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Assessment of Competitiveness and Logistics Infrastructure of the Philippine Garments Industry

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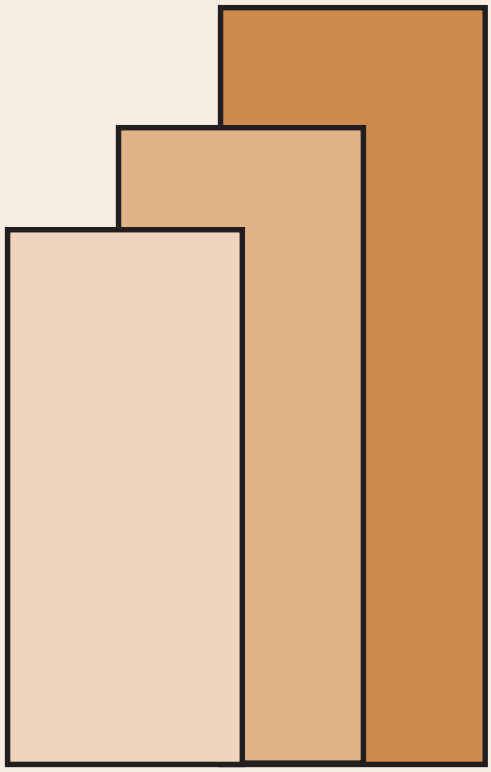

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Abstract

The paper discusses the state of the Philippine Garments Industry, with specific focus on its competitiveness and logistics infrastructure, and how the industry can make use of the prospective Free Trade Agreement with the US. With the signing of the Agreement on Textiles and Clothing on January 1, 2005 which called for the removal of all quotas over a 10-year phase-out period, textiles and apparels had been integrated into the mainstream of trade. The question, therefore, is how the Philippines should position itself into this new era of trade in garments. For the Philippines to compete, the industry needs to move up in the value chain, significantly improve its supply chain and seek preferential access to the US. Consolidation of resources among firms and investments generation for productivity enhancement are greatly needed. An FTA can likely increase the Philippines' competitiveness in the US market but the long-term solutions should be focused on industrial upgrading. Logistics must be improved and investments on physical and human capital must be made to improve the clustering programs between garments producers and textile firms.

***Key Words**: WTO, garments quota, phase-out, tariff, preferential access, competitiveness, logistics infrastructure, supply chain, Rules of Origin, Change in Tariff Classification (CTC), local value content (LVC), tariff preferential levels (TPL), Customs Trade Partnership Against Terrorism (C-TPAT), non-tariff barrier, Free Trade Agreements.*

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1 Background

From 1974-1994, trade in textile and clothing with the United States, European Union and Canada has been governed by the quota system under the MultiFibre Agreement (MFA). In 1995, the Uruguay Round under the World Trade Organization came into effect and integrated textiles and apparel into the mainstream by removing all quotas over a ten-year phase-out. The Agreement on Textiles and Clothing (ATC) was signed and covered the modality of phasing-out of quotas over a 10-year period and under four phases (Table 1).

Table 1. The Agreement on Textile and Clothing: Stages of Quota Phase-Out

Stages of Phase-Out	**Description**
January 1995	Integration of at least 16% of the import volume of 1990 for textile and clothing
January 1998	Integration of another 17% of the 1990 import volume
January 2002	Integration of another 18%
January 2005	Total integration of all textile and clothing

Source:

The quota phase-out has significant implications to the Philippines given that 89 percent of all garments and textile exports are bound to quota countries. By January 2005, all remaining quotas have been completely phased-out.

Apart from the declining market shares in the US, exporters have been concerned about the employment impact of the phase-out, considering that the two industries combined employ around 320,000 workers, mostly women. Historical records reveal that the changes in sourcing behavior of buyers, financial and economic difficulties and the lack of competitiveness have led to closure of firms and workforce reduction (Table 2). Based on the report of the Bureau of Labor and Employment Statistics, a total of 121 firms have closed down while 231 reduced their workforce from 1998-2003. That is equivalent to an average of 5,000 workers displaced per year. Main economic reasons cited for closure and displacement were uncompetitive demand and financial constraints.

Table 2. Establishments Resorting to Permanent Closure/Retrenchment Due to Economic Reasons and Workers Displaced in Wearing Apparel: 1998-2003

Indicator	1998	1999	2000	2001	2002	2003
A. Establishment Reporting	**46** [a]	**43**	**50** [a]	**52**	**66**	**90** [a]
- Closure	19	13	17	24	20	28
- Reduction of Workforce	29	30	35	28	46	63
B. Workers Displaced	**4,873**	**3,965**	**4,465**	**3,023**	**6,856**	**9,443**
- Closure	2,512	2,063	3,088	1,998	3,083	3,389
- Reduction of Workforce	2,361	1,902	1,377	1,025	3,773	6,054

a Details may not add up to total due to multiple reporting.

Source: Establishment Termination Reports submitted by employers to DOLE Regional Offices.

Based on the recent data from BLES, the garments industry accounted for 11 percent of nation employment during the period 1998-2003 compared to 16.5 percent in 1994-1998.

How can the Philippines cope with the restructuring induced by the phase-out? Can the Philippines still be competitive in the US market, its major market? Answers to these questions require an assessment of the participation of the Philippines in the global apparel value chain, the trade facilitation processes and cost competitiveness. In 2002, the Garments and Textile Export Board (GTEB) gathered the industry stakeholders to prepare the industry transformation plan. Under that plan, there were three policy interventions identified and implemented. These were:

- **Development assistance programs** designed to improve productivity through investments in technology and skills upgrading, to address speed-to-market concerns, develop and promote diversified markets and products, and provide access to financing;
- **Lowering of business costs** through reduction in quota fees by 30% to help exporters compete with other low-cost countries;
- **Quota incentives** to encourage exporters to undertake productivity and growth enhancing activities that are necessary to be competitive.

Today, exporters seek for the acceleration of institutional reforms to enhance reliability and productivity, to lower costs of trade facilitation and to create value. The industry is advocating for the Philippines to gain preferential access to the US market in order to become cost and price competitive.

Given this background, this paper aims to:

- Assess the development of the Philippine garments industry as part of the global apparel chain
- Evaluate the ability of the industry to compete under a quota-free environment
- Examine the implications of a free trade agreement with the US on the competitiveness of the garments industry

To address these objectives, this paper will first present the current state of Philippine garments exports and discusses the performance under the quota regime. The second section examines the effects of the quota phase-out and the evolving business models. The third section analyzes the issues related to the value chain of the Philippine garments industry, focusing on logistics infrastructure. The fourth section is an assessment of the implications of the RP-US free trade agreement on the industry and raises issues in negotiating duty or preferential access to the US market. Lastly, the paper concludes with a brief summary of the findings and points for negotiations and presents recommendations.

2 Development of the Philippine Garments and Textile Industries

In 2003, the Philippines exported US$2.4 B worth of garments and textiles products to both quota and non-quota countries and contributed 6.3% to the country's US$36 B export earnings[2]. The garments industry alone generated US$2.1 B. Based on GTEB data, there are 945 active manufacturers, 106 traders and 854 subcontractors employing around 320,000[3] workers, mostly women. These firms are located mostly in Luzon and inside industrial parks or economic processing zones.

The current structure and performance of the garments industry has been shaped by past industrial policies. From a cottage-based industry in the late 1950s, small enterprises emerged to replace the traditional home sewing and custom tailoring and dressmaking shops. The industry started to grow rapidly in the 60's through the Embroidery Act (RA 3137) of 1961. Garment firms under the Act enjoyed privilege duty-free importation of textiles. The industry was also covered under the Basic Industries Act (RA 3127) and the Investment Incentives Act (RA 5186) that extended tax exemptions, credit and deductions to critical industries.

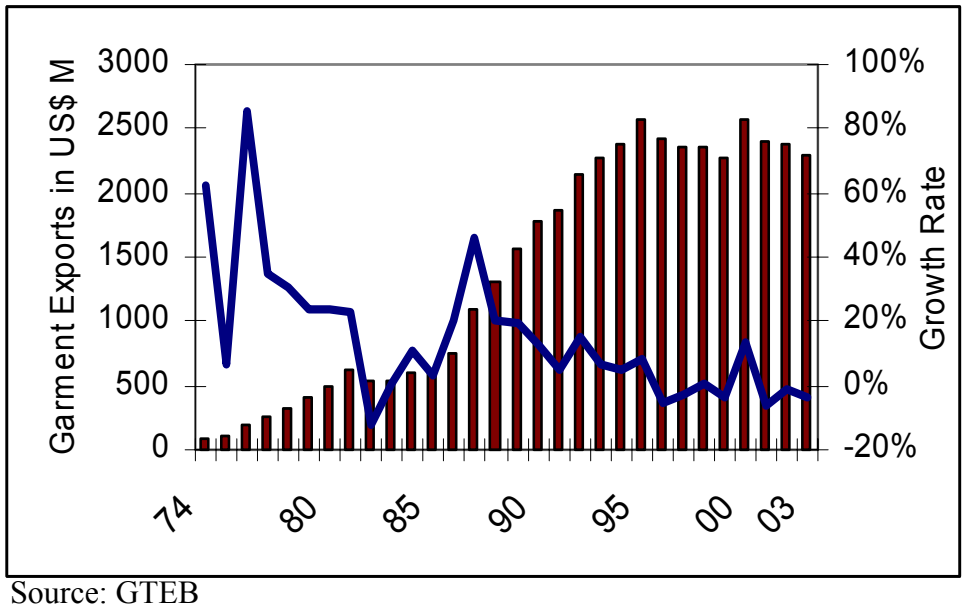
In the 1970s, restructuring was forced by the foreign exchange crisis, the weak domestic consumption and the general industry glut. From an inward-looking strategy, the government adopted an export-oriented industrialization strategy. It was at this time when the MFA took effect and opened windows of opportunity for Philippine firms to access the growing US market for clothing and textiles. The government supported the industry further through the Export Incentives Act (RA 6135) and the Export Processing Act (PD 1966). In the 1990s, the Export Development Act was passed as another incentives framework.

The quota allocations under the MFA therefore enabled the garments industry to become export-oriented and the second largest exporter, next to electronics. In 1971, the Philippines exported onlyUS$2M garments products. This increased to US$94 M in 1974, hit the US$1 B mark in 1987 and peaked in 1995 when the industry grossed US$2.6B (see Figure 1). Growth of garment exports gradually slowed starting in the early 1990s.

[2] See Appendix 1 for breakdown.

[3] The figure is 110,000 using the 1998 Annual Survey of Establishments of the National Statistics Office. This survey covers only those firms with more than 10 employees.

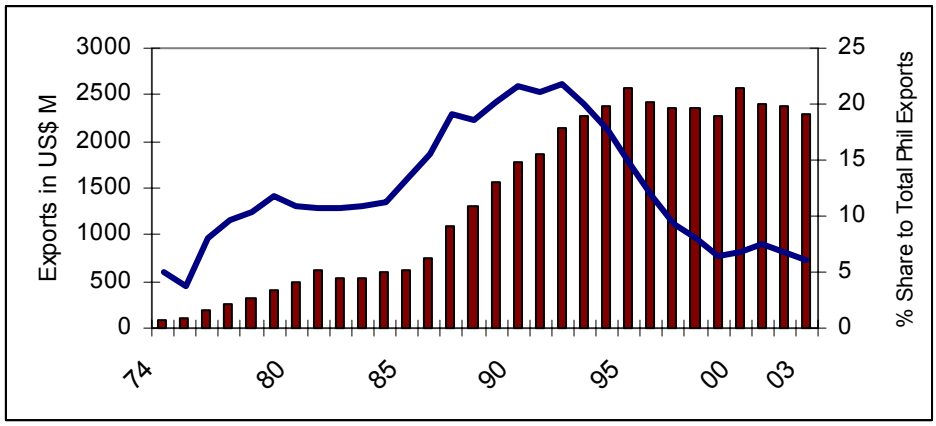
Figure 1. Value and Growth of Garment Exports



Source: GTEB

In 1974, it accounted for only 5 percent of total Philippine exports. Under the MFA, the industry's share dramatically increased in the 1980s and early 1990s. However, the intense competition in the mid 1990s (i.e. emergence of low cost suppliers and preferential trading arrangements), and the lack of competitiveness of the industry contributed to the decline in export revenues and shares of garments exports to total export earnings (see Figure 2).

Figure 2. Declining Share of Garments to total Philippine Exports.



Source: GTEB

Most of the competitors of the Philippines in the mass market enjoy the benefits of an integrated textile and garments industry. High production costs relative to world prices confined the industry to the domestic market and enjoyed protection (import and foreign exchange controls, had liberal access to dollar allocations for the importation of machinery and raw materials, and had easy access to loans and tax concessions) against imported textiles up to the 1980s. The textile producers operated below "best practices" standards (Cororaton and Austria 1997) thereby leading to their technical inefficiency. The industry suffered from the rapid expansion due to the incentives packages coupled with domestic market saturation and rampant smuggling.

The protection given to the textile industry penalized the downstream garments production. Before the end of the 70's the industry was adjudged not competitive and thus needed a rehabilitation program. Studies had revealed severe operating and structural problems because of obsolete machines and equipment, lack of specialization, poor technical processes and high cost of production. The Textile Rehabilitation Program of the late 70's was aimed to rehabilitate the industry using World Bank funds to be implemented in the early 80's. However, the Import Liberalization Program of the 80's effectively reduced the tariff rates making it even tougher for the textile industry, which then was undergoing intensive care. It was too late. The textile industry accelerated its decline in the latter 80's and the early 90's as the domestic market shifted to imports.

Export Markets

The major markets for garments and textiles are the quota countries. Based on 2003 data, they accounted for 89 percent of the US$2.4 B exports. For garments, quota markets received 91 percent of the total shipments. The United States was the biggest market with a share of 75 percent of all apparel exports (to quota and non-quota markets) and 83 percent of all quota exports (Tables 3a and 3b).

Market Shares

Focusing on the US market, the Philippines's market share increased from 1.8 percent in 1990 to about 5 percent in 1995 but declined to 2.8 percent in 2004 (Figure 3). Producers such as Mexico and China, however, significantly increased their shares over time. In 2004, China's share has reached 14 percent in terms of volume and 12 percent in value (Table 4).

Table 3a. Destination of Garments and Textile Exports (in US$ M)

	2000			2001			2002			2003		
	Apparel	**Textile**	**A&T**	**Apparel**	**Textile**	**A&T**	**Apparel**	**Textile**	**A&T**	**Apparel**	**Textile**	**A&T**
Quota	2,299.26	69.98	2,369.24	2,194.85	45.89	2,240.75	2,161.73	61.33	2,223.06	2,078.96	80.14	2,159.10
United States	1,926.25	58.03	1,984.28	1,862.24	35.32	1,897.56	1,809.54	51.55	1,861.09	1,718.93	69.95	1,788.89
EU	313.28	10.82	324.09	269.19	9.70	278.90	288.75	8.76	297.51	300.88	8.67	309.55
Canada	59.73	1.13	60.87	63.42	0.87	64.28	63.44	1.02	64.47	59.15	1.52	60.66
	-	-	-	-	-	-	-	-	-	-	-	-
Non-Quota	216.33	54.37	270.70	214.43	51.22	265.65	211.54	61.05	272.59	211.91	56.11	268.02
	-	-	-	-	-	-	-	-	-	-	-	-
Total	2,515.59	124.35	2,639.93	2,409.28	97.11	2,506.39	2,373.28	122.37	2,495.65	2,290.88	136.25	2,427.12

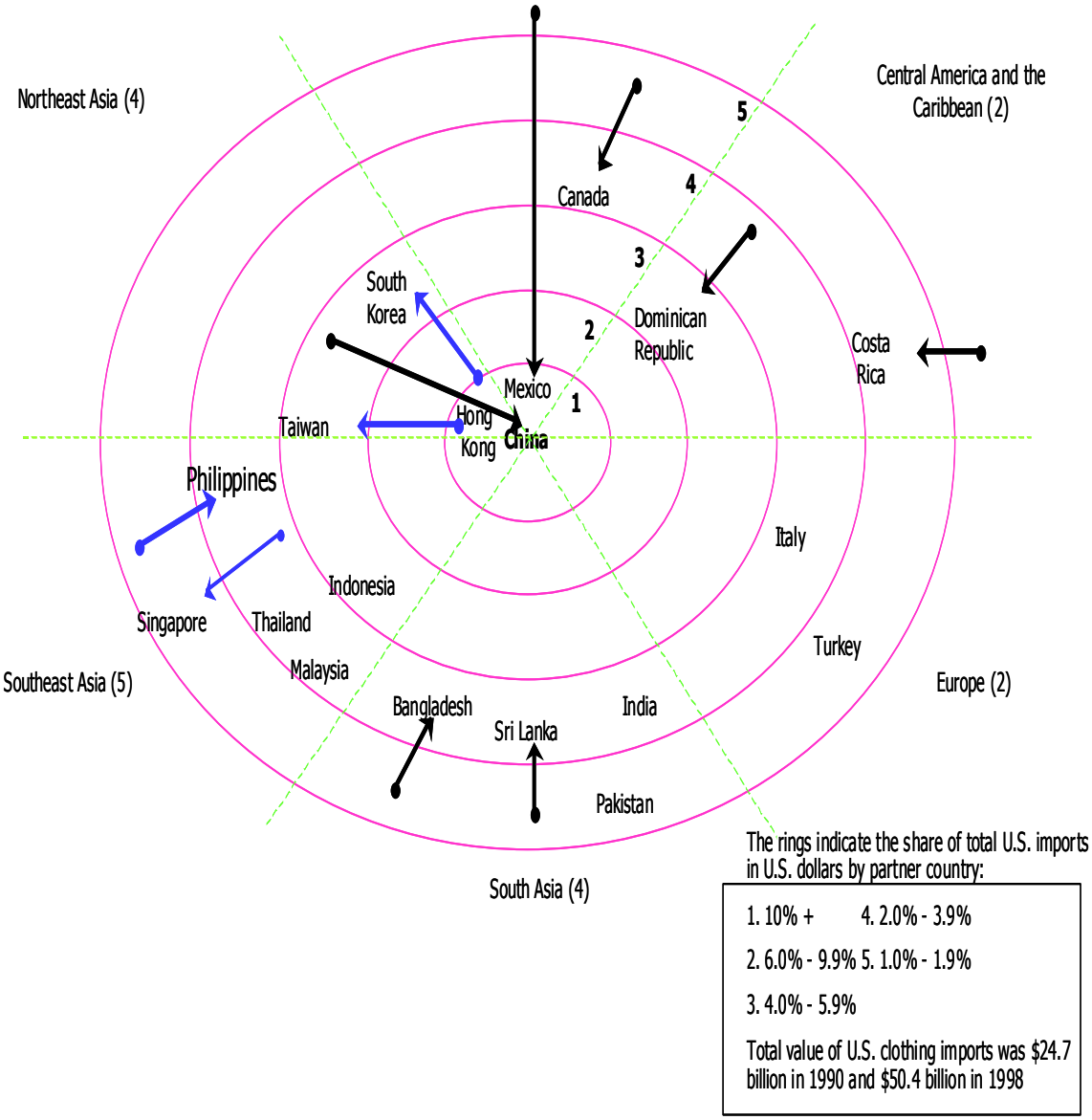
Source: GTEB

Table 3b. Percent Share of Quota and Non-Quota Markets to Total Garments and Textile Exports

	2000			2001			2002			2003		
	Apparel	**Textile**	**A&T**	**Apparel**	**Textile**	**A&T**	**Apparel**	**Textile**	**A&T**	**Apparel**	**Textile**	**A&T**
Quota	91.4%	56.3%	89.7%	91.1%	47.3%	89.4%	91.1%	50.1%	89.1%	90.7%	58.8%	89.0%
United States	76.6%	46.7%	75.2%	77.3%	36.4%	75.7%	76.2%	42.1%	74.6%	75.0%	51.3%	73.7%
EU	12.5%	8.7%	12.3%	11.2%	10.0%	11.1%	12.2%	7.2%	11.9%	13.1%	6.4%	12.8%
Canada	2.4%	0.9%	2.3%	2.6%	0.9%	2.6%	2.7%	0.8%	2.6%	2.6%	1.1%	2.5%
Non-Quota	8.6%	43.7%	10.3%	8.9%	52.7%	10.6%	8.9%	49.9%	10.9%	9.3%	41.2%	11.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: GTEB

Figure 3. Shifts in the Regional Structure of U.S. Apparel Imports from 1990 to 2004[1]



[1]The 1998 position corresponds to the ring where the country's name is located; the 1990 position, if different, is indicated by a small circle. The arrows represent the magnitude and direction of change over time.

