



Philippine Institute for Development Studies

## The Effects of the MFA Phase Out on the Philippine Garments and Textiles Industries

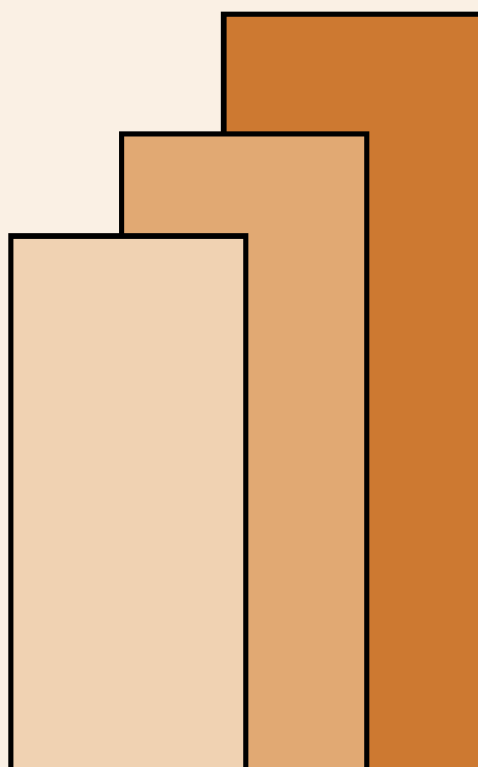
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# **The Effects of the MFA Phase Out on the Philippine Garments and Textiles Industries<sup>1</sup>**

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Since the quota system under the Multi-fibre Arrangement (MFA) has assured the Philippines of markets for its exports of textiles and garments, there are fears that considering the current state of the industries, the country will lose its markets with the eventual abolition of the MFA in January 2005. It should be pointed out, however, that even during the MFA years, the competitive position of the country's garments industry has always been threatened because the country is not as competitive as the other major Asian garment exporters. Despite being the country's top dollar earner, the garments industry has lost its competitiveness in the manufacture of low cost and mass-produced clothing products to the highly mechanized and low cost garments industries of its new competitors.

The 10-year gradual phase out of the MFA would mean that the global market will be opened to the best suppliers who can provide quality and reasonably priced products at the shortest possible time. Given the current state of the industries, will the country's garments and textiles industries survive in the face of the MFA phase out? This paper will try to answer this issue. In particular, it will analyze the export performance of the industries during the MFA years focusing on the role of quota and the administration of quota in the country. The likely effects of the abolition of the MFA are then analyzed focusing in particular on export markets, prospects for survival in a quota-less world, investments in the garments and textiles industries and the benefits to the country from the phase out.

## **Brief Industry Profile**

In the Philippines, garments and textiles industries are treated as separate industries. This was largely due to the differences in the support these industries received from the government over time. While the textile industries was one of the industries developed and sheltered under heavy protection since the 1950s, the garments industry is one of the less protected industries. Nevertheless, the garments industry has become the second largest source of non-traditional exports of the country, the largest being semiconductors. The industry accounted for about 14 percent of the country's total exports in the 1980s; the share increased to 19.4 percent during the first half of the 1990s.

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As of 1993, there are about 1,553 direct exporters and 2,418 subcontractors. About 6.4 percent of the real value added in manufacturing in 1991 was accounted for by the industry. Between 1972 and 1991, the share of the industry to total manufacturing employment increased by four times (Table 1). The figures on employment, however, are understated because the Annual Survey of Establishments and the Census of Establishments, which are the official sources of establishments data in the country covered manufacturing enterprises alone. The industry, in fact, includes homeworkers and small contractors to garment exporters.

In contrast, the textile industry contributes less than 1 percent to the country's total exports. Production is geared principally towards the domestic market. It was only after 1985 that indirect exports of textiles through garment exporters started to gain prominence. The industry's share to value added and employment in manufacturing is also minimal and has decreased over time (Table 1).

### **The Agreements on the MFA Phase Out Under the GATT**

During the period 1974 - 1994, international trade in garments and textiles was governed by the MFA. Prior to this period, trade of these products was limited by the Short Term Arrangement Regarding International Trade in Cotton Textiles (STA) during the period 1961-1962 and the Long Term Arrangement Regarding International Trade in Cotton Textiles (LTA) for the period 1963-1973. All these agreements were intended to provide protection for the domestic garments and textiles industries of developed countries from exports of developing countries in order to allow them to adjust to foreign competition. However, the coverage of the MFA became more and more comprehensive and restrictive across markets over time (Erzan, Goto and Holmes 1990). While the MFA was administered under the auspices of the GATT, it is contrary to the spirit of the GATT as it violated the GATT principles on non-discrimination and the elimination of quantitative restrictions on trade.

Several studies have shown the restrictive effects of the MFA on the exports of developing countries and more importantly, on national and global welfare (Hamilton 1990; Yang 1990; Trella and Whalley 1990; Martin and Yang 1994). Hence, under the GATT Uruguay Round, the gradual phase out for the MFA was agreed upon. The main objective of this negotiation was to secure the eventual full integration of garments and textiles trade into the rules and disciplines of the WTO.

Table 1. Contribution of garments and textiles industries to manufacturing value added, employment and number of establishments.

Industry	Number							Contribution in manufacturing (%)						
	1972	1975	1978	1983	1988	1991	1992	1972	1975	1978	1983	1988	1991	1992
Textiles														
No. of establishment	226	431	583	317	546	567	592	5.05	6.74	6.92	5.53	4.75	4.96	5.03
Employment	60870	72487	77181	85585	89485	89485	79390	13.85	14.16	14.61	12.21	10.44	8.91	8.20
Value added (P million, 1985 prices)	4185	5308	10605	5856	4977	4977	5021	7.31	6.39	10.67	5.82	4.53	3.91	3.52
Garments														
No. of establishment	316	576	815	436	1556	1776	1861	7.06	9.01	9.68	7.61	13.54	15.54	15.82
Employment	19009	32912	75749	75259	142160	172874	177531	4.33	6.43	6.25	10.74	16.59	18.27	18.33
Value added (P million, 1985 prices)	576	913	2469	2790	6371	8807	8255	1.01	1.10	2.48	2.78	5.81	6.42	5.79

Source: Annual Survey of Establishments, National Statistics Office (various years).



The phase out will be carried out in three stages over a ten-year period starting January 1995. The transition period will involve two processes, namely, the gradual phase out of quotas and the accelerated quota growth for those remaining under quota in each stage of the phase out. In Stage 1, beginning 1 January 1995, each party should integrate into the GATT products from the specific list in the Agreement which accounted for not less than 16 percent of its total volume of imports in 1990. In Stage 2, beginning 1 January 1998, products which accounted for not less than 17 percent of the 1990 imports should be integrated. Another 18 percent should be integrated at the start of Stage 3 on 1 January 2002. At the end of the transition period on 1 January 2005, all remaining products should have been integrated. At each stage of the transition process, importing countries are free to choose the products to be integrated from the following categories: tops and yarns, fabrics, made-up textile products and clothing.

