 million kilos in 2006 to 24.2 million units (5.2%) in 2007 (Clotrade 2008). Once again, although this reflects an overall decline, Clotrade show that once these figures are adjusted by the 38.5 to 42 million units brought forward, the net effect is an increase of 3-4% year on year in the value of imports and a decline of 7.4%-8.7% in unit imports.

This is alternatively shown by a relative comparison of activity in fourth quarter Chinese imports in 2006 and 2007 (

Figure 13); the latter is considerably subdued compared with the former. Finally, the spike in aggregate and non Chinese imports in the last two quarters of 2007 reaffirms the previous outcome that **Chinese quota line imports are being displaced by imports from other regions.**

Figure 13: Comparison of quarterly import activity in quota lines 2003 – 2007



Data source: Quantec Own calculations

5.2 Trans-shipment and increased illegal activity

One of the industry's greatest concerns was that quotas would entrench the culture of illegal import activity (Clotrade 2007a) ranging from mis-declarations of tariff codes, under-valuations to avoid import duties and avoiding importer registration requirements. Although country-of-origin legislation was recently introduced, SARS and UTIC lack the capacity to monitor imports and enforce restrictions on a continuous basis. As a result, the potential for transshipment, a global problem driven by quotas, was widely foreseen. Certainly there is **evidence of round-tripping** from China through Hong Kong which may also plausibly explain the impromptu rise in imports from Zimbabwe since quotas were introduced.

Additional support for under declarations is gained from unit price data. The price effects of quotas are examined in detail in section 8. Clotrade (2007a) show that imports from Malaysia grew 555% - from R2.5m (2006) to R16.5m (2007). Units grew from 38,000 to 2 million, a growth of over 5000%. Imports declared under kilograms grew from 7,500 kg to 62,000kg, a growth of 726%. Average prices dropped from R47.73 in 2006 to R6.72 in 2007[20]. Similarly, imports from Macau grew from R613, 000 in 2006 to R4.82m in 2007, a growth of 687%. Unit imports grew by 700% (5000 to 40 000) and kilo imports by 53 025% (32 to 17 000).

6. Supply bottlenecks

Supply bottlenecks were widely anticipated. There is significant qualitative evidence that **quotas** have caused significant **supply chain disruption** and created an extra level of **inefficiency**. This has happened for several reasons.

First, **local textiles firms lack capacity** to meet local demand, not only in the short run, but also in general (Edwards et al 2006). Firm interviews reveal that the delay in implementation, in particular, closed the window of opportunity that quotas were supposed to offer local suppliers since importers brought forward many future orders.

Second, the **allocation mechanism is flawed**. Quota for the next period is based on quantity ordered in the current period. Consequently, only those firms who previously imported fabric from China in those precise categories under quota were eligible to apply for additional quota (Clotrade 2007a, 2008). Given market unpredictability due to volatile consumer tastes and frequent fashion changes, it is virtually impossible to place future orders based on current demand patterns. As one firm interviewed put it,

> "If we have an order on, say, code 6405 for this year, then we get quota for next year on this code …. But we may not need it next year because fashions may have changed. And the fabric that we do need we can't get because we didn't order it this year…"

Calculations for quota were based on an 18 month formula spanning one Summer and two Winter seasons. Since for most manufacturers 75% of purchases are done for Summer, this significantly jeopardized the percentages and created tremendous

[20] Clotrade in a circular to members in September 2007, make this point very forcibly "Malaysia, coming from a position of exporting only 80,000 units to South Africa in 2006, has now passed India to become the second largest exporter to South Africa after China in **volume** terms. Exports from Malaysia are now 10,4 million units at an average price of R5.09 for a total value of only R52,8 million, a 26,000% growth year-on-year. Even China would be impressed with this remarkable performance in such a short period."

imbalance in (fabric) supplies. According to interviews conducted, three areas which were hardest hit in terms of reduction in percentage were ironically those which, from a retail and consumer perspective, experienced the most significant shifts in demand; in particular, woven cotton fabrics 5208 and 5210, as well as knit, 6006. Comparatively, too much quota was granted for categories 5514, 6005 and 6006. These problems are captured by low utilisation rates of fabric under quota (Table 18).

Table 18: Quota utilisation rate for fabric: 2007

Period	*Knit*		*Woven*			
	60.05	**60.06**	**52.08**	**52.09**	**52.10**	**56.14**
2007	30.4%	39.1%	71.33%	15.3%	56.2%	55.4%

Source: Clotrade 2008

Firms use several tactics to get around these restrictions. They may 'buy' quota from clearing agents at a R3.00 premium per item, irrespective of cost. Or, they may use more innovative methods such as applying for quota on behalf of others as new entrants, albeit at greater cost or using the quota of their customers. In the first case, the flat rate premium provides added incentive to import high cost garments and make the cheap one locally with the obvious effect of driving local manufacturers down the value chain. Firms also point out that the allocation criteria ironically prejudice those who have historically been the most supportive of local industry since more quota is granted the greater the quantity imported in the past. Firms who have tried to source mainly locally received no quota. Additionally, Clotrade (2007a) observes that any new opportunity to produce garments as import replacements is excluded to a firm who has not previously imported the specific fabric required for those garments should it originate from China.

Third, the scope and design of the restrictions acutely **overlook** the **complexity** and **range of products** covered - for example, where there is a quota on the fabric but not on the fully made-up garment. The inclusion of fabrics at all in the restrictions is problematic. Even firms who have invested in upgrading their plant and workforce to be internationally competitive, and should have been ideally poised to benefit from quotas, experienced losses due to fabric shortages (Bisseker 2007a).

This is also the case where manufacturers were importing components to make up garments or where manufacturers are also importers and trying to balance their bottom line in production by importing high minute rate garments. In anticipation of falling prices received from retailers, and hence falling margins on their own products in the future, many local clothing firms had recently established or expanded their own imported clothing lines in order to maintain profits.

CASE STUDY: FAULTY QUOTA MECHANISMS

Seven years ago, a large CMT identified a market gap for an underwire bra, which requires specific competency. It developed a product line with two bra lines, underwire and T-shirt to sell in combination with two of their established underwear lines, the g-leg and panty. The firm subsequently landed a contract to supply a large retailer contingent on its ability to supply a combination pack which included a padded bra. This latter component incorporates seam-free technology which is available exclusively from China. The firm began to import padded bras in February 2006. When quotas were introduced in January 2007, since they were a new entrant with a historically low import volume of this category, the firm was awarded zero quota for padded bras. The quota was awarded mainly to one large established company who had previously imported large volumes of padded bras. However, since there was a large amount of unallocated quota for panties, the firm was awarded substantial quota for this category which it did not need. The firm lost its contract with the retailer and had to retrench 15% of its intimate wear workforce, the equivalent of 8% of its total workforce. This was the first retrenchment that the firm had witnessed in 18 years of operation. For the first six months of this year, solely because of quotas, the firm's average monthly turnover has fallen by 52%.

Source: Morris and Reed 2008

Fourth, **lengthy application** processes and red tape delay the granting of additional quota to firms which prejudices their ability to service their customers' needs and extract future orders from retailers which results in business going to overseas firms.

The Business Alliance (2006) concluded:

> "The China interventions were not based on an impact assessment on prices, quality availability or material inputs. Nor based on a detailed analysis of the local capacity to produce the necessary product lines specified. Finally, there is no knowledge management mechanism in place to ensure the necessary flexibility to deal with market distortions and disruptions on a continuous basis. The industry runs the risk of

being locked into a pre-formulated plan and administrative quota allocation mechanism without the information feedback to correct the ensuing chaos."

7. Employment

The bold statement that "more than 55, 000 new jobs could be created" by quotas, (Acting Deputy Director General, Iqbal Sharma), is unsupported by employment trends in the industry. Most studies of employment in the clothing and textile industry cite the official Stats SA data. For example, Kriel 2006, uses this data to argue that employment dropped from 206 947 in January 2003 to 142 203 in June 2006 (a loss of 64 744 jobs). However, as Edwards and Morris 2007 demonstrated, there are major problems in using this data source as an indicator of employment trends for the clothing and textile sector. For this reason, the following discussion on employment draws on data from the National Clothing Bargaining Council and the Textile Bargaining Council. This is the most reliable data available, but does not include firms who avoid compliance officers' detection, nor those small CMT operations with less than five or six workers. Table 19 and Figure 15, Figure 16 and Figure 17 show the **declining trend in employment** and the number of firms in the clothing sector.

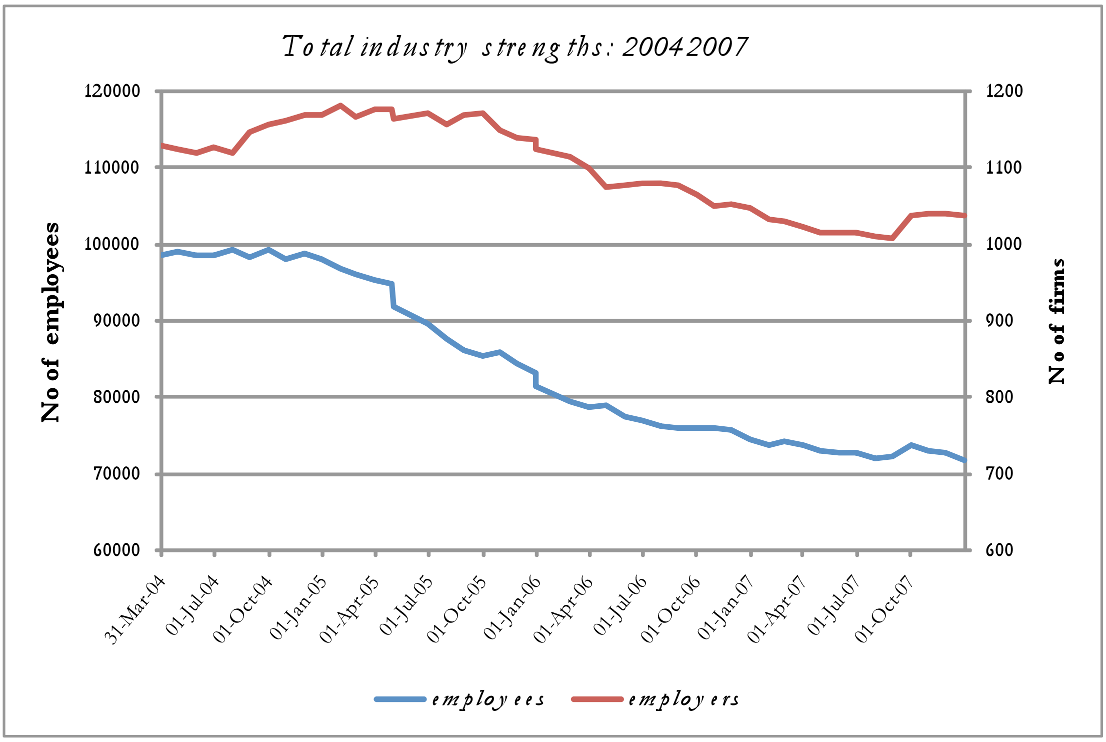
Table 19: Total clothing manufacturing firms and employee strengths 2004 - 2007

