SOUTHERN AFRICA GLOBAL COMPETITIVENESS HUB

The Elimination of Quotas Under the World Trade Organization Agreement on Textiles and Clothing:

The Impact on Swaziland

Submitted by:

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Executive Summary

On January 1, 2005, the global textile and apparel market will experience significant changes due to the expiration of quotas under the Agreement on Textiles and Clothing (ATC). As a result, Swaziland's textile and apparel sector, supporting nearly 30,000 employees, most of whom are women, will experience increasing international competition. The resulting fallout will likely reduce production of apparel in Swaziland, and therefore exports and jobs in this sector.

As the global industry adjusts to this new environment, there will be winners and losers, but a good portion of textile and apparel production is likely to migrate to regions that are cost-efficient and have developed economies of scale, such as Asia. There are several factors that will mitigate the risk to Swaziland:

- AGOA tariff preferences until September 30, 2007;
- China safeguards;
- Provisions negotiated in the Southern African Customs Union Free Trade Agreement (SACU FTA);
- The desire of buyers to maintain some degree of diversified global sourcing.

While some of these factors could soften the impact, the period after January 1, 2005 does not amount to an easy adjustment for Swaziland. The country will face numerous challenges. The Swazi apparel industry is characterized by reliance on the production of basic quota-constrained apparel goods, with nearly all inputs originating from Asia. Swaziland faces additional challenges including the appreciation the rand; relatively high labor costs; low productivity; and high transportation costs. Further complicating the matter, some producers and buyers in the industry identify the political environment in Swaziland as a deterrent to doing business in the Kingdom.

The combined impact of the immediate concern about the appreciation of the rand; the competitive factors of production; the political climate; and the shifting macro environment of the textile and apparel industry are cause for significant concern. Recent economic modeling by the World Trade Organization (WTO) predicts that the current U.S. market share held by sub-Saharan African textile and apparel producers could decline by nearly 70 percent once quotas are removed. Additional studies indicate a large percentage of apparel products imported under the African Growth and Opportunity Act (AGOA) from sub-Saharan Africa, including those from Swaziland, are at high risk of losing U.S. market share. Once third-country fabric provisions expire under AGOA on September 30, 2007, the situation becomes even more critical. Swaziland is in urgent need of a focused strategy to mitigate the impacts to the textile and apparel industry once quotas are eliminated.

Swaziland stands at a crossroads: fluctuations in the global economy - in this specific instance, the global textile and apparel industry - threaten the ability of the Kingdom to rely on foreign investment flows for sustainable economic development. This study and subsequent recommendations offer an opportunity to mobilize stakeholders to offset potential significant losses in the Swazi textile and apparel sector.

Introduction

This report is a qualitative assessment of the textile and apparel sector in Swaziland in the context of the phase-out of textile and quotas on January 1, 2005 as required by the World Trade Organization Agreement on Textiles and Clothing. The competitive factors and structure of textile and apparel industry structure are discussed based upon field work conduced with apparel firms operating in Swaziland interviews with producers, buyers, and textile and apparel associations in the United States.

The report includes a trade and apparel industry profile of Swaziland detailing the major categories of apparel imports, and the level of quota constraint in those categories, and potential threat to the industry posed by quota elimination. In addition, macro and micro policy considerations are presented, along with issues and recommendations.

The report is divided into four sections: World Trade Organization Agreement on Textiles and Clothing; Swaziland and the Expiration of Quotas; China; Mitigating Factors; and Issues and Recommendations.

1 WTO Agreement on Textiles and Clothing

The ATC is the transitional agreement that regulates trade in textiles over the 10-year Multi-Fiber Arrangement (MFA) phase-out period. The basic premise of the ATC is to ensure the removal of restrictions applied by a number of developed countries including the United States, the European Union (EU), Canada, and Norway on imports of clothing and textiles, by requiring these countries to remove restrictions in four stages over a 10-year period, as illustrated in Table 1-1.

Table 1-1:

Agreement on Textiles and Clothing: Stages for Quota Elimination

Stage	**Starting date**	**Share of trade integrated**	**Quota growth rate[1] increase**
1. 1995-1997	**1/1/1995**	**16**	**16**
2. 1998-2001	**1/1/1998**	**17**	**25**
3. 2002-2004	**1/1/2002**	**18**	**27**
4. -	**1/1/2005**	**49**	**N/A**

[1] The acceleration of quota growth will be advanced by one stage for supplying countries that accounted for 1.2 percent or less of an importing country's total quotas as of December 31, 1991.

Source: Agreement on Textiles and Clothing, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations.

1.1 ATC Stages

In stage one, the large importing countries integrated goods totaling 16 percent of trade starting on January 1, 1995; 17 additional percent of trade starting on January 1, 1998; 18 additional percent on January 1, 2002; and a final 49 percent on January 1, 2005.[1]

Products that remain restricted are allowed an increase in growth rates.[2] In stage one, quotas for such products will be increased by 16 percent; in stage two, by an additional 25 percent, and by stage three, by an additional 27 percent. The acceleration of quota growth will be advanced by one stage for supplying countries that accounted for 1.2 percent or less of an importing country's total volume of the imported restrictions.