Simultaneous with the removal of the quotas will be the annual expansion of the growth rates of quotas of products remaining under restraint. In Stage 1, bilateral agreements as of 31 December 1994 should be increased by at least 16 percent. In Stage 2, annual growth rates should be 25 percent higher than Stage 1. Finally, in Stage 3, growth rates should be 27 percent higher than Stage 2. The progressive growth of the quotas is intended to speed the integration of the remaining products.

## **Exports Performance**

***Textiles.*** The country's textiles industry has always been uncompetitive in the world market despite the fact that the country has pioneered the industry among the ASEAN (Austria 1994). The protection accorded to the industry discouraged the export of textiles because of the seemingly high domestic profit. The reliance of the industry on the domestic market for its products is shown by its small contribution to the country's total export earnings (Table 2). The industry's export performance is also unstable as can be seen from the sharp increases and decreases in the annual growth rate of export earnings. Nevertheless, exports had begun to improve, as shown by the industry's increasing share (albeit by small amount) to total exports, after the implementation of the advance tax credit scheme in 1985. Under the scheme, local millers can offer tax and duty-free textiles to garment exporters with bonded manufacturing warehouses. The Board of Investment will then issue local millers with tax credit certificates equivalent to the tax and duty garment exporters would have paid had they bought imported textiles. It is therefore not surprising that much of the increase in the export of textiles after 1985 was due to indirect exports through the garment exporters.

***Garments.*** Garments account for about 91 to 95 percent of the country's exports of garments and textiles. Despite the bilateral restrictions imposed by the country's trading partners on its exports of garments, the industry has been a consistent efficient foreign exchange earner for the country, ranking second to the electronics industry. During the 1980s, the value of garment exports went up from US\$616.5 million in 1981 to US\$1574.9 million in 1989. By 1995, the value reached US\$2,161.8 million (Appendix Table 1). The industry's share to the top 20 exports and manufacturing and total exports of the country has been increasing during the 1980s (Figure 1).

**Table 2. Exports performance of the textile industry, 1980-1994**

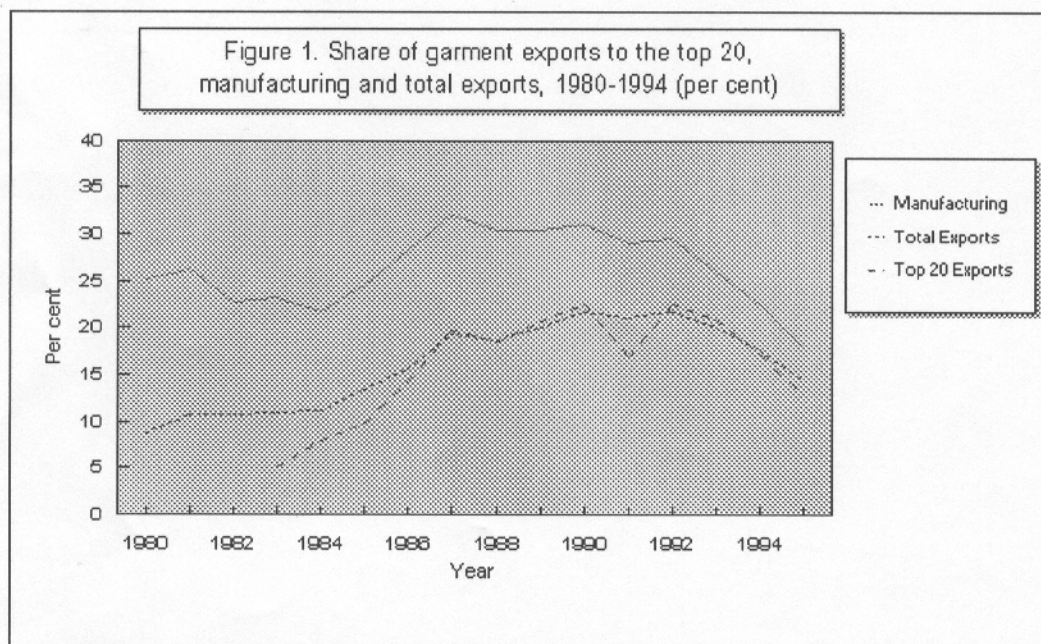
Year	Value of exports (US\$ million)	Per cent share to total exports (%)	Annual growth rate (%) (1985 US prices)
1980	74	1.3	
1981	69	1.2	-15.2
1982	56	1.1	-23.6
1983	44	0.9	-24.5
1984	38	0.7	-17.3
1985	39	0.8	- 1.0
1986	44	0.9	9.9
1987	68	1.2	49.8
1988	71	1.0	0.5
1989	87	1.1	17.3
1990	93	1.1	2.4
1991	100	1.1	3.4
1992	121	1.2	17.9
1993	118	1.0	-5.1
1994	172	1.3	45.8

**Source:** *Selected Philippine Economic Indicators*, Central Bank, Manila (various years).

The favorable performance of the industry during the period reflects the industry's resiliency amidst the unfavorable international environment and the unstable economic and political situation in the domestic economy during the 1980s, compared with other exports of the country. As shown in the figure, however, its share started to decline since 1991. The industry is undergoing a drastic and painful shakeup since 1990 as it adapts itself into the fast changing and liberalizing business conditions here and abroad.

The country's major markets for garments are the MFA importing countries which include the leading industrial countries (US, the European Community, Canada, Norway, Austria, Finland and Sweden). These are the countries that set restraints on the physical volume of the country's exports through bilateral agreements. This group of countries accounted for about an average of 85 to 90 percent of the country's total exports of garments (Table 3). On the other hand, the non-MFA importing or non-quota countries which include Japan, Australia, Saudi Arabia and the United Arab Emirates, absorbed the remaining 10 to 15 percent. As will be explained below, the share of quota countries rose during the 1980s but the trend was reversed in the first half of the 1990s (Figure 2). This is also supported by the lower (and even negative) average annual real growth rate of exports to these countries during the period 1990-95, a stark contrast to the favorable growth rate posted during the period 1981-1990 (Table 4).