	WESTERN CAPE		EASTERN CAPE		KWAZULU--NATAL		NORTHERN AREAS		NATIONAL TOTAL	
As at	Firms	Emply's	Firms	Emply's	Firms	Emply's	Firms	Emply's	Firms	Emply's
31.03.2004	346	34,130	47	4,673	375	37,077	361	22,659	1,129	98,539
30.06.2004	345	32,981	45	4,501	371	38,156	367	22,828	1,128	98,466
30.09.2004	350	33,220	45	4,501	404	39,487	358	21,999	1,157	99,207
31.12.2004	353	33,508	45	2,715	417	39,715	354	22,020	1,169	97,958
31.03.2005	362	33,196	47	2,732	421	38,538	347	20,878	1,177	95,344
30.06.2005	360	31,628	47	2,330	420	36,401	344	19,249	1,171	89,608
30.09.2005	359	30,896	44	1,427	407	34,627	363	18,473	1,173	85,423
31.12.2005	346	29,547	43	1,384	396	34,204	353	17,946	1,138	83,081
31.03.2006	329	28,680	44	1,582	386	32,476	341	15,946	1,100	78,684
30.06.2006	326	28,375	44	1,462	379	31,977	332	15,034	1,081	76,848
30.09.2006	325	28,591	44	1,473	370	31,492	326	14,296	1,065	75,852
31.12.2006	321	28,451	46	1,903	358	30,147	323	13,955	1,048	74,456
31.03.2007	311	28,369	46	1,930	350	29,846	316	13,467	1,023	73,612
30.06.2007	307	27,878	48	1,946	348	29,065	312	13,682	1,015	72,571
30.09.2007	309	28,291	49	2,215	352	29,210	328	13,974	1,038	73,690
30.11.2007	303	28,114	50	2,512	349	27,750	338	14,207	1,040	72,583
31.12.2007	302	27,502	50	2,517	348	27,463	338	14,207	1,038	71,689
	43.14%	47.84%	7.14%	4.38%	49.71%	47.78%	32.56%	19.82%	100%	100%

Source: Clothing National Bargaining Council

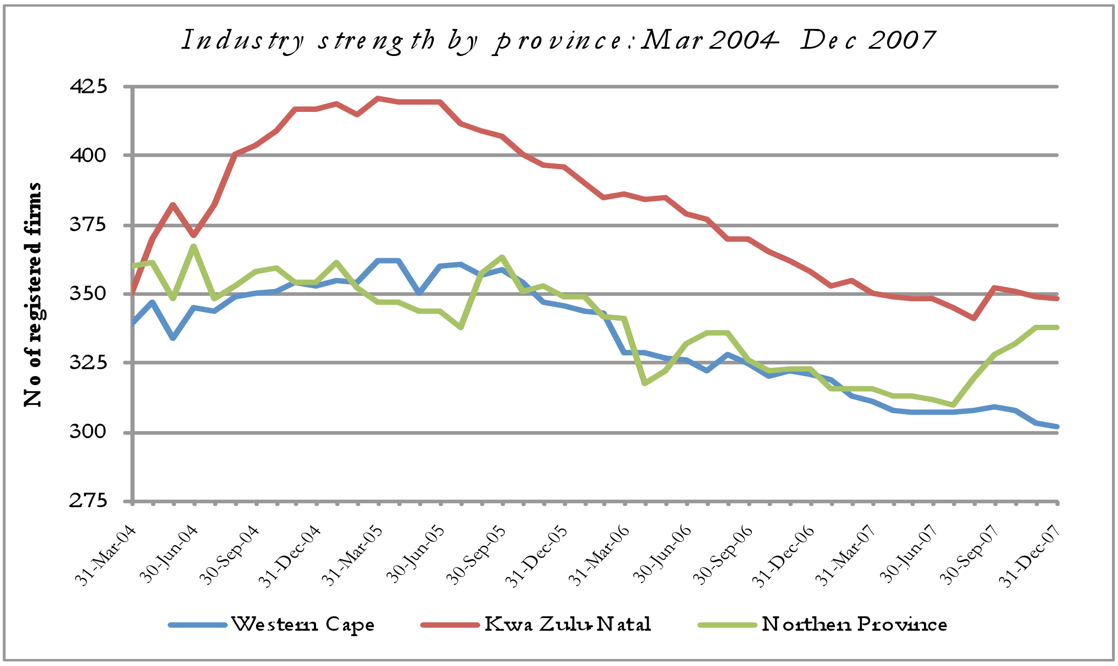
NBC data records that in **2007** (the first year of the imposition of Chinese quotas), **2767 jobs were lost and 10 firms closed down** (January to December 2007). If one takes the heartland of the sector (Western Cape and KwaZulu-Natal), which were supposed to benefit the most from the Chinese quotas, the employment losses have been even greater 3633 (comprising 949 and 2684 respectively).

Figure 15: Total clothing manufacturing industry strengths: 2004 – 2007



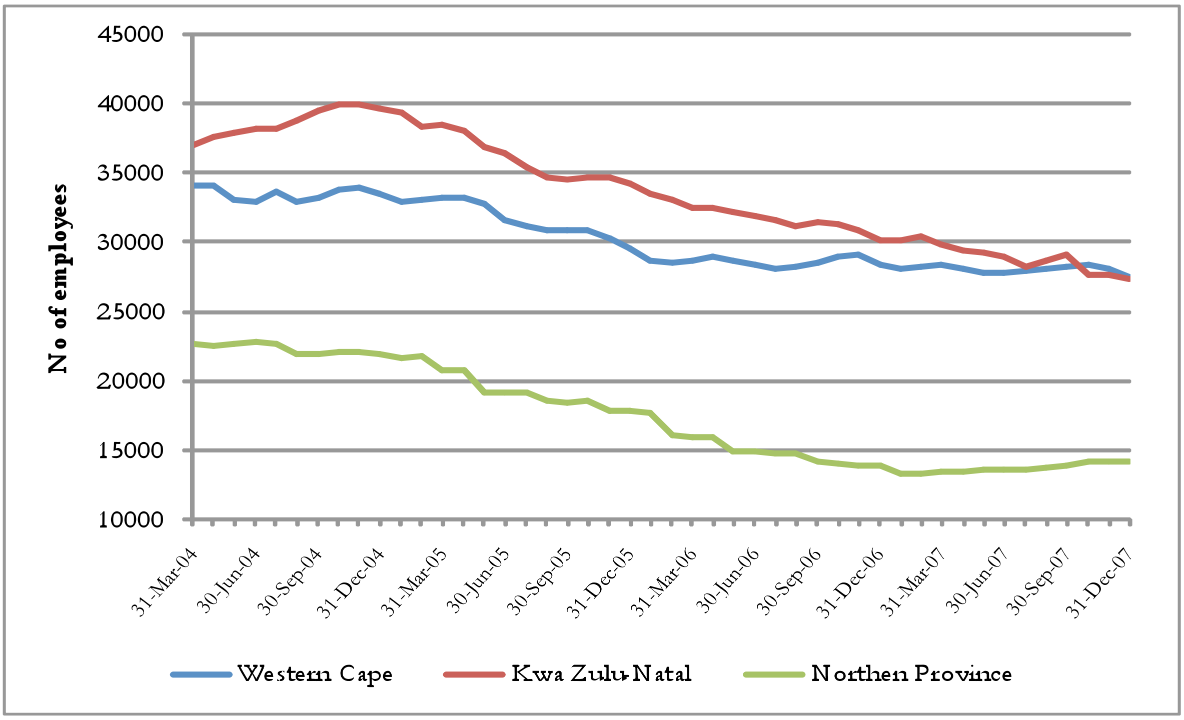
Source: National Bargaining Council

Figure 16: Industry strength by province: 2004 - 2007



Source: National Bargaining Council

Figure 17: Employment strength by province: 2004 - 2007



Source: National Bargaining Council

A 2007 Clotrade survey on employment prospects indicated: whilst 19% of member firms intended on increasing staff in the next six months, 15% still intended reducing employment whilst 66% intended remaining the same. In particular, the delay in the Customised Sector Programme (CSP) due to the fall out between business and the

DTI over the China Voluntary Restraint Agreement is accountable for much of the job loss between August 2006 and July 2007 (Clotrade 2007b). This is because a Key Action Programme in the CSP that proposed the removal of duties on fabric and trim would have made a significant contribution to job creation.

The sector specific macro data on the textile industry is unreliable and reliable data is hard to come by. There is combined data from STATSSA for the clothing, textile and leather sector but, as demonstrated by Edwards and Morris (2007), this is unreliable. Nor does the Textile Federation have up to date data either. But a sample of 10 textile firms that belong to the Cape and KZN Clothing and Textile provides indicative but not definitive data on employment trends in the industry. This is reflected in Table 20 which shows a steady decrease in employment from 2004 -2006 in this sample of textile firms, with a marginal increase of 92 employees in 2007.

Table 20: C&KZN CTC sample textile firms employment strength 2004 - 2007

2004	2005	2006	2007
4,003	3,656	3,357	3,449

Source: Cape & Kzn Clothing and Textile Cluster

The statistical results on employment presented above are backed by evidence gathered from qualitative interviews with 20 clothing and textiles manufacturers in KwaZulu Natal and Western Cape conducted in September 2007. These are summarised below.

Since the imposition of quotas, 13% of the firms interviewed have expanded their workforce, 40% reported no changes at all, and 47% of firms reported either a reduction in the workforce or had put workers on short time, or both. With regard to the last group, it is important to note that most of the downsizing was not wholly or directly the result of quotas which occurred exclusively in non-core production areas. For one firm, it was part of a strategic move to shrink its merchandise design band. In the remaining firms, it was largely driven by a consolidation of the management function in response to a general downturn of the industry. However, the real impact of quotas on employment is better measured by the “opportunity cost” to employment – i.e. by estimates of how much employment firms believe they could have created had quotas not been imposed. By these counts, the cost is significant.

> "We were growing nicely before quotas and we could have employed more people, but the quota on fabric has cut all possibility of increases."

Even in the two exceptional cases, where the firm has actually expanded its workforce, this growth is either not attributed to quotas,

> "Our growth is entirely due to our adoption of WCM practices; it is a classic product of proper value chain alignment and forging collaborative relationships with other stakeholders."

Or, is expected to reverse once quotas have disappeared.

> "The quotas have helped us with our political battle to grow employment, but since it has occurred exclusively in an area which competition from Chinese imports is most fierce, we cannot guarantee that it will continue once quotas go."