[1] Agreement on Textiles and Clothing, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations.
[2] Hanna Kheir-El-Din, *Implementing the Agreement on Textiles and Clothing*, Development, Trade, and the WTO: A Handbook, 2002, The World Bank, p. 186.

1.2 "Back-loaded" Nature of the ATC

Stage three and especially stage four are important in understanding how developing countries such as Swaziland will fare after January 1, 2005. In stages one and two the elimination of quotas had a smaller impact because the removal of quotas did not apply to products that had previously been constrained by quotas, and imports were below quota levels.[3] This is true for the United States, as the list of items notified indicate that until the end of 2001, products were not originally quota-constrained, or were of little importance.[4] This has resulted in nearly 80 percent of clothing imports, or $61 billion in the United States that are subject to quotas until January 1, 2005.[5]

The "back-loaded" nature of the quota transition period does not amount to an easy adjustment period for Swaziland. The 49 percent of textile and apparel products that will be integrated on January 1, 2005 will clearly subject Swaziland to increased competition in international markets. Goldman Sachs found that 71 percent of American and European manufacturers, wholesalers and retailers base more than 20 percent of sourcing decisions on quotas.[6] China and second-tier producers such as India and Pakistan will undoubtedly capture additional market share in the United States after 2004.

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[3] Peter Minor, "Changes in Global Trade Rules for Textiles and Apparel: Implications for Developing Countries," November 20, 2002, p. 9.
[4] *Ibid.,* Kheir-El-Din, p. 189.
[5] "The Looming Revolution" *Economist*, November 13, 2004. p. 78.
[6] *Ibid.,* 78.

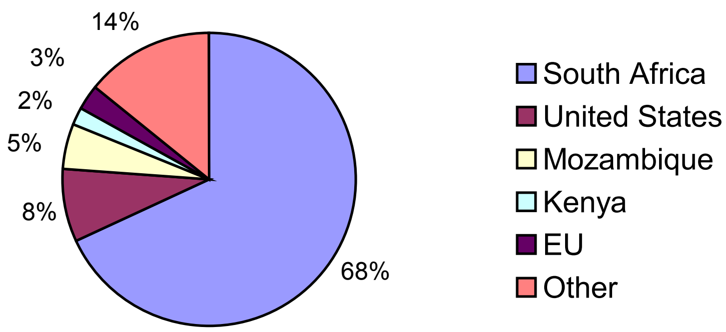
2 Swaziland and the Expiration of Quotas

2.1 Economic Environment

The Kingdom of Swaziland is the second smallest country on the African continent, bordered by Mozambique and Southern Africa. With a small domestic market due to a population of just over a million people, the country relies upon export-oriented industry. The value of exports exceeds 65 percent of the country's GDP.[7] Due to the export-oriented nature of the economy, Swaziland's economic performance is dependent upon global economic trends in growth, commodity prices, and flows of capital and aid.[8]

South Africa is a dominant force in Swaziland's economy, accounting for most expatriate employees and investors. Over 85 percent of the country's imports come from or through South Africa, and 50 percent of Swaziland's exports go to South Africa.[9]

Figure 1-1: Destination of Swaziland Exports 2002



Source: United Nations COMTRADE database.

Destination of Swaziland Exports 2003

While the Kingdom's exports rely on agriculture, the manufacturing sector is emerging as a dominant sector of the economy.[10] The industrial sector, which accounts for over 35 percent of GDP, produces value-added goods in several sectors including wood pulp production, drink processing, fruit canning, sugar processing, and more recently, textiles and apparel.

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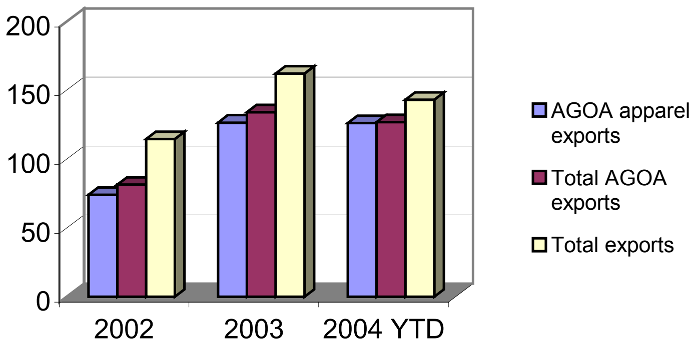
[7] *Swaziland Country Commercial Guide 2002*, United States Department of Commerce, p.2.
[8] *Ibid*, p.1.
[9] *Ibid*, p.1.
[10] *Ibid*, p.3.