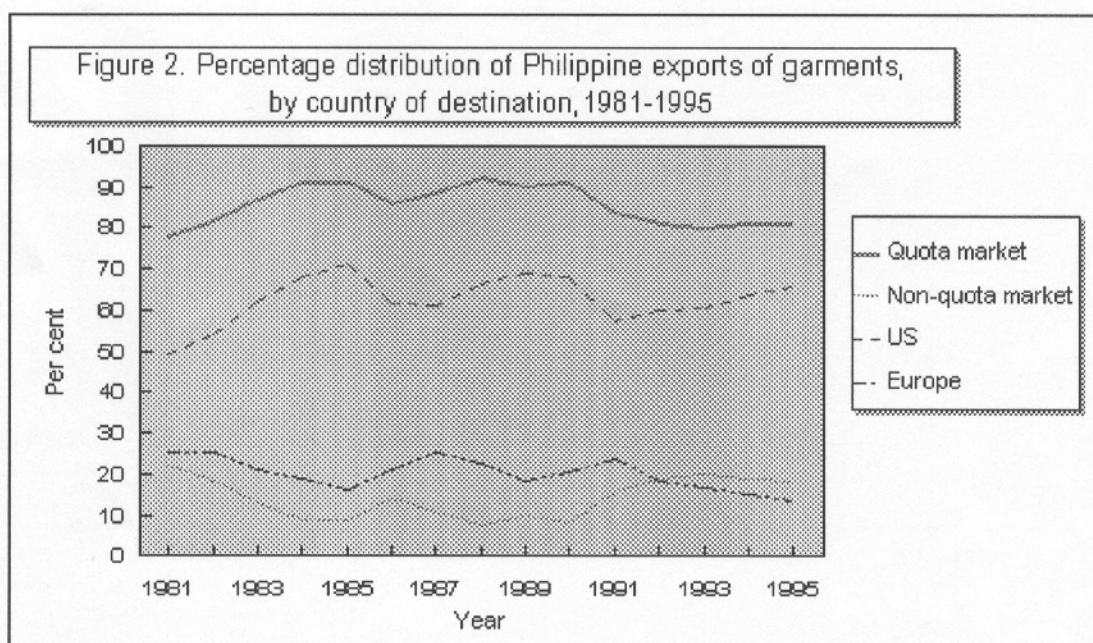
Source: Bureau of Export Trade Promotion, DTI, Makati.

Table 3. Average percentage distribution of Philippine exports of garments, by country of destination, 1981-1995 (per cent)

Country	1981-1984	1985-1989	1990-1994
<b>Quota market</b>	84.6	90.0	83.3
USA	58.4	65.8	62.4
EC	20.8	19.7	17.6
Other Europe	1.8	1.0	0.5
Canada	3.6	3.4	2.7
<b>Non-quota market</b>	15.4	10.0	16.7
Japan	2.2	1.9	3.8
Australia	1.8	0.7	0.5
Hongkong	2.2	1.7	2.5
Others	9.2	5.7	9.8

Note: See Appendix Table 1 for the annual values of exports.

Sources: (1) *Foreign Trade Statistics*, NSCB (various years); (2) Bureau of Export Trade Promotion, DTI, Makati.



Source: Bureau of Export Trade Promotion, DTI, Makati.

Table 4. Average annual real growth rate of garments exports, 1981-90 and 1990-95 ( per cent, 1985 US prices)

Classification/Country	1981-1990	1990-1995
Quota Countries	10.98	-0.26
United States	11.92	1.43
European Community	6.34	-5.88
Non-quota Countries	-2.88	19.66
Total Exports	8.05	2.11

Sources: (1) *Foreign Trade Statistics*, NSCB (various years); (2) Bureau of Exports Trade Promotion, DTI, Makati.

While the US and the EC are the country's major markets, exports from the Philippines comprised only a small portion of the total garment imports of these countries (Table 5 ). For the period 1985 to 1994, the average market share of the Philippines to the US and EC were 3.4 percent and 5.7 percent, respectively. As will be discussed in the next section, however, there are specific product categories for which the Philippines has a relatively large market share in these countries. As shown in the table, in contrast to the country's increasing market share in the 1980s, the share was on a downtrend since 1990.



This is also supported by the lower share of these countries to the country's total exports during the first half of the 1990s compared to the second half of the 1980s (Table 3).

**Table 5. Market share of Philippine exports of garments to the USA and EC, 1985-1994 (per cent)**

Year	USA	EC
1985	0.30	3.49
1986	2.73	4.51
1987	3.08	5.88
1988	3.50	6.00
1989	4.27	7.31
1990	4.24	6.26
1991	4.03	7.09
1992	3.98	6.26
1993	3.94	6.05
1994	3.86	4.01

**Note:** (1) Computed as the percentage share of garment imports from the Philippines to total garment imports of the US and EC.

**Source:** United Nations, *Commodity Trade Statistics* (various years).

The weakening demand was partly due to the emergence of new competitors to these markets. The Caribbean countries, for example, were able to capture market shares in the US through the Caribbean Base Initiative (CBI). Under this agreement, these countries re-export to the US garments made out of US pre-cut fabrics under a quota free arrangement and are taxed only for the value added portion of the products. Likewise, Mexico was able to pull through because of the North American Free Trade Agreement (NAFTA) which enabled the country to have a freer access to the US markets for its exports. As shown in Table 6, the Dominican Republic, Jamaica and Mexico experienced an increasing share in the US markets. The past few years also witnessed the entry of many low-cost countries like China, Vietnam, Bangladesh and Sri Lanka into the US markets for garments (Austria 1994).

On the other hand, the EC has established especial trade relations with the Mediterranean countries through various types of agreements. Under these agreements, exports of garments and textiles from these countries were free of quantitative restrictions in the EC markets.

**Table 6. Share of the Dominican Republic, Jamaica and Mexico to the US garment market, 1980, 1985, 1990,1994 (per cent)**

Country	1980	1985	1990	1994
Dominican Republic	1.29	1.38	2.76	4.24
Jamaica	0.21	0.35	0.90	1.20
Mexico	.57	1.80	2.66	4.94

**Source:** United Nations, *Commodity Trade Statistics* (various years).

### **Quota Utilization**

*Value of exports from quota.* The country's exports of garments and textiles to its major trading partners are restricted by quota set by the latter through bilateral agreements. The level of restraints vary from country to country and from product category to category, depending on the importance of a particular product to the country's bilateral trade. Some agreements put limits on both specific categories and group of categories. The country had 34 categories under quota restrictions in the US and 13 categories in the EC. In the EC, products are either under community limits or regional limits. In the former, products are constrained by all EC member countries while in the latter, products are constrained by only some of the members.

The MFA quota have played a very important role in the country's exports of garments. About 64 to 67 percent of the country's total exports were covered by the MFA (Table 7). This excludes the quota coverage of Canada and other European countries due to the non-availability of data. Exports covered by US quotas accounted for more than 50 percent of the country's total exports. Nevertheless, despite the large share of export earnings generated through quota, the value of unutilized quota as a percentage of total garments exports remained quite high (Table 8). In 1994 for example, exports could have been higher by US\$227.3 million in the US and by US\$206.5 million in the EC had the country filled its quota from these countries. In the 1980s, the value of unutilized quota reached more than 50 percent of total exports in the US market (World Bank 1987).