Similar to employment, the quotas have failed to provide a sustained impetus for **innovation** and output growth. Neither have they led to greater competitiveness. Clotrade reveals that only 9% of respondents in their survey thought that quotas had had a positive impact on their business whilst 31% felt that it had actually hampered their business and 60% reported that they had had no impact at all (p.8). If anything, **quotas have aggravated the situation for clothing manufacturers**. This is particularly true where restrictions on fabric are linked to unprecedented fabric price increases following the announcement of quotas (Clotrade 2007a).

Firm level interviews confirm that, on the whole, the impact from quotas on clothing manufacturing firms appears to have been **negative in terms of output**. Twenty six percent of firms interviewed report a contraction of between 20%-40% of output (in units). Forty eight percent report unchanged volumes. This is attributed to a complete over-stocking in the retail chain as a result of forward-buying in anticipation of quotas, which was widely predicted.

> "We were just starting to grow nicely when our whole ability to expand was curtailed. In six months, we have shrunk by 30%; not only did we not increase orders, but we lost our existing supply base because we couldn't fill orders. "

> "If not for quotas, we would have had two full production lines with 20 people per line. Instead we have seen a 20% drop in output because our design house cannot source the fabric."

The countervailing view among manufacturers who are hardest hit by quotas is that there is no garment that can be made locally that is not available everywhere else in the world. This simple fact increases retailers' bargaining power to the extent that pricing has become a unilateral process. Furthermore, 26% of firms believe that retailers are not committed to supporting the local industry and will follow the best price. They argue that the only benefit to sourcing locally is that retailers have the option of stopping production midstream to restyle. However, for this convenience, retailers offer no premium, which leaves local firms to compete on the basis of labour alone. This is impossible given current constraints imposed by unions on wages and working hours.

> "We sell labour with the constraints and costs of producing a brand. We design a garment, source the fabric and carry all the costs of getting it to market, but at the end of the day all that we sell is labour…If we weren't unionized, we would survive. And, if we had a piecework system, our productivity would go through the roof, but the bargaining council would shut us down."

> "All we hear now from the retailers is: "We can import this garment at x cost. Can you meet it?" They only favour local suppliers for speed to market and because they have control over the product which allows them to make changes early in the process but all the whiles they are squeezing companies down the value chain out of business."

Twenty percent of firms have historically been supported by local retailers and expect this to continue in the future once restraints have been lifted. These firms generally produce in those categories that are not under quota. Of those clothing manufacturers who have experienced a drop in turnover, this was not exclusively due to fabric shortages brought about by quota on fabric, but in two cases, due also to quota on fully assembled garments. This reveals a failure of the DTI to acknowledge that some manufacturers are also importers who would be negatively impacted by quotas. Furthermore, 60% of those firms who are unaffected by fabric shortages have experienced a drop in the quality of fabric available from both local and foreign suppliers as well as increasingly poor delivery times. This points to mounting problems in the supply chain, which cannot be directly addressed by quotas.

Textile firms interviewed, who should be the primary beneficiaries of fabric quotas and expected increases of at least 5% due to quotas, reported no significant increase in their order base for the first six months of the year.

There are some exceptions – three firms indicate that local orders have increased in the past six months; however, even these cases require qualification. Of the three firms concerned, one reported that, although orders had increased, they were very low priced and that the substantial talk around orders has generally not translated into actual orders. In the second case, the growth is a continuation of a trend that preceded the quotas. In the final case, the firm regained a lot of orders lost to Chinese competition but regards this as a temporary success and has attributed it to the low profitability associated with producing the garment. Furthermore, most of this growth was accommodated through outsourcing to CMTs.

A key finding is that **all firms**, without exception, **regard *skills* to be their *greatest* constraint to growth**, not the availability of fabric or the potential to secure orders. Precipitately, skills shortages have prevented local manufacturers from exploiting the improved bargaining position afforded to them by quotas. Even the most severely affected firms believe that a skilled workforce could have mitigated the negative impact of quotas. Quotas simply make a bad situation worse.

7.1 Skills

Research conducted to assess the impact of quotas on skills provides important insights into whether, as a result of quotas, i) firms have increased their skills demand which would translate as increased employment and indicate a growing supply base, and ii) firms have changed their skills requirements, which would be the case if they have changed place in the value chain. The latter also partly addresses question of whether firms have been encouraged to innovate and progress to more complex garments or whether they are producing basics due to fabric shortages and other constraints. The level and composition of demand for skills is therefore an important measure of competitiveness.

It is not always possible to isolate changes in skills needs at the firm level but two clear patterns do emerge: Firstly, the prophecy that quotas would assist in driving firms up the value chain has been largely unfulfilled - there is no **significant evidence that firms have up-graded to more complex garments**. Manufacturing firms who were importing high minute-rate garments from China to supplement their local range have simply switched to alternative sources, mainly Bangladesh, Malaysia and India. As have the retailers.

Similar to clothing, there is **no evidence** that the constraints have encouraged **innovation or investment in textiles**. This is an expected outcome given that the amortization period on this type of investment is twenty years whilst the quotas have a two year window. None of the textile firms in the sample have increased their capital investment in the past six months and neither do any have any plans to do so. Whilst all of the textile firms have increased their prices in the past six months, this has been attributed to rising import costs of chemicals and dyes.

There are only two cases where firms have changed their output mix as a direct result of the restrictions. In neither case has the shift been toward more complex, higher-end garments, nor is the trend expected to last beyond quotas. Both firms concur that they been forced into niche markets in which they will not be competitive in an open economy. Both cases demonstrate the unintended consequences of quotas for local clothing manufacturers and illustrate how the quota allocation mechanism inherently favours firms who historically have been least supportive of the local market.

CASE STUDY 9: TRANSITORY IMPACTS OF QUOTA

One large clothing firm has significantly expanded its schoolwear division as a direct result of quota on "woven shirts" which was sufficient only to cover its customer's requirements for outerwear. In addition to this, the firm has opened a new factory to manufacture male underwear; a product which it previously imported and did not make locally. This was a strategic decision pre-empted by uncertainty surrounding the amount of quota that the firm would be granted as an importer of this product. The project has cost billions of Rands and has created 200 new jobs. However, in neither case are the gains expected to be sustained once the constraints are lifted. In the latter case, in particular, the project is expected to generate a net financial loss to the company and the firm anticipates that the employment gains will also be reversed.

Source: Morris and Reed 2008

8. Price effects

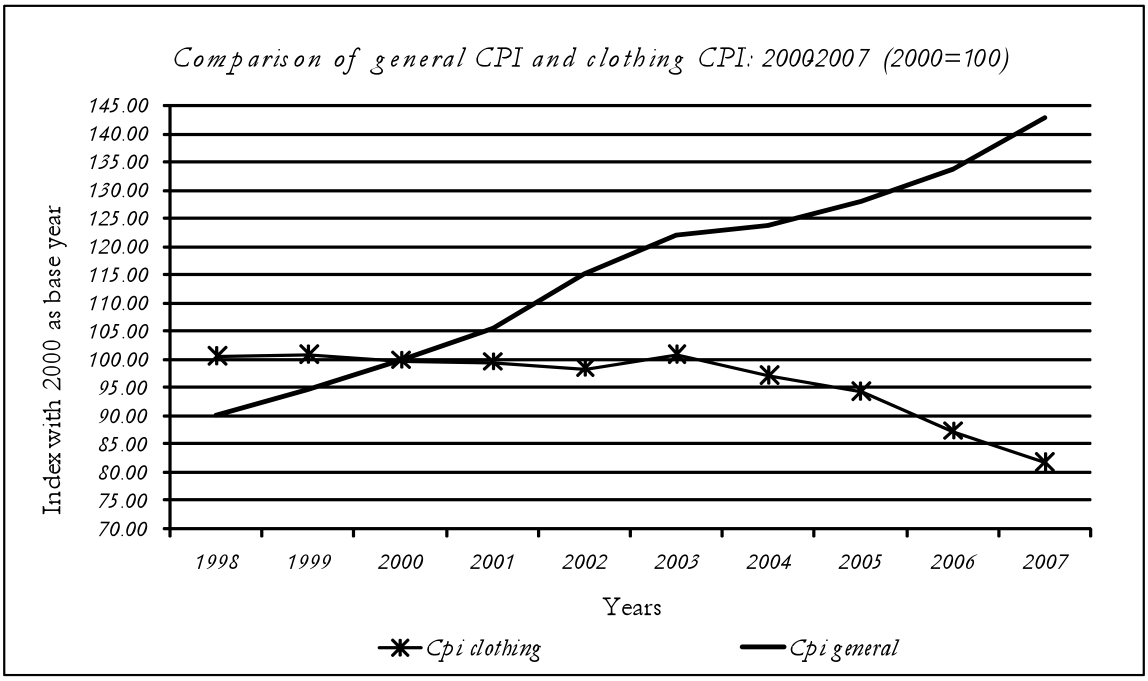
The impact of quotas on price distinguishes two separate effects; i) the change in retail prices and its effect on consumer welfare and ii) the change in producer prices and its effect on manufacturers.

Quotas and consumer welfare

The core issue in any welfare debate is the impact that an intervention has on consumers. Sustainable industrial policy is concerned with industrial competitiveness on the one hand and welfare on the other (Morris 2007; Morris and Einhorn 2008), and the effectiveness of any intervention is measured against how well it balances and meets these requirements. The competitiveness focus shies away from strictly protectionist measures which seek merely to defend the status quo. It is concerned with ensuring long-term sustainability of the sector by altering the ability of firms to compete and: i) raising the dynamic production capabilities of individual firms and ii) increasing the systemic competitiveness of firms as they interact along the value chain. The welfare requirement, is concerned with raising employment in the sector and favorably impacting on the consumer basket. The welfare consumption aspect of policy is concerned with raising the disposable income of the masses of consumers by decreasing the prices of goods in the target sector and thereby increasing the standard of living of the mass population. In conclusion, the long term impact of such policy should be to incease the competitiveness of labour through the consumption of cheaper wage goods which will feed through to lower wage costs across all sectors.

The debate on quotas and consumer welfare centres chiefly on the impact of quotas on price and its effect on consumer welfare via consumer retail prices. To determine the impact of quotas on welfare, it is important to understand the effect that quotas have on import prices and on the local prices of garments generally. Both of these issues are dealt with extensively through examining the effect of falling import inflation on consumer prices and welfare (Einhorn 2007, Morris and Einhorn 2008) primarily in response to the proposition that falling imported inflation is a primary source of deflation in some sectors (such as clothing) of the South African economy (Hazelhurst 2006a). This is manifest in the divergence of the general CPI which is for a diverse basket of goods and the clothing CPI which is sector specific (Figure 18).