2.2 AGOA

Swaziland became AGOA eligible on October 2, 2000, and qualified for the apparel provision on July 26, 2001. Swaziland is eligible for the special rule for apparel, which provides the opportunity for the apparel industry to use non-U.S. fabric and yarn in apparel wholly assembled in Swaziland and still qualify for duty-and quota-free treatment until September 30, 2007.[11]

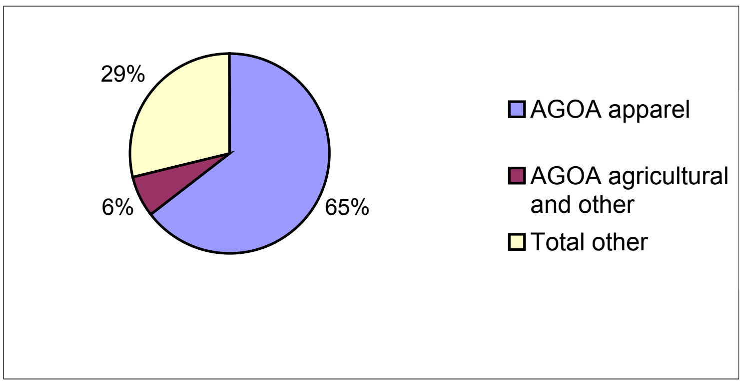
Figure 1-2: Swaziland's AGOA and Total Exports to the United States



Value in millions of dollars. YTD includes January – September 2004.

Source: Compiled by the U.S. International Trade Commission from official Statistics of the U.S. Department of Commerce.

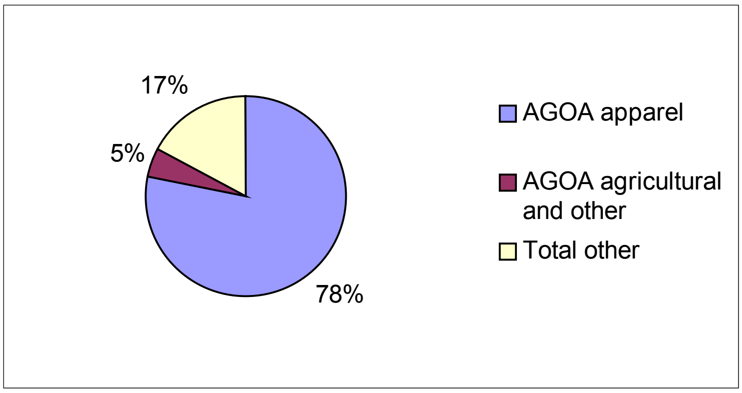
Figure 1-3: Composition of 2002 Swaziland Exports to the United States



Source: Compiled by the U.S. International Trade Commission from official Statistics of the U.S. Department of Commerce.

[11] Lesser-developed countries are those with a per capita gross national product of less than $1500 a year in 1998 as measured by the World Bank.

Figure 1-4: Composition of 2003 Swaziland Exports to the United States



Source: Compiled by the U.S. International Trade Commission from official Statistics of the U.S. Department of Commerce.

As figures 1-2 and 1-3 indicate, Swaziland's exports to the United States are heavily concentrated in apparel. For 2002 and 2003, AGOA exports totaled 65 and 78 percent of total exports to the United States, respectively. Apparel exports for January – September 2004 nearly exceeded exports for the entire 2003 calendar year. AGOA apparel exports to the United States accounted for at least 5 percent of Swaziland's GDP in 2003.

2.3 Textile and Apparel Sector in Swaziland

The apparel industry in Swaziland is labor intensive and employs mostly women. The sector supports nearly 30,000 employees.[12] At least 28 firms are producing textile and apparel products in Swaziland. As is the case in other developing countries, apparel companies in Swaziland offer poor women, who have few options for employment other than this sector, income at levels that cannot be produced in the informal sector. This phenomenon is not significant to Swaziland. Many of the textile and apparel sectors in Southern Africa offer unskilled manufacturing employment to women, as an opportunity to leave the informal sector.

Swaziland's eligibility for the apparel provisions in July 2001 spurred foreign direct investment (FDI) in the industry, primarily from Taiwan. The apparel industry in Swaziland is characterized as largely mass production of lower-quality basic products sold to high-volume discount chains in the United States, such as Wal-Mart. The main apparel products produced for the industry include cotton products, cotton apparel, man-made fiber products and apparel, and knit shirts and blouses.

Taiwanese firms dominate the production of wool, cotton and polyester products. Additional firms from South Africa, Hong Kong and Indonesia produce apparel products for the local market, South Africa and the EU.

[12] Swaziland Trade Promotion Unit, figure includes seasonal employees.

However, a majority of the apparel firms in Swaziland export 100 percent of their products to the United States.

Table 1-2:

Textiles and Apparel: United States General Imports from Swaziland
2001 – 2004, in Millions of Square Meters Equivalent

Category	Description	2002	2003	YTD[1]
0	Textiles and apparel total	25.2	49.1	39.3
1	Apparel	25.7	49.2	39.4
30	Cotton products	17.8	25.8	18.9
31	Cotton apparel	17.8	25.8	18.9
60	Manmade fiber products and apparel	7.5	23.3	20.5
338	Knit shirts	1.8	.9	1.4
339	Knit blouse	5.7	7.1	5.9
340	Cotton not knit shirts, men and boys	1.1	.9	.7
345	Cotton sweater	1.3	.7	-
347	Cotton men and boys trousers	3.1	4.1	3.2
348	Women and girls slacks	3.3	6.2	4.7
351	Cotton nightwear and pajamas	.1	1.4	.5
634	Manmade coats, men and boys	.2	.3	.8
638	Manmade knit shirts, men and boys	1.1	3.7	3.7
639	Manmade knit blouses, women's and girls	1.4	4.4	1.6
647	Manmade trousers, men and boys	.7	2.2	3.5
648	Manmade slacks, women's and girls	.7	3.2	4.8
651	Manmade nightwear and pajamas	2.4	7.3	3.7
659	Manmade other apparel	.4	.3	1.5

[1] Year-to-date (YTD) includes exports from January – September 2003.
Source: United States Department of Commerce, Office of Textiles and Apparel

To administer the United States textile and apparel quota program, articles are grouped under 3-digit category numbers, which cover 10-digit statistical reporting numbers under the Harmonized Tariff Schedule (HTS) of the United States. The numbers represent levels of import aggregation, for example "1" represents imports of apparel, "60" represents imports of manmade fiber products and apparel, etc.