Source: World Trade Analyzer, based on United Nations data for SITC 84 ("Article of apparel and clothing accessories, Gereffi (2002), updated by author

Table 4. US Apparel Imports in 2001 and 1st half of 2004
(Volume and Value Shares)

	2001	1st Half '04 Volume Share	2001	1st half '04 value share
World	100	100	100	100
China	6.06	13.61	8.15	12.98
Mexico	14.22	10.47	13.83	11.20
Honduras	6.34	5.91	4.15	4.22
Bangladesh	6.00	4.69	3.72	2.96
El Salvador	4.49	4.25	2.85	2.68
Indonesia	3.69	3.85	3.92	3.95
Dominican Republic	4.68	3.80	3.99	3.18
Vietnam	0.17	3.77	0.08	4.0
Hong Kong	5.69	3.52	7.46	5.27
India	2.50	3.46	3.04	3.86
Cambodia	2.23	2.92	1.66	2.2
S. Korea	3.92	2.78	3.86	2.73
Guatemala	2.41	2.76	2.84	3.15
Taiwan	3.81	2.71	3.21	2.31
Philippines	3.44	2.63	3.35	2.82
Pakistan	2.15	2.62	1.65	1.71
Thailand	2.81	2.59	3.22	2.63
Macau	1.66	2.11	2.0	2.1
Sri Lanka	2.50	2.11	2.67	2.35

Note: Sorted out by volume shares in 2004
Volume in square meters equivalent and value in US$
Source: US Department of Commerce office of Textiles and Apparel and Emerging Textiles.com

There are a number of reasons behind the relatively poor performance of Philippine exports despite the rapid growth in the US imports of apparel and vis-à-vis other suppliers.

- Entry of more low-cost suppliers from South Asia, Eastern Europe and the regions which enjoyed preferential access to the US. The Caribbean economies, for instance, gained significant increases in market shares via the Caribbean Basin Initiative (CBI). Mexico's share jumped from less than 1 percent in 1991 to 7 percent in 1995 to 13 percent in 2004 due primarily to the NAFTA. US textile and clothing import prices have fallen continuously since 1996, as is the case in Europe, Japan and many other markets. In an oversupplied, liberalized market, this trend is likely to continue, potentially bringing about a deterioration in developing countries' terms of trade.

- Secondly, the Philippines was not competitive relative to other suppliers in terms of labor cost, logistics, turnaround time and reliability (This will be discussed in the next section). This became very evident in January 2002, when the third stage of the phase-out was implemented for certain categories in Table 5 (UNDP 2004). These products suffered from relatively huge losses in export values.

Table 5. List of Selected Integrated Products in 2002

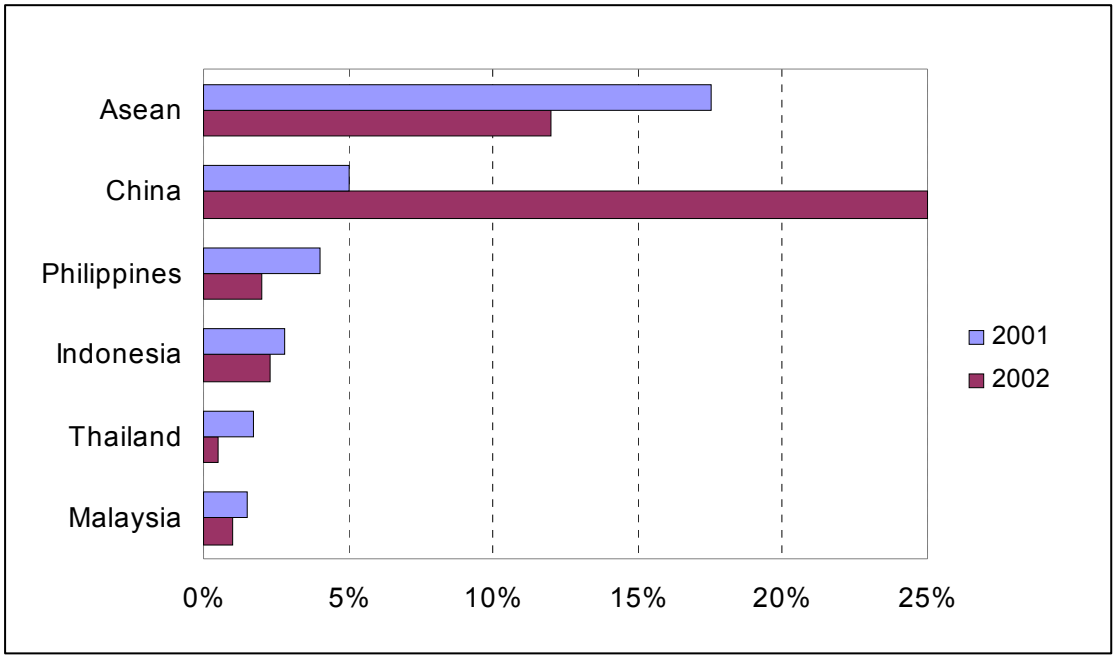
CAT	UNIT	DESCRIPTION	2003	2002	2001
350	DZN	DRESSING GOWNS/BATHROBES/MDE O		-100.0%	-0.6%
844	NMB	SUITS,WGI,SILK BLENDS & OTHER		-100.0%	1.4%
834	DZN	OTHER COATS,MB,SILK BLENDS & V		-100.0%	-9.6%
859	KGM	OTHER APPAREL,SILK BLENDS & OT	-100.0%	-92.5%	67.2%
330	DZN	HANDKERCHIEFS,COTTON	478.4%	-88.2%	-95.9%
3/631	DPR	GLOVES, OF COTTON/MANMADE FIBE	-6.0%	-76.5%	-1.8%
649	DZN	BRASSIERES, OF MAN-MADE FIBER	6.9%	1.0%	21.5%
349	DZN	BRASSIERES APPAREL, COTTON	57.8%	98.4%	-49.3%

Source: GTEB

- Thirdly, the quotas restricted access to some exporters which were competitive in certain products.

- Fourthly, the Philippines was not able to utilize its quotas efficiently due to reasons such as poor logistics, slower turnaround time, lack of locally sourced raw materials and cost of quotas (Austria, 1994).

Figure 4 Share of U.S. dressing gown imports after 2002 quota phase out



Source: US International Trade Commission

The Quota System and Allocation

While the quotas gave business to many exporters, they worked against competitive producers. They were intended more for the domestic industries of the US, EEC and Canada to be competitive and to move to value-adding models. It provided access to developed markets for developing countries which would not have been able to sell to those markets under free competition.

Other effects of the system merit a closer review. First, the quotas led to a global dispersion of production in clothing and textile. Buyers moved from one country to

another in search of quotas rather than manufacturing capabilities and of suppliers that can produce at the lowest cost possible. As a result, some firms in developing countries became complacent as they were assured of market access as long as they had quotas.

Second, jobs in developed countries were protected. However, the system did not provide incentives for domestic industries of importing countries to develop because of market share protection..

Third, quotas restricted access of exporters which – under market conditions - could have produced larger volumes because they are competitive. This has been the experience of East Asian countries such as Hong Kong, South Korea and Taiwan. They run out of quota allocations so they started investing in developing countries such as the Philippines which had the quotas. Furthermore, these restrictions forced them to upgrade, to move up the higher portion of the value chain by investing in design and developing efficient marketing and distribution networks.

Fourth, quotas added up to the costs of production and therefore raise prices. They are bought by firms from the allocating bodies, usually government. Some exporters who cannot fill up their quotas sell their quotas to others. Thus, the business of selling of quotas became prevalent in the industry.

Fifth, there is an issue related to the transparency of quota allocation. Quota allocations were usually based on historical performance creating an incentive for a firm to increase exports to unrestricted third markets even these are not directly profitable thus increasing losses accruing in unrestricted markets (Kathuria et al 2001). Exporters buy quotas and pass up the opportunity of selling quotas they already hold.

Quota Utilization

Despite the rapid growth in garment exports in the 1980s, the Philippines had the lowest overall utilization rate among all major Asian exporting countries (World Bank 1987). In the 1970s and 1980s, they were a result of the anti-export bias of government policies on garments. Costs of doing business were also higher.

However, there are certain categories where utilization rates are very high, going beyond the 100 percent level. These products are the most saleable items in the US. Except for Cat 338/9, all their market shares to total US apparel imports in the year 2003 were higher relative to the overall market share of the Philippines (Table 6). Note that the market shares of Cat 3/641, 638/9 and 3/640 in 2003 were even higher compared to their 1995 shares. Exporters of these products were able to use the flexibility provisions of the MFA to respond to the rapid changes in the demand of their buyers.

Table 6. Top Selling Apparel Items to the US, Quota Utilization and Market Shares in the US Market

GCCODE	CAT	DESCRIPTION	Market Shares			TYPE	Level of Utilization		FOB Values in US$			
			1995	2002	2003		2003	2002	2003	2002	2001	2000
10US	347/8	TROUSERS/SLACKS/SHORTS MDE OF	2.91%	2.69%	2.72%	Q	100.0	94.1	285,156	292,274	242,081	257,763
10US	338/9	SHIRTS & BLOUSES, KNIT TOPS OF	4.54%	2.49%	2.10%	Q	99.7	97.1	200,324	215,356	195,931	187,796
10US	638/9	SHIRTS & BLOUSES, KNIT TOPS OF	2.72%	3.03%	3.58%	Q	98.0	86.7	120,660	126,846	94,833	116,126
9000	3/641	BLOUSES,NOT KNIT,OF COTTON/MMF	1.72%	3.36%	4.14%	Q	89.4	78.8	95,457	74,118	62,631	71,604
10US	647/8	TROUSERS,SLACKS,SHORTS,OF MANM	2.83%	2.64%	2.76%	Q	89.1	87.1	90,716	93,604	103,064	109,468
20CD	3/640	SHIRTS,NOT KNIT,OF COTTON/MMF	2.60%	3.70%	3.79%	Q	61.2	67.1	89,749	91,561	104,144	126,818
10US	239	INFANTS SET	20.82%	12.77%	9.59%	F			84,907	116,996	164,352	146,921
10US	3/642	SKIRTS, OF COTTON OR MAN-MADE	6.75%	5.91%	5.93%	Q	89.1	87.1	71,235	69,959	47,096	60,799
10US	636	DRESSES, OF MAN-MADE FIBER	9.74%	6.36%	6.82%	Q	21.9	25.2	60,116	54,962	80,799	93,749
		Market Share of Philippines in the US market	3.52%	2.60%	2.41%							

Sources: GTEB, USITC

3 The Quota Phase-Out: Issues and Challenges

Given our dependence on the quotas, what is in store for the Philippines? Can we compete? If yes, how?

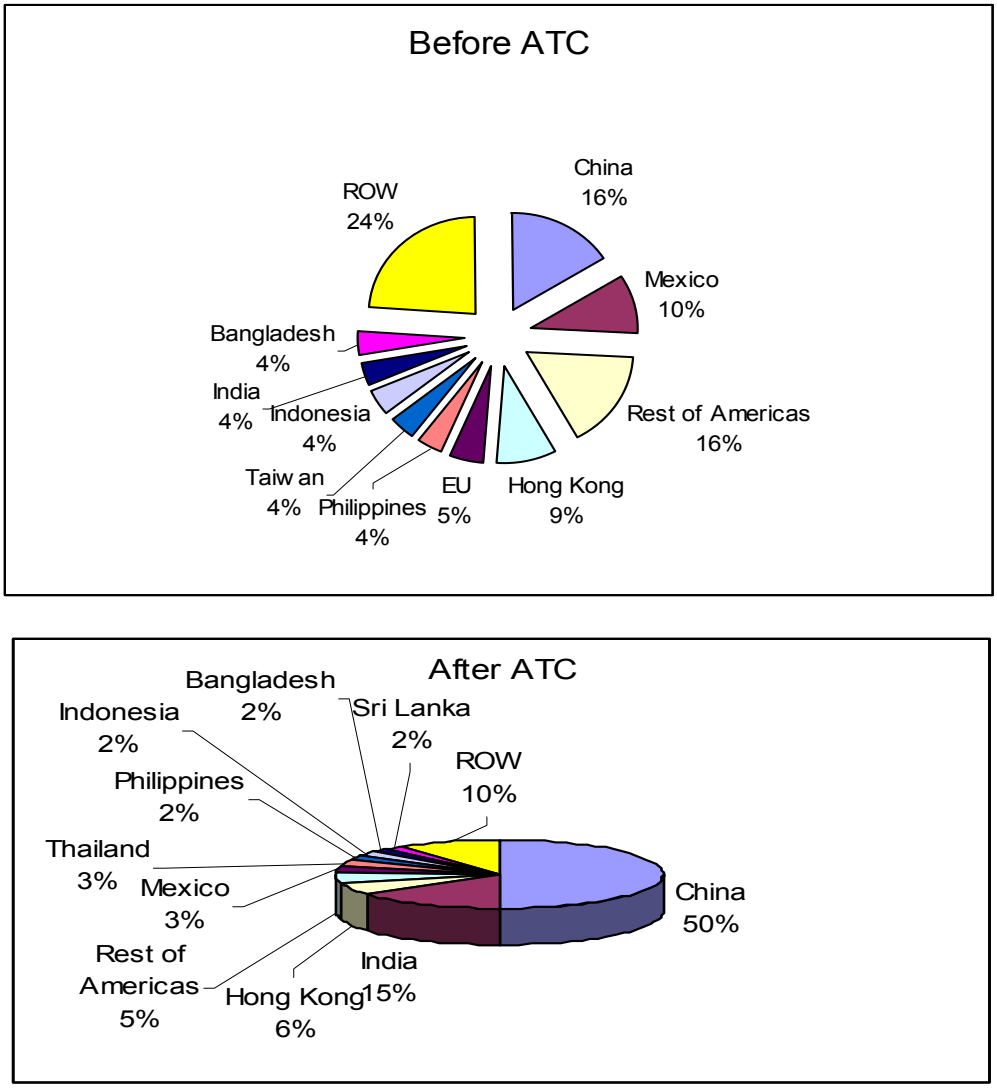
Effects of the Quota Phase-Out

A number of studies have already been conducted to measure the economic impact of the phase-out. These studies argue that the immediate beneficiaries are the consumers who will experience lower prices as production shifts to the lowest-cost countries and quota rents are eliminated (Slater 2003). Price reductions of at least 50 cents to US$2 are predicted (Speer 2002). For developing countries, they can gain market shares. Studies have shown that the import prices of garments and textiles in the MFA importing countries will decrease as a result of the removal of the MFA restrictions, thereby stimulating an increase in demand, increase in production for exports. Garments and textiles will benefit from increased market access in the developed country that will more than compensate for the loss in quota rents. Studies on South Asia revealed that they will become a beneficiary of the quota phase-out. The gains to the region are estimated to be around US$2 Billion per year (Kathuria et al 2001). A recent survey undertaken by the OECD (2003) indicates that the estimates of welfare gains will depend originally highly on the scenario considered for the simulation and the simplifying assumptions taken, show a wide range of figures with the expected annual global benefits ranging fromUS$6.5billion to US$324 billion (Francois et al, 1994). Asia is expected to experience the greatest changes in the distribution of production. China has generally the highest predicted growth. The most extreme impact study revealed that China which holds about 1/5 of the global apparel market will have a 150% increase in their overall textile and clothing exports or nearly 50percent of the world market after the phase-outs (Ianchovichina and Martin 2001).

For the Philippines, net welfare gains have been estimated in the study of Trella and Whalley (1990)[4] of US$127 million if both quotas and tariffs are removed and US$3 million if quotas alone are removed. The first estimate represents about 1.57 percent of the total gains of the developing countries and 0.54 percent of the gain of all countries while the second estimate represents 0.10 percent and 0.01 percent of the gain of all countries (Austria 1994). The market share of the Philippines is expected to decline from 4% to 2% as China and India combined will make up 65% of the US import market for apparel (Nordas 2004). All others will lose market shares and the largest losses will be incurred by the African countries and Mexico (market shares will decline by close to 70 percent) despite the fact that they already enjoy duty-free and quota free access to the US. This is explained by the fact that they are still not as cost competitive as China. These results are consistent with other GTAP simulations. However, Nordas (2004) cautions that the GTAP results are driven by changes in relative prices, rendering the previously restricted low cost products more competitive and this increasing their market share. The model simulations do not capture the changes in technology and possible increase in the relevance of time and distance as a trade barrier.

[4] As presented in Austria (1994).

Figure 5. Impact of Quota Phase-Out: US Market



Source: Nordas (2004)

Eliminating quotas will likely consolidate production into larger companies and a number of supplying countries because of the economies of scale that can be achieved (Speer 2002). Levis, for instance, has reduced its factories from 6 to 3 and in the Philippines it has reduced its contractors from 10 to 6. The likes of Gap, JC Penney, Liz Claiborne and Wal-mart, which used to source from 50 countries now sources from 30-40 and are expected to reduce the figures to 10-15 after quota eliminations (Appelbaum 2004). Therefore, the advantage of the quota phase out is that it now grants unrestricted access for business on highly utilized critical categories. The elimination of quota prices can increase profits and the limited capacities on many duty free countries can give the Philippines more time for the Philippines to explore advantages.[5]

[5] Based on the presentation of Mr.Serafin Juliano, Executive Director of the GTEB during the Conference on FASHIONomics: Prospects in the Philippine Fashion Industry. September 1, 2004, University of Asia and the Pacific. Pasig City.

More producers in more remote locations are at a disadvantage especially in producing fashion-oriented garments, even if they have some cost advantages. It was thus shown that the negative impact on countries like Mexico, Central and Eastern European countries and North Africa of quota elimination is smaller when proximity to markets is considered.

Evans and Harrigan (2003) argue that the shift from Asia to Mexico in the late 1990s was due to the lean retailing practices of most US retailers. They found evidence in the relevance of distance in "replenishment goods". They argue that distance matters because of its correlation with time and not necessarily transport costs. Nordas (2004) argues that vertical specialization implies that the inputs embodied in the final product cross borders several times and such trade is sensitive to tariff level. *Hence the outcome of the phasing out of quotas will depend much more on the prevailing tariff rates and the preference margins of countries receiving such preferences that are captured by conventional estimates.* The time to market is important particularly in the fashion clothing sector. Therefore countries close to their major markets have an advantage and likely to be less affected by competition from India and China. It is shown that having a common border with the importer and facing low or zero tariffs have a substantial impact on bilateral trade.