Figure 18: Comparison of CPI indices for metropolitan areas

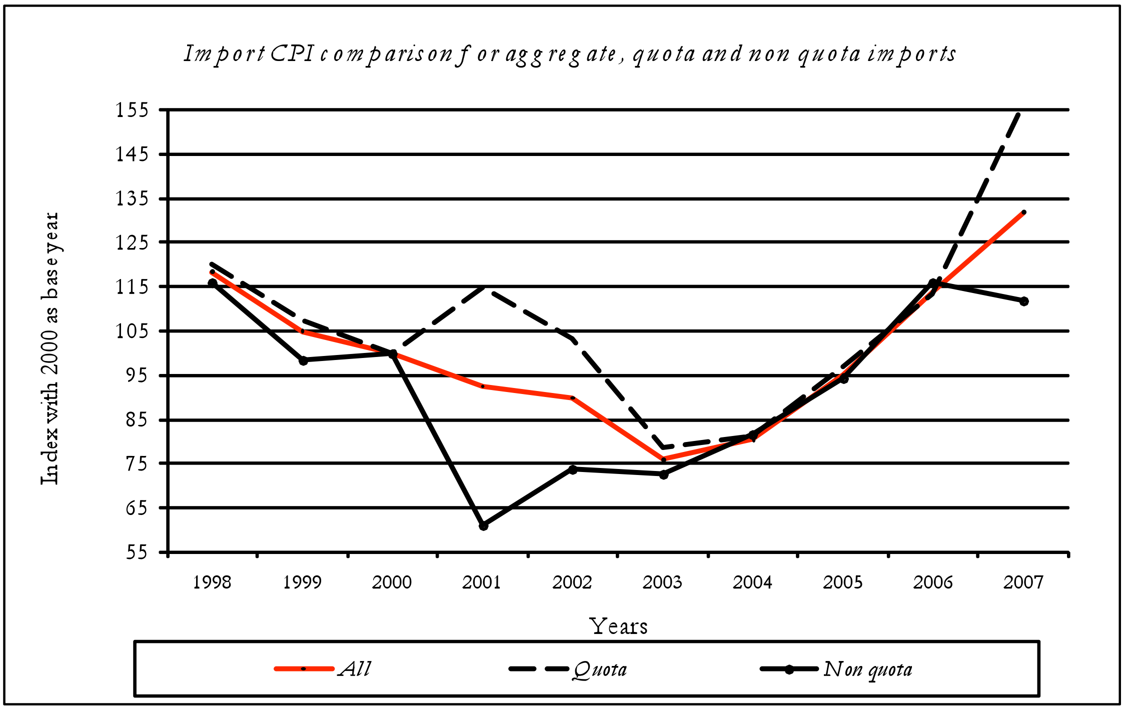


Data source: Stats SA

In sum, deflation in clothing prices between 2000 and 2006 is explained by falling import prices and more specifically, import prices from China (Einhorn 2007, Morris and Einhorn 2008). This is due to three effects: i) a direct effect from falling FOB prices (by approximately 25% during this period); ii) a rise in the share of relatively cheaper imports and iii) an indirect effect of falling import prices on clothing prices in general since “as imported inflation falls, local producers are forced to compete and domestic prices fall into line.” (Hazelhurst 2006a). The main welfare implication is that cheap imports imparted significant benefits on consumers both directly, and indirectly by suppressing the prices of domestic garments (Morris and Einhorn 2008). Access to cheap Chinese imports clearly benefitted consumers and especially those poorer consumers at the low end of the market where Chinese imports are concentrated.

A comprehensive analysis of the impact of quotas on consumer welfare requires a twofold analysis – a macro analysis of imports, and a sample of retail prices in the stores. Such comprehensive data is not yet available and hence we have only partially commented on this issue in this report. Figure 19 demonstrates the variation between the import CPIs for quota and non quota categories which is due exclusively to the variation in FOB prices for quota and non quota imports.

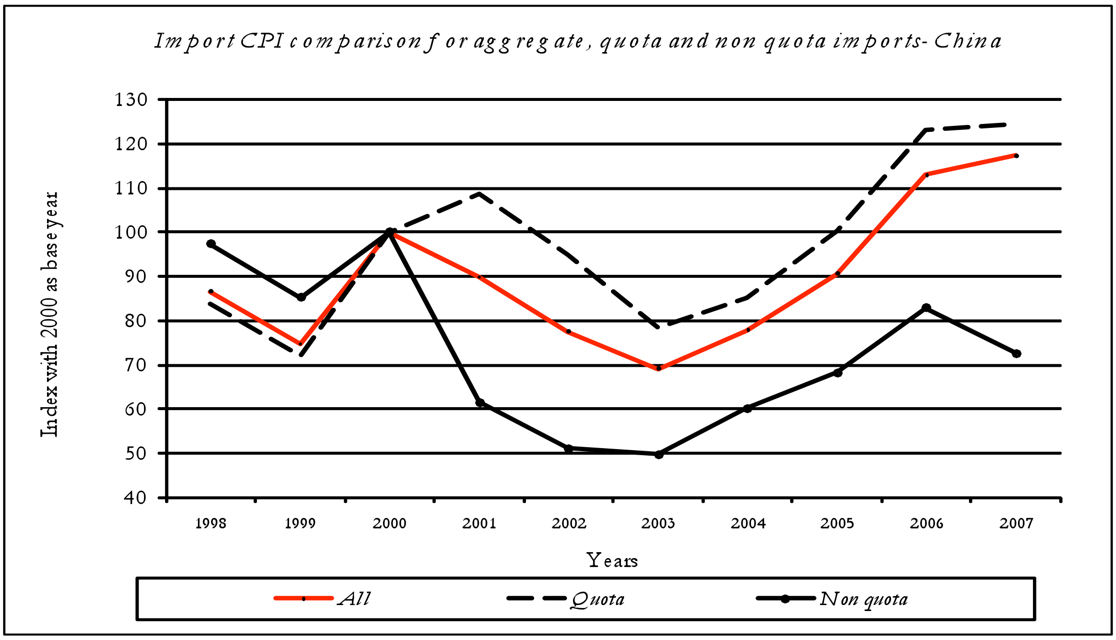
Figure 19: The variation in the import CPI for quota/non quota imports



Source: Own calculations

This point is more starkly revealed if import prices from China are used to construct the indices (Figure 20). Inflation in aggregate FOB prices from China is driven by quota imports to the extent where the aggregate index tracks the quota index.

Figure 20: The variation in the import CPI for quota and non quota imports from China



Source: Own calculations

Table 21 (below) summarises the percentage changes in the value, volume and price in quota and non quota categories and clearly demonstrates the variation in the magnitude of the price change in quota and non quota categories during 2007. Prices of quota imports from China increased by 57.20% between 2005 and 2007 (with 43.21% of this rise between 2006 and 2007 alone) whilst those in non quota categories actually fell by 7.99% (falling by 14.44% between 2006 and 2007 after rising slightly in 2006). Similarly, between 2005 and 2007, in World quota categories, prices increased by 53.60% (45.32% between 2006 and 2007) whilst prices in non-quota categories fell by 7.18% and by an even greater 13.73% during 2006 and 2007 after rising slightly between 2005 and 2006.

Table 21: Changes in Dollar denominated FOB prices in quota and non quota categories

	CHINA			WORLD		
	% change 2006-2007			% change 2006-2007		
	Value	volume	Price	value	volume	Price
aggregate	-30.79	-33.91	4.72	-12.17	-21.16	11.41
quota	-52.02	-66.49	43.21	-27.44	-50.07	45.32
non quota	22.15	42.76	-14.44	21.62	40.97	-13.73

Source: Own calculations

In conclusion, between 2006 and 2007, the primary source of **inflation** in the **clothing CPI** is rising prices of **quota imports** which increased by 45.32% during this period. Simultaneously, the prices of non quota imports fell. Since quota imports have the dominant value share in aggregate imports in 2007 (57%) the net effect on import values would be positive. This is possibly driven by increases in import prices from China which rose by 43.21%. The similar magnitude of changes in prices from China and World prices suggests that China still drives the latter. Anecdotal evidence suggests that dollar denominated FOB unit prices from China are gradually increasing due to currency revaluations, the weakening of the US Dollar, a reduction in export incentives and increased labour demands. However, these factors would lead to price increases across the board where only those for quota imports have increased. The fact that price inflation is limited to imports in restricted categories implies that **quotas are to blame** for the sharp increases during the quota period.

Even within quota and non quota categories, there is substantial variation in prices between unit and kilogram imports. Table 22 summarises changes in unit values - denominated in Dollars to exclude the exchange rate effect – in respective quota and non quota and unit and kilogram categories for both the World and China.

Table 22: Changes in Dollar denominated FOB prices in unit and kilogram categories

	All categories			Unit categories			Kilogram categories		
	% change 2006-2007			% change 2006-2007			% change 2006-2007		
	value	volume	Price	value	volume	price	value	volume	price
CHINA									
Aggregate	-30.79	-33.91	4.72	-34.10	-33.91	1.50	-12.41	-5.27	-7.53
Quota	-52.02	-66.49	43.21	-52.85	-66.42	40.39	-45.89	-69.36	76.63
non quota	22.15	42.76	-14.44	19.65	41.99	-15.73	30.31	53.28	-14.99
WORLD									
Aggregate	-12.17	-21.16	11.41	-15.64	-22.28	8.53	7.73	5.21	2.40
Quota	-27.44	-50.07	45.32	-29.69	-50.14	41.00	-9.26	-47.52	72.91
non quota	21.62	40.97	-13.73	20.42	40.24	-14.13	25.54	50.88	-16.80