**Table 7. MFA coverage of garment exports, 1990-94 (per cent)**

	1990	1991	1992	1993	1994
USA	51.1	51.2	51.6	52.8	54.2
EC	13.7	16.2	12.9	11.6	10.7
Total	64.8	67.4	64.5	64.4	64.9

**Notes:** (1) MFA coverage is computed as the percentage of exports covered by quota to total garment exports of the country; (2) No data for Canada and other European countries.

**Source:** Garment and Textile Exports Board, Department of Trade and Industry.

**Table 8. Value of unutilized quota as a percentage of total exports**

	USA	EC
1990		
Value of unutilized quota (US\$ million)	97.30	76.67
% to total exports of garments	8.10	21.70
1991		
Value of unutilized quota (US\$ million)	124.30	114.30
% to total exports of garments	12.40	28.40
1992		
Value of unutilized quota (US\$ million)	89.30	139.85
% to total exports of garments	7.40	38.50
1993		
Value of unutilized quota (US\$ million)	136.00	184.90
% to total exports of garments	10.50	52.20
1994		
Value of unutilized quota (US\$ million)	227.30	206.50
% to total exports of garments	16.10	62.90

**Source of basic data:** Garments and Textile Exports Board, *Category Status Report*, DTI, Makati, (various issues).

**Quota utilization rates.** The country had the lowest quota utilization rates to the US and EC markets among all the major Asian exporters of garments (World Bank 1987; Cabalu 1993). Nevertheless, the country's performance in the US had improved over time (Table 9). There are certain product categories, however, where the country utilized a substantial portion (at least 90 percent) of its quota in the US (Table 10). These include babies garments (SITC 239), MB shirts, not knit (3/640), nightwear and pyjamas (3/651), underwear (3/652), sweaters (345), MBWG trousers, breeches and shorts (347/8 and 647/8), MBWG knit shirts and blouses (338/9 and 638/9) and headwear (659). These are the specific products for which the country is competitive as shown by the relatively

large share of the country in the US markets for these products compared to the country's overall market share as discussed earlier (Table 11).

There are some products for which the quota has been exceeded, i.e utilization rate is more than 100 percent. This reflects the ability of the country's exporters to use the flexibility provisions of the MFA to respond to changing economic conditions and rapid changes in fashion. Under the flexibility provisions, exporting countries can *carry over* up to 10 percent of the unused portion of the preceding year's quota, and *carry forward* up to 5 percent of the following year's quota. There is also a *swing* provision here a particular quota can be exceeded by 7 percent provided there is a corresponding reduction in another quota.

Table 9. Average quota utilization rates in garments by market, 1980-1994 (per cent)

Year	US	EC	Norway	Sweden	Canada
1980-82	44	76	NA	NA	NA
1985-87	60	80	NA	NA	NA
1987	88	79	69	54	81
1988	79	76	40	66	77
1989	85	66	44	61	76
1990	102	64	31	4	76
1991	99	70	NA	NA	NA
1992	87	60	NA	NA	NA
1993	82	60	NA	NA	NA
1994	80	32	NA	NA	NA

**Sources:** (1) Garments and Textile Exports Board, *Category Status Report*, DTL, Makati (various issues);  
 (2) Cabalu, H., 1993. Philippine Clothing Exports, *Overcoming Domestic Policy Impediments and the Multi-fibre Arrangement*, Unpublished thesis, ANU, Australia.



Table 10. Quota utilization rates in the US by category, 1987-1995 (per cent)

Product Category	1987	1988	1989	1990	1991	1992	1993	1994	1995
237 Playsuits and sunsuits	88	75	105	79	83	61	97	66	-
239 Babies' garments & clothing accessories	-	62	81	89	92	108	92	97	101
3/640 MB shirts, not knit	86	84	84	93	100	95	110	102	83
3/641 WG shirts, blouses, not knit	78	65	73	90	102	87	97	80	57
3/642 Skirts	104	73	71	79	81	99	88	70	109
3/651 Nightwear & pyjamas	72	74	81	92	104	98	102	100	115
3/652 Underwear	95	95	110	100	98	110	76	88	70
331 Gloves and mittens	112	95	117	121	ND	ND	ND	ND	-
333/4 MB suit-type coats	88	80	72	69	47	61	109	60	74
335 WG coats	99	79	55	82	79	77	80	95	53
336 Dresses	69	77	72	91	64	91	86	104	95
338/9 MBWG knit shirts & blouses	109	90	86	115	104	102	82	67	119
345 Sweaters	99	79	93	91	67	76	106	96	81
347/8 MBWG trousers, breeches & shorts	110	88	96	105	107	88	0	67	92
369 Shop towels, made of cotton	59	-	-	10	0	0	35	104	-
431 Gloves and mittens	36	21	23	25	14	20	98	0	-
433 MB suit-type coats	113	74	47	40	56	99	108	47	103
443 MB suits	112	104	92	57	61	84	30	107	83
445/6 MBWG sweaters	97	69	79	33	14	25	74	100	118
447 MB trousers, breeches & shorts	30	55	7	20	32	56	0	65	50

Table 10 continuation.....

Product/Category	1987	1988	1989	1990	1991	1992	1993	1994	1995
604 Yarn containing 85% or more of synthetic fibre	22	-	3	0	ND	ND	ND	ND	-
631 Gloves and mittens	77	65	71	55	ND	ND	ND	ND	-
633 MB suit-type coats	31	35	52	96	51	57	28	87	-
634 Other MB coats of synthetic fibre	70	87	93	108	84	100	110	32	95
635 WG coats	99	78	81	72	84	98	114	103	78
636 Dresses	87	94	86	94	60	73	65	108	63
638/9 MBWG knit shirts & blouses	100	82	95	99	109	100	93	72	70
643 MB suits	46	34	34	48	38	72	49	43	-
645/6 MBWG sweaters	124	80	80	84	45	54	38	36	-
647/8 MB breeches, trousers & shorts	71	89	108	106	112	90	105	99	94
649 Brassieres and other supporting garments	98	102	87	76	81	99	67	48	-
650 Robes, dressing gowns, etc.	48	71	68	97	66	101	115	90	72
659 Headwear	120	84	107	106	92	96	100	105	90

Note: Figures for 1995 are as of October of the same year.

Sources: (1) Garments and Textile Exports Board, *Category Status Report*, 1990-94, DTI, Makati; (2) GTEB, 1995. *Quota Watch*, GTEB Update, 1(4): p.10.