The effects of the quota phase-out are somehow weakened therefore by the existence of preferential trade agreements which have allowed selected developing countries to improve their competitive position. Given that the average tariff for apparel is 17% in the US, preferential treatment can make a large difference in the ability of a country to export to the US (Gibbon, 2003a). Quota elimination will remove a principal support from those countries that currently benefit from preferential trade agreements, since they will lose the competitive advantage previously conferred once highly-constrained exporters such as China are also freed from quota constraints. While such countries enjoy preferential tariff treatment, on the other hand, *tariffs are generally less costly to exporting countries than are quota restrictions.* Nathan Associates (2002) concludes that the tariff benefits are likely to be far less significant than quota benefits have been since US textile and apparel benefits are not prohibitive." The average tariff of 17% provides only a thin margin of preference over producers not receiving preferential access – a margin that in some cases may be less than the production cost advantages that large Asian suppliers may enjoy vis-a-vis preferential suppliers in the Caribbean Africa, and Mexico. Furthermore, tariff advantage may be short term as many try to seek greater market access. The USA has indicated total duty free by 2015.

Creating Niches as Business Models Evolve

Furthermore, the global apparel market is a US$320 billion industry. The Philippines can gain some advantage if our products, especially the competitive ones, can enter the US markets duty-free. On top of this, the industry needs to *accelerate efforts to reduce transaction costs* in order to cope with the evolving business models in the industry.

In the past, buyers sourced on the basis of cost and quota availability. Today, they have become more discriminating, focusing on costs, quality, reliability and shorter

lead time. Some buyers are aggressively sourcing suppliers who can manage the supply chain efficiently and create value-added services for them. Lean retailing practices have become more prevalent. It is important for today's exporters to be able to move up the value chain. Hence, business models need to change.

Gereffi (1994) refers to value chain as the whole range of activities involved in the design, production, and marketing of a product. Two types of value chain exist: buyer-driven and producer-driven. In the buyer-driven model, retailers generally design and/or market but do not make the branded products they order. They are manufacturers without factories, with the physical production of goods separated from the design and marketing. This pattern of trade-led industrialization has become common in labor-intensive, consumer goods industries such as garments, footwear, toys, handicrafts, and consumer electronics. Tiered networks of third world contractors that make finished goods for foreign buyers carry out production. Large retailers or marketers that order the goods supply the specifications. Producer-driven models on the other hand derive firm profits from scale, volume and technological advances and the manufacturers of key advanced products become the key agents in the development. This is characteristic of capital- and technology-intensive industries such as automobiles, aircraft, computers, semiconductors, and heavy machinery.

There are three types of lead firms in the apparel commodity chain: retailers, marketers, and branded manufacturers (Gereffi, 1999) that have evolved as a result of the policy environment on quotas. As apparel production has become globally dispersed and the competition between these types of firms intensified, each has developed extensive global sourcing capabilities (Figure 4). The lead firms in the global apparel chain are:

Retailers. In the past they were the manufacturer's major markets but now they have direct competitors and have resorted to imports due to growing consumer demands. Examples are Walmart, K-mart and JC Penney.

Marketers. These are manufacturers without factories and include companies such as Liz Claiborne, Donna Karan, Ralph Lauren, Tommy Hilfiger, Nautica and Nike (Gereffi, 1994; 1999, 2002). To deal with the influx of competition, marketers have adopted several strategic responses – they are shrinking their supply chains using fewer but more capable contractors and instructing contractors where to obtain needed components thus reducing their own purchase and redistribution activities; they are discounting certain support functions (such as pattern grading, market making and sample making) and reassigning them to contractors; they re adopting more stringent vendor certification systems to improve performance and the shifting geographic sourcing from Asia to the Western Hemisphere.

Branded manufacturers. The decisions are no longer whether to engage in foreign production but how to organize and manage it. These firms supply intermediate inputs to their extensive suppliers. This kind of international subcontracting exists in every region of the world. It is called the 807/9802 program in the US where the sourcing networks of the US are predominantly located in Mexico and Central America and the Caribbean. Examples of these firms are Sara Lee, Levis and Avon which also run their own facilities in other countries.

The success of a country under a buyer driven commodity chain depends on its ability to move up from mere assembly to a more domestically integrated and higher value-adding form of production system known as original equipment manufacturing (OEM) and eventually original brand manufacturing (OBM). This is evidenced by the experiences of East Asian economies such as Japan in the 1950s and 1960s and China in the 1990s. Today, Japan, Taiwan, South Korea and Hong Kong have become OBMs by joining their production expertise with the design and sale of their own branded merchandise in domestic and overseas markets. Apparel thus embodies two contrasting production systems characteristic of buyer-driven chains: the assembly and the OEM models. Whereas the assembly model is a form of industrial subcontracting in which manufacturers provide the parts for simple assembly to garment sewing plants, the OEM model is a form of commercial subcontracting in which the buyer-seller linkage between foreign merchants and domestic manufacturers allows for a greater degree of local learning about the upstream and downstream segments of the apparel chain.

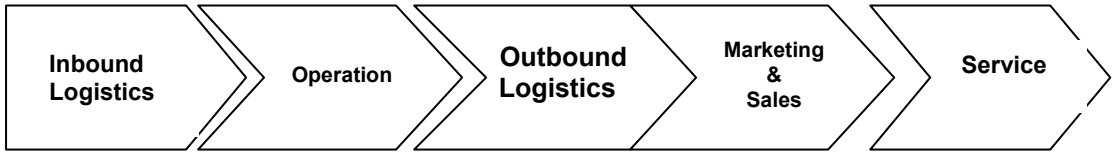
For the past decades, the Philippines has concentrated in the assembly portion of the production system with a relatively few firms such as Luen Thai, Eastland and recently Fil-Pacific Apparel providing full package supply or OEM. The industry is basically part of what is called the triangle manufacturing (Gereffi, 2002), where a foreign buyer deals with an agent in a newly industrialized economy which then outsources production in the Philippines. The triangle is completed when the Philippine supplier ships the products to the buyer. The competitive advantage of these firms lies in the existence of a large pool of human capital (and relatively low labor cost compared to Singapore, Taiwan and South Korea) and of the quota allocations from the United States and the European Union. In recent years, mass retailers have shifted from the Philippines to these low cost (primarily due to lower labor costs) exporters in Asia. The Northeast Asian economies of South Korea, Taiwan, Japan and Hong Kong have been able to move up the value chain to become OEMs and OBMs as well. Hong Kong, for instance, sells its own brand such as Giordano. Mexico is upgrading to become OEMs to its North American buyers.

Thus, a garments firm participating in this buyer-driven chain will have to upgrade if it is to increase its competitiveness in the market. In recent years, the theory of international trade has focused more on other possible sources of factor endowments apart from labor. Studies have focused more on frictions in trade and investment due to geography, institutions, transport and information costs (Venables, 2001; Bond 2001) and the transmission of knowledge across borders (Grossman and Helpman, 1991). These traditional notions of endowments can be combined with the newer ones to help understand why lesser developed countries engaged in the observable patterns of trade.

For an industry like apparel where it can take 10 suppliers to produce a jacket or a shirt, the supply chain from sourcing of raw materials via design and production to distribution and marketing is being organized as an integrated production network where the production is sliced into specialized activities and each activity is located where it can contribute the most to the value of the end product. When the location decision of each activity is being made, costs quality, reliability of delivery, access to quality inputs and transport and transaction costs are important variables.

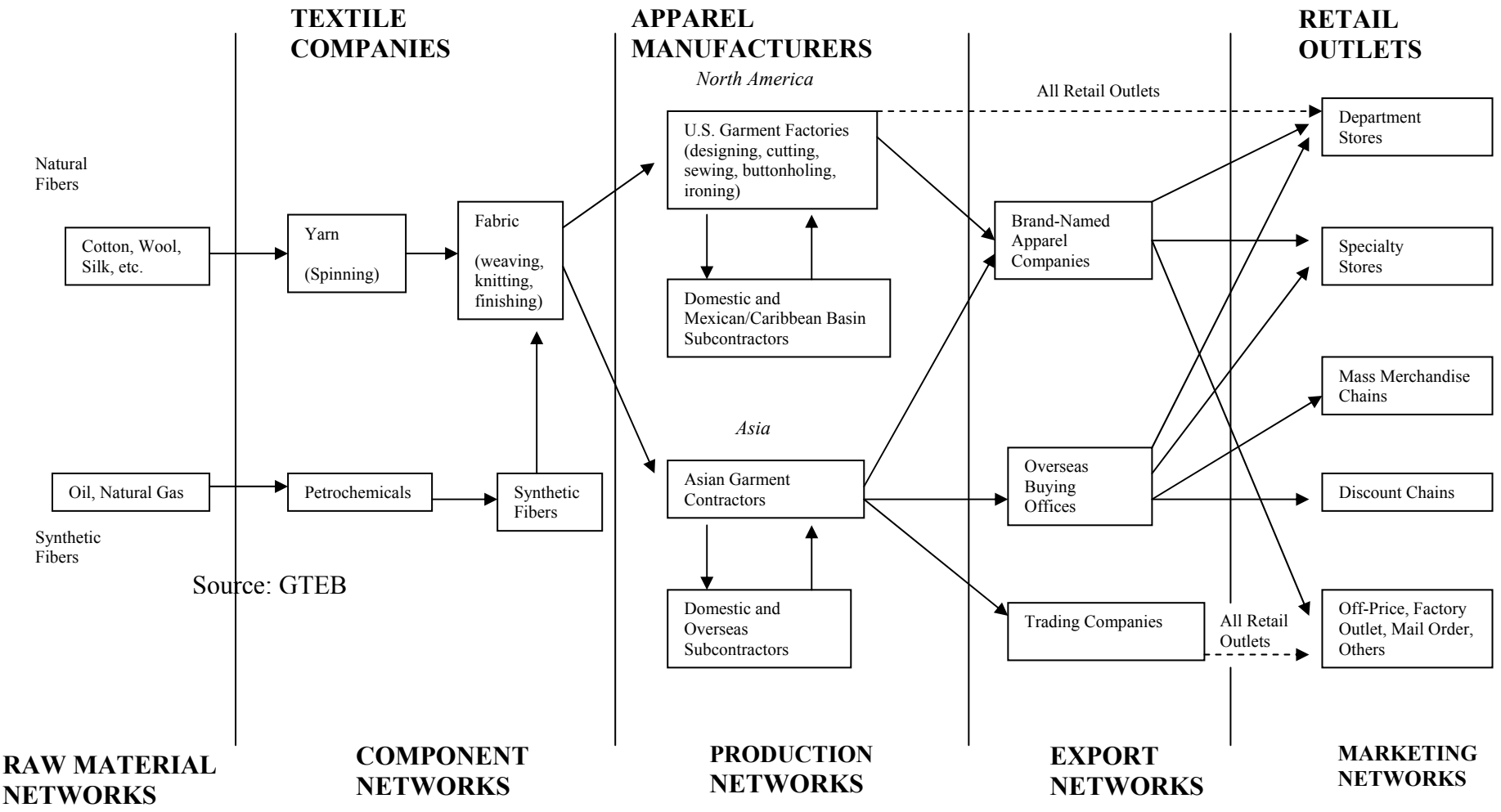
Porter's (1990) framework of value-chain analysis helps identify ways by which firms can create competitive advantage. The model is depicted below:

Primary Value Chain Activities



Each portion of this value chain requires some levels of infrastructure to make the firm meet the demands of buyers and minimize costs of operations and delivery. It is important to understand and assess how firms will still be able to generate profit margins from its activity. Value chain analysis hypothesizes that policy impediments exist that if removed will unleash competition which will raise productivity and investment leading to growth. The new institutional economics (Williamson, 1975; Coase, 1972; North, 1992) argues that transaction costs exist that if removed would enable firms to maximize use of resources within a network or supply chain to deliver a product most efficiently raising productivity of the entire chain. Value chain analysis can identify policy-induced costs related to the rules of the game but also non-state transactions costs (e.g. logistics and manufacturing support) which firms will have to assess if they or others outside the organization can deliver more efficiently.

Figure 6
The Apparel Commodity Chain



Source: GTEB

Trends in Sourcing Decisions by Buyers

The USITC report (2003) revealed that some considerations by US buyers or importers in their sourcing decisions are the following: cost competitiveness, proximity to markets, and efficient logistics. Location decisions, on the other hand, for branded manufacturers would include costs of doing business, political and investment climate, and logistics. These are factors which local suppliers have to address in order to become cost competitive.

US buyers have become more discriminating in recent years due to pressures from the consumers who have become more conscious of quality. According to a study by the Marymount University 85% of consumers would pay more for a garment if they knew it was not made in a sweatshop.[6] Lobby groups in the US have exposed operations of major US buyers in low cost countries, highlighting the low wages and poor working conditions.[7] A survey by the Lifestyle Monitor in 2003[8] revealed that the majority of consumers are still willing to pay more for higher quality garments but that attitude may be fleeting. While consumers are demanding more in terms of quality (the way an item fits, how it is sewn and how well it launders, its durability) they are growing less inclined to pay a premium for it.

Apart from these, US retailers have consolidated therefore implying greater bargaining power. Under restructuring programs, they have begun to adopt lean retailing practices which give more emphasis now on timely deliveries and shorter lead times. Technological building blocks of lean retailing include: bar codes and uniform product codes, EDI and data processing distribution centers and common standards across firms. Furthermore, buyers are streamlining their organizations, forming closer links with their retail customers, collaborating will mills and factories in product development, shifting more functions to suppliers, being more aggressive in compliance standards, sourcing from less countries and factories and working towards "end to end" integration. Value-added services of suppliers will become the only differentiator for competition.[9] For Claiborne, value creation means "concept to in-store or shelf." The lead time therefore is about 32 weeks from the traditional 52 weeks (Table 7).

[6] Sweatshop
[7] Ibid
[8] Textile Consumer, Quarterly Newsletter of Consumer and Industry Trends. See http://www.cottoninc.com
[9] Based on the presentation *"Value Added Full Service Provider: The Next Generation Manufacturer"* of Kirkor Balci, VP for Corporate Sourcing and Group Manufacturing Director of Liz Claiborne during the Material World Seminar, May 17, 2004, Florida.

Table 7. Speed to Market: Concept to In-Store"

	Traditional	Possible	Chase/QUICK	Replenishment
Product Development	22 weeks	15 weeks	3 weeks	0
Manufacturing	18	11	7	4 weeks
Logistics	8	3	3	2
Distribution	4	3	1	2
Total	52	32	14	8

Source: Based on the presentation *"Value Added Full Service Provider: The Next Generation Manufacturer"* of Kirkor Balci, VP for Corporate Sourcing and Group Manufacturing Director of Liz Claiborne during the Material World Seminar, May 17, 2004, Florida.

How do buyers perceive the Philippines as a supplier? Table 8 provides a comparison of the Philippines with some Asian countries. Thailand was chosen because it is a major competitor of the Philippines in a quota-free and duty-free environment under FTAs.

Table8. Survey of US Buyers/Importer Perceptions

	Philippines	Thailand	Hong Kong
Products	Highly flexible labor; ability to produce fashion-oriented products Good communication and interpersonal skills	Ability to make basic product Price and quality are competitive	High ability to make high-quality product; high price
Delivery	High reliability for high end products Relatively poor reliability in some basic items Delivery time can be longer due to bottlenecks in bureaucratic procedures	Delivery time longer than Hong Kong, Taiwan	High reliability: factories have intention to work with customer in order to produce a high quality product within a given time period Hong Kong has advantage in timing and pricing for import of fabric and parts
Concerns	Need to improve reliability on an industry-wide basis High cost of labor relative to Vietnam, Indonesia and China Need to engage in information technology	Lacks efficiency and the needed support to grow Need to improve communication systems, logistics, transportation infrastructure	Factories reluctant to bring in new technologies Land and labor costs are high

Sources: Interviews with members of the Foreign Buyers Association, USITC Report (2003);Wattanapanom et al (1997)

Luen Thai is one company that has strongly differentiated itself by creating value-added services for its buyers. About five years ago, it evolved to become a full-package supplier. It invested heavily in information and communications technology and in improving its supply chain and logistics. Today, its logistics is defined more in terms of design to shelf. Its hub in China is an epitome of this differentiation. Its designers work with the designers of their buyers, execute the sample within a few hours and start producing within a few days. Its Philippine factories area part of this overall supply chain management and value creation for their buyers.

Has the Philippines truly failed in moving up the value chain? About ten years ago, around 65% of exports were sold in discount stores or chains.[10] This was evidenced by the more prominent share of the large discount retailers such as Walmart and K-mart in the list of top buyers from the US in the 1990s. In the past two years, however, mass retailers reduced their orders as they closed down their buying offices here. More fashion- oriented and higher value brands such as Liz Claiborne and Ann Taylor fortunately increased their purchases, sending signals of trust on the Philippine's reliability. Mass retailers have consolidated their operations and are concentrating in low-cost sources such as Cambodia, Sri Lanka, China and Vietnam. In particular, there has been a significant shift to Mexico and the Carribbean economies whose duty-free and quota-free access to the US under certain conditions of rules of origin and categories allowed Levis and Gap to establish strong presence in those countries.

It is only in recent years that we have started to notice more buyers of high end brands accounting for the top three orders. Based on the GTEB records, GAP has been the number one buyer for many years. In 1998, the top five buyers were Gap (US$219.9M), J.C. Penney (US$56.3M), Walmart (US$48.8M), K-Mart (US$45.8 M) and Liz Claiborne (US$43.5M). As of December 2003, the top 5 buyers were Gap, Liz Claiborne, Ann Taylor, Tellas Ltd and Walmart (which reduced its orders by 27% from 2000 to 2003).

Table 9. Profile of Buyers: 1998 vs 2002

	1998		2002	
1	GAP INC.	US$220	GAP INC.	US$ 348
2	J.C. PENNEY	56.3	LIZ CLAIBORNE	67.4
3	**WAL-MART CORP.**	48.8	ANN TAYLOR	58.7
4	K-MART	45.8	TELLAS LTD.	51.8
5	**LIZ CLAIBORNE**	43.5	WAL-MART CORP.	39.5
6	BABY TOGS INC.	40.8	WEAR ME	37.6
7	NISSHO IWAI	38.9	WARNACO	37.1
8	KASPER	37.5	VAN HEUSEN CO.	31.4
9	VAN HEUSEN	36.5	J.C. PENNEY	28.5
10	JONES APPAREL	36.9	KASPER ASL	27.7

***FOB Value in millions**

Source: GTEB

Buying offices have been converted to QA offices

I

[10] Based on GTEB report " Global Competitiveness in a Quota-Free Environment Beyond 2004."

4 Competing Under A Quota-Free Environment: Issues and Challenges

The phase-out has raised concerns on a number of issues plaguing the industry for quite a long time now. Among these are employment, costs of labor, supply of raw materials, investments, logistics and infrastructure, access to financing, and trade facilitation. Each of these issues is discussed below and later related to the Industry Transformation Package. The issues affecting competitiveness will be discussed within the framework of the apparel value chain.

As mentioned, the value chain consists of all activities related to whole range of activities involved in the design, production, and marketing of a product (Figure 7). The Philippines has concentrated mostly on the manufacturing or assembly portion for more than three decades. However, in today's competitive environment, it is critical that the industry move up the value chain, work towards becoming OEM and OBM by enhancing and developing capabilities in the other portions of the value chain presented. The DAP study broke down the value chain cost structure as presented in Table 10. Note that apart from production and assembly, the next biggest expense in terms of share to total expenses and FOB costs is inbound logistics.