Table 1-2 illustrates Swaziland's exports of textiles and apparel to the United States reflects data from the first two calendar years of AGOA eligibility collected for Swaziland, 2002 and 2003. Figures in the year-to-date (YTD) column reflect data from January 1, 2004 – September 30, 2004.

2.4 Quota Constraints on Apparel Products from Swaziland

Swaziland's textile and apparel exports to the United States consist primarily of cotton products and apparel, and manmade fiber products and apparel. According to the Office of Textiles and Apparel calculations at the U.S. Department of Commerce, *quotas constrain nearly 100 percent of apparel goods exported from Swaziland to the United States*. This is cause for grave concern because Swaziland will lose its protection against competition from Asia in these product areas effective on January 1, 2005.

Table 1-3: Top 4 Swaziland Apparel Products and Related Quota Constraints

Apparel product	Percentage of total apparel exports	Number of quota-constrained countries	Weighted Average MFN Tariff Rate
Cotton trousers/slacks	20%	15	17%
Cotton Knit shirts	16%	13	18%
Manmade nightwear	14%	17	16%
Manmade trousers/slacks	10%	8	28%

Source: Office of Textiles and Apparel, United States Department of Commerce.

2.5 Significance of Quota Constraints on Apparel Products from Swaziland

Not only are Swaziland's apparel exports to the United States quota constrained, but they are constrained by countries with the greatest potential to increase market share in these product areas. For each category, quotas constrain different countries. For the top two categories, cotton trousers/slacks and knit shirts, China and India represent the greatest potential for U.S. market share after the removal of quotas.

After January 1, 2005, many countries will compete for market share for the top four apparel products exported to the United States from Swaziland. Swaziland will keep the advantage of AGOA tariff preferences, but with the appreciation of the rand, and uncompetitive business costs as described in the next section, the country may not be able to overcome the downward pressure on price, even with tariff preferences.

2.6 Competitive Factors in the Swaziland Apparel Industry

2.6.1 Domestic Business Incentives

Swaziland is a free-market economy with relatively little government intervention and a largely open market policy. The Government of the Kingdom of Swaziland encourages FDI by providing factory shells to the industry, and extending tax allowances to foreign firms. Dividends are exempted from withholding tax for ten years.

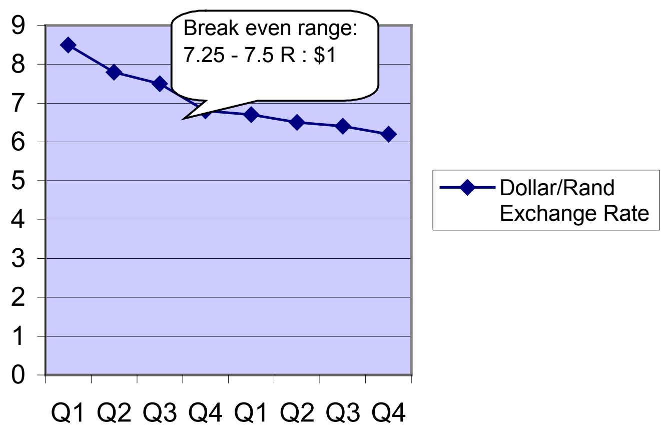
Apparel firms operating in the Matsapha district rank the quality of the factory shells in Swaziland as superior to others in the Southern Africa region. While the provision of factory shells draws investors in the apparel sector, it also allows for mobility – i.e. the potential for these firms to easily exit Swaziland in search of lower-cost production areas.

2.6.2 Appreciation of the Rand

The Swazi currency, the lilangeni, is pegged 1:1 with the South African rand. The appreciation of the rand remains the immediate and critical concern of apparel producers in the Kingdom. Every apparel producing firm interviewed in this study cited the appreciation of the rand as an extremely significant concern. Apparel firms operating in Swaziland have lost nearly 50 percent in potential revenue in 2004. Nearly 10 percent of the 30,000 workers in the Swaziland apparel industry have lost their jobs since August 2004. Further reporting suggests 3,500 employees in the apparel sector lost their jobs in November 2004. While transportation costs and labor productivity contribute to cost concerns, firms cited the gradual appreciation of the rand as the primary reason for the retrenchments.[13]

Swaziland producers claim the break-even point at which the rand must trade ranges between 7.25 – 7.5 :$1. Two firms interviewed indicated an eminent collapse within the next 12 months if the rand continues to appreciate. One firm interviewed indicated potential collapse within the next six months. Some Taiwanese apparel owners indicated that they have sold their homes in Taiwan to keep their businesses operating.[14]

Figure 1-5: Dollar/Rand Exchange Rate 2003-2004



Source: South African Reserve Bank, based upon average quarterly exchange rate.