Source: Own calculations

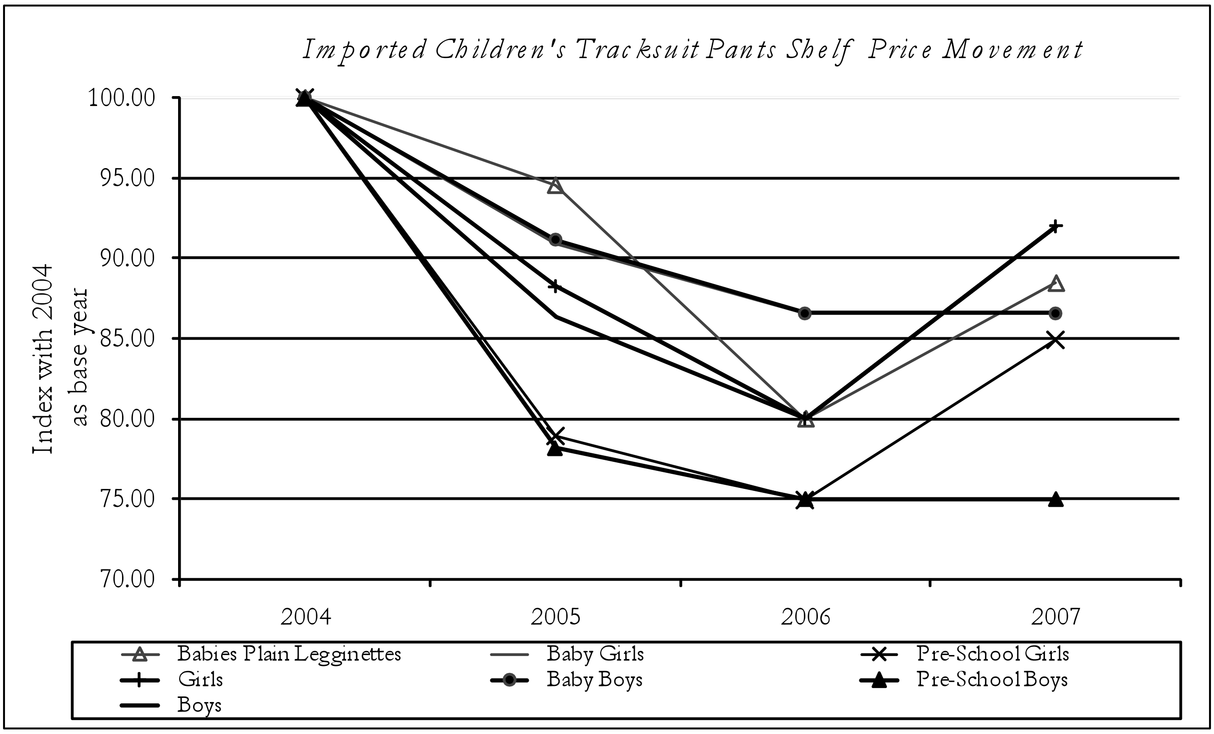
Analysing data at this bare bones level exposes anomalies in the data which hint at undervoicing or other irregular import practices. For example, on aggregate (quota and non quota categories combined), the price of kilogram imports increased by only 6% compared with 16% for unit categories with 2% and 8.5% of this increase occurring during the quota period. In quota categories, the price of kilogram imports rose by 80% compared with 50% for unit categories between 2005 and 2007 with 73% and 41% of this rise occcurring during the quota period. In non quota categories, the price of kilogram imports fell by 15% between 2005 and 2007 compared with 5.5% for unit imports for the same period with prices falling by 15% and 16% in respective unit and kilogram categories during the quota period. The results for China are similar. At the aggregate level, the price of kilogram imports fell by 2% (with a fall of 7.53% during the quota period) whilst the price of unit imports increased by 13% (1.50% of this rise between 2006 and 2007). In quota categories the price of kilogram imports almost doubled (93%) whilst the price of unit imports increased by 55.5%. In non quota categories, the price of kilogram imports fell by 14% compared with 7.5% for unit imports between 2005 and 2007; prices fell by 15% and 16% for kilogram and unit imports respectively during the quota period alone.

The finding that the price of kilogram imports in quota categories from China and in aggregate increased is contrary to expectation. One rational explanation is that as a result of the quota allocation mechanism which calculates future allowance on the basis of past import history, importers are having to adhere more strictly to tariff headings and declare items under the correct headings. As a result, prices in these categories are rising. This is ironic since in the past kilogram import categories were easy targets for underinvoicing practices given that they are more diffiicult to police generally containing garments which are small and of great variety. However, the fact that prices for non quota kilogram imports are falling may still be due to imports being underdeclared as many suspect they are.

The welfare impact of higher import prices depends on several factors. If consumers are compensated for the price increases by improvements in garment quality and complexity and access to a greater variety of garments, this mitigates (some) of the welfare loss associated with decreased spending power. Whilst the price index can reliably indicate the direction of price changes, it is unable to comment on the nature and quality of garments. Nor is macro-economic price data able to give an accurate indication of market trends. It is also impossible to determine from the data whether the price increase is due to importers buying more expensive high-end garments or whether the prices of existing garments have increased.

However, we have gathered a limited data set to augment the previous analsyis by Morris and Einhorn 2008. Although by no means sufficiently comprehensive, higher shelf prices of one line of imported basic childrens tracksuit pants, which have not changed significantly in quality and/or complexity, suggest that **low end consumers may be paying higher prices** for existing garments (Figure 21).

Figure 21: A demonstration of movements in the shelf price of imported basics



Morris and Einhorn 2008 for 2004-2006, extended with 2007 data.

In summary, in the absence of detailed retail price and product data as used by Morris and Einhorn 2008 for the pre quota period, and whilst cautioning against the pitfalls and shortcomings of using macroeconomic price data to estimate price trends, the following tentative conclusions about the welfare impact of quotas are:

i) the disposable income of consumers is reduced by rising import prices of garments in restricted categories. Since the restricted categories are most likely those at the low end of the market, this price inflation would more than likely impact most on the very poor.
ii) Anecdotal evidence suggests that substitutes do not match up in quality or durability to products to Chinese imports of similar price. By all accounts, quotas have reversed the fortuitious position where consumers were getting “more spend for their buck”.
iii) Import restrictions have motivated importers to upgrade their import basket and import more high end sophisticated garments which has pushed local manufacturers towards supplying the low end of the market where competition is most fierce from alternative foreign suppliers.

Producer prices and manufacturers

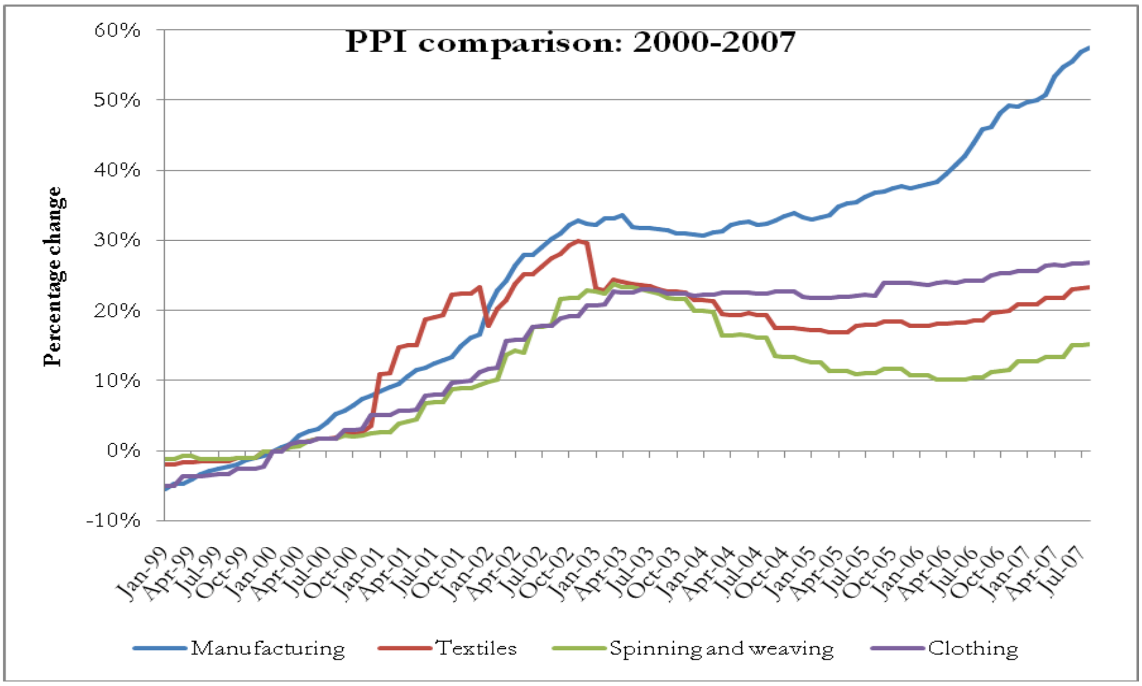
Quotas could potentially impact on manufacturers in two ways:

i) fabric prices and supply bottlenecks leading to shortages (Edwards et al 2006);
ii) import prices - both directly and indirectly (by changing the composition of the import basket with the result that local manufacturers are forced toward supplying the low end of the market).

The principal challenge facing clothing manufacturers is the pressure on margins, which is clearly brought out in the PPI graph below (Figure 22). Whilst general manufacturing continues to do well, climbing rapidly to 11.9%, clothing languishes at 1.6%, which is simply not enough to ensure new investment in upgrading of equipment and technology. With regard to input costs, clothing firms reported price increases from textile mills last September (Clotrade 2007a). Figure 22 indicates a sharp improvement in the PPI for Textiles and Spinning and Weaving shortly after the announcement of quotas. As one of the firms interviewed put it:

> "After quotas were announced, company 'X' Textiles increased their prices on shirting by 16%, just like that!"

Figure 22: Comparative PPI for clothing and textiles 2000-2007



Source: Stats SA

The textile industry claims that it has merely passed on recent increases in chemical costs from its overseas suppliers and that retailers continue to squeeze their suppliers to barely operable margins. Meanwhile clothing manufacturers find themselves in a position of having to absorb increased prices for fabrics but are unable to pass on these increased costs in total to retailers.

With regard to the impact of quotas on manufacturers via import prices, the price movements from the foregoing analysis are largely in accordance with expectations that quotas would bring about a price increase for three reasons; i) quota trading[21]; ii) a higher landed cost of imports, and iii) changes in the composition of the import basket. The increased price of imported garments might have provided local manufacturers with some margin of competitiveness had the industry been poised to exploit this comparative price advantage. Qualitative evidence shows this was not so.

As discussed in Section 2.2, a well recognised outcome of quantitative restrictions is a shift in the direction of higher value-added, higher quality goods because margins on these goods are generally higher. Consequently, importers substitute high-end expensive garments for cheap basics in order to maximize the profit on their import bundle. This appears to be borne out in the data. Aggregate import volumes decreased by 22% between 2006 and 2007 whilst import values fell by only 12% with the implication that less garments of a higher price were imported since the value falls by less than the volume flux. This difference is even more pronounced for quota categories where import volumes fell by 50% with a 27% decrease in the value. In contrast, in non quota categories, import volume and value (in unit categories) rose by 40% and 25% respectively indicating a fall in prices. However the notion that importers would switch their import basket due to quotas was soundly rebutted by large retailers since allocated quota is apportioned across all firms in the group who supply different maket segments[22].

[21] Although retail defends all allegations of quota trading, there is some evidence that it did occur in the immediate wake of restrictions with agents commanding a premium of 20-30% (Bisseker 2006).
[22] Established during an internet interview with Interviewee#1

> "The DTI does not realise that there is not one buyer per quota classification in big organisations. Each classification is shared across divisions with differing age groups within gender such that it is not unusual for a single classification to be split between 6 or 8 buyers and then manage this to ensure that we did not overbuy."

9. The second year of quotas: 2007-2008

This section reviews macroeconomic trade and firm level data for the first six months of 2008. The main purpose is to evaluate whether, over the longer term, quotas have begun to have the desired positive impact on employment and competitiveness of the industry. The first measure of success to be evaluated is trade performance.