**Table 11. Market share of Philippine exports by product category in the US, 1989-1994 (per cent)**

Product Category	1989	1990	1991	1992	1993	1994
Babies garments & clothing accessories	30.90	32.96	27.45	27.46	27.48	25.18
MB shirts, not knit	2.32	2.35	3.10	2.82	3.11	3.13
Nightwear, pyjamas & underwear	13.17	14.37	13.46	13.39	11.39	11.34
MBWG knit shirts & blouses	11.20	12.92	13.01	13.27	10.88	9.23
MBWG trousers, breeches & shorts	8.17	10.08	7.38	6.43	6.88	6.59
Other MB coats of synthetic fibre	6.64	8.36	7.98	9.37	9.93	12.70
MBWG knit shirts & blouses	11.20	12.92	13.01	13.27	10.88	9.23
MB breeches, trousers & shorts & headwear	5.50	6.47	4.51	3.29	3.41	3.11

**Note:** Computed as the percentage share of imports from the Philippines to total imports of the US per product category.

**Sources:** (1) United Nations, *Commodity Trade Statistics* (various years); (2) Garments and Textiles Exports Board, DTI (various years).

On the other hand, the average quota utilization rates in the EC had been rather low compared to the US and was deteriorating through time (Table 9). Among the EC members, quota utilization was relatively high in France, Benelux (Belgium, Netherlands and Luxemburg), Great Britain and Germany. Among the product categories, only shirts, t-shirts, pull-overs and undervests (SITC 4) had relatively high utilization rates (Table 12).

**Reasons for low quota utilization rate.** Differences in quota utilization rate among product categories and importing countries are caused by both demand and supply factors. In the 1970s until the early 1980s, supply bottleneck was caused primarily by the anti-export bias of government policies on garments. This attitude of the government towards the industry, however, has improved since the mid-1980s due to the substantial contribution of the industry to the country's foreign exchange earnings.

Table 12. Quota utilization rates in EC markets by category, 1987-1995 (per cent)

Product Category	1987	1988	1989	1990	1991	1992	1993	1994	1995
4 Shirts, t-shirts, pull-overs, undervests	105	91	97	106	101	81	76	70	54
5 Knitted jerseys, jackets, cardigans, jumpers	75	82	100	74	89	92	99	102	85
6 MBWG trousers, slacks, shorts, breeches	91	77	130	102	96	76	64	55	-
7 Blouses, shirts, shirt-blouses	106	77	79	81	75	60	50	47	-
8 MB woven shirts	45	41	59	38	46	41	35	30	-
10 Gloves, mittens and mitts	45	44	23	29	21	34	20	17	-
13 MBWG underwear-briefs, knickers	67	70	60	50	35	20	13	12	-
15 WG woven overcoats, blazers, jackets	62	59	68	41	34	35	21	16	-
21 Parkas, anoraks, windcheaters	66	55	98	71	82	57	44	33	-
26 WG knitted or woven dresses	86	80	85	89	90	78	76	65	-
31 Woven, knitted or crocheted brassieres	55	83	85	73	78	79	77	85	70
73 Track suits of knitted or crocheted fabric	NS	NS	89	57	86	114	82	77	70

Note: Figure for 1995 is as of October of the same year.

Sources: (1) Garments and Textile Exports Board, *Category Status Report*, DTI, Makati, 1990-94; (2) GTEB, 1995. *Quota Watch*, GTEB Update, 1(4).



The supply condition is aggravated by the relatively high cost of labor, energy and money compared to other Asian countries, low productivity, inadequacy of infrastructure support and a weak and inefficient textile industry. Garment exporters rely on imported textiles for 80 to 85 percent of their textile requirements, with the bulk coming mostly from Taiwan, Hong Kong and China. This puts the country's exporters at a disadvantage since the situation makes it hard for them to comply with the required lead time (which is now 30 to 45 days) for delivery unlike the country's competitors who can afford the shortest possible lead time because they have efficient textile industries to back them up. And worse, the high tariff accorded the textile industries makes the cost of garment production high.

The administrative capacity of the country in the allocation of quota among its exporters is another factor that affects the country's quota utilization rate, the discussion of which, however, is deferred until the next section.

On the demand side, the weak demand due to the recession in the early 1980s in the industrial countries is often cited by exporting countries as the cause for their being unable to fill their quotas (Cabalu 1993). In the EC markets, the appreciation of the European currencies and increased protectionism also contributed to the low demand (World Bank 1987). As presented earlier, the loss of the country's market share to the emerging low cost competitors in its major markets contributed to the decline in the quota utilization rate in the 1990s. Also, there is a tightening of market conditions in the 1990s as importers became more quality and value conscious. The rapid change in fashion and buyers' preferences in the face of limited flexibility of quota makes it difficult for garment exporters, including the big and established ones, to cope with the changing trading environment.

### **Export Quota Allocation in the Philippines**

Developing member countries of the MFA have different set of rules governing the internal allocation of quotas among their exporters of garments and textiles, depending on their specific circumstances like the structure of their industries, structural constraints in the mobility of resources, and the general business climate. The system of allocating the quotas affects the amount of export earnings and the efficiency with which resources are used. An ideal system would be one where export earnings are maximized (i.e. to meet at least the minimum export earnings had there been no MFA) ensuring at the same time that resources are used most efficiently (World Bank 1987). If all exporters have access to the same information and all are using the same technology and operating at the same efficiency, then it does not matter who gets the quota. However, this is not the case in the real world. Not all exporters have the same access to information nor do they operate with the same efficiency. Hence, it is necessary to direct the quotas to the most efficient exporters.

In the Philippines, the Garments and Textile Export Board (GTEB) which is mandated to oversee the entire garments export operations of the country, administers the annual allocation and restoration of quota. One factor considered in the allocation of

quota is the local value added (LVA). All export quota shall have a minimum LVA of 34 percent on a per category or company basis whichever is favorable (GTEB 1994). In case a garment firm does not meet the 34 percent LVA requirement on a particular category, the LVA percentage of the firm may still be considered for purposes of its quota restoration provided that its absolute LVA in the particular category is higher than the industry's average LVA. There is a fine of 10 percent of LVA for the non-compliance of the LVA requirement.

Also, a firm's performance during the year is a significant factor that affects the allocation and restoration of its quota the following year. As shown in Table 13, the higher the export performance during the year, the higher is the quota restored the following year.

Beginning in 1994, export quotas are awarded by the GTEB subject to payment of a fee of P0.50 per square meter equivalent (SME) but in no case lower than P100.00 (GTEB 1994). The fee shall be paid within 15 calendar days from the date of publication in a newspaper of general circulation; otherwise said entitlements shall be considered withdrawn.

Quotas can also be transferred or surrendered if an exporter thinks that he will be unable to fulfill the quota during the year. A maximum quantity of 40 percent of a firm's export quota holdings can be transferred with a service or processing fee of P0.06 per SME of quantity transferred. However, the transferee is liable to pay the monetary penalty of P0.12 per SME of quantity unperformed in accordance with the rules. Likewise, quotas may be surrendered with restoration rights and a penalty in accordance with some prescribed schedule and depending on the type of product categories (whether these are critical, semi-critical and non-critical categories).