Table 10. Value Chain Cost Structure

	Based on Total Expenses	Based on FOB Value
R&D/Product Design	0.31%	0.12%
Inbound Logistics	4.91%	1.91%
Assembly and production	87.12%	33.96%
Outbound Logistics	2.20%	0.86%
Marketing	1.73%	0.67%
Others	3.73%	1.45%

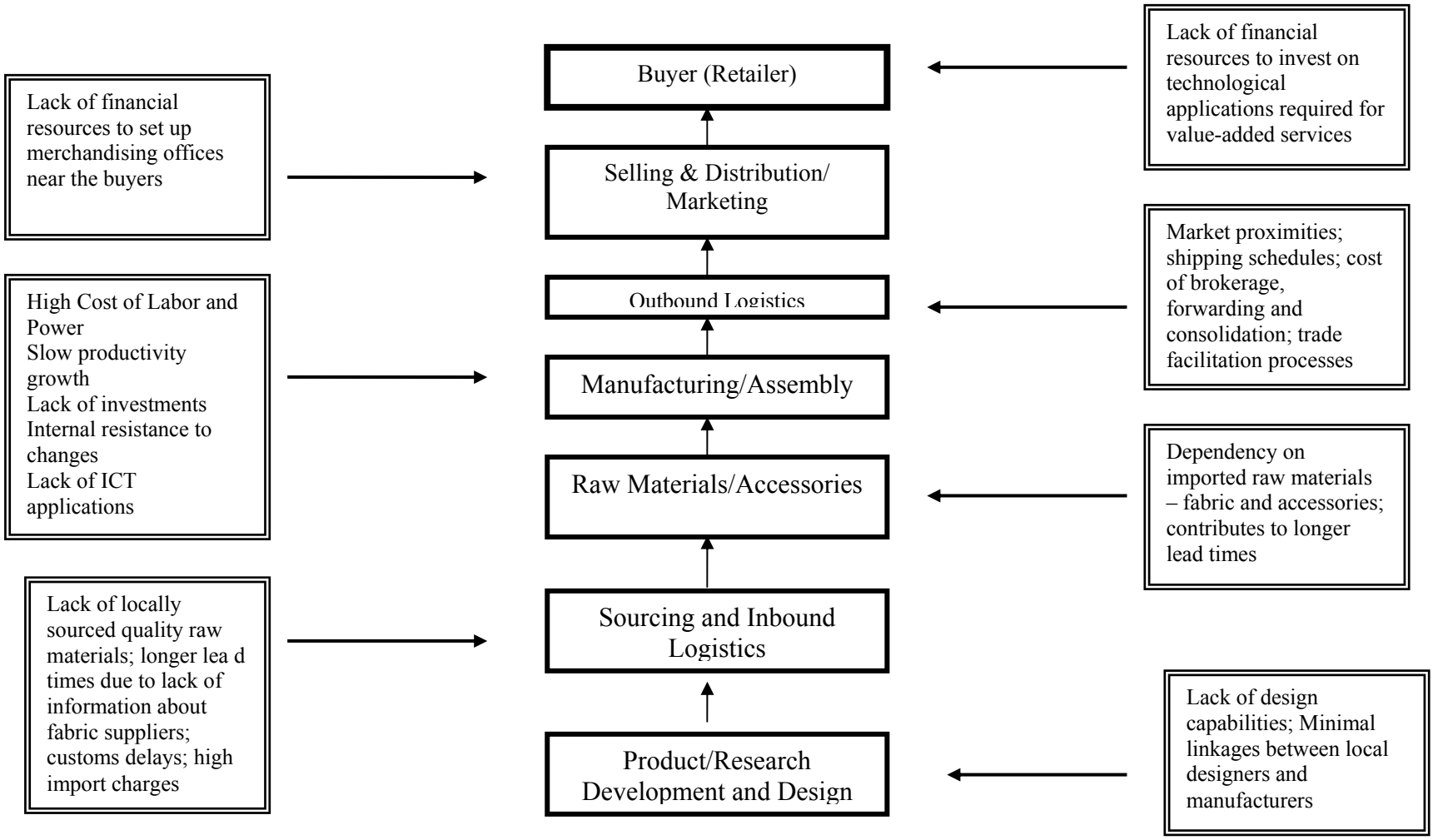
Source: DAP (2004)

- **Product Development/Research & Development and Design**

Concentrating on the assembly portion of the value chain, the Philippines has not developed capabilities in design needed for value creation. The value-added services which most of the firms, particularly the large firms, have created were mostly in the area of assembly or production. This can be evidenced by the fact that there are only very few full-package suppliers in the country today.

There have been attempts in the past for the manufacturer and the designer to work together in developing brands. However, they have not been very successful since these designers did not also enjoy very good infrastructure for training and product development. Hence, it became relatively easier for most firms to simply concentrate on assembly given that they only needed the quotas.

Figure 7. Value Chain of the Philippine Garments Industry



- **Sourcing of Raw Materials and Inbound Logistics**

Exporters have always lamented at the absence of an integrated textile industry that can support their requirements. Buyers nominate the fabric suppliers, mostly from China, India, Hong Kong. Imports of fabric from the US and Italy are commonly used for the production of high-end products such as branded women's blazers. Other inputs such as accessories are also imported from China, Taiwan, South Korea and Hong Kong. Cartons are sometimes locally purchased. Most garments firms import 100 percent of their raw materials. In the case of the Philippines, even textile millers have difficulty sourcing their raw materials and tend to import about 80 percent of their raw material requirements such as polyester fiber, cotton, rayon and acrylic. The absence of an efficient, reliable and high volume domestic textile, particularly cotton, industry has been cited as a major reason for the declining competitiveness of apparel exports. Recently, in an effort to reduce lead time, some garments companies have linked up with local yarn and textile producers and are now sourcing 10-20 percent of heir requirements locally. Such clustering allows textile producers to niche and upgrade their capabilities.

The Philippines is not a major cotton producer. In 2002, for instance, we produced only about 2,000 metric tons (MT) compared to other countries (Table 11). Furthermore, our cotton is relatively more expensive.

Table 11. Cotton Production, Supply and Distribution By Country (2001/2002)
In 1,000 Metric Tons

Country	Beg. Stocks	Production	Imports	Total Supply	Use	Loss	Exports	End. Stocks
China	2513	5313	87	7913	5280	0	54	2578
US	1307	4421	5	5733	1633	7	2286	1807
India	819	2569	381	3769	2874	0	11	885
Australia	456	653	0	1109	33	-36	642	470
South Korea	84	0	359	444	348	0	4	91
Hong Kong	23	0	131	154	120	0	7	27
Taiwan	51	0	288	340	267	0	1	72
Thailand	88	10	408	506	397	10	0	98

Source: US Department of Agriculture, Economic Research Service (**http://www.ers.usda.gov/data**)

However, the absence of a cotton industry should not stop us from becoming competitive. If we look at the East Asian model, they moved up the value chain based on design capabilities and logistics efficiency. They are also not major cotton producers. In fact, they import their cotton requirements. However, they are good with the design and finishing sectors of textile.

The Philippines has a longer lead time or turnaround time[11] compared to its Asian counterparts. In the mid 1990s, lead time was between 120 to 145 days for the Philippines which improved to 90-120 days in the year 2000. Pro-active producers

[11] Turnaround time consists of the time for the sourcing, order and delivery of the fabric, customs clearance, fabric cutting, sewing, finishing, preparation of export documents and the preparation to ship the final goods

who invested heavily towards the late 1990s were able to lower lead time to 40-60 days. However, the likes of Hong Kong, Thailand and Malaysia have already improved their lead times to 35-60 days in the same year 2000 from 70-150 days in 1995.[12] Reasons behind this include difficulties in sourcing, inefficient inbound and outbound logistics and production bottlenecks.

Let us consider sourcing and logistics first.

While some producers are supported by foreign buying offices which secure the raw materials for them, most are still burdened with searching for appropriate and reliable fabric supplier from abroad and securing timely release of shipments. Bureaucratic red tape in the release of goods at customs, and production bottlenecks contribute significantly to prolonging lead times.[13]

There is a longer lead time due to the absence of good quality raw materials in the local market which can be produced in huge volumes. In countries such as China and Indonesia, raw materials can be delivered within hours after the orders are placed. In our case, since our buyers usually nominate the suppliers of fabrics and even accessories from China, Taiwan, Hong Kong and India, transit time for shipments add to the lead time. It averages 7 to 10 days from China and 3 to 5 days from Hong Kong. The goods are then released to the common bonded warehouse within 5 days on the average, higher than Malaysia's 3 days and Singapore's 2 hours. Electronic customs declarations will soon be implemented across Vietnam following a two-year trial run in Hanoi, HCM City, Hai Phong, Dong Nai and Binh Duong, which showed a 30-50% reduction in customs clearance time from the current 15 days. The longest time in the Philippines is estimated at 15-20 days, depending on whether the importer "cooperates" in resolving his importation problems. And for small companies which usually rely on consolidated shipments, delays can be caused by problems of other companies with customs procedures or intricate approval procedures.

Since these exporters have to deal a lot with government agencies, they consider the following as very serious constraints in their companies' competitiveness: customs procedures, local duties and levels and official corruption. Document processing is slowed down by official corruption.

The import clearance procedures tend to burden companies with additional transaction costs related to bribery. Clearance time for shipments under a manual, paper-based and assembly line cargo clearance system involved 90 steps and more than 40 initials and signatures. The Tariff and Customs Code requires the following paper documentation: 69 copies of 18 documents, to import; and 44 copies of 12 documents, to export.[14] One company estimated its hidden costs to be equivalent to a supervisor's salary per month (P15,000 – P20,000). The Philippine Chamber of Commerce and Industry has initiated the project of computerization of importation procedures which

[12] PDCP Industry Digest (1995).
[13] Cited during the 1st CEO Forum, March 2001, The Peninsula Manila.
[14] "Business@ Philippines.com: Electronic Commerce Policy Issues in the Philippines," was conducted by Emmanuel C. Lallana, Rodolfo Noel S. Quimbo, and Lorraine C. Salazar. Published by the Carlos P. Romulo Foundation for Peace and Development, with financial support extended by The Asia Foundation.

should allow the exporters to receive their imported supplies within three days. It could have been shorter without the truck ban. However, a number of small and medium are still not able to avail themselves of this service due to lack of access to the e-mail system or internet. A common reason cited is lack of funds.

Based on the interviews conducted[15], garment exporters consider power supply, water supply, and telecommunication network as the basic infrastructure affecting firm competitiveness. They have invested in power generators in order to cope with the relatively inefficient power supply system especially during rainy season. Transport services, especially the reliability of air freight, are considered to be extremely important too. Vendors are normally given 20-30 days to finish production from the time the shipments of fabric and accessories land in the Philippine ports. They are unable to meet production schedules on time due to complicated customs procedures. It normally takes five working days and two working days before loose cargo and container cargo are released. Compare this to Hong Kong's 2 days and half day processing for each cargo type respectively.

An improvement of the road infrastructure and implementation of related ordinances such as truck bans are expected to aid the delivery of goods in the factories on time. It should be noted that operations are not housed under one facility and therefore call for better hard infrastructure to reduce productivity losses and operational costs.

Import charges in the Philippines are expensive compared to Vietnam, Indonesia and China but at par with Cambodia (Table 12). It is cheaper to ship a 20-footer van from Taiwan to Indonesia than to the Philippines. For less container load (LCL) shipments (that occupy 3.67 cubic meter of space, the Philippines is the most expensive relative to the countries cited in the table).

Table 12. Comparison of Import Charges (in US$)

Volume in CBM	Phi	VN	Ind	China	Cambodia
90 (1x20')	1080.04	760.04	891.62	714.78	1139.46
3.67	558.84	211.82	357.63	128.75	483.7936
63 (1x40')	1580.68	1247.79	1421.2	1046.67	1608.94

*Based on shipments from Taiwan to these countries
**includes transport and non-transport related costs
Source: Documents Obtained from Exporters

Removing transport costs (e.g. freight and trucking) from the computation, non-transport-related costs are quite expensive in the Philippines as well. It costs about US$403 in the Philippines compared to Indonesia's US$300 or Vietnam's US$333. But they are cheaper compared to Cambodia's US$510.

Using a 20-footer container van as an example, the non-transport related charges in Vietnam are largely accounted for by terminal handling charges (49%) and followed by brokers' fees (18.7%). In the Philippines, brokers' fees alone account for 33.2% and miscellaneous charges take up quite a substantial portion as well. The differences are highlighted when it comes to consolidated shipments. Miscellaneous

consolidation charges and liquidation expenses make up for almost half of total non-transport-related charges.

Thus, the passage of Republic Act 9280 was not welcomed by the industry. This act espouses that only licensed or professional brokers can be allowed to engage in the brokerage business. This implies higher costs of doing business for the exporters, at a time when they are trying to reduce and ultimately eliminate these unnecessary transactions costs.

Table 13. Breakdown of non-transport related charges (in %)

Charges	**90 (1x20')**		**3.67**	
	PH	**VN**	**PH**	**VN**
Broker Fee	33.2	18.61	31	36
Customs Inspection Fee	6.9	-	2.2	-
Terminal handling charges	18.9	48.7	4.8	27
Handling Fee	-	6.0	2.7	6.6
Miscellaneous broker fee/Customs Facilitation	13.3	-		
Bonded Fee	5.18	-	1.0	-
Container Freight Space Fee	-	-	15.5	9.5
Service fee	2.7	4.5	3.5	9.8
Documentation Fee	5.1	-	2.4	-
Bill of Lading Fee	3.8	3.0	4.7	6.7
CY Charge	14	-	12	-
Storage	1.2	3.0	4.0	3.2
Misc. Consolidation Charges	-	-	18	-
Liquidation	4.5	-	4.0	-

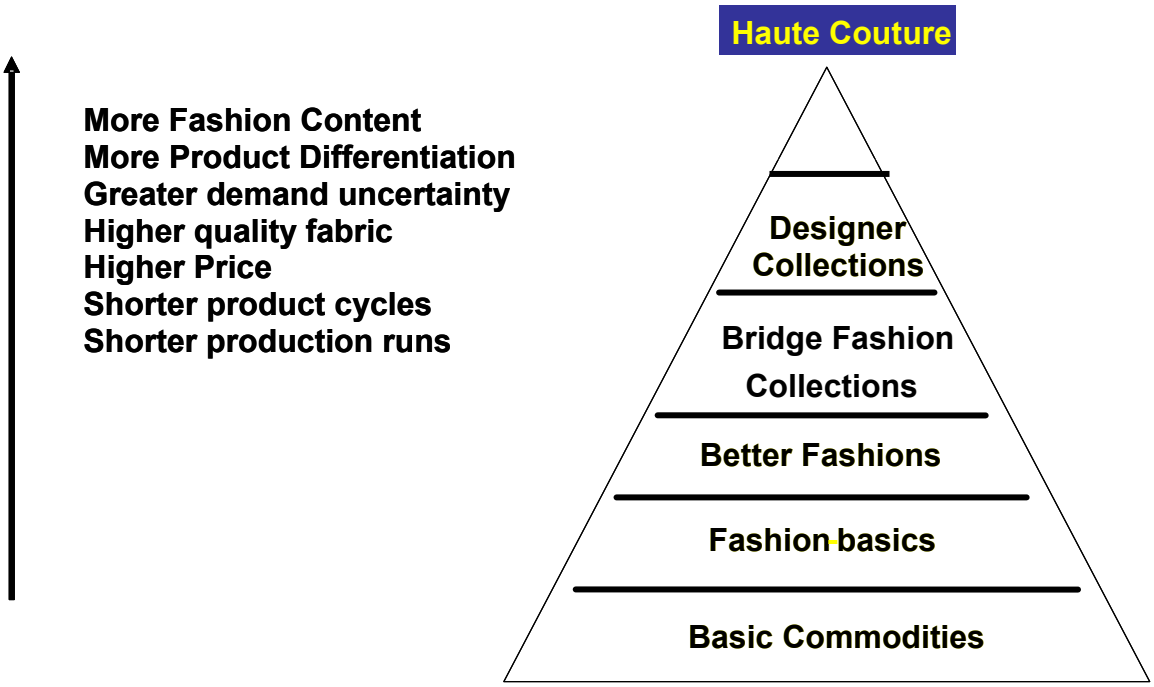
Source: Documents obtained from exporters

The industrial upgrading experienced by the East Asian economies revealed that they have become competitive suppliers based on design and manufacturing and logistics capabilities rather than labor cost. It should be noted that their labor cost advantage was eroded in the 1980s. Hence, if the Philippines is to differentiate itself from the rest of the suppliers, the garments industry needs to move up the fashion pyramid.

The relevance of logistics becomes more important as an exporter moves up the fashion pyramid (Figure 3). This implies shorter lead times and innovation on the part of the exporter. This can be translated to the supplier pyramid which classified producers based on their capability to respond to the growing demand If the exporter will concentrate on the lowest stage of the pyramid, the basic commodities, then price

is the major consideration for competition. As a result of low prices, profit margins tend to be squeezed. And with the absence of productivity improvement, margins tend to be eroded. Producers at this stage of the pyramid tend to utilize only half of their rated capacity as production is subjected to peak and lean seasons.

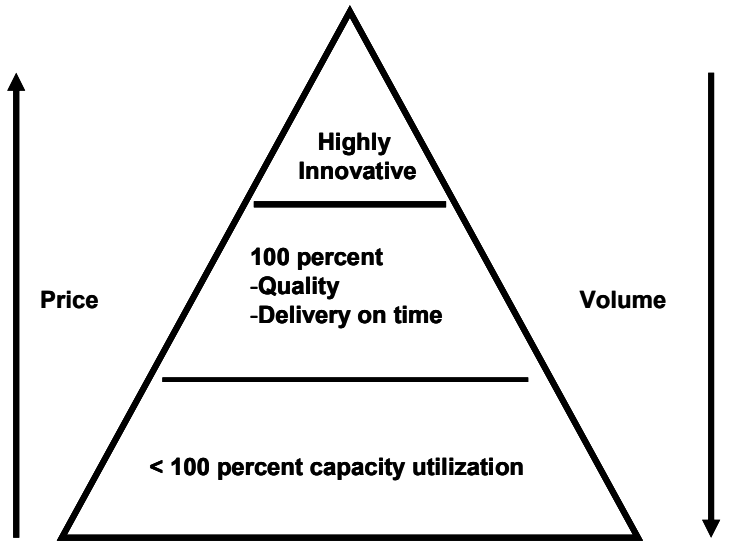
Figure 8. The Fashion Pyramid



Source: Doeringer and Crean (June 2004)

As one moves up to the more fashion-oriented type of products, the supplier becomes more innovative and must assure 100% reliability and 100% product quality. The pressures increase as the exporter tries to create value-added services to the buyers. The returns are higher as buyers tend to focus more on quality and reliability rather than on low prices. This is especially true for buyers who already give their suppliers the flexibility to produce their own designs, make samples, offer landed duty paid prices instead of just FOB and manage the inventory of the buyers in the US. They use air freight for their shipments frequently not because their shipments are delayed but more because they are requested by buyers to use such mode of transport. The costs of air freight are shouldered by the buyers who place high value on fashion items. These are services already being offered by full-package suppliers like Luen Thai, Fil-Pacific Apparel, Eastland Manufacturing. These companies are very innovative in that they even create needs for certain services by their buyers. They recognize that they need to be close to their markets by setting up offices in the US, hiring designers and sales agents there. The name of the game is to make one's presence felt.