[13] Based upon interviews with textile and apparel producing firms in Matsapha, Swaziland.
[14] Unclassified State Department Cable, Mbabane 519, "Textile Industry Loses Jobs and Fears More to Come," October 4, 2004.

2.6.3 Vertical Integration

Most firms interviewed cited the lack of local inputs as a significant cost of doing business in Swaziland, and the development of a textile industry as critical to survival over the longer term – i.e. after third country fabric provisions expire under AGOA on September 30, 2007. Fabrics sourced locally would reduce costs significantly. Currently, producers import fabrics from Asia to manufacture apparel for export. The Tex-Ray Group currently has a spinning mill, and a knitting and dyeing mill are due to come online in May or June 2005. The new facility will bring an additional 3,000 jobs to Tex-Ray operations in Swaziland, and cut down the lead-time for some products from four months to 2.5 months.[15] This investment indicates the intent of Tex-Ray to remain in Swaziland over the longer term.

While firms cited a Swazi textile industry as critical to cutting costs, none believed it is realistic to set up a competitive vertically integrated industry in Swaziland for two primary reasons. First, material supply operations are highly capital intensive. Second, firms in Swaziland cited a need for access to nearly 80 types of fabric to remain competitive. According to apparel producers in Matsapha, the country requires 10 plants, as each plant realistically produces five or six quality fabrics each. No such investment is forthcoming, and it is unrealistic to expect it to materialize. Firms in Swaziland source nearly all materials from Asia, and will continue to do so. When asked about sourcing materials from the United States, firms said that prices made this option out of the question. When asked about sourcing from countries in the region, firms interviewed cite low quality and high transportation costs as a deterrent.

2.6.4 Political Climate

While Swaziland maintains largely free-market policies, the country does not subscribe to a multi-party democracy. Firms cite the Swazi political tradition, which combines traditional Swazi power structures with westernized democracy, as an impediment to the country's economic progress.[16] One producer claims that Swaziland is on the unofficial "blacklist" of American buyers due in part to the rule of law crisis, and transshipment problems.[17]

> "In terms of the political environment, which I believe directly impacts businesses in this nation, the government should take steps to improve the situation for business in Swaziland."
> *– Apparel producer in Swaziland*

[15] Interview with Tex-Ray, Matsapha, Swaziland, November 2004.
[16] Based upon business confidential interviews with apparel firms.
[17] *Ibid.*

Buyers in developing countries are increasingly concerned about labor conditions in apparel producing countries.[18] Firms in Swaziland also cite a need to develop a workable framework for business and labor to build a strong foundation for the country's economic growth.

2.6.5 Labor

Swaziland has an abundant supply of unskilled labor suitable for work in light manufacturing. Firms claim turnover ranges from 10-15 percent. Wages for workers in the apparel industry in Swaziland have increased by six percent effective September 1, 2004.[19] Apparel firms in Swaziland pay workers between roughly $155 per month. According to firms interviewed as part of this study, workers in Swaziland are no match for Asian counterparts in terms of the cost of labor and productivity. One firm cited a comparison to its operations in Vietnam, where workers are paid $80 per month and produce on average 50 percent more product.[20]

Firms also cited absenteeism as a critical concern. One producer claimed that on any given day, the company expects an 8-12 percent absentee rate.[21] This compares with absentee rates of 2-3 percent for this company's factories in Asia.[22] Absenteeism impacts line production, as employees must be rotated to fill specific spots on each line. When five workers fail to show up on a 50-person line, productivity inevitability decreases, adding precious time to the order completion process.[23]

HIV/AIDS undoubtedly contributes to absenteeism in Swaziland. Nearly 40 percent of Swaziland's adult population is infected with HIV. In addition to social consequences, this high infection rate will have profound impacts upon future economic performance.[24]

2.6.6 Transportation and Infrastructure

All firms interviewed in this study cited local transportation costs as high and unreliable. To illustrate this point, the cost of shipping by sea from Hong Kong to Durban for a container shipment averages between 2,500-3,000 rand, and from Durban to Mbabane, inland transport averages between 7,000-10,000 rand. In addition to the expense, transport of goods is unreliable, and

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[18] *Ibid.*, Minor, p. 30.
[19] Swaziland Government Gazette Extraordinary. Volume XLII, No, 106, Mbabane, Swaziland.
[20] Based upon business confidential interviews with firms.
[21] *Ibid.*
[22] *Ibid.*
[23] *Ibid.*
[24] The IMF estimates the country's population may shrink by .4 percent annually, beginning in 2010. The number of children orphaned by AIDS is expected to increase to 25 percent of all children, and life expectancy could fall to 27 years. The IMF estimates that the level of per capita output could fall by 7 percent in the medium term.

shipments arriving via road are often delayed, creating additional costs and production concerns for apparel firms.