9.1 Trade

In the first half of 2008 (January to June), imports of apparel totaled R3,580 million, an increase 32.16% on the comparable 2007 period[23]. Imports from China totaled R2,310m, a share of 64.47% in total imports and a increase of 32% on comparable 2007 imports. In second place was India with R1,410m or a 4% share, closely followed by Mauritius with R1,320m (4% share). Quota imports from China totaled R976m for January to June 2008, an increase of 18% on the relevant 2007 figure. However, the share of quota imports in total imports from China fell for 46.29% in 2007 (Jan-Jun) to 42.30% in 2008. This reinforces previous conclusions that i) quotas have reduced activity from China in quota lines but ii) activity in non quota lines has increased, with the net result that **imports from China have increased year on year**. However, quotas have reduced China's share in total imports from 66.20% in 2007 to 64.47% in 2008.

Table 23 below shows total imports and quota imports for comparable 2006, 2007 and 2008 periods. Several conclusions are reached which reinforce earlier findings: i) quotas have successfully reduced imports from China in quota lines which fell by 29% for the comparable 2006 and 2008 periods; and ii) quotas reduced the share of quota imports in total imports from China.

[23] Kipling 2008 argues that the year on year increase is more likely 13-14% once the 2007 import statistics are inflated by the R393m-R420m (or 38.5 to 42m units) in imports brought forward for purchasing in 2006 in anticipation of quotas.

Table 23: Demonstration of changes in total imports and imports in quota and non quota categories between 2006 and 2007.

	China			Change
	2006	**2007**	**2008**	**06-08**
Total imports	2058.81	1793.38	2307.86	12%
Quota imports	1373.24	830.17	976.23	-29%
% share total M	76.53%	66.20%	64.47%	-12.06%
% quota in total M	66.70%	46.29%	42.30%	-24.40%

9.2 Employment

National bargaining council figures for 2008 show a **continued decline in employment** with a further **4682 jobs lost** in the first eight months of 2008 (

Figure 23). This brings **total job losses to 7449 since quotas began** with employment sitting at 67,007 as of 31 August 2008. This is despite a period of expansion from new entrants entering into the industry between September 2007 and June 2008. However, for the entire quota period, industry strength has deteriorated by 4 firms. As of 31 August 2008, there were 1,044 firms in the industry.

Figure 23: Total industry strength and employment: 2004-2008

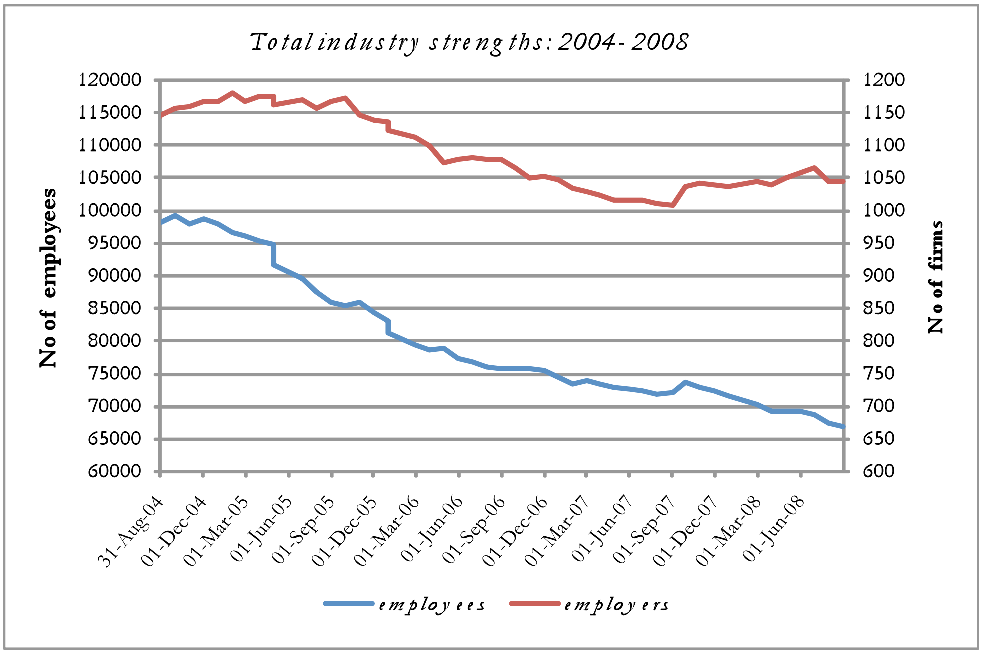


Figure 25 and

Figure 26 below decompose the national figures by province. The sudden increase in the number of firms after 2007 for the Northern Province is most probably a reflective of greater Bargaining Council compliance rather than new entrants into the industry especially given persistent job losses during this time. Ironically, during a recent (Sep) 2008 survey of South African manufacturing firms, it was revealed that employees do not want to be registered with the bargaining council and UIF since they believe that the government will steal from them.

Figure 25: Industry strength by province: 2004-2008

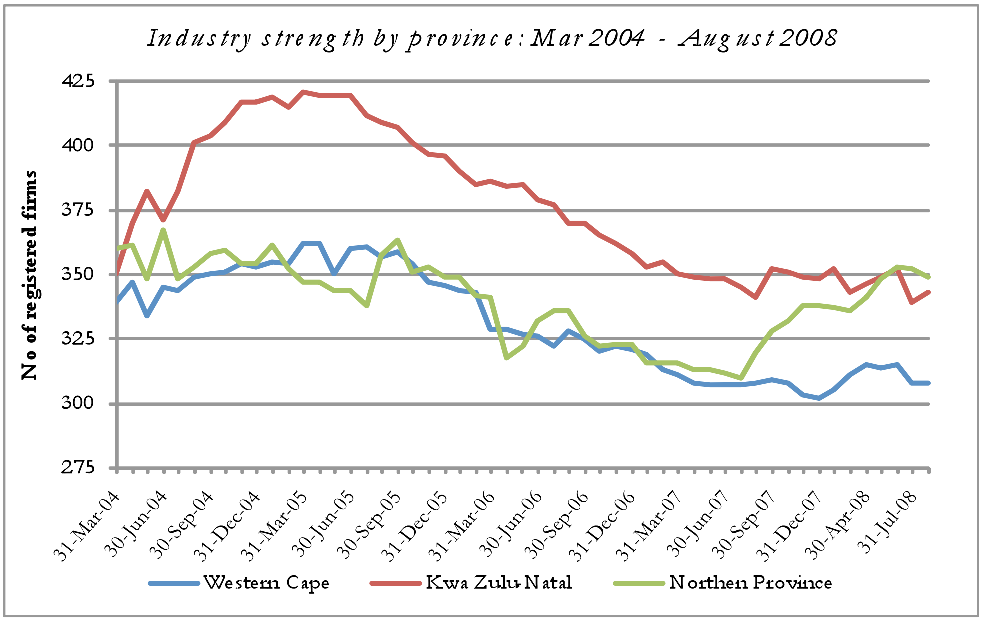
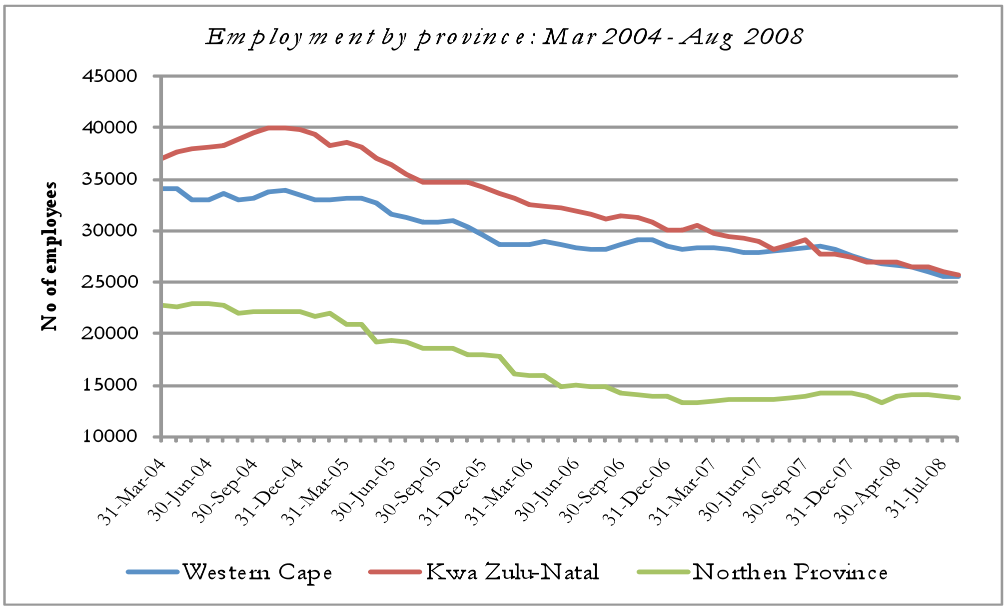


Figure 26: Employment by province: 2004-2008



10. Evidence from the firms – 2008 survey data

Evidence collected during a recent survey of South African clothing manufacturers largely **confirms the negative impact of quotas** on the industry, particularly in respect of quotas on fabric. The findings are essentially a continuation of the trends revealed by 2007 interviews which are reported in Section A.

Fabric availability and price

An endemic problem is the **fabric shortage** due to poorly contrived **quota allocation mechanisms and implementation** systems which expose authorities' ignorance and incomprehension of the fundamental issues which underpin the real problems in the sector. Kipling 2008 states:

> "It is globally acknowledged that China is the most cost effective supplier of fabric and a major source of fabric to all apparel producing nations who are exporting to South Africa and therefore direct competitors to South African apparel manufacturers. Restricting South African clothing manufacturers direct access to Chinese fabric would give South African competitors (…) a distinct competitive advantage."

Quota utilisation in the first half of 2008 closely follows the pattern of usage in 2007 (Table 24**Error! Reference source not found.** below). Underutilisation broadly confirms problems with the manner in which quotas were allocated and the procedures and regulations for the granting of additional quota[24].

Table 24: Quota utilisation for fabrics: 2007 and 2008

Period	Knits		Wovens			
	60.05	60.06	52.08	52.09	52.10	56.14
Jan-Dec 07	30.4%	39.1%	71.3%	15.3%	56.2%	55.4%
Jan-Dec 08	9.9%	16.7%	26.5%	5.7%	20.5%	26.2%

Source: Clotrade 2008

Two thirds of the respondents in the 2008 survey of manufacturers indicated that they had been **negatively affected by fabric shortages or delays**. Of these, 45% reported they had suffered a severe adverse impact whilst the remaining 55% felt that the negative impact was manageable. Where some firms did not suffer fabric shortages, they reported problems relating to deteriorating fabric quality[25]. Furthermore, 41% of respondents believed that quotas had led to significant **increases in local fabric prices**. Three of the firms in the sample (10%) did not respond to the question on price. In two cases, this is due to the fact that the fabric is not available in South Africa at any price. In the third case, it was argued that local mills were so incompetent that they were not even worth consideration as a potential supply source, thus ruling out the possibility of price comparisons.