Figure 9. The Supplier Pyramid



Source: Modified presentation of supplier capability by Matthias (2003)

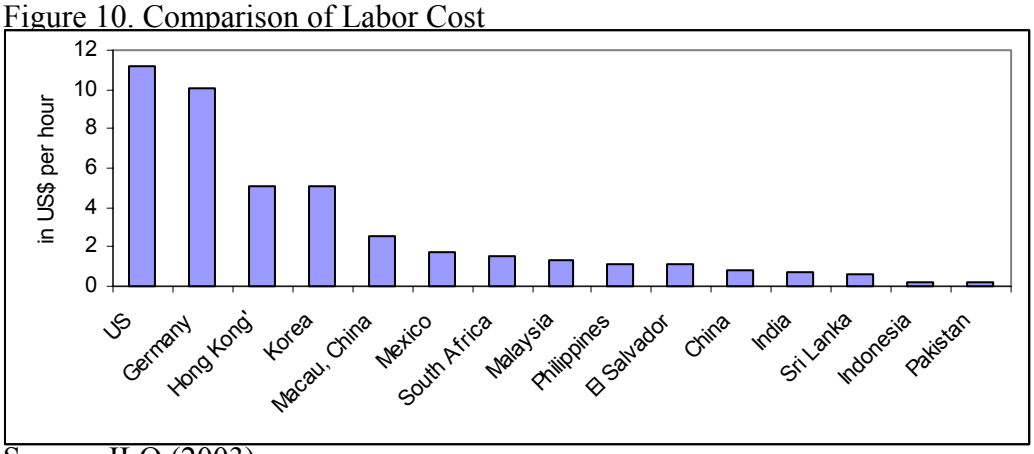
Pro-active producers who have significantly reduced their lead times established network with foreign suppliers of fabrics, improved logistics management, and increased productivity in the production process through enhancement programs, computerization of work processes and use of more efficient technology.

Manufacturing/Assembly

- ***Cost of Labor and Power***

Labor cost is high in the Philippines relative to large mass producers such as China (Figure 10). Hourly labor cost in the Philippines is around US$1.10 while only half is offered in Vietnam and Bangladesh. Latin American vendors pay higher wages to their production workforce but their competitive position has been facilitated by the entry of US producers and their privileged access to the US market.

Figure 10. Comparison of Labor Cost



Source: ILO (2003)

Table 14. **Average Share of Labor Cost to Total Cost in Non-Agricultural Establishments Employing 20 or More By Industry Group and Employment Size: 2002**

Industry Group	All Sizes	20-99	100-199	200 and Over
All Industries	**21.1**	**20.1**	**23.7**	**25.6**
Manufacturing	**20.1**	**19.0**	**21.8**	**23.5**
Manufacture of Textiles	22.5	22.2	20.0	25.2
Manufacture of Wearing Apparel	22.9	20.9	28.2	26.9
Tanning and Dressing of Leather, Mfg. of Luggage and Handbags	8.5	6.0	17.0	29.7
Manufacture of Footwear	15.6	14.4	18.7	25.4

Source: BLES

In another estimate, the DAP National Productivity Organization (2004) cited that the average annual labor cost which includes both direct and indirect labor is about 9.4% of the FOB value or about 17.15 percent of total expenses. The medium-sized companies registered the highest percentage of labor cost to total expenses (34.02%) for medium where the companies operated on consignment basis and where the cost of raw materials was hardly defined, estimated or provided by the respondents during the data gathering (DAP 2004).

Even power has become very costly. It accounts for another 10-15 percent of total cost. The Philippines has the second highest electricity rate in Asia.

- ***Productivity***

The relatively higher labor cost is aggravated by the low productivity performance of workers. Data from the BLES reveal that slower growth in labor productivity measured in terms of value-added per worker (in constant terms).

Table 15. Labor Productivity

Growth Rate	1999	2000	2001	2002
ALL INDUSTRIES	-0.75%	7.09%	-3.06%	1.28%
Manufacturing	-0.03%	6.15%	-2.83%	4.81%
Textile and Apparel	-19.31%	8.04%	8.91%	7.43%

Source: BLES

Value-added per worker is estimated at US$980 per year compared to China's US$4,680 and India's US$2,240.[16] China's productivity has dramatically improved by 17 percent in the period 1995-2002 primarily due to the foreign direct investments in the garments sector. Jobs increased by 160,000 between 1995 and 2002 in the garments sector while a decline of 44 percent (from 2.5 M to 1.3 M workers) was observed in the textile sector. However, the decline in jobs was compensated by increases in productivity of about 14 percent in the textile sector.[17]

In the Philippines, the slower growth in productivity can be attributed to the decline or lack of investments in the industry. However, some companies like Luen Thai have noted that the productivity levels in their Philippine factories are at par with their China factories. As shown in Table 16, there were no investments infused in the textile and garments sector from 2002 to 2003. However, commitments based on the Board of Investments data seem positive (Table 17).

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[16] Based on the data from the statistical yearbooks of Philippines, India and China.

[17] Based on a study entitled "China's Experience with Productivity and Jobs: benefits and Costs of Change by Robert H. McGuckin and Matthew Spiegelman (2005)by the Conference Board in cooperation with the National Bureau of Statistics in China. See http://www.pwcglobal.com/extweb.

Table 16. BSP Foreign Direct Equity Investments

Item	1996	1997	1998	1999	2000	2001	2002	2003
TOTAL	1281.0	1053.4	884.7	2106.4	1398.2	857.8	1431.4	1488.2
Banks and Other Financial Institutions	513.3	226.3	193.1	258.3	483.9	476.4	153.0	530.5
Manufacturing	477.7	172.2	245.5	1049.2	171.7	262.9	943.1	215.2
Textiles and Garments	1.8	2.6	1.5	6.6	0.6	0.2	0.0	0.0
Transport Equipment	35.7	23.3	6.5	21.4	6.1	25.8	0.0	17.8
Petroleum and Coal	0.2	0.1	13.3	0.1	0.0	1.6	67.7	0.0
Mach., App, Appl and Supplies	157.5	68.9	53.5	81.7	18.1	78.5	76.3	4.6
Paper and Paper Products	4.5	6.0	0.9	10.3	0.0	0.0	10.8	0.0
Non-Metallic Min. Products	99.7	2.7	4.0	27.1	0.0	83.7	14.6	37.8
Wood, Cane and Cork	0.0	0.0	0.2	0.4	2.7	3.8	4.1	2.3
Leather Products	0.0	0.2	0.8	0.5	0.2	0.0	0.3	0.0
Mining	**3.2**	**2.8**	**161.3**	**27.3**	**239.5**	**66.2**	**114.6**	**138.8**
Commerce	**84.8**	**78.0**	**161.9**	**166.3**	**62.3**	**23.3**	**26.6**	**57.7**
Trading	31.9	28.5	126.3	92.3	49.1	19.1	21.0	13.8
Real Estate	52.8	49.4	37.8	74.0	13.2	4.1	5.6	43.9
Services	**34.6**	**33.4**	**12.1**	**16.7**	**5.2**	**8.4**	**21.5**	**11.7**
Business	11.2	10.4	8.5	3.7	2.8	6.2	12.5	10.6
Medical, Health & Rec.	13.8	0.4	0.3	0.5	0.0	0.0	0.1	0.2
Tours and Travel	0.0	0.4	0.1	1.9	0.1	0.0	0.0	0.0
Transport and Storage	0.0	2.9	0.3	9.9	0.0	0.2	0.4	0.2
Waterworks	0.0	14.5	0.0	0.0	0.0	0.0	0.0	0.0
Restaurant and Hotel	0.0	0.0	1.6	0.2	0.5	0.1	0.3	0.1
Educational	0.0	0.0	0.2	0.1	0.0	0.0	0.0	0.0
Others	5.2	4.6	1.2	0.5	1.7	1.7	8.2	0.7
Public Utility	**120.6**	**297.8**	**67.9**	**552.5**	**423.5**	**20.6**	**131.8**	**433.5**
Agri., Fishery and Forestry	1.5	0.1	0.3	0.8	0.3	0.0	0.02	0.0
Construction	45.4	242.8	6.1	1.8	0.9	0.2	40.87	100.7
Others	0.0	0.0	36.6	33.8	10.1	0.0	0.00	0.0

The export processing zones have become familiar sites for garment exporters. Around 93 firms are located within the export processing zones and distributed in the following manner: 37.6 percent in Cavite, 18.4 percent in the Bataan Economic Zone, another 22.6 percent in the Mactan-Cebu Economic Zone II.

Some firms operate under joint venture agreements between Filipinos and a host of nationalities including Koreans, Japanese and Europeans. Dong Seung Apparel Corporation for instance is a 50-50 joint venture between Filipinos and Koreans. It specializes in the production of knitted and woven wearing apparels. The bulk of foreign direct investments in the past decades flowed to the garments sector, coming mostly from Taiwan, South Korea and Japan. These are the countries which relocated their operations to developing economies like the Philippines in order to overcome the quota restraints they faced in the US market. Hence, technological upgrading and skills development in these firms operating either under a PEZA or BOI status came from the mother companies. Expatriates are sent to the Philippines to train the workers and address productivity issues. These are the firms who hardly participate in the GTEB productivity enhancement programs.

SELECTED STATISTICS IN BOI-REGISTERED PROJECTS (1990 - OCTOBER 2004)

Textiles & Garments Sub-Sector	Data	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Grand Total
Chemical Fiber	Project Cost (P'000)	-	111,300	2,550,350		49,562	3,600			4,671							2,719,483
	# of Projects	1	1	2		2	1			1							8
	Projected Employment	267		469		35	49			33							853
Dyeing and Finishing	Project Cost (P'000)	138,903	55,589	28,120	570,107	407,664	31,205		49,670								1,281,258
	# of Projects	3	1	2	6	7	1		1								21
	Projected Employment	848	170	190	901	724	86		45								2964
Energy-Related Projects of Textiles Mills	Project Cost (P'000)							-									-
	# of Projects							1									1
	Projected Employment							40									40
Finished Materials	Project Cost (P'000)	388,869	101,598	191,865	244,002	556,081	140,898	187,944	124,995	114,783	294,287	30,890	6,399	19,392			2,402,003
	# of Projects	87	46	32	46	78	33	29	17	36	44	6	3	5			462
	Projected Employment	12689	5297	4509	8243	9239	4299	5158	2197	5661	4931	919	368	627			64137
Garment Accessories	Project Cost (P'000)	105,639	24,274	81,355	46,702	95,599	3,330	9,000		130,036	550		142,967	4,652			644,104
	# of Projects	17	4	7	3	4	1	2		1	1		1	1			42
	Projected Employment	876	366	878	251	277	30	636		122	6		339	64			3845
Garments	Project Cost (P'000)						19,378	-	-		30,772	77,195	102,276	43,119	138,622	90,597	501,959
	# of Projects						2	1	1		3	7	21	10	12	10	67
	Projected Employment						312	107			463	1249	3373	2112	2318	2602	12536
Industrial Textiles	Project Cost (P'000)	63,572	3,355				524,810			8,000							599,737
	# of Projects	5	1				1			1							8
	Projected Employment	231	63							51							345
Knitted Fabrics	Project Cost (P'000)	223,774	129,520	40,876	90,513	106,976	31,731	11,902	157,795	32,000	-		100,000		18,046		943,133
	# of Projects	8	4	2	2	5	3	3	4	2	1		4		1		39
	Projected Employment	1721	497	167	115	130	130	217	214	72	24		327		22		3636
Spun Yarn	Project Cost (P'000)	373,295	464,023	200,796	1,233,118	2,874,412		24,730	84,205	4,000					210,689	167,500	5,636,768
	# of Projects	6	3	3	4	8		1	3	1					2	1	32
	Projected Employment	690	813	173	959	811		15	726	21					172	45	4425
Textiles	Project Cost (P'000)														-	5,000	5,000
	# of Projects														1	1	2
	Projected Employment														0	58	58
Woven/Non-Woven Fabrics	Project Cost (P'000)	1,899,449	2,752	5,336	225,179	1,692,800	-	126,672	-	229,160							4,181,348
	# of Projects	9	1	1	4	7	4	3	1	1							31
	Projected Employment	2636	78	59	335	470	244	211	100	132							4265
Total Project Cost (P'000)		3,193,501	892,411	3,098,698	2,409,621	5,783,094	754,952	360,248	416,665	522,650	325,609	108,085	351,642	67,163	367,357	263,097	18,914,793
Total # of Projects		136	61	49	65	111	46	40	27	43	49	13	29	16	16	12	713
Total Projected Employment		19958	7284	6445	10804	11686	5150	6384	3282	6092	5424	2168	4407	2803	2512	2705	97104

EQUITY INVESTMENTS (P'000)

Textiles & Garments Sub-Sector	Nationality	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Grand Total
Chemical Fiber	AMERICAN			29,380													29,380
	BRITISH			405,562													405,562
	FILIPINO	5,250	111,300	2,033,192		444,867	3,600			4,671							2,602,880
	HONGKONG			47,078													47,078
	JAPANESE			22,799		278											23,077
	TAIWANESE			12,339		21,000											33,339
Chemical Fiber Total		5,250	111,300	2,550,350		466,145	3,600			4,671							3,141,316
Dyeing and Finishing	<unknown nationality>																
	<Various Nationalities>					360											360
	AMERICAN			6,500													6,500
	AUSTRALIAN				2,805												2,805
	BRITISH			1,500		1,440											2,940
	FILIPINO	129,503	49,753	12,000	539,887	391,830	31,205		49,670								1,203,848
	RESIDENT CHINESE	4,000	5,836		27,415												37,251
	SOUTH KOREAN					5,400											5,400
	TAIWANESE					8,634											8,634
Dyeing and Finishing Total		133,503	55,589	20,000	570,107	407,664	31,205		49,670								1,267,738
Energy-Related Projects of Textiles Mills	BRITISH							800									800
	FILIPINO							1,200									1,200
Energy-Related Projects of Textiles Mills Total								2,000									2,000
Finished Materials	<unknown nationality>					6,031							902				6,933
	<Various Nationalities>					10,203								4,392			14,595
	AMERICAN	349	4		11,124	71,278	5,778	10,699									99,232
	ANTIGUAN/BARBUDAN										289						289
	AUSTRALIAN									300							300
	BANGLADESH	1,415															1,415
	BRAZILIAN						67										67
	BRITISH	726	600	700	4,003	7,110				849	9,355						23,343
	CANADIAN				1,640	300											1,940
	CAYMANIAN					5,000											5,000
	FILIPINO	284,173	91,137	185,590	226,328	1,188,863	70,876	171,463	57,530	81,895	92,365	30,045	2,192				2,482,457
	GERMAN	8,940			12,026					1,239							22,205
	HONGKONG	15,400				950	8,000	2,250			4,125		1,500				32,225
	INDIAN	8,610	2,023		2,360	108,708	14,470	3,700	592	735	12,237	3,800	548				157,783
	ISRAELI					1,451											1,451
	ITALIAN			5,629						855							6,484
	JAPANESE	2,168	11,191	1,100		40,000	2,979		15,250		18,825						91,513
	PANAMANIAN					4,088											4,088
	RESIDENT CHINESE	23,206	5,938	800	8,850	60,309	387	7,153	455	10,828	3,710						121,636
	SINGAPOREAN	277										3,489					3,766
	SOUTH KOREAN	7,294	7,400	4,063	800	3,730	753		7,338	965	2,357	1,055	1,257	15,000			52,012
	TAIWANESE	9,323	5,969	2,500	10	9,131	11,951	9,123		43,315	38,518						129,840
Finished Materials Total		361,881	124,262	209,382	267,141	1,517,152	115,261	294,388	81,165	140,981	181,781	38,389	6,399	19,392			3,258,674
Garment Accessories	<unknown nationality>																
	<Various Nationalities>												106,585				106,585
	AMERICAN			11,700				250									11,950
	BRITISH												36,382	4,398			40,780
	CANADIAN		2,930			69,622											72,552
	FILIPINO	88,504	6,051	47,495	47,002	27,677	3,330	4,042		130,036	330			254			354,721
	JAPANESE	9,265	11,355	20,954							220						41,794
	RESIDENT CHINESE	2,239	3,938		100	800											7,077
	SOUTH KOREAN	3,940															3,940
	TAIWANESE							4,958									4,958
Garment Accessories Total		103,948	24,274	80,149	47,102	98,099	3,330	9,250		130,036	550		142,967	4,652			644,357
Garments	<unknown nationality>												8,077		875		8,952
	<Various Nationalities>												15,112	2,064			17,176
	AMERICAN											408	4,800				5,208
	BRAZILIAN												11				11
	BRITISH												2,280				2,280
	CANADIAN												4,800				4,800
	FILIPINO						11,615	100			17,027	68,434	65,047	2,400	8,456	77,414	250,493
	HONGKONG													5,098			5,098
	INDIAN										8,721	4,920	1,204	1,600	11,527	4,004	31,976
	ISRAELI						1,291										1,291
	RESIDENT CHINESE															3,000	3,000
	SOUTH KOREAN										1,026	4,033	300	1,000	87,515		93,874
	TAIWANESE						6,472					1,900	1,220	30,957	30,000	6,179	76,728
Garments Total							19,378	100			26,774	79,695	102,851	43,119	138,373	90,597	500,887
Industrial Textiles	<unknown nationality>																
	BRITISH									7,840							7,840
	FILIPINO	55,942	3,265				554,743			160							614,110
	JAPANESE	400															400
	SOUTH KOREAN		90														90
Industrial Textiles Total		56,342	3,355				554,743			8,000							622,440
Knitted Fabrics	<unknown nationality>																
	BRITISH	50															50
	FILIPINO	35,448	131,570	68,996	92,638	104,877	30,499	11,402	154,692	3,210	1,000		93,895		18,046		746,273
	HONGKONG								4,763								4,763
	INDIAN					2,099							25,000				27,099
	JAPANESE								140								140
	RESIDENT CHINESE				375		1,232	2,750	200	1,500							6,057
	SOUTH KOREAN												800				800
	TAIWANESE	182,457								31,040							213,497
Knitted Fabrics Total		217,955	131,570	68,996	93,013	106,976	31,731	14,152	159,795	35,750	1,000		119,695		18,046		998,679
Spun Yarn	<unknown nationality>																
	BAHAMANIAN	36,000															36,000
	BRITISH				914	3,884									76,282		81,080
	FILIPINO	329,475	461,523	179,996	1,232,203	2,713,216		24,730	90,880	4,000					134,407	167,500	5,337,930
	HONGKONG					9,840											9,840
	INDIAN					147,472											147,472
	JAPANESE	1,380		12,300													13,680
	RESIDENT CHINESE				176,000												176,000
	SOUTH KOREAN			8,500													8,500
	TAIWANESE	6,080															6,080
	VIRGIN ISLANDER		7,500														7,500
Spun Yarn Total		372,935	469,023	200,796	1,409,117	2,874,412		24,730	90,880	4,000					210,689	167,500	5,824,082
Textiles	<unknown nationality>																
	FILIPINO															5,000	5,000
Textiles Total																5,000	5,000
Woven/Non-Woven Fabrics	<unknown nationality>																
	AMERICAN	3,948															3,948
	BELGIAN	349															349
	BRITISH				2,226												2,226
	FILIPINO	1,824,497	2,752	5,336	180,026	1,533,615	3,225	117,672	2,250	169,160							3,838,533
	GERMAN				34,800												34,800
	RESIDENT CHINESE	9,486			8,127		150										17,763
	SOUTH KOREAN									60,000							60,000
	TAIWANESE					7,985											7,985
Woven/Non-Woven Fabrics Total		1,838,280	2,752	5,336	225,179	1,541,600	3,375	117,672	2,250	229,160							3,966,604
Grand Total		3,090,094	922,125	3,126,009	2,611,659	7,012,048	762,623	372,292	383,760	552,598	210,105	118,084	371,912	67,163	367,108	263,097	20,230,677

Foreign ownership is a common denominator of the companies in the list of Top 15 markets. The biggest market share of 1.60 percent is cornered by Leader Garments Corporation, an 80% foreign-owned company (Table 17).