2.6.7 Additional Factors

Adding additional downward pressure on producers in Swaziland, second tier producers including India, and Pakistan reduced prices between 25 – 30 percent in the past 12 weeks, in preparation for quota removal. Further, buyers are using the quota factor as a negotiating tool, placing further downward pressure on Swazi producers.

Nearly all firms surveyed indicated that they have received orders that will carry them through the next several months. Firms expressed concern about orders forthcoming in the next cycle, from February – March 2005.

3 China

China has the ability to make nearly any type of apparel or textile product at a competitive price.[25] The domestic textile and apparel industry in China has been preparing for the elimination of quotas by restructuring the industry. From the period of 1997-1999, the Chinese industry cut nearly one million jobs as the Chinese government privatized much of the previously state-financed industry.[26] In addition, China has invested in new textile and apparel machinery. According to the United States International Trade Commission, in 2002, China accounted for nearly three-fourths of purchases of shuttleless looms, machines that are adept at advanced weaving technology.[27]

> **Shanghai's Shenda Group Co.: Restructuring to prepare for quota removal.** From 1998-2004, Shenda Group fired 50,000 people and closed 20 factories. At the same time, the company purchased high-tech equipment and trimmed employment to 10,000. With the new equipment and fewer and more productive employees, the company boosted annual sales from $170 million to $415 million in that time period. "We can beat any competitors in international markets, we are ready for expansion." --- *Yao Xiyi, Shenda General Manager*

Chinese textile and apparel companies also are working to meet the changing demands of buyers. Luen Thai Holdings, Ltd., in Dongguan, China is working with a new concept in apparel production, the "Supply-Chain City." The Supply Chain City concept is a huge industrial campus – a two million square foot facility - that includes a factory, a dormitory for 4,000 workers, and a hotel for buyers that includes a gym, coffee shop and karaoke lounge.[28] Liz Claiborne is already buying into the concept, relocating several sourcing employees to the Luen Thai campus in southern China.

After quotas are removed, Liz Claiborne intends to consolidate sourcing from over 35 countries in 2004, down to just a few countries in the coming years.[29] Andrew Tsuei, Wal-Mart's global procurement chief, has indicated their company has plans to reduce the number of companies where their company has deals from 63 to four or five that can produce as much as Wal-Mart orders. China is at the top of the list.[30] Manufacturers interviewed in Swaziland as part of this study indicated that Wal-Mart recently has placed

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[25] United States International Trade Commission, *Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market*, Investigation No. 332-448, USITC Publication 3671, January 2004, p.3-22.
[26] "Ready to Take On All Competitors and Markets", *Washington Post.* November 17, 2004, p. A-19.
[27] *Ibid.* p. A-19.
[28] "Making Labels for Less," *Wall Street Journal,* August 13, 2003, p. B-1.
[29] *Ibid.* p. B-1.
[30] Blustein, Paul and Peter Goodman. "A New Pattern is Cut for Global Textile Trade: China Likely to Dominate as Quotas Expire," *Washington Post*, November 17, 2004, p. A-1.

downward pressure on price.[31] Such consolidation will reduce the time and expense to large retailers of producing in various countries throughout the world.

In addition to these factors, China also has existing infrastructure and logistics in place for buying and shipping non-textile products. Major retailers indicate that they establish buying offices in countries holding other business lines, thus negotiating better rates with large volume loads.[32] In addition, China has an abundant low-cost supply of labor. In the apparel sector, workers are considered very productive.[33] Workers in Chinese factories routinely work 12 hour shifts, and are compensated by piece, rather than per hour.

With cheap and productive labor, improving technology, and an industry responsive to the demands of buyers, China is in a good position to capture additional market share once the final quotas are removed in January 2005. Further evidence supports this view:

- For Australia and Japan, countries that do not have quotas, China maintains nearly 70 percent of the textile market.[34]
- In 2002, the United States eliminated quotas on baby clothing, and China's share of those imports surged from around 10 percent to nearly 55 percent at the end of 2003.[35]
- During the first six months of 2002, exports from China to the United States increased by 100 percent and higher for 12 of the 18 constrained categories that had quotas at least partially eliminated in 2002.[36]

3.1 Second tier production – India and Pakistan

Most U.S. retailers have indicated that they will expand sourcing from South Asia, of which India and Pakistan top the list. Of these second-tier producers, India stands the largest chance of increasing market share, and Pakistan has invested nearly $4 billion in the textile and apparel sector in the last four years.[37] India is the world's third largest cotton producer and houses the world's largest polyester production facility. India is the world's second largest yarn-spinner behind China. A WTO study (Nordås 2004) indicates that India's share of the United States market will increase from 4 percent to 15

[31] Based upon business confidential interview in Matsapha, Swaziland.
[32] *Ibid.,* USITC 3-23.
[33] *Ibid.,* USITC 3-24.
[34] *Ibid., Washington Post.,* p. A-19.
[35] According to data analyzed by Pietra Rivoli, Trade Expert at the McDonough School of Business, Georgetown University, Washington, DC.
[36] *Ibid.,* p. 19. Minor also indicates that China's exports to the United States increased over 400 percent over the same period, which shifted numerous jobs from many regions of the world to China.
[37] *Ibid., Economist,* p. 79.

percent; China's share will increase from 16 percent to 50 percent; and the sub-Saharan African share could decline as much as 70 percent.[38]

[38] Nordås, Hildegunn Kyvik, "The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing" World Trade Organization, Geneva, Switzerland, 2004, p. 30.