Any remaining allocable balances after the quotas are allocated are placed in a "free basket". In the event that the allocable balance in a particular category is sufficient to accommodate the total applications received, the quantity applied for by the exporter shall be automatically be granted. However, if the allocable balance is not sufficient to accommodate all the applications received, the quotas are awarded to firms depending on their past export performance, declared local value added and participation in international trade fairs and exhibits. Also, firms operating outside the National Capital Region are entitled to 20 percent of the allocable balance on all categories.

**Table 13. Rules in the allocation and restoration of quota based on past export performance.**

Quantity Performed (exported) (% of net export quota)	Quantity to be Restored (% of net export quota)
95 % or more	100 % restoration
90 % but less than 95 %	<p><i>General rule:</i> actual performance</p> <p><i>Exception:</i> 100 % restoration if the firm has generated an export income during the immediately preceding year/period of at least 10 % of FOB value through export:</p> <ul style="list-style-type: none"> <li>a. to non-quota markets, and/or;</li> <li>b. under non-critical categories;</li> <li>c. under trigger/consultation level categories.</li> </ul>
75 % but less than 90 %	Actual performance subject to a fine of P0.12 per square meter equivalent of the quantity unperformed.
75 % but less than 90 % for second consecutive year	<p>Actual performance less 20 % of the unperformed quantities in the preceding year or current quota year/period whichever is lower; and</p> <p>A fine of P0.12 per square meter equivalent of the unperformed quantity of the current quota year/period.</p>
50 % but less than 75 %	Actual performance subject to a fine of P0.12 per square meter equivalent of the quantity unperformed.
50 % but less than 75 % for second consecutive year	No restoration.
Below 50 %	<p>No restoration; and</p> <p>A fine of P0.12 per square meter equivalent of the quantities unperformed.</p>

**Source:** GTEB, 1994. *Revised Rules and Regulations*, Makati.

### ***Limitations of the Philippine quota allocation system***

It should be pointed at the outset that quota utilization rates cannot be readily used as a measure of the efficiency of the quota allocation system. There are cases for which an exporter may consider it rational not to fill his quota. For example, quota given for certain commodities may be too small that it is unprofitable to produce them and penetrate the foreign market (Hamilton 1986). Likewise, as shown by past experience of exporting countries, higher quota utilization rates and increasing proportions of shipments reaching quota limits entail greater probability of cases of export restraints and outright rejection of import licenses (Cabalu 1993). Quota can also be redundant especially when demand is weak. In other words, shipments could have been the same in the absence of quota because of weak demand.

Nevertheless, the country's system in the allocation of quota has its own limitations and these already affects the quota utilization performance and hence, the country's exports earnings and the efficiency in the use of resources. It should be said at the outset however, that there are no concrete studies as yet that estimate the amount of domestic resources lost as a result of the deficiency of the system. Thus, the discussion below on the costs of the limitations of the system are qualitative.

The use of *local value added* could be subject to abuse if not properly implemented and monitored. An exporter can falsify his record for purposes of declaring a high value added content for his products. Also, the GTEB at anytime, may suspend the implementation of this requirement and grant exemptions on highly exceptional and meritorious cases. But what is exactly highly exceptional and meritorious is not defined in the rules and hence could be subject to abuse and could provide incentives to bribe civil servants administering the quota allocation.

The use of *past performance* as a criteria restricts the entry of new and more efficient producers since they do not have a past record to refer to when applying for a quota. This protects existing quota holders against new domestic competition and hence, provides a breeding ground for inefficiency and high cost of production.

The *transfer of quotas* promotes efficiency of resource use within the industry since it allows the transfer of license from high cost quota holders to low cost exporters or from exporters who are unable to meet the quota to newcomers who have the prospect of exporting or has export orders but no quota. However, the given maximum allowable quantity (40 percent of a firm's export quota holdings) that can be transferred restricts the full transfer of resources to where they can be used most efficiently within the industry.

*Surrender of quota* carries a penalty. If the penalty is high, a quota holder may choose to use its resources inefficiently just to fill its quota rather than surrender his quota and pay the penalty. On other hand, if the penalty is small, a quota holder has no incentive to exert extra effort to improve its performance to be able to fill his quota.

Finally, the rules governing the allocation and restoration of quotas have been revised several times over time. This practice of *changing and revising rules*, especially

if done almost annually as in most ASEAN countries (Hamilton 1986), creates instability in the production and export planning of exporters, apart from the inherent constraint posed by a quota system on the uncertainty of a forthcoming quota. It also creates the tendency for exporters to engage in rent seeking activities to lobby for changes in next period's allocation rules. As already shown by many studies, rent seeking activities are outright waste of resources from the society's point of view.

Suffice it to say, however, that despite the above limitations of the system in the country, the changes in the rules have improved the allocation and restoration of export quota over time.

## **Effects of the MFA Phase Out**

### **1. Exports in a quota-less world**

With the eventual abolition of the MFA, there are two important related issues that should be addressed. First, will the country lose its markets formerly assured by the MFA quota to more competitive suppliers? Second, will the country's garments and textiles industries survive in the face of the MFA phase out?

*On export markets.* Even without the abolition of the MFA, the country's position in its major markets is already being threatened. The US-Caribbean and EC-Mediterranean nexus have altered the rules of the game such that the quota system is no longer working to the advantage of everyone. As discussed earlier, the country has been losing on its market shares because of the trade diversion caused by the entry of Mexico and the Caribbean and Mediterranean countries to the US and EC markets. The Dominican Republic, for example, have dislodged South Korea (one of the three big Asian garment exporters) and the Philippines from the fourth and fifth ranks, respectively, in the US market in 1993 (DTI 1995). The potential loss of the country from these recent trade developments would depend on the extent to which the consumers in the country's trading partner would substitute Caribbean and Mediterranean garments for those coming from the Philippines, assuming that there are no other barriers to trade like tariffs.

The good news however is that, the removal of quota will increase the country's market access to the developed countries, especially for the products which it has comparative advantage. In a quota-less world, the name of the game is **GLOBAL COMPETITIVENESS**. Exporters from all countries will have to compete for whatever demand there will be. The strategy therefore is to focus on the manufacture of high-value garment products where the country now enjoys some degree of competitiveness. According to the GTEB and as supported earlier by Table 10 and Table 11, these products include infants' and children's garments, shirts, nightwear, underwear, coats, dresses, shirts and blouses, trousers, suits, robes, dressing gowns and headwear. These are the same product categories which Austria (1994) found to be not only the most competitive but also the most technically efficient among the garments industries. Also, a particular competitive advantage of the country lies in the industry's skills for detailed



decorative work especially in nightwear and lingerie where much of the output is heavily embroidered.