Table 18. List of Top15 Exporters

RANK	FIRM NAME	2003	2002	2001	2000
1	LEADER GARMENTS CORPORATION	48.68	45.02	62.36	52.07
2	FORMOSTAR GARMENT (PHILS.) CO.	37.75	31.13	34.47	34.58
3	CRISMINA GARMENTS, INC.	34.19	38.24	35.86	44.62
4	DESIGNS APPAREL INTERNATIONAL,	31.28	19.04	14.03	17.82
5	CARINA APPAREL, INC.	30.89	24.41	17.24	7.32
6	KAY LEE FASHION, INC.	26.68	25.14	25.45	26.89
7	KNITJOY MANUFACTURING, INC.	26.22	24.51	22.48	27.13
8	NOVELTY PHILIPPINES, INC.	25.77	31.72	51.39	40.90
9	SARA LEE PHILIPPINES, INC. (IN	25.45	25.02	20.81	28.98
10	GOLDEN DRAGON APPAREL, INC.(FR	24.76	10.87	13.30	16.38
11	FIL-PACIFIC APPAREL CORP. (JAG	24.58	25.19	22.01	23.46
12	INTERNATIONAL YING MING IND'L	23.92	21.07	30.92	31.29
13	CHAMPAN GARMENT CORPORATION	23.75	33.95	31.68	23.04
14	DIAMOND APPAREL MFG. INC. (FRM	23.40	21.61	12.40	9.40
15	CAPITAL GARMENT CORPORATION	21.96	23.19	23.72	35.48

Source: GTEB

Foreign equity participation is a common denominator among these top exporters. Leader Garments, for instance, is majority-owned by Taiwanese. Both Tri-State and Luen Thai Holdings are majority-owned by Chinese principals.

Have there been efforts to improve productivity in the Philippines? Data reveal that firms without unions have been more inclined to provide job-related trainings for their rank and file (Table 19). In terms of ownership, more Filipino firms provided training to their rank and file.

Table 19.

Number of Textile and Wearing Apparel and Other Manufacturing Establishments Employing 20 or More Which Provided Job-Related Trainings for Rank & File (regular) By Type of Ownership and With or Without Union:2002

			Specific Industry			Specific Industry		
		Total	Textiles	Apparel	Other Mfg	Textiles	Apparel	Other Mfg
TOTAL		**2,761**	**33**	**300**	**2,428**	**1.20%**	**10.87%**	**87.94%**
Ownership	Wholly Filipino	2,046	15	181	1,850	**0.73%**	**8.85%**	**90.42%**
	With Foreign Equity	416	11	87	317	**2.64%**	**20.91%**	**76.20%**
	Wholly Foreign	299	7	32	260	**2.34%**	**10.70%**	**86.96%**
TOTAL		2,761	33	300	2,428	**1.20%**	**10.87%**	**87.94%**
With/Without	With Union	746	11	76	659	**1.47%**	**10.19%**	**88.34%**
Union	Without Union	2,015	22	225	1,769	**1.09%**	**11.17%**	**87.79%**

Most firms in the garments industry tried to innovate by improving their products and services and introducing new products (Table 20). These firms encountered difficulties in implementing improvements. Most firms cited lack of financial resources as the major impediment, followed by insufficient skilled personnel, internal resistance to change, and insufficient information on technologies (Table 21).

Table 20. NUMBER OF TEXTILE AND WEARING APPAREL AND OTHER MANUFACTURING ESTABLISHMENTS EMPLOYING 20 OR OVER WITH INNOVATIONS/IMPROVEMENTS INTRODUCED, PHILIPPINES

			Specific Industry		
		Manufacturing Industries	Mfg of Textiles	Wearing Apparel	Other Mfg Industries
Innovation Introduced	Total	5,722	207	705	4,810
	Implementation of Total Quality Management	58.5%	50.2%	49.6%	60.1%
	New products or services	59.2%	70.0%	55.3%	59.3%
	Improved products or services	71.9%	83.6%	73.5%	71.2%
	New processes	56.6%	61.4%	55.3%	56.6%
	Improved processes/re-engineering	58.1%	62.8%	55.2%	58.3%
	New technology	55.6%	48.3%	46.0%	57.3%
	Adoption of flexible working hours	41.1%	40.6%	53.5%	39.3%

Source: BLES

Table 21. NUMBER OF TEXTILE AND WEARING APPAREL AND OTHER MANUFACTURING ESTABLISHMENTS EMPLOYING 20 OR OVER WITH IMPEDIMENTS ENCOUNTERED IN THE IMPLEMENTATION OF INNOVATIONS, PHILIPPINES: 2002

			Specific Industry		
		Manufacturing Industries	Mfg. of Textiles	Wearing Apparel	Other Mfg. Industries
Impediment Encountered	Total	5,433	259	630	4,544
	Internal resistance to change	30.9%	20.8%	28.6%	31.8%
	Insufficient skilled personnel	26.8%	35.1%	31.3%	25.7%
	Insufficient financial resources	60.4%	78.0%	80.5%	56.6%
	Insufficient information on markets	19.5%	14.7%	22.4%	19.4%
	Insufficient information on technologies	24.3%	44.4%	28.6%	22.6%
	Deficiencies in the availability of external technical services	17.7%	23.9%	4.8%	19.2%
	Barriers to cooperation with other firms	11.1%	3.1%	9.0%	11.8%
	Barriers to cooperation with scientific and educational institutions	7.5%	1.5%	8.3%	7.7%
	Insufficient information on govt-initiated assistance programs	14.4%	12.0%	20.6%	13.7%
	Insufficient government incentives	15.3%	22.4%	15.9%	14.8%
	Inappropriate government standards and regulations	4.1%	1.5%	6.3%	3.9%
	Other impediment encountered.	15.4%	3.9%	4.9%	17.5%

Source: BLES

Over the years, firms have adopted various strategies such as sending operators and sewers for training in external institutions such as TESDA, assigning a productive worker as the benchmark and trainor for the rest of the workers, sending technical personnel such as industrial engineers for training abroad (at the company's expense), tying up with suppliers of machines to provide training, adopting team-building seminars and adopting internal benchmarks in specific processes as basis for yearly targets in productivity improvement. The Dual-Tech training is a common program employed in the industry.[18] Some exporters interviewed commented that the TESDA –training programs can be improved to suit the needs of the firms particularly the subcontractors who are also being subjected to inspection by buyers.

The average turnover rate is a low 10% which usually moves producers to offer early retirement programs for older employees and to accommodate new batches of trainees. Some firms also provide productivity level bonus (based on performance and efficiency) on top of the daily wages.[19] Proactive producers have begun using the electronic mail (e-mail) to improve communication between the workers and management. Workers are encouraged to send ideas, suggestions and concerns directly to management through the e-mail. Luen Thai is one of the most pro-active producers in the Philippines. It has set up an Apparel Academy at Clark which is tied up with the Hong Kong Productivity Center . In-house instructors and training consultants implement a progressive schedule of multi-level courses from basic skills of cutting, pattern-making and sewing to the mastering of supervisory skills, and technical knowledge.

The GTEB has also taken an active role in motivating labor and management to work together to improve productivity. The Productivity Program of the GTEB together with the Development Academy of the Philippines aims to establish baseline information on productivity performance of the industry or benchmarking purposes, develop general framework for productivity-based compensation scheme and conduct seminars and trainings for top, middle management and workers on production principles, techniques and skills.

The industry has likewise advocated for productivity-based wages as a measure for productivity enhancement. Such initiative has been met with resistance by union members who think that the workers will be placed at a disadvantage because of the flexibility gained by the employer. The current Productivity Incentives Act provides for the determination of piece-rate wages and has made a significant shift at least in the garments industry from regular employment and fixed wage systems to more flexible employment and wage arrangements, such as subcontracting and piece-rate wage. The International Labor Organization has quite a number of studies related to productivity-based wages which can be subjected to further discussion between government and the private sector.

[18] The training is a structured 18-month course in garment manufacturing where a batch of around 30 trainees in the 18-22 age bracket and at least high school graduates are recruited every 9 months. They are educated by trainors from Germany and the Philippines on theories of garments production and its manufacturing process. Training covers basic time and method study to get familiar with production, the different operations and quality standards.

The urgency to address productivity not only by the Philippines but other developing countries as well is highlighted by the fact that foreign direct investments are driving up productivity of Chinese workers.

- ***Use of Information and Communications Technology***

The Internet has become an invaluable resource for most garment producers. It renders communication between garment buyers and suppliers more efficient and less costly (Hong Kong Trade Development Council 2001). Part of the logistics chain is the production network. Here investments in research and development are critical in an industry where around 90% have not engaged in product development and if one is to compensate higher labor costs with higher productivity of workers. For large companies, they have set up their own R&D units which have developed custom-made programs for tracking each stage of the production process. But for smaller companies, their capability to move up the value chain is impeded by the lack of financing to invest in such programs and in the absence of a common resource for R&D for the industry.

The garments industry is more labor-intensive compared to other manufacturing industries. There is quite a slow development in technology in the past decades as most firms became complacent with their quota holdings. Over the last five years, the bulk of investments in ICT have been in the form of computers for document processing and in facilitating pattern-making process. Around P2-3 million worth of investments have been allocated in the Computer Aided Design and Drafts by most garments firms. Most of the time, new technology is sourced from foreign affiliates as a requirement by the buyers in the proper execution of orders. Initiatives to improve with the use of ICT have become more prominent in the 1990s with the competition from newly opened economies and low-cost suppliers such as Vietnam, Cambodia, Laos and India.

ICT has been quite significant in improving their marketing capability, product processing, pattern-making and alterations procedures, in coordinating production schedule and in managing human resources. On the average, ICT has provided a significant contribution in areas such as gaining access to R&D information, dealing with input suppliers and keeping in touch with clients.

Most foreign buyers are now using their Internet websites as venue for communicating orders with the vendors and in tracking the state of operations in the vendors' factories. In order to increase productivity, some firms such as Tri-State and Luen Thai have set up their own Management Information Systems unit to develop programs that will simplify process flow and reduce the time spent for processing transactions. The programs being used include ecTrack-a web-based events and communications tracking system which provides automatic assignment of supply chain (inter-company and intra-ompany) responsibilities and automatically creates an interaction plan based on individual order characteristics and real-time adjustment for each purchase order. It is also designed to improve forecasts and lead times. The G2000 or Garments Operations 2000 is another program being used in the supply chain integration. It is an end-to-end Enterprise Resource Planning Solution for the garment manufacturing industry with SAP R/3 as its backbone system. The business world today is focusing on improving customer service and integration in the supply

chain. The GO2000 is designed to facilitate order management, facilitate easy multi-country consolidation, ordering, tracking and inventory control of materials, enable shop floor tracking of production information at the right level to facilitate accurate capturing of manufacturing costs and calculation of quality output-based worker compensation and efficiently handle administrative and accounting tasks to manage business units.

Suppliers are able to create more value for their buyers if they can reduce FOB Cost associated with cost of raw materials, cut-trim-make and packaging. Investments by pro-active firms on critical path management systems, for instance, have been cited to generate higher productivity and reliability of delivery and quality products. The CPM closely monitors the completion of each of the critical steps necessary to meet the required delivery date of the customer for each style ordered. For one company, it has reduced delays by about one week and reduced overtime cost from 5 million pesos to 2.5 million pesos per year or 10,640 per employer per year on overtime pay. This is also a reduction of 3 percent on total overhead. On-time production and shipments have contributed savings of 15 percent of the cost of freight per piece since air freight need not be used. In the case of knitted shirts, the biggest cost is accounted for by raw materials and accessories. Freight usually accounts for 6 percent of total retail price.

- ***Social Compliance***

Unpleasant stories of rampant child labor, perilous and unsanitary working conditions, and unjust wages have forced companies, notably multinational firms, to publicize their strict adherence to internationally recognized workplace or ethical standards with a view of enhancing their fragile corporate image.

In the garments industry, buyers are demanding transparency in their suppliers' operations, as well as ethical business practices that conform to the customers' code of conduct and other major industry and international policies.[20] The Social Accountability International (SAI, formerly known as the Council on Economic Priorities and Accreditation Agency or CEPAA) has developed a standard for workplace conditions and a system for independently verifying the compliance of factories. Called Social Accountability 8000 (SA 8000), the standard its verification system draw from established business strategies for ensuring quality (such as those used by the International Standards Organization for ISO 9000) and add several elements that international human rights experts have identified as essential to social auditing.[21] Some buyers have also developed their own company standards. Thus, an exporter whose factory is socially compliant may not necessarily pass another buyer's standards. These exporters may even be required to set up their own testing laboratories duly accredited by the buyers. This requires huge investments but exporters perceive such moves as way of building long-term relationships.

The Philippines is the first Asian country to become socially compliant. Problems on child labor are not experienced in the same degree as the firms in China, Cambodia, and Sri Lanka.

[20] Rodolfo, Cherrylyn. "Dressing the World." *Industry Monitor*, May 2001. UA&P.
[21] www.cepaa.org

Outbound Logistics

Even the government has realized the necessity of improving its support infrastructure to the garments industry. It has invested in the creation of a One Stop Export Documentation Center to simplify export documentation procedures. The GTEB has also improved its communication system by adopting the latest technology in computer-to-computer messaging for the transfer of business data. In 1996 the Department of trade and industry in Cebu City, in cooperation with the GTEB in manila and the Philippine Exporters Confederation Inc of Cebu agreed to set up the GTEB/EDI Cebu Service Center to cater to the needs of the exporters who previously had difficulty in getting clearance since the GTEB is based in Manila. The project was fully implemented in 1997. The GTEBNetwork (GTEBNet) is a network community set up between the GTEB and its exporters to facilitate electronic transmission of export documents. The GTEBNet Project envisions to simplify GTEB procedures, enable exporters to transact electronically with GTEB through the EDI, automate processing of documents and ensure compliance to the US Customs requirement in the implementation of the Electronic Visa Information System. The EDI has benefited the GTEB in terms of administrative efficiency, maximized utilization of quota allocation and faster dissemination of information

One major complaint cited by exporters is the relatively high transaction cost associated with LCL type of shipments. They do not have control over their forwarded or consolidator(usually nominated by the buyers). In the 1980s, the exporters can go directly to the shipping line for consolidation shipments. Today, shipping lines handle only full container loads. Exporters have complained about the relatively high consolidation charges. Based on records of garments companies, these charges can account for 57 percent of all export charges.

Competitive producers have begun to invest in improving garments logistics to achieve exceptional performance and expertise in the critical areas of on-time delivery, quality and superior customer service. While subcontracting of logistics operations has become a viable option some bigger producers have set-up their own logistics subsidiaries or division such as the CTSI Logistics in the case of Luen Thai Holdings in Hong Kong. This company utilizes SAP R/3 and advanced e-commerce solutions and information technology to generate speed and expertise for superior customer service in air and sea transportation. It provides service to the various manufacturing plants of Luen Thai including those in the Philippines.

In the US ITC report (2003), a survey of US buyers indicated the following as critical in their sourcing decisions: proximity to markets and reliability. For those considering a country for its location decisions, other factors have been added namely: infrastructure and logistics, business and investment and political climate. Reliability of suppliers is also linked to availability of good infrastructure and efficient logistics chain. These preferences by the buyers are likewise matched by the responses of exporters in recent interviews and surveys. In 1995, price is ranked as the number factor affecting their competitiveness of all firms. In 2000, price has been ranked fourth especially among the bigger exporters. The first was reliability, followed by quality and speed of delivery. Reliability is also a function of logistics cost. Exporters commonly complain about the inefficiencies encountered in inbound

logistics – longer lead times due to customs procedures and aggravated by relatively low productivity due to the lack of investments in management systems aimed at ensuring reliability and quality. The issue of poor infrastructure and inefficient logistics are major concerns especially for the small and medium sized exporters who even at this stage of the quota phase-out are still ill-equipped in technical upgrading, access to ICT applications.

Outbound logistics becomes a major issue when exporters fail to meet delivery date. They tend to resort to air freight therefore increasing transportation costs. Records of reliability tend to be relatively poor as evidenced by concerns on the high cost of air freight shipments which can average P3.3 million for a delayed shipments of 800 pairs of denim jeans (costs are exacerbated when overtime charges imposed by buyers which can amount to at least US$5-$10 per hour).

Domestic infrastructure and logistics have likewise been cited to increase transaction costs. Truck bans, poor roads particularly the Alabang viaduct and the absence of rail transport from Region 4, for example, or the development of the Batangas port are part of the poor domestic infrastructure. Most of the freight forwarders handling the outbound logistics of suppliers are nominated by the buyers and are normally efficient. However, it was noted that hidden costs in dealing with customs tend to force these forwarders to charge the exporters with additional costs such as representation expenses and overtime charges.

- **Buyer (Retailer)**

More than 90 percent of garments firms concentrate primarily in pattern making down to finishing. Those with buying offices abroad simply wait for the purchase orders and fabric and accessories. Their competitive advantage is in properly executing the design dictated by the buyers through the use of CAD and in delivering the shipments on time.

In some cases, buyers dictate the design and the type of raw materials to be used but still require the vendors to source the raw materials. It is very crucial for these vendors to establish a wide network of fabric suppliers both in the local and foreign market especially China, Taiwan and South Korea (due to their closer proximity to the Philippines).

Subcontracting is also common among top exporters under the buyer-driven value chain. But vendors catering to branded markets are careful in choosing the subcontractor. They normally require subcontractors to commit their operations and facilities with their orders alone. This is a way of ensuring that high quality products are delivered, zero defects and no re-works. These firms assign their own quality assurance supervisors in the factories of their subcontractors.

5 RP-US Free Trade in Garments: Issues and Prospects

This section will examine the competitiveness of Philippine garments in the US market and identify the advantages and disadvantages of entering into a free trade with the US. The potentials for the garments sector in the US market can be seen in Table 22 which presents the average spending of the Top 20 percent of Americans on clothing and accessories. Clothing is the third biggest expenditure category for average Americans.

Table 22 U.S. spending by type of income

	Top 20% Income Group	Single Parent
Average Income	$70,000	$25,270
Average Spending on Product		
Clothes total	$3,500	$2,051
Children's 2-15	$382	$447
Baby 0-2	$148	$90
Shoes	$536	$476
Furniture	$906	$209
Vehicle Purchase	$6,555	$1,872
Health	$2,921	$1,134
Entertainment	$4,053	$1,375
Wine	$183	$38
Jewelry	$278	$71

Source: The Big Bang: Ending Quota and Tariff Policies (January 2004)

The US is net importer of garments from the Philippines while the latter is a net exporter. In 2003, the US imported a total of US$ 1.7 B from the Philippines, a 5% decline from the previous year's level. On the other hand, it exported only US$350M of garments to the Philippines, or 1.1 percent of total garments imports by the Philippines in 2003. The US is the eight source of imported apparel, accounting for only 2% of total importation. Hong Kong is the major supplier with a share of 33.2 percent.