4 Mitigating Factors for Swaziland

While China and other second tier producers will likely dominate the textile and apparel industry in the long term, there are factors that will mitigate the impact for Swaziland. There are four factors that may soften the impact for Swaziland: safeguards; AGOA preferences; potential SACU FTA provisions; and the desire of buyers to maintain some degree of diversified global sourcing.

4.1 Safeguards

China became a member of the World Trade Organization (WTO) in December 2001. At that time, China became party to the ATC, to include quota phase-out for textiles and apparel on January 1, 2005. China's accession agreement includes safeguard provisions that can be utilized in response to import surges of Chinese textiles and apparel from China for four additional years – from January 1, 2005 until December 31, 2008. There are two types of safeguards the United States may use against China. The first is a product-specific safeguard, which is applied after an investigation determines that China's imports are the cause of market disruptions in the United States. This safeguard provides three years of protection, with the possibility of a two year extension, which is accessible for twelve years after 2005. The second safeguard, the sector-specific safeguard provides one year of protection, available through December 31, 2008.

The United States is currently examining imposing safeguards on at least five categories of clothing, three of which are in areas of Swaziland's top four apparel exports in terms of volume. If imposed, these safeguards will limit China's export growth in each category to 7.5 percent.[39] If safeguards are applied in these categories, the result will be uncertain periods of market opportunity for Swazi apparel exports to the United States.

4.2 AGOA Preferences

After January 1, 2005, many countries will compete for additional market share for the products exported to the United States from Swaziland. At the same time, Swaziland will maintain the advantage of tariff preferences under AGOA. Swaziland is eligible for the special rule for apparel, which provides the opportunity for the apparel industry to use non-U.S. fabric and yarn in apparel wholly assembled in Swaziland and still qualify for duty-and quota-free treatment until September 30, 2007. As illustrated in Table 1-4, tariffs range from 18-32 percent on the main apparel exports to the United States

[39] http://www.otexa.ita.doc.gov

from Swaziland. Even with these preferences, Swaziland may not be able to maintain competitiveness in the U.S. market.

4.3 Potential SACU FTA Provisions

The AGOA legislation sets out provisions for the negotiation of free trade agreements between the United States and countries in Southern Africa.

> SEC. 103 (4) "Congress supports negotiating reciprocal and mutually beneficial trade agreements, including the possibility of establishing free trade areas that serve the interests of both the United States and the countries of sub-Saharan Africa."[40]

The United States and the Southern African Customs Union (SACU) – South Africa, Botswana, Lesotho, Namibia and Swaziland – launched negotiations toward a free trade agreement (FTA) in Pretoria, South Africa on June 2, 2003. A free trade agreement between the United States and SACU presents the opportunity to potentially "lock in" and build upon some of the benefits of AGOA. A free trade agreement also sends a signal to the private sector about building a comprehensive infrastructure for trade and investment between the United States and the SACU countries.

For the textile and apparel sector, the SACU FTA represents an opportunity to negotiate improvements in textile and apparel benefits, offering duty-free treatment for luggage, fabrics, comforters, and made-ups (home furnishings) currently unavailable under AGOA.

For most apparel products, a final negotiated agreement could offer a better rule of origin: both the free trade agreement and AGOA would provide duty- and
quota-free treatment for apparel. The U.S. free trade agreement proposal for these apparel products is generally a yarn-forward rule, provided the cutting, sewing, and visible lining requirements are met; only the component that determines the tariff classification confers origin. A free trade agreement would make permanent this treatment whereas AGOA is set to expire in 2015 and the third country fabric provision for Swaziland expires September 30, 2007.[41]

4.4 Diversified Global Sourcing

Buyers have indicated a desire to maintain some degree of globalized sourcing in a post-quota environment. Buyers may choose not to have all

[40] Trade and Development Act of 2000, Sec.103(4). www.agoa.gov

[41] Under the AGOA preferences, all components must confer origin, not just the outer shell. Exceptions include findings and trimmings, interlinings, de minimus, collars, cuffs, drawstrings, padding/shoulder pads, waistbands, belts attached to garments, straps with elastic, and elbow patches.

production in a few countries because of uncertainties in the global marketplace, such as SARS. Still, major buyers of basic apparel have indicated their intent to significantly reduce the number of countries from which they source, in order to reduce costs.

5 Issues and Recommendations

Issue 1: Apparel exports from Swaziland are highly quota constrained.

Recommendation: Apparel diversification strategy.

Apparel producers should consider diversifying from products that are heavily quota-constrained, to products that have a high level of tariff preference. While U.S. duties average 17 percent, peak tariffs exceed 30 percent. Duties are substantially higher on products that are made from manmade fibers. For example, knit shirts and blouses produced with manmade fiber average 32 percent. By strategically diversifying into these areas, producers in Swaziland may be able to overcome the disadvantage when quotas are lifted on January 1, 2005.