Figure 28 summarises the response pattern. Only 30% of firms believed they were unaffected by fabric quotas at all. 37% of respondents were affected by both fabric non availability and increasing prices. 7% reported increasing prices but no problems with supply; 26% reported supply problems but did not believe that prices had increased. Ione firm argued that the closure of some major South African fabric

[24] Kipling 2008 illustrates one specific case in point. T-shirts was a product specifically excluded from quota whilst quota was implemented on fabric for the use in the manufacture of T-shirts. Imports of T-shirts from China totaled 81 million units in 2007, up 36% on 2006 imports and this trend has continued into 2008. Imports of T-shirts for the first six months if 2008 totaled R36.6m, up 16% on the comparable 2007 period. This growth in imports during the quota period has likely been at the expense of local T-shirts manufactured in 2006 which may explain the low utilisation of the quota. What is more, should the current trend in imported T-shirts persist, this will result in a major decline in demand for knitted single jersey fabric Kipling, J. (2008). *Analysis of imports of apparel: January - June 2008.* Cape Town: Clotrade.

[25] Firm 29 reported ongoing problems with quality of fabric from China and some new sources such as Bangladesh.

factories (such as BMD and Gregory) also reduced the options of local manufacturers.

Figure 28: Demonstration of perceived impact of quotas on fabric availability and prices

	Price increase	No Price Increase
Fabric Shortage	Price increase & fabric shortage **37%**	No price increase & fabric shortage **26%**
No Fabric Shortage	No fabric shortage & price increase **7%**	No price increase & no fabric shortage **30%**

Comments from firm representatives illustrate the above points:

> "As far as the beneficial impact of quotas on the local market is concerned, these have been negligible. But they have made doing business more difficult The quotas are a blunt instrument and have not taken into account the fact that a number of fabrics and garments that were being imported from China are not readily available in SA."
>
> "Application for extra quota took over four months. This resulted in numerous orders being cancelled while our fabric was stuck in the docks awaiting clearance."

Output and margins

To measure the effectiveness of quotas in stimulating local manufacturing activity, firms were asked to report on their **output levels** during 2008. 14% reported that they had produced more garments since quotas, **59% produced less and 28% produced the same as before quotas**. However, the real story is in the margins.

Of those respondents who reported that their output had expanded due to quotas, 60% said that **margins had fallen** whilst the remaining 40% reported that margins had remained the same. Of those respondents who reported that their output had contracted during the quota period, 82% reported that their margins had also fallen and for 57% of these, the fall was severe. In at least one case, this resulted in the organisation running at a loss. 6% managed to maintain their margins and only 12% (one firm with a highly specialised and technical product) reported that margins had (marginally) increased. Finally, of those respondents who reported the same level of output before and during quotas, 50% reported that margins had fallen while the other 50% said that margins had been maintained.

In summary, **not one firm both increased its output and its margins during the quota period**; either the gains to be had from increased sales were summarily negated by falling margins or the gains to be had from increased margins were offset by falling output volumes.[26]

Competitiveness and output mix

43% of respondents reported that they had changed their output mix due to quotas. A somewhat unexpected result is that this shift was predominantly toward more complex (69%), high value added (23%) garments with only 23% reporting a shift toward garments of lower complexity. This is the antithesis of what is expected from quantitative restrictions. However, there is significant qualitative evidence that firms are struggling to meet the new requirements in terms of greater garment complexity and enhanced quality.

> "Having no quota available forced us to task local contractors with production complexity beyond their capacity and/or capability. Orders were delayed and customers cancelled."
>
> "We have received orders for garments with greater complexity which is hard on labour."

This is conceivably due to the continued exodus of skills form the industry. Problems with recruiting machinist and other production staff have intensified in the last twelve months. 67% of respondents reported skills shortages and gaps in their production line with fill times ranging from two to twelve weeks. 27% of respondents reported that they are tackling skills shortages by training internally. Reasons given as to why machinists are leaving the industry still partially relate to the provident fund (55%) and flight to the informal industry which is consistent with findings of the 2007 survey. However, more recent opinions emphasise the fading popularity of manufacturing jobs amongst young people:

[26] Two firms attributed falling output volumes to the slowdown of the general economy such that the analysis comes with the important caveat that it is not always possible to disentangle the effects of the quotas and the generally depressed economy; the effects are likely due to a combination of both.

> "We initially thought that the lack of machinists was due to the provident fund and UIF but we are now of the opinion that machinists feel that they work too hard and the new generation has an attitude of not wanting to work in a factory."

Protection from foreign competition and customer relations

Problems with fabric quality, the lack of ranges and postponed delivery dates for garments, all directly as a result of quotas, had an adverse impact on customer relations for 37% of respondents. What is more, manufacturers convey retailer sentiments that their current predicament is largely self inflicted.

> "Our customers have become more distant with price being the only criteria..."

> "Our customers believe that as manufacturers we requested the quota which is simply not true. As a result, they sought cheaper garments elsewhere, and found even better value than China in Bangladesh, Vietnam, Malaysia and Myanmar, or simply resorted to buying transhipped garments."

The belief that local firms have lost business to illegal imports is incongruent.

> "A lot of my customers buy from the Chinese who are able to supply quota items..."

Firms were asked to rank on a scale of 1 to 10 (1=lowest; 10=highest) the effectiveness of quotas in providing protection from import competition. A breakdown of their responses appears in Table 26 below.

Table 26: Demonstration of perceived impact of quotas on import competition

Scale	Respondents
1	53%
2	20%
3	3%
4	7%
5	10%
6-10	7%

In general, firms argue that **relief from foreign competition was temporary and short-lived** because customers sought goods elsewhere and new sources were found. However, when asked whether they believed their orders would increase or decrease once quotas had expired, responses show that although 37% of firms expect their orders to fall (with 17% expecting a major fall), 30% expect their order books to grow. 33% expect their orders to be unchanged post quota. Firms argue that rising costs in China will be a major factor in influencing future sourcing decisions and that this will govern the extent to which orders will revert to China. However, retailers emphasize the non-cost benefits of dealing with Chinese suppliers which may override price concerns:

> "China prices are not the best in the World in quota and non quota classifications... China is however, more reliable in delivery date achievement and quality predictability than some of the cheaper sources."

11. Evaluating the justification for the quota intervention

The effectiveness of any particular industrial policy intervention should be tested against how it meets the two primary concerns of sustainable industrial policy, namely, consumer welfare and the competitiveness of the sector. The welfare concern spans issues of employment in the sector, and consumption focusing on the standard of living (particularly of the poor) proxied by the price and availability of cheap wage goods. The competitiveness concern, on the other hand, focuses on the long term sustainability of the sector. The complexity of managing the welfare and competitiveness foci require that sectoral interventions are based on sound and detailed knowledge of the dynamics governing the particular sector, well grounded information and analysis of their impacts and sustained consultation with the business (Morris, 2007). Rodrik (2004) asserts that, increasingly, there is recognition for the need to embed private initiative into the framework of public action. Hence the autonomy of the state is replaced by the paradigm of a 'learning government'. Industrial policy provides the opportunity for government to interact with private enterprises and learn about the constraints that exist and the opportunities that are available. Industry has identified three key areas to inform their response: the source of the problem in the sector, the information basis of interventions, and the detailed mechanisms characterising the China quotas (Morris, 2007). Hence, this report elicited information from enterprises in order to provide detailed feedback about the **impact of quotas on the industry *from the industry***. This is a critical missing link in the current chain of decision of government.

There are **three primary reasons** why quotas could and would not meet the objectives set by the DTI. First, the **timing** of the intervention - quotas came **too late**. Second, the **motivation** for the intervention - the **real problem was never identified**. China is simply a symptom of other underlying problems, not the cause. Third, the **scope** of the intervention and manner of its implementation. These shall each be dealt with systematically in following sections.

The timing of quotas

According to Kipling (2008) the crucial error lies not with the intervention itself, but with the timing. To understand this position, it is necessary to situate the imposition of quotas in the context of developments in the clothing manufacturing industry leading up to the event. 2002 witnessed some key changes in the South African clothing industry triggered in principle by the collapse of the Rand. Key players in the industry began to look beyond South Africa's borders albeit for different reasons; manufacturers were chasing exports and with their supply needs marginalised, retailers were compelled to seek alternative (foreign) suppliers. This marked a paradigm shift in mindset where industry went from blinkered to global and South Africa transformed from being a net earner of foreign currency to a net user. Coincidentally, in 2003 Clotrade sought protection for the industry on three primary grounds: i) illegal imports and dumping; ii) China not competing on a level playing field, and iii) the huge distortion factor posed by undervaluations and underinvoicing of imports. Each of these arguments warrants elaboration:

i) Illegal imports: Kipling (2008) asserts that South Africa has "porous" borders. The surge in imports in 2003 exposed custom's inability to control its borders and to prevent illegal imports and transshipments. Recent trade data suggests that this threat remains with an increased level of such activity indicated since quotas were introduced. This is gleaned from massive increases in imports from regions which have historically low levels of imports, such as Zimbabwe, although Singapore (and Malaysia) are commonly fingered as gateways. As one interviewee put it:

> "As soon as I heard about quotas, my first thought was: How can I get around this? I flew straight to Bangladesh and inquired how I could get my

> garments made up there and sent to South Africa with my Company's label on. The answer was: There is no difference, the stuff is still made in China, just the paperwork changes because it leaves from Singapore!"

The exact magnitude of transshipments and round-tripping will be revealed at the end of 2008 when imports from suspect countries fall away following the withdrawal of restrictions and sourcing patterns change.

ii) Unfair playing fields: The origins of China's dominance are diverse, although most pundits accredit it to its industrial policy. Kipling (2008) argues that the cornerstone of China's policy is to fix the currency against the US currency to achieve a measure of undervaluation, provide non-repayable loans at 1½% interest per annum, and export incentive of 18% per annum payable in cash. These factors combine to yield a benefit that far outweighs any of the usual factors which enhance a country's comparative advantage such as proximity to markets, a stable business environment, market access and skilled labour.

iii) Undervaluation/underinvoicing: When a large importer places an order with its Chinese supplier, there is an automatic 10% redundancy/reject margin built into production. On a global scale, this translates into billions of dollars worth of overruns. Furthermore, since these garments are fully costed into the invoice amount and thus are thus effectively already paid for, they are available to spillover markets for "literally beans". Since South Africa has similar styles and tastes to the United States, coupled with the convenience that it runs 6 months behind US fashion, its market is particularly suited to these overruns.