Revealed Comparative Advantage (RCA)

In the previous sections, it was revealed that the Philippines tends to be competitive in certain products based on their FOB value and quota utilization. Another measure commonly used is the RCA. The RCA is a commonly used measure of trade competitiveness. Its popularity rests on its simplicity, *i.e.,* easy to calculate and based on widely accessible trade data, as well as on its theoretical underpinning. This traditional measure is based on the neoclassical trade paradigm that a country's trade pattern reveals information regarding its competitive position in the world market, *i.e.*, a country specializes on commodities where it has comparative advantage. An

RCA of greater than 1 reveals that a product is competitive while an RCA index of less than 1 imply that a product is not competitive:

RCA is defined by:

$$\mathbf{RCA} = \frac{\mathbf{X_{ij}}/\Sigma_{\mathbf{i}}\,\mathbf{X_{ij}}}{\Sigma_{\mathbf{j}}\mathbf{X_{ij}}/\Sigma_{\mathbf{j}}\Sigma_{\mathbf{i}}\,\mathbf{X_{ij}}}$$

where: X_{ij} = exports of product "i "by country "j"
$\Sigma_i X_{ij}$ = total exports of country "j"
$\Sigma j X_{ij}$ = world exports of product "i"
$\Sigma_j\Sigma_i X_{ij}$ = total world exports

The RCA Indices for garment products under Harmonized Tariff System Code 61 and 62 have been computed using the Comtrade Database for 2000-2002. Those products with RCA indices greater than 1 are presented in Table 23. They are mostly knitted garments where creative designs are also incorporated by the suppliers as form of product differentiation and value creation for the buyers. These are the top selling items presented in the earlier sections of the paper.

It should be noted, however, that there are some products whose RCA indices have increased from 2000 to 2002, an indication of increasing advantage. These products are mostly (ranked according to 2002 indices) knitted ones (Table 24).

Table 23. Products With Revealed Comparative Advantage

Product Code	Product Description	2000	2001	2002
620930	Babies garments & clothing accessories of synthetic fibres,not knitted	34.68	28.45	23.76
611130	Babies garments and clothing accessories of synthetic fibres, knitted	11.84	17.44	22.04
610520	Mens/boys shirts, of man-made fibres, knitted	15.49	16.82	12.98
620413	Womens/girls suits, of synthetic fibres, not knitted	16.61	13.37	12.86
621220	Girdles, panty girdles and parts thereof, of textile materials	5.05	7.11	12.64
620920	Babies garments and clothing accessories of cotton, not knitted	15.54	17.50	11.72
610510	Mens/boys shirts, of cotton, knitted	9.22	9.93	10.94
620443	Womens/girls dresses, of synthetic fibres, not knitted	8.00	10.85	9.23
620333	Mens/boys jackets and blazers, of synthetic fibres, not knitted	8.55	8.66	8.64
630493	Furnishing articles nes, of synthetic fibres, not knitted or crocheted	15.34	12.35	8.63
620442	Womens/girls dresses, of cotton, not knitted	10.84	9.91	8.06
610311	Mens/boys suits, of wool or fine animal hair, knitted	1.79	0.62	7.84
610610	Womens/girls blouses and shirts, of cotton, knitted	6.12	6.58	7.44
611212	Track suits, of synthetic fibres, knitted	8.91	9.48	7.03
610323	Mens/boys ensembles, of synthetic fibres, knitted	9.46	8.47	6.40
621143	Womens/girls garments nes, of man-made fibres, not knitted	9.61	9.57	6.37
610321	Mens/boys ensembles, of wool or fine animal hair, knitted	0.00	2.20	5.75
630130	Blankets (o/t electric) and travelling rugs, of cotton	1.78	2.13	5.71
610443	Womens/girls dresses, of synthetic fibres, knitted	4.97	6.54	5.68
610343	Mens/boys trousers and shorts, of synthetic fibres, knitted	4.26	4.79	5.57
620520	Mens/boys shirts, of cotton, not knitted	4.92	5.26	5.25
630210	Bed linen, of textile knitted or crocheted materials	3.39	5.87	5.21
610333	Mens/boys jackets and blazers, of synthetic fibres, knitted	5.75	5.48	4.95
610620	Womens/girls blouses and shirts, of man-made fibres, knitted	5.60	5.22	4.89
621112	Womens/girls swimwear, of textile materials, not knitted	6.95	7.00	4.85
610413	Womens/girls suits, of synthetic fibres, knitted	0.43	4.91	4.82
621210	Brassieres and parts thereof, of textile materials	3.57	4.30	4.74
610442	Womens/girls dresses, of cotton, knitted	4.44	6.94	4.65
610811	Womens/girls slips and petticoats, of man-made fibres, knitted	2.03	3.25	4.56
610331	Mens/boys jackets and blazers, of wool or fine animal hair, knitted	0.70	1.79	4.54
620462	Womens/girls trousers and shorts, of cotton, not knitted	4.43	4.51	4.42
610892	Womens/girls bathrobes,dressing gowns,etc,of man-made fibres,knitted	5.60	3.95	4.39
620343	Mens/boys trousers and shorts, of synthetic fibres, not knitted	3.90	4.22	4.16
620431	Womens/girls jackets, of wool or fine animal hair, not knitted	3.68	4.99	4.01
611120	Babies garments and clothing accessories of cotton, knitted	4.12	5.21	3.92
610463	Womens/girls trousers and shorts, of synthetic fibres, knitted	2.57	3.31	3.88
610210	Womens/girls overcoats,anoraks etc,of wool or fine animal hair,knitted	0.61	3.05	3.81
610453	Womens/girls skirts, of synthetic fibres, knitted	1.77	2.73	3.78
620119	Mens/boys overcoats&sim articles of oth textile materials,not knittd	2.20	2.79	3.77
620463	Womens/girls trousers and shorts, of synthetic fibres, not knitted	4.08	3.78	3.76
620432	Womens/girls jackets, of cotton, not knitted	1.80	3.18	3.47
621142	Womens/girls garments nes, of cotton, not knitted	2.36	3.44	3.34
610342	Mens/boys trousers and shorts, of cotton, knitted	1.08	1.35	3.30
610822	Womens/girls briefs and panties, of man-made fibres, knitted	2.12	2.75	3.16
620342	Mens/boys trousers and shorts, of cotton, not knitted	2.40	2.36	3.03
620312	Mens/boys suits, of synthetic fibres, not knitted	4.85	4.18	2.97
620332	Mens/boys jackets and blazers, of cotton, not knitted	3.35	3.42	2.79
610462	Womens/girls trousers and shorts, of cotton, knitted	1.85	2.19	2.78
620111	Mens/boys overcoats&similar articles of wool/fine animal hair,not knit	0.88	2.25	2.77
610690	Womens/girls blouses and shirts, of other materials, knitted	0.79	1.10	2.70
620212	Womens/girls overcoats and similar articles of cotton, not knitted	0.53	0.81	2.64
610832	Womens/girls nightdresses and pyjamas, of man-made fibres, knitted	3.56	3.97	2.50
610431	Womens/girls jackets, of wool or fine animal hair, knitted	0.08	0.52	2.43
620213	Womens/girls overcoats&sim articles of man-made fibres,not knittd	2.50	3.51	2.40
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	1.22	1.57	2.37
620461	Womens/girls trousers & shorts,of wool or fine animal hair,not knitted	5.68	7.30	2.35
621020	Mens/boys overcoats&similar articles of impreg,ctd,cov etc,tex wov fab	1.47	2.49	2.31
610722	Mens/boys nightshirts and pyjamas, of man-made fibres, knitted	1.65	4.40	2.31
620323	Mens/boys ensembles, of synthetic fibres, not knitted	4.19	2.11	2.24
610230	Womens/girls overcoats, anoraks etc, of man-made fibres, knitted	0.16	0.37	2.22
630319	Curtains,drapes,interior blinds&curtain/bd valances,oth tex mat,knit	0.80	0.33	2.16
610423	Womens/girls ensembles, of synthetic fibres, knitted	3.15	4.25	2.16
620412	Womens/girls suits, of cotton, not knitted	0.96	1.63	2.13
610312	Mens/boys suits, of synthetic fibres, knitted	1.01	4.33	2.07
620311	Mens/boys suits, of wool or fine animal hair, not knitted	1.53	2.02	1.97
620321	Mens/boys ensembles, of wool or fine animal hair, not knitted	0.00	0.11	1.94
621111	Mens/boys swimwear, of textile materials not knitted	6.53	5.84	1.91
610432	Womens/girls jackets, of cotton, knitted	1.83	1.68	1.90
620113	Mens/boys overcoats & similar articles of man-made fibres,not knitted	2.61	3.33	1.87
611020	Pullovers, cardigans and similar articles of cotton, knitted	1.56	1.49	1.82
610452	Womens/girls skirts, of cotton, knitted	1.66	1.43	1.82
620620	Womens/girls blouses & shirts,of wool or fine animal hair,not knitted	1.26	2.02	1.81
610433	Womens/girls jackets, of synthetic fibres, knitted	1.37	1.95	1.77
611030	Pullovers, cardigans and similar articles of man-made fibres, knitted	1.99	2.03	1.73
610329	Mens/boys ensembles, of other textile materials, knitted	0.01	1.02	1.68
630392	Curtains/drapes/interior blinds curtain/bd valances,of syn fib,nt knit	3.40	2.45	1.65
610821	Womens/girls briefs and panties, of cotton, knitted	1.05	1.41	1.55
610332	Mens/boys jackets and blazers, of cotton, knitted	1.72	2.18	1.54
620211	Womens/girls overcoats&sim articles of wool/fine animal hair nt knit	0.15	1.54	1.50
610412	Womens/girls suits, of cotton, knitted	0.01	0.88	1.50
610110	Mens/boys overcoats, anoraks etc, of wool or fine animal hair, knitted	0.14	0.67	1.39
620510	Mens/boys shirts, of wool or fine animal hair, not knitted	7.07	1.55	1.32
630253	Table linen, of man-made fibres, not knitted	10.59	4.14	1.27
620990	Babies garments&clothg accessories of oth textile materials,not knittd	1.57	2.44	1.26
621131	Mens/boys garments nes, of wool or fine animal hair, not knitted	1.94	2.42	1.25
610322	Mens/boys ensembles, of cotton, knitted	1.35	1.36	1.24
620411	Womens/girls suits, of wool or fine animal hair, not knitted	1.91	1.67	1.19
620441	Womens/girls dresses, of wool or fine animal hair, not knitted	2.93	2.24	1.19
610712	Mens/boys underpants and briefs, of man-made fibres, knitted	3.33	2.13	1.13
630411	Bedspreads of textile materials, nes, knitted or crocheted	0.81	0.53	1.12
620293	Womens/girls anoraks & similar article of man-made fibres,not knitted	1.08	0.98	1.09
610441	Womens/girls dresses, of wool or fine animal hair, knitted	0.13	0.60	1.07
620331	Mens/boys jackets and blazers,of wool or fine animal hair,not knitted	1.00	0.87	1.06
620530	Mens/boys shirts, of man-made fibres, not knitted	1.97	1.79	1.05
610130	Mens/boys overcoats, anoraks etc, of man-made fibres, knitted	0.52	0.92	1.01

*ranked based on 2002 RCA indices.

Source: Computed from the UN COMTRADE Database

Table 24. Products With Increasing RCA

Product Code	Product Description	2000	2001	2002
611130	Babies garments and clothing accessories of synthetic fibres, knitted	11.84	17.44	22.04
621220	Girdles, panty girdles and parts thereof, of textile materials	5.05	7.11	12.64
610510	Mens/boys shirts, of cotton, knitted	9.22	9.93	10.94
610311	Mens/boys suits, of wool or fine animal hair, knitted	1.79	0.62	7.84
610610	Womens/girls blouses and shirts, of cotton, knitted	6.12	6.58	7.44
610321	Mens/boys ensembles, of wool or fine animal hair, knitted	0.00	2.20	5.75
630130	Blankets (o/t electric) and travelling rugs, of cotton	1.78	2.13	5.71
610343	Mens/boys trousers and shorts, of synthetic fibres, knitted	4.26	4.79	5.57
621210	Brassieres and parts thereof, of textile materials	3.57	4.30	4.74
610811	Womens/girls slips and petticoats, of man-made fibres, knitted	2.03	3.25	4.56
610331	Mens/boys jackets and blazers, of wool or fine animal hair, knitted	0.70	1.79	4.54
610463	Womens/girls trousers and shorts, of synthetic fibres, knitted	2.57	3.31	3.88
610210	Womens/girls overcoats,anoraks etc,of wool or fine animal hair,knitted	0.61	3.05	3.81
610453	Womens/girls skirts, of synthetic fibres, knitted	1.77	2.73	3.78
620119	Mens/boys overcoats&sim articles of oth textile materials,not knittd	2.20	2.79	3.77
610342	Mens/boys trousers and shorts, of cotton, knitted	1.08	1.35	3.30
610822	Womens/girls briefs and panties, of man-made fibres, knitted	2.12	2.75	3.16
620342	Mens/boys trousers and shorts, of cotton, not knitted	2.40	2.36	3.03
620432	Womens/girls jackets, of cotton, not knitted	1.80	3.18	3.47
610462	Womens/girls trousers and shorts, of cotton, knitted	1.85	2.19	2.78
620111	Mens/boys overcoats&similar articles of wool/fine animal hair,not knit	0.88	2.25	2.77
610690	Womens/girls blouses and shirts, of other materials, knitted	0.79	1.10	2.70
620212	Womens/girls overcoats and similar articles of cotton, not knitted	0.53	0.81	2.64
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	1.22	1.57	2.37
610230	Womens/girls overcoats, anoraks etc, of man-made fibres, knitted	0.16	0.37	2.22
630319	Curtains,drapes,interior blinds&curtain/bd valances,oth tex mat,knit	0.80	0.33	2.16
610329	Mens/boys ensembles, of other textile materials, knitted	0.01	1.02	1.68
610431	Womens/girls jackets, of wool or fine animal hair, knitted	0.08	0.52	2.43
630411	Bedspreads of textile materials, nes, knitted or crocheted	0.81	0.53	1.12
610821	Womens/girls briefs and panties, of cotton, knitted	1.05	1.41	1.55
610441	Womens/girls dresses, of wool or fine animal hair, knitted	0.13	0.60	1.07
610130	Mens/boys overcoats, anoraks etc, of man-made fibres, knitted	0.52	0.92	1.01
610412	Womens/girls suits, of cotton, knitted	0.01	0.88	1.50
610110	Mens/boys overcoats, anoraks etc, of wool or fine animal hair, knitted	0.14	0.67	1.39

Source: Computed from the UN COMTRADE Database

Implications of Duty-Free Access

The quota –free environment should enable competitive exporters to increase their market shares. However, they are still concerned about the price factor. They hardly have room for reducing prices because of the relatively high transaction costs associated in the supply and value chains. Hence, they see the FTA as a window of opportunity to become more price competitive and for the FTA to be signed soon since more countries are considering FTAs with the US as a source of advantage today.

Tariffs continue to serve as a major barrier for our products since we do not enjoy preferential access to the US. We are not part of the Generalized System of Preferences which grants some least developed countries zero percent tariff or certain tariff reductions. UNDP (2004) cited that ordinary clothing are imposed with higher tariffs compared to luxurious clothing products (Table 25).

Table 25. Comparative Tariff Structure of Cheap vis-a-vis Luxurious Products

Product	Tariff Number	2003 Tariff Rate
Acrylic Sweater	61103030	32.2%
Cashmere Sweater	61101210	4.4%
Men's Suit, Polyester/Wool Blend	62031115	27.5%
Men's Suit, Silk/Wool Blend	62031220	7.5%
Linen Tablecloth	63025210	11.4%
Polyester Tablecloth	63025300	5.6%
Men's or boy's overcoats, of wool or fine animal hair	61011000	16%
Men's or boys' overcoats, knitted of cotton	61012000	15.9%
Women's or girls' trousers, knitted or crocheted, of cotton	61046220	14.9%
Women's or girls' trousers, knitted or crocheted, of synthetic fibers	61044320	16%

Source: UNDP (2004); list expanded by the author using the US Tariff Database

Under MFN rates, garments are subject to a range of tariffs, 0.7% for raw materials, 5.3% for yarns, 11.9% for clothing. The overall average rate for textile and clothing is 9%.

Eliminating tariffs can bring down the import price and make consumers benefit from lower prices. However, there are concerns that such advantage can be short term only if Thailand eventually enjoys the same status. Currently, the Philippine FOB prices in the US are 17-32 percent higher than Thailand's prices.[22] China can likewise bring down FOB prices due to its labor cost advantage. The relatively high cost of labor has been identified as a major reason for the higher FOB prices of Philippine garments. Labor cost accounts for an average of 27 percent of manufacturing cost for the garment sector. This is higher than Thailand's 22 percent or Mexico's 19 percent and Indonesia's 5 percent. Labor cost in the Philippines is US$1.4 per hour compared to Indonesia's US$0.24 and India's US$0.71. In the end, however, it still benefits our exporters if duty-free access can be enjoyed. For those engaged in full package supply including delivering goods at landed duty prices, the savings derived from the duty-free access can be used to improve services to the buyers or even create new services for them.

Consider brassieres[23]. The volume of Philippine brassiere exports to the US increased by 7.6% in 2003 under a quota-free regime for this product. Other suppliers which enjoyed growth in volume were Thailand, Indonesia, and Sri Lanka (ranked). Our landed duty-paid price per dozen in the first half of 2003 was US$34.89 compared to Thailand's US$39.33 or Sri Lanka's US$80.11. ***If the duties are removed under a free trade regime, the Philippine's landed duty-paid value would be around US$28, lower than China's US$32.6.*** Sri Lanka's high import price is due more to the fact that it has already found a niche in high end products. If Thailand is able to enjoy duty-free access, Thailand can directly compete with the Philippines, especially if its currency depreciates at a faster rate than the Philippine peso. Or even if the

[22] Based on US data of imports of apparel.
[23] Based on position paper of the American Footwear and Apparel Association. 2004.

Philippines gets ahead in signing the FTA with the US, the benefits can be eroded if Thailand competes by reducing FOB prices through more efficient logistics and lower costs of doing business.

Using point of sale is more relevant because it reveals whether our products are competitive or not at the retail stores. Using brassieres as the example, the table below shows that removing tariffs truly enhances our chances of becoming more competitive.

Table 26a. Comparison of Indicative Store Prices for Brassieres (2003)

	Phil	Thai	China	Indo
FOB	US$31.73	US$35.76	US$29.62	US$36.09
Tariff	10%	10%	10%	10%
Landed Duty Paid Value	34.89	39.33	32.57	39.69
35-50% Mark-up	47.1-52.3	53.1-58.9	43.9-48.9	53.9-59.5
Sales tax	5%	5%	5%	5%
Store Price	49.4-54.9	55.7-54.9	46.2-54.9	56.2-54.9

*average FOB prices are used. Note that some brassiere products are top selling items because of the product differentiation – mostly based on design.

Table 26b. Comparison of Indicative Store Prices for Brassieres (2003)

	Phil	Thai	China	Indo
FOB	US$31.73	US$35.76	US$29.62	US$36.09
Landed Duty Paid Value	34.89	39.33	32.57	39.69
35-50% Mark-up	47.1-52.3	53.1-58.9	43.9-48.9	53.9-59.5
Sales tax	5%	5%	5%	5%
Store Price	42.8-47.6	53.1-58.9	43.9-48.9	53.6-59.5

*average FOB prices are used. Note that some brassiere products are top selling items because of the product differentiation – mostly based on design.

Sources: Basic data from the USITC

Consider T-shirts produced by the Philippines and sold at stores such as JC Penny and May Department Stores which will become more competitive if duties are removed (Table 27).