An apparel diversification strategy may include:

- Targeting non-quota constrained products to products enjoying a high tariff preference.
- Conducting market research to determine apparel products that can compete effectively in the new environment.
- Performing a feasibility study of shifting production to these products as an adjustment strategy.
- Examining the potential regional supply chains to support vertical integration in these categories.

Issue 2: The SACU FTA presents an opportunity to negotiate improvements for the textile and apparel sector in Swaziland.

Recommendation: Swaziland should proactively engage in the SACU FTA negotiations, especially in the textile and apparel and rules of origin discussions.

In the context of the apparel sector, it is in the best interest of Swaziland and the additional SACU countries – Botswana, Namibia, Lesotho and South Africa – to work together and conclude a comprehensive free trade agreement with the United States as soon as possible. For the BLNS countries, the looming expiration of third-country fabric provisions on September 30, 2007, should be incentive to move negotiations in these areas forward immediately.

The BLNS countries also should consider requesting specific trade capacity building assistance through the Cooperative Group on Trade Capacity Building on taking a proactive approach in the negotiations in order to benefit their respective textile and apparel industries.[42] Negotiators should understand how the textile and apparel provisions of AGOA and the SACU FTA may intersect, and keep government and industry officials in the SACU countries informed of their interests in this sector.

Issue 3: Buyers and producers cite the political uncertainty, which impacts the business environment, as a deterrent to doing business in Swaziland.

Recommendation: Improvements in predictability of the business climate.

- King Mswati's tendency to rule by decree creates uncertainty among foreign investors. For example, the King recently ordered the Royal Swazi Sugar Corporation (RSSC) not to fire any workers. The RSSC, a major exporter, is facing pressure due to the appreciation of the rand.
- Royal intervention in business and employment issues serves as a deterrent to foreign investment.
- Swaziland lacks adequate and comprehensive legislation for the business sector, including an Investment Code, Securities Act and Companies Act. Adequate legislation when implemented would provide comprehensive framework for the private sector.
- Improvements in these areas will elevate Swaziland's reputation in the eyes of international investors.

Issue 4: Apparel firms in Swaziland are not as productive as competitors in other regions of the world.

Recommendation: Capacity building in apparel productivity.

- Provide training to improve worker productivity.
- Identify of areas for potential outsourcing to local service providers to promote greater participation of SME service providers in the garment manufacturing value chain.

While it is difficult to quantify, HIV/AIDS undoubtedly impacts labor productivity in the textile and apparel workforce. Swaziland should take steps to formulate concrete steps to mitigate this problem. Some apparel firms expressed an interest in engaging in concrete action on HIV/AIDS, but lack support. For example, Robert Maxwell of ProCon Investments has written a working paper on HIV/AIDS in the workplace for his apparel company.

- Discussion of the HIV/AIDS pandemic in the context of productivity in the textile and apparel sector may initiate dialogue about clear

[42] South Africa is not a participant in the Cooperative Group for Trade Capacity Building.

guidelines in this area for development of the future workforce in this sector and others.

Issue 5: The GKOS lacks a focused public-private sector strategy for the apparel sector in the post-quota environment.

Recommendation: Diversification strategy.

Short-term

In the short term, the GOL should look at how to salvage the most competitive sectors in the textile and apparel industry, as mentioned in the apparel diversification strategy.

Long-term

The long-term strategy may include planning to diversify exports into non-traditional products. Discussions should take place in the context of a national dialogue that will bring together public/private sector stakeholders trade officials, labor representatives and business associations.

These stakeholders in Swaziland possess a special knowledge of the Swaziland's trade-related advantages and challenges, and are positioned to carry out policy implementation. By including members of the local business community, the group can also identify any local regulatory and structural obstacles to trade under AGOA and take action to address these as well. For example, Swaziland may want to consider structural measures, such as taking steps to make its canning industry more competitive for the food processing sector.

Many items already enjoy duty-free entry into the U.S. under either GSP or zero-tariff MFN rates. Swaziland stakeholders may consider examining methods to access AGOA tariff benefits by processing or otherwise adding greater value to these goods since processed goods generally face higher tariffs, except under AGOA provisions.

Table 1-4:

AGOA Products with High Tariff Preference Levels

Product	Tariff Preference Advantage for Swaziland
Ceramic products	4.5 – 30%
Cut roses[1]	6.8%
Electronic products	2 – 15%
Essential oils	1 – 4%
Glass and glassware	4 – 38%
Foot wear	4 – 48%
Fruit juices	4.5 – 7.9 cents/liter
Fruit paste/preparations	11.2 – 15.3%
Honey	1.9 cents/kg
Leather products	3-6%
Nuts	6.6 – 32.6 cents/kg
Nut pastes	10%
Plastics	2 – 8%
Sugars and sugar confectionary	4 – 12%
Vegetable preparations	5 – 14%

[1]Several East African countries have found a market for cut roses in the United States due to AGOA. Swaziland may consider a feasibility study for cut rose production in Malkerns.

Table 1-4 illustrates AGOA products with high tariff preference levels for Swaziland. These items serve as a starting point for discussions about diversifying into value-added products for export to the United States. Each of these products will have tariff preferences under AGOA until 2015.

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