*On prospects for survival.* While market access will not be a problem for the country, the country's garments and textiles industries face the grim prospect of collapsing if nothing is done with their present sorry state. The recent shakeup of the industries due to the government's move to liberalize the industries by reducing tariffs is a clear manifestation that the industries are far from competitive compared to their Asian competitors. The 10-year transitional period which started last January 1, 1995 and to end on January 1, 2005 is very critical for the government and the garments and textiles manufacturers to get their acts together to be able to survive in a quota-less world.

Under Stage I, the initial offers of the US, EC and Canada in terms of the products to be integrated into the WTO system show that none of the items are actively traded by Philippine exporters. If this trend continues until Stage 3, then there is a greater probability that the country's major garment products will not be touched until after 10 years. There are strong speculations circulating among trade analysts that most of the "import-sensitive" products will remain under quota until the end of the transition period (Whalley 1995). While this may not give meaningful trade liberalization to the MFA, it will undoubtedly give the country enough time to improve on its competitiveness and prepare itself for the full integration at the end of the transition period.

However, competition will grow stiffer because of the geometrical growth to be applied on items that remain under restriction during each stage of the phase out. For products for which quotas have not been met, the country should explore other formerly non-quota countries. Although efforts along this area can be seen from Figure 1 with the increasing share of the non-quota countries to the country's total exports in the early 1990s, efforts should be further intensified. Market studies on specific products in potential markets should be done immediately.

On the other hand, for the products for which the country has been using its quota fully, while the agreement would mean bigger quotas to work with, it would also mean that quota will expand at a rate much faster than the growth of markets. This overcapacity will be exploited by importers by forcing down prices to lower levels. Unless the industry improve on its price competitiveness, it cannot probably compete in the quota-less world. Further liberalization in both the textile and garment industries is urgent since the high cost of garments production is caused by its heavy dependence on imported textiles. Already, the government has adopted a tariff reduction program to prepare the garments and textiles industries for the phase out. Under this program, tariff rates will be brought down to as low as 3 percent for raw materials and 10 percent for finished products by the year 2000. Likewise, the government should adopt productivity-based wage policies instead of mandated wage increases. Measures should also be adopted to bring down the cost of energy which is among the highest in Asia.

Above all else, however, whatever remaining strengths and competitiveness the garment industry has on the products mentioned earlier can be eroded under a regime of stiff competition unless there is a back up from a strong and efficient textile industry.

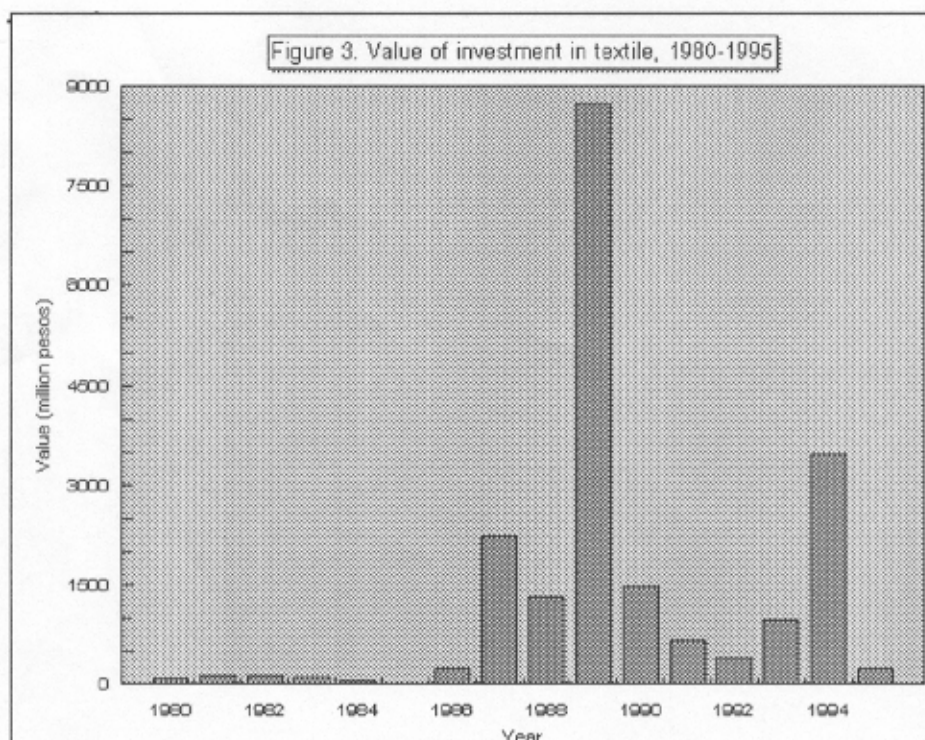
Again, the government has already initiated efforts along this line. The government has embarked on a textile modernization and expansion program through technology upgrading beginning in 1994 and to be completed in 1998. This is the second time for the industry to undergo such process. The first program in the early 1980s did not succeed despite the loan facility made available by the World Bank because of the political and economic instabilities at that time. The current modernization program, however, has no backing of specific foreign financing facility; but a generous package of incentives is offered under the Omnibus Investment Code. The program covers all areas in the industry from staple fiber production to finishing. However, since the focus of the garments industry will now be on high-value products, dyeing and finishing should be given priority.

## **2. Investments**

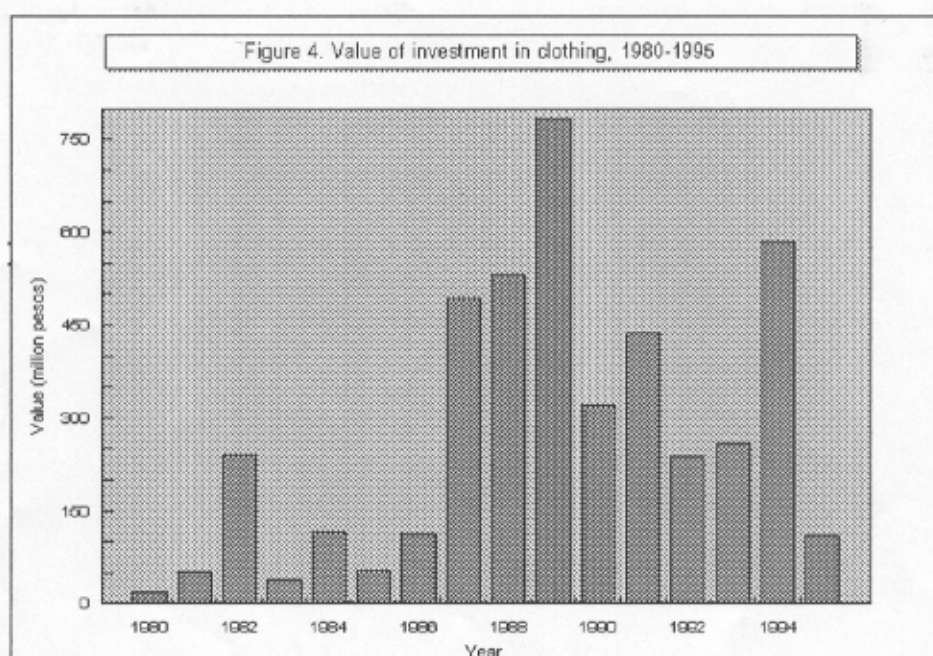
It has often been argued in the literature that major garments and textiles exporters have directed their foreign direct investments (FDI) in nonrestricted and less restricted developing countries to circumvent the restrictions imposed by developed countries (Goto 1989; Whalley 1995). While a reversal of this trend is likely to occur with the eventual abolition of the MFA, the US-Caribbean and EC-Mediterranean trade agreements and NAFTA have already resulted to investment diversions just as they had created trade diversion from the Asian region to these countries.