Table 27. Indicative Point of Sale Price With and Without Tariffs

	With Tariffs	**W/O Tariffs**	
FOB	US$40	FOB	US$40
Tariff	x 1.70	Tariff	x ---
Landed Duty Paid	= $46.8	Landed Duty Paid	= $40
35-50% Mark-up	x 1.35 -1.50	35-50% Mark-up	x 1.35 -1.50
	US$63.2-70.2		US$54 – 60
Sales tax	x 1.05	Sales tax	x 1.05
Store Price	**US$66.4-73.7**	**Store Price**	**US$56.7-63**

Sources: FOB and tariff data from USITC

Issues for the Negotiating Panel

- **Pursue more liberal Rules of Origin (ROOs)**

Negotiating for a free trade with the US will require an assessment or evaluation of the issues related to rules of origin (ROOs) for the garments industry. The first step is to examine the nature of the free trade agreements signed by the US with other countries. This exercise will enable us to identify the most likely negotiating stance of the US as regards ROOs for garments.

What's the rationale for ROOs? These ROOs are intended to prevent trade deflection or transshipments (to ensure that substantial transformation has taken place in the partner country) and support trade measures such as quantitative restrictions and anti-dumping and countervailing duties and safeguard measures as well as for requirements relating to origin marking, public procurement and for statistical purposes (Brenton, 2004). ROOs can be restrictive or liberal depending on the objectives of the major trading partner. In most cases, however, the ROOs are manipulated to protect domestic industries such cotton and textile by increasing the cost of production of the preferential partner through complex ways of complying with the rules and changes in the production that will lead to higher costs of inputs.

In the case of garments, a preferential partner that has an efficient integrated textile and garments industry will find it relatively easier to comply with ROOs that require intermediate inputs to be locally sourced. However, those who do not have integrated industries and have resorted to regional sourcing of supplies (based also on the arrangements with the buyers) will usually find it harder to comply with the rules.

There is no single standard ROO used worldwide. The US, for instance, has used a combination of the three methods, namely: (i) change of tariff classification (ii) value added (iii) specific manufacturing *process*.

Table 28. Summary of ROOs From Different Agreements

	CTC	Value-Added	Specific Manufacturing process	Cumulation	Tolerance	Absorption
		Domestic Content				
AMERICAS and with US						
NAFTA	Yes	Yes (60%)	Yes	Bilateral	Yes 7%	Yes
Canada-Chile	Yes	Yes(35%)	Yes	Bilateral	Yes 9%	Yes
US-Israel		Yes(35%)		Bilateral	NA	Yes
ASIA/PACIFIC						
AFTA	Yes	Yes- 60%		Full	NA	
ANZERTA	Yes	Yes-50%		Full	NA	
Singapore-Japan	Yes	Yes – 60%	Yes	Bilateral	Yes	No
Singapore-NZ		Yes – 40%		Bilateral	NA	
Singapore-US	Yes	Yes – 55%	Yes	Bilateral	Yes 10%	No

Sources: Brenton P. (2004); updated by author to include US-Chile, US-Jordan and AGOA.

The FTAs of the US usually have provisions on tolerance (*De Minimis)*. Such rules allow a certain percentage of non-originating materials to be used without affecting the origin of the final product. It should be noted that this rule applies to the change of tariff heading and the specific manufacturing rules but does not affect the value added rules. Thus, the tolerance rule can act to make it easier for products with non-originating inputs to qualify for preferences under the change of tariff heading and specific manufacturing process rules. However, they seldom adopt the absorption principle, which provides that parts or materials which have acquired originating status by satisfying the relevant rules of origin for that product can be treated as being of domestic origin in any further processing and transformation. In other words any non-originating materials are no longer taken into account when assessing the nature of further operations.

An examination of the various FTAs of the US would reveal the restrictiveness of the ROOs to qualify for duty-free treatment for countries that do not have efficient textile industries to support them (Table 27). Note that the NAFTA is the basic point of reference for all other FTAs of the US.

The ROO is yarn-forward (Yarn used in apparel must originate within the preferential partners) and fabric –forward (Fiber must originate within the preferential partners). Except for US-Jordan and US-Israel, the rest of the FTAs require complex rules that represent a combination of local value content, change in tariff classification and specific manufacturing processes. However, the provisions on tariff preference levels allow for some degree of tolerance. Exceptions to this basic rule are intended to give producers flexibility to import product where needed. Under the TPLs, yarn, fabric and apparel that is made in the partner country, say Philippines, but that does not meet the stricter ROOs content requirements, can be eligible for preferential duty treatment up to an agreed annual levels.

Table 29. Preferential Trade Agreements

Trade Agreements	Key Features
North American Free Trade Area (NAFTA)	Basic Rule of origin for apparel: **yarn-forward**, (Yarn used in apparel must originate within a NAFTA country in order to enjoy the full benefits of the agreement) with the following exceptions: • Man-made fiber sweaters are under a fiber-forward (Fiber must originate within a NAFTA country) rule between the United States and Mexico; • Apparel made from fabrics in short supply in North America (Harris tweed, velveteen, fine wale corduroy and others) are under a single substantial transformation rule of origin; (Apparel must be cut or knit to shape and sewn, or otherwise assembled in a NAFTA country). • Men's dress shirts made from certain specific cotton and cotton and man-made fiber blend fabrics are under a single substantial transformation rule of origin; • Nightwear and women's underwear made from fine count cotton knit fabric (greater than 100 metric) are under a single substantial transformation rule of origin. • Brassieres are under a single substantial transformation rule; and • Silk and linen apparel are under a single substantial transformation rule. In addition, linings are to be of NAFTA origin from the fabric stage forward for tailored clothing and coats. For textile and clothing firms that comply with the rules of origin, restrictive quotas on originating goods will be eliminated immediately. A schedule for elimination is provided for the remaining quotas on non-originating products. Specific products that do not meet NAFTA rules of origin can still qualify for preferential treatment up to a specified import level or "tariff preference level" which is negotiated among the three countries. Even before NAFTA, Mexico had already enjoyed favorable access to the US market. About 45% of Mexico's exports to the US are under the *maquiladora* program under which duty is paid only on the value added to the assembly of US inputs into finished products, which averages 2%. Another 27% enters duty-free because the duty is either MFN zero or GSP free.
Caribbean Basin Initiative (CBI)	The Caribbean Basin Economic Recovery Act of 1983 (CBERA) was institutionalized. The significance of the policy lies in the member countries' granting of preferential access to the United States in exchange for US economic assistance, Caribbean Basin country self-help efforts, and deduction on US taxes, and governments and trading partners support functions. CBERA's goal was harnessed by the implementation of the Caribbean Basin Economic Recovery Expansion Act of 1990 (CBERA Expansion Act) that calls for the permanent and continued support for growth and diversification of Caribbean Basin economies. Finally, the US-Caribbean Trade Partnership Act of 2000 (CBTPA) permitted the duty-free and quota-free entry into the United States of apparel manufactured in eligible CBI countries from US yarns and fabrics.
African Growth and Opportunities Act	▪ Lifts all existing quotas on textiles and apparel products from sub-Saharan Africa ▪ Five types of textiles and apparel products imported from eligible Sub-Saharan African countries can enter the US duty-free and quota

(AGOA)	free. The rules origin for apparel include: **unrestricted access on apparel assembled from US formed and cut fabric from US yarn* **unrestricted access on apparel assembled and further processed from US formed and cut fabric from US yarn* **unrestricted access on apparel cut and assembled from US fabric from US yarn and thread* **tariff rate that grows from 1.5to 3.5percent of total US apparel imports for apparel assembled from regional fabric from US or African yarn* **unrestricted for four years but exports counted against the 1.5 to 3.5 percent caps specified above for apparel assembled in a lesser developed country using foreign fabric or yarn* **unrestricted for cashmere sweaters, knit to shape and for Merino wool sweaters, knit to shape with fibers 18.5 microns or finer*
US-Singapore	Textiles and apparel products may qualify as originating goods under US-SFTA if they meet the requirements as specified in the Agreement. The duty rate for this merchandise will be identified in the special column. Although there are differences, these requirements are similar to the NAFTA. Below is a summary of the type of processes required for some of the more basic products to be considered eligible for US-SFTA. There are exceptions even to these requirements, depending on the specific type of product. a) Yarn – generally, fiber must originate in Singapore or U.S., in order to qualify for US-SFTA treatment. b) Fabric – generally, yarn must originate in Singapore or U.S., in order to qualify for US-SFTA treatment. Cotton and man-made knit fabric are under fiber forward rules. c) Apparel – generally, yarn must originate in Singapore or U.S., in order to qualify for US-SFTA treatment. **US-SFTA Qualifying Based on Tariff Preference Levels (TPL)** TPLs have been established for certain apparel products, of cotton and man-made fibers to allow entry under a reduced duty rate up to a specific quantity of goods that are not originating goods. These goods are both cut (or knit to shape) and sewn or otherwise assembled in Singapore from fabric or yarn produced or obtained outside the territory of one of the Parties. Once that quantity is reached, the product is dutiable at the column 1 rate and the merchandise processing fee (MPF) is due. These are contained in the U.S. Note 13, Subchapter X of Chapter 99. A valid preferential Certificate of Origin/Eligibility (Certificate) is required whenever a TPL claim is made. This Certificate must be an original and must be filed with the entry documents. This Certificate will contain a stamp by the Director General of Singaporean Customs in box 12 of the form. The certificate will also contain a number in a standard visa format (i.e. 4SG123456) that must be reflected in column 34 of the CBP Form 7501. For additional information see note QBT-2003-062 and 2003-063 dated December 30, 2003. For TPL goods, the Special Program Indicator (SPI) "SG" must be placed in front of the chapter 9910 HTS number when the entry is filed. In

	addition to the 9910 number, the appropriate Chapter 1-97 number must be shown. The applicable rates of duty are located in Annex II (C) of USITC publication number 3651.
US-Moroco	▪ **Yarn-Forward Rule of Origin** ▪ Limited allowances for the use of yarn and fabric from a non-party under a Tariff Preference Level (TPL) ▪ But unlike NAFTA, the TPL in the Morocco FTA is temporary. It is set at an initial level of 30,000,000 square meters equivalent (sme) for the first four years of the FTA and is reduced over the next six years and eliminated entirely after ten years. The TPL is equal to less than 1% (0.08%) of total U.S. imports. After the TPL expires, all trade under the Morocco FTA must adhere to the yarn-forward rule of origin. U.S. exporters also have the same TPL access to Morocco's market, allowing U.S. fabric and apparel exporters some flexibility in their inputs. o Special allowance for the U.S. and Moroccan industry to use cotton fibers from least-developed sub-Saharan African countries, where those fibers are normally required to originate in a Party. This provision is supported by the domestic cotton industry. **Reciprocal Market Access:** o The FTA provides fully reciprocal market access for U.S. producers. On a product-by-product basis, the U.S. and Morocco will adhere to the same schedule for tariff elimination. If a U.S. tariff on any given product is eliminated immediately, Morocco's tariff on that same product is also eliminated immediately. o For the majority of textile products, tariffs will be eliminated over six years. In addition, for selected items, the U.S. and Morocco will provide duty free treatment to designated quantities of products, an innovation that enabled the United States to obtain reciprocal access to Morocco's market. ▪ **A Special Textile Safeguard:** Allows either party to re-impose MFN tariffs if imports from the other party damage domestic production. This safeguard allows longer periods of relief than the textile safeguards of any other U.S. FTA.
US-Chile	**US-CFTA Qualifying for Textiles and Apparel** Textiles and apparel products may qualify as originating under US-CFTA if they meet the requirements as specified in the Agreement. The duty rate for these goods will be identified in the "special" column. Although there are differences, these requirements are similar to the NAFTA. Below is a summary of the type of processes required for some of the more basic products in order for them to be considered eligible for US-CFTA. There are exceptions even to these requirements, depending on the specific type of product it is. a) Yarn – generally, fiber must originate in Chile or U.S. in order to qualify for preferential tariff treatment.

	b) Fabric – generally, yarn must originate in Chile or U.S. to qualify for preferential tariff treatment. Cotton and man-made knit fabric are under fiber forward rules. c) Apparel – generally, yarn must originate in Chile or U.S. in order to qualify for preferential tariff treatment. **US-CFTA Qualifying Based on a Tariff Preference Level (TPL)** A TPL has been established for certain fabric goods of cotton and man-made fibers provided for in Chapters 52, 54, 55, 58 and 60 of the HTS. In Chapters 52, 54 and 55 the TPL covers woven fabrics (Headings 5208 to 5212; 5407 and 5408; 5512 to 5516). These goods must be wholly formed in Chile from yarn produced or obtained outside the territories of the Parties. For Chapters 58 and 60, these goods must be wholly formed in Chile from fibers or yarn produced or obtained outside the territories of the Parties. In addition, a TPL was established for certain apparel of cotton and man made fibers. This TPL requires that the apparel must be both cut (or knit to shape) and sewn or otherwise assembled in Chile from fabric or yarn produced or obtained outside the territory of one of the Parties.
US-Israel	The free trade agreements (FTAs) with Israel and Jordan allow for the use of unlimited third-country yarn and fabric in apparel eligible for duty-free treatment. "country of origin" requires that an article or material, not wholly the growth, product, or manufacture of a Party, be substantially transformed into a new and different article of commerce, having a new name, character, of use, distinct from the article or material from which it was so transformed. 5. For purposes of determining the 35 percent domestic content requirement under this Agreement, the cost or value of materials which are used in the production of an article in one Party, and which are products of the other Party, may be counted in an amount up to 15 percent of the appraised value of the article. Such materials must in fact be products of the importing Party under the country of origin criteria set forth in this Agreement. 6. (a) For the purposes of this Agreement, the cost or value of materials produced in a Party includes: (i) The manufacturer's actual cost for the materials, (ii) When not included in the manufacturer's actual cost for the materials, the freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer's plant.

	(iii) The actual cost of waste or spoilage (material list), less the value of recoverable scrap, and (iv) Taxes and/or duties imposed on the materials by a Party, provided they are not remitted upon exportation. (b) Where a material is provided to the manufacturer without charge, or at less than fair market value, its cost or value shall be determined by computing the sum of: (i) All expenses incurred in the growth, production, or manufacture of the material, including general expenses; (ii) An amount for profit, and (iii) Freight, insurance, packing, and all other costs incurred in transporting the material to the manufacturer's plant. If the pertinent information needed to compute the cost or value of a material is not available, the appraising officer may ascertain or estimate the value thereof using all reasonable ways and means at his disposal.

Source: US International Trade Commission

Notice that the FTAs of the US are restrictive in the sense that they intend to protect the domestic cotton and textile industries. For the Philippines, meeting the yarn-forward requirement for 100 percent duty-free access will not be easy to comply with given the state of our local textile industry.

However, we should seek to negotiate for liberal tariff preference levels should the US and Philippines conclude a yarn-forward rule. The Philippines should negotiate for more liberal rules of origin with the US, particularly in negotiating for the tariff preference levels for goods where the materials are sourced or obtained from outside the US and the Philippines. The transition period should allow the government and industry time to remove the institutional bottlenecks and to move up the value chain. This way, the relatively higher costs of manufacturing due to labor and infrastructure costs are compensated by the value created for the buyers and the differentiation made in the market. Such differentiation will allow the exporters to command higher prices for their product.

The mode should be as simple as possible. The CTC is the least burdensome in terms of administration and the easiest to implement among the three. A combination of the three modes can only lead to higher transaction costs for exporters since they will need to comply with complex rules instead of just one simple rule. This can likewise open up venues or opportunities for graft and corruption with customs officials. Local value content rule is applied as a single rule in the US-Israel and US-Jordan agreements. Proving local content rule requires a number of tasks to establish the origin of raw materials.

The government should continue to actively push ASEAN to form an FTA with the US rather than the US pursuing complex web of bilateral agreements with more countries. Such US-ASEAN FTA will also deepen regional integration among ASEAN economies.

To prepare for the negotiations, a more detailed study on the ROOs needs to be undertaken to determine the appropriate value content that the Philippines can meet and investigate further the issues related to using CTC and specific manufacturing processes as other criteria.

- ***Trade Facilitation***

Apart from tariffs, the implementation of the Customs Trade Partnership Against Terrorism (C-TPAT) wherein the Philippines customs and port facilities do not have the technology to conform with the port security initiatives facilitating efficient security check and faster release of goods bound for the US serve as non-tariff barrier. A lot of transactions will have to be handled by customs – from clearance procedures to documenting and certifying rules of origin. Trade can be facilitated if the standards of custom practices are harmonized between the Philippines and the United States.

This will give us more capabilities to prevent smuggling, illegal transshipments and enable customs officials to accurately declare data or information for rules of origin and for security purposes.

5 Conclusion and Recommendations

This paper looked into the issues affecting the performance of the garments industry along its value chain. The findings reveal that business models should be geared towards competition, product differentiation and value creation for the markets. At this stage of the industry's development, it would merit for the industry to manage its value chain and its supply chain rather than push for building integrated textile and garments industry. Value creation can start in the finishing and dyeing sectors of the textile industry and in the design and logistics portion of the garments value chain. Other issues that need to be urgently addressed are sourcing and logistics, productivity-based wages, access to financing and establishing networks with buyers abroad.

The US market is a major trading partner which the Philippines cannot neglect and where the Philippines should seek for preferential access through free trade. At this stage, all suppliers are at par with each other. And those (like China) who can offer competitive prices have an advantage to capture the gains from the quota phase-out. If garments can enjoy duty-free access to the US, the exporters will be able to compete. But it takes time to negotiate with the US. And the Philippines is racing against time given that Thailand is also pursuing an FTA with the US. Cambodia recently made an announcement about its intention to pursue the same FTA.

Thus, given that more ASEAN members intend to enjoy preferential treatment from the US, it is necessary that ASEAN as a whole negotiate as one trading block with the US. This will deepen ASEAN regional integration and increase the bargaining power of ASEAN members.

As pointed out in the previous section, the ROOs will be a major issue during the negotiations. The US FTAs are all prohibitive. The Philippines should seek to request that our exporters be allowed to source fabric from third countries and not be restricted by the rules of origin imposed in NAFTA or even AGOA.

Among the three modes of ROOs, the change in tariff classification is relatively the easiest to implement. The simpler the rule, the better for the industry. The Philippines should likewise negotiate for tariff preference levels that will allow the industry to implement reforms such as clustering during the transition period provided for by the TPLs. Thus, when the end of the transition period comes, more products may be able to qualify for the basic rules of origin. A study pertaining to the rules or origin of the industry should be done to support negotiators in determining the acceptable ROOs that will support our industry's development.

The Philippines is no longer competitive in the assembly portion but relatively competitive in fashion-related goods. This is where consolidation among firms, investments generation for productivity-enhancement technologies and measures are greatly needed.

While negotiations for an FTA are being done, the industry should continue to advocate for the removal of all unnecessary transaction costs discussed in the paper. In particular, inbound and outbound logistics concerns should be a priority since

most of the firms affected are those located outside of the PEZA areas. These are the firms likely suspected of smuggling.

Investments are needed to improve the clustering programs between garments producers and textile firms. They will help enhance productivity as evidenced in the Chinese garments industry and in the experiences of Philippine export firms that made a big leap in investing in ICT and training. Furthermore, investments can address the financing concerns of many firms, particularly the subcontractors who are now losing orders to China.

Based on results of quantitative studies on the effects of the quota phase-out, the Philippines is not considered an immediate winner because of the lack of cost advantage to compete with China, Indonesia, Vietnam, India, Morocco and Turkey. However, the net gains (welfare effects) for the country are positive especially when tariffs are eliminated. The Philippines enjoys certain advantages which can be maximized. These include flexible labor and very good communication and interpersonal skills. We are very good in interpreting the designs of buyers such that there are firms which can graduate from mere contractor operations to full package provider. This implies the ability to reduce lead time (from product development to distribution) from 52 weeks to 32 weeks as in the case of Liz Claiborne.

Lastly, the paper recommends that the reforms started under the transformation plan be accelerated.

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