Clotrade first requested quantitative controls in 2003, emphasizing the need for swift and decisive efforts to curb illegal and unfair imports. Action by the DTI only came in 2006. The outcome might have been different had the DTI acted with the same speed and proficiency of the US and EU who suffered a surge in imports following the termination of the MFA. In both cases, quotas and safeguards were in place by April 2005. As it was, by the time South African authorities acted, the industry had lost much of its critical mass. Since the clothing industry depends on a critical mass of firms and employment in order to create cost-effective production, remaining firms find it hard to compete effectively on a global stage where firms are forced to compete on the basis of efficiency and flexibility. Kipling concludes that:

> "Had the Voluntary Restraint been imposed in January 2004, even at the current level proposed, before 20,500 jobs had been lost in the clothing industry and when the restraint would have been equal to 80% of the imports of the previous year 2003, when 215 million units and 8 million kilos were imported, it would have been a successful intervention " (Kipling 2007)

Motivation for quotas.

When implemented correctly and timeously, Kipling (2008) argues that quotas are an effective mechanism for dealing with illegal imports:

> "Clotrade was, and is in favour of quantitative controls as a mechanism for addressing disruptive surges of imports brought about as a result of unfair trade practices, gross undervaluations or dumping of product in the SA market." (Kipling 2007)

Clotrade's lack of support for quotas was not in *principle*, but in the *detail* (Kipling 2007). Quotas are not an effective industrial policy measure to address employment and competitiveness issues which was the stated objective of the DTI. Whether this was simply a case of misdiagnosis of the real cause, or a correct diagnosis with the wrong prescription, is controversial. Whatever the case, there are several key arguments warning against the use of quotas in their current scope and form.

First, the fundamental problem does not simply lie with profiteering by retailers or the surge in Chinese imports, but in the lack of competitiveness of the domestic clothing sector relative to Asia as a whole. China is simply the "vanguard of the wedge"; a symptom of greater underlying problems such as the fact that local firms generally lack the production capabilities – technology and knowledge of World Class manufacturing – to compete on price, quality and flexibility. The reluctance of individual firms to aspire to world class manufacturing principles and incorporate WCM practices into their factories penetrates far deeper than competitive pressure from the Chinese. Morris and Reed (2008) reveal that local manufacturers face significant skills constraints which inhibit and retard efforts by individual firms to make the transition to WCM. It is these greater issues, like the lack of skills, which impact directly on the competitiveness of the industry. They will not be resolved by import restrictions, a view which is broadly confirmed by retailers who scored a zero when asked to rate on a scale of 1-5 to what extent they believe quotas have achieved their objectives of stimulating local manufacturing activity, and improved productivity and efficiency of local producers. One source comments:

> "There have been no published success stories, there are no new factories, the ones that are operating are hanging in desperately, local suppliers have got even more clever at taking product out to come in at a price, deliver performance is no better, quality is worse, turnaround time is worse, innovation is no better, factories have still closed, suppliers are complaining that it's all our fault because our price expectation is too keen…"

Second, competitiveness is closely associated with wage costs and working hours (Lawrence et. al. 2006). The former is rooted in general labour market rigidity in the South African economy toward which the considerable power of unions is a major contributor. The latter is a controversial point with many manufacturers arguing that a shift or piecework system would significantly raise productivity and better enable them to compete with Asian countries which operate along these lines.

Third, there is insufficient obligational cooperation along the domestic value chain to ensure systemic competitiveness. Once again, the cause of the problem does map directly back to Chinese competition but has political and historical roots. The textiles and clothing industries have never been "close" with textiles manufacturers unable to meet quality and lead times requirements, as well as historically exporting rather than supplying the local clothing industry. Again, quotas are unlikely to occasion the formation of strategic and collaborative relationships between these sectors, particularly given their short time horizon. In fact, this problem may actually escalate if local textiles firms act on plans to export more and increase the level of industrial textiles produced in future in order to reduce their exposure to Chinese competition.

Good industrial policy would tackle the source of the problem, i.e. value chain alignment and pipeline development, something which quotas do not. On a positive note, however, despite significant potential for quotas to derail the delicate obligational relationships between manufacturers and retailers that have been fostered over the past few years, largely thanks to the Business Alliance, this has not transpired. Firm level interviews reveal that supply relations remain on a reasonable standing between local suppliers and major retailers, and firms continue to benefit from participation in the clothing clusters established over the past two years. Although retailers in principle support the "buy local" campaign, they remain cautious about the ability of local fabric suppliers to deliver on quantity and quality across the board. As one major retailer explained there are limits to this process:

> "We intend to increase our local component significantly, but are extremely concerned that there are a number of fabrics that the local market cannot make that are identical or similar, correct fashionability for the season and of correct texture and weight."

In addition they warn that a price which is "too far out" will simply lead to the procurement of ready-made garments from quota-free areas.

Implementation, scope and allocation of quotas

With regard to the quotas themselves, the Business Alliance (2006) observed that without consultation with key players (retailers and manufacturers), and direct feedback from the industry itself, the DTI would lack the detailed knowledge necessary to design a quota mechanism with the necessary flexibility to handle ongoing production incapacities and market distortions. The limited production capacity of local fabric firms to meet demand, and in some cases, the complete inability of local firms to produce the fabric at all, spelled chaos and significant market disruption in the short term. These capacity shortages were a key reason why quotas would likely fail to stimulate output in the local industry with many producers simply unable or, in the opinion of some, unwilling to.

> "The local industry did absolutely nothing to step up to the plate in delivering extra capacity to make up for quota restrictions and this cost us market share loss."

Neither would the DTI be able to appreciate the full range of products affected, or deal with the direct, but also indirect and unintended, consequences of the quotas. In the long term, the problem was also regarded as unlikely to be rectified given the short-term nature of the intervention. Edwards et al (2006) warned that the inclusion of textiles in the restrictions could have the perverse consequence of choking supply to the manufacturing industry, the very industry the measures are intended to help. Morris argued that this was also potentially the case where clothing manufacturers were also importers of components (in Hazelhurst 2006b).

Key stakeholders argue that quotas on fabric directly prevent South African manufacturers from being competitive since China is globally acknowledged to be the most effective supplier of fabric. Since all of South Africa's competitors, both Far Eastern and African, source their fabric from China, restricting South Africa's access to this cheap fabric gives these countries a distinct competitive advantage (Clotrade 2007a, 2007b, 2008). Apart from the implications of price increases from restrictions on supply, manufacturers report increasingly poor delivery performance and product quality from local fabric suppliers in the wake of quotas. However, even where firms are not directly affected by restrictions, one senior official contends that quotas are a "psychological problem" since they strengthen the position of fabric suppliers and reduce clothing manufacturers' bargaining power. As a result, lead times increase which puts manufacturers under pressure.

The restriction on certain fabrics but not on the fully made-up garment from those fabrics led to the bizarre consequence of increasing the incentive to import the ready-made garments. Also, since quota was allocated against previous imports, new firms were prevented from entering the market and existing firms could not innovate and develop garments using new fabrics embodying the latest technology. Most manufacturers interviewed dismissed quotas as a thinly disguised political tool to achieve leverage with respect to Bargaining Council compliance. As one interviewee put it,

> "SACTWU decides who get additional quota. We import most of our fabric and use a fabric that is not available anywhere in South Africa. Our quota has been used up. But to get additional quota, you have to prostitute yourself in terms of additional machinists, committing a percentage of turnover for training and undertaking to buy more local fabric. Quotas have nothing to do with the needs of the industry, they are a political instrument."

Retail reinforces this view:

> "(…) some retailers sold their souls for additional quota so that playing fields were manipulated at labour whim."

12. Conclusion

Preliminary analysis of macroeconomic trade and employment data and evidence from key stakeholders confirm earlier findings that **quotas have failed as an intervention which was intended to stimulate growth and employment** in the clothing industry. By all accounts, the crisis which gripped the industry in 2005 has since deepened whilst the challenges facing South African manufacturers have been amplified by general economic downturn.

Macroeconomic trade data shows that whilst quotas have effectively curtailed Chinese clothing imports, especially in quota lines, **local firms continue to be challenged by competitors from emergent supplier locations which are even cheaper than China**. This has had a deleterious effect on the reprieve from foreign competition that quotas were intended to afford the local industry. A combination of increasingly challenging economic conditions and the renewed exposure to China's formidable competitive forces is likely to see the South African clothing industry in a **worse position in the future than from which it started prior to quotas**.

The **government** has demonstrated a tunneled vision perspective on the clothing sector crisis, **bowing to the narrow political agendas of sectoral interest groups**. This is despite considerable international evidence that import restrictions would not be the silver bullet that would boost employment and revive output. The belief that low cost Chinese imports are the cause of the crisis reflects a simplistic and shallow understanding of the complexity of the problems which engulf the sector. As predicted, the DTI has had to backtrack on its initial statement that quotas "were cast in stone" and additional quota has been granted albeit with strings attached (Clotrade 2007b, 2008).

The empirical evidence presented in previous sections suggests that quotas have had **little impact on employment and output but instead may have simply encouraged retailers to prematurely identify alternative supply bases**. Given rising costs in China and increasing pressure to conform with environmental and human rights standards, this may have **robbed local manufacturers of a window of opportunity** in which they could win supply contracts before alternative foreign suppliers were established. According to one firm interviewed, whereas retailers previously "just imported from China, they have now developed a whole import strategy". Furthermore, if suppliers are secured in even lower cost locations that China, this could exert additional downward pressure on local supplier prices and further erode their bargaining position relative to their customers, swinging the balance of power more towards retailers. In particular, the **quotas on fabric are**

counterproductive, especially where fabric unavailability had created an incentive to import already made-up garments.

The failure of quotas to achieve forecasts for employment and manufacturing activity should constitute sufficient motivation for their discontinuation. However, if domestic reasons are inadequate for quota withdrawal, growing tension in South Africa's trade relation with China is additional motivation. Chinese authorities are openly discontented with the repercussions which restrictions on their clothing imports have on their domestic industry and employment which are unjustified if they do not reduce cheap imports into South Africa as a whole but simply fuel clothing exports from other countries (Enslin-Payne 2007). Given the significant contribution of clothing and textiles industries to their employment and GDP, the Chinese are unlikely to find the agreement conducive to sustainable future trade relations. This disquiet also comes amid recent controversies relating to human rights abuse in some of the newly emerging supplier countries such as Myanmar (Robbins 2007). In tandem with the Chinese, the WTO has issued a similar warning against the efficacy of safeguards which in the US and the EU had not led to a reduction in imports but had simply benefited a host of other countries rather than alleviating the burden on local manufacturers (Le Roux 2007). The Chinese quota agreement has run a substantial part of its life time without achieving any of its purported aims. It remains to be seen whether the DTI will acknowledge this and act on it.

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