Investments in the garments and textiles industries in the country suffered from a decline since 1990 (Figure 3 and Figure 4). The shares of these industries from the total manufacturing investments and total investments have been declining, especially in the 1990s (Table 14 to Table 17). This is true for both domestic and foreign investments. Various disruptive events in the late 1980s, like political uncertainty, natural calamities including the killer earthquake in 1990, have contributed to the decline. However, the falling competitiveness of the industry vis-a-vis other developing countries as a profitable investment site has been the major factor for the drop in investments in these industries. This is aggravated by the investment diversion created by the US-Caribbean and EC-Mediterranean trade nexus since there are a number of European and US garment manufacturers in the country.

The downward trend of investment should be reversed for these industries to survive, with or without the MFA. Foreign investment could be significant for the modernization of the textile industry. The Foreign Investment Act (FIA) of 1991 which represents a substantial liberalization of FDI in the country is envisioned to encourage more FDI, both for the garments and textile industries. The FIA has been revised recently and it has expanded the number of sectors open to full foreign ownership, streamlined the investment approval process and liberalized the definition of export enterprises with generally no restriction on foreign equity participation. Also, the Securities and Stock Commission (SEC) reported that the liberalization program of the government is expected to encourage FDI into the country (Business World, 12 April 1996).



Source: Board of Investment, DTI, Makati.



Source: Board of Investment, DTI, Makati.

**Table 14. Share of investment in clothing to total manufacturing investment, by type, 1980-1995 (in per cent)**

Year	Domestic	Foreign	Total
1980	1.29	2.15	1.74
1981	2.29	1.03	1.85
1982	6.90	0.94	5.86
1983	3.17	0.88	2.01
1984	4.73	1.44	2.49
1985	3.23	0.88	1.78
1986	6.20	6.38	6.30
1987	7.74	11.41	9.07
1988	4.87	3.82	4.23
1989	2.39	3.56	2.92
1990	1.96	1.34	1.68
1991	1.51	1.67	1.59
1992	1.12	1.51	1.20
1993	1.45	0.95	1.24
1994	0.63	0.78	0.69
1995	0.24	0.16	0.19

**Source:** Board of Investment, Department of Trade and Industry.

**Table 15. Share of investment in clothing to total investment, by type, 1980-1995 (in per cent)**

Year	Domestic	Foreign	Total
1980	0.35	1.02	0.61
1981	1.17	0.48	0.92
1982	5.79	0.81	4.94
1983	1.60	0.69	1.24
1984	3.18	1.17	1.90
1985	1.64	0.67	1.13
1986	3.30	3.80	3.55
1987	5.45	6.55	5.90
1988	2.69	2.94	2.82
1989	1.58	2.48	1.98
1990	0.73	0.55	0.65
1991	0.99	1.01	1.00
1992	0.86	0.83	0.85
1993	0.90	0.58	0.76
1994	0.33	0.42	0.37
1995	0.08	0.11	0.09

**Source:** Board of Investment, Department of Trade and Industry.

**Table 16. Share of investment in textile to total manufacturing investment, by type, 1980-1995 (in per cent)**

Year	Domestic	Foreign	Total
1980	13.99	0.12	6.70
1981	4.03	5.18	4.41
1982	3.89	0.97	3.39
1983	9.86	0.28	4.99
1984	4.12	0.13	1.39
1985	0.73	0.32	0.49
1986	25.09	2.43	12.97
1987	59.50	8.63	41.09
1988	23.10	2.51	10.50
1989	44.59	17.77	32.44
1990	10.81	3.98	7.72
1991	2.45	2.29	2.37
1992	1.79	2.96	2.03
1993	7.00	1.49	4.68
1994	5.72	1.52	4.09
1995	0.79	0.17	0.42

**Source:** Board of Investment, Department of Trade and Industry.

**Table 17. Share of investment in textile to total investment, by type, 1980-1995 (in per cent)**

Year	Domestic	Foreign	Total
1980	3.76	0.06	2.33
1981	2.08	2.41	2.20
1982	3.27	0.83	2.85
1983	4.99	0.22	3.08
1984	2.78	0.10	1.07
1985	0.37	0.24	0.31
1986	13.36	1.44	7.32
1987	41.89	4.95	26.75
1988	12.75	1.93	7.01
1989	29.55	12.40	21.99
1990	4.02	1.64	3.00
1991	1.60	1.39	1.50
1992	1.39	1.62	1.45
1993	4.33	0.92	2.88
1994	3.04	0.81	2.17
1995	0.25	0.12	0.20

**Source:** Board of Investment, Department of Trade and Industry.

### **3. Welfare effects**

That the country will benefit from the abolition of the MFA is shown by the results of the studies of Trela and Whalley (1990) and Cabalu (1993) (Table 18 and Table 19). Both studies have shown that the import price of garments and textiles in the MFA importing countries will decrease as result of the removal of the MFA restrictions, thereby stimulating an increase in demand. This would translate to an increase in the production for exports in the MFA exporting countries. While the country will lose its quota rents, the gains of garments and textiles producers as a result of improved market access in the developed countries will more than compensate for the loss in quota rents.

Trella and Whalley (1990) have estimated a net welfare gain for the country 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. The second estimate represents 0.10 percent and 0.01 percent of the total gains of developing countries and all countries, respectively. Cabalu (1993), on the other hand, estimated a US\$56 million welfare gain for the country from the removal of quota and tariffs or 43 percent of the total gains of MFA exporting countries and 0.85 percent of the total gain of the



world. The two studies differ in the magnitude of their estimates because of the differences in their assumptions. Trella and Whalley (1990) assumed that the products traded are homogenous while Cabalu (1993) assumed differentiated products where the goods produced in each country are imperfect substitutes for the goods produced in other countries. Nevertheless, their estimates show that the country will undoubtedly gain from the eventual phase-out of the MFA.

**Table 18. General equilibrium effects of removing bilateral MFA quotas and tariffs, Philippines**

	Removal of quotas and tariffs	Removal of quotas alone
Hicksian equivalent variation (1986 \$ billion)	0.127	0.003
Change in value of production of textiles and garments (%)	25.83	17.41
Change in value of imports or exports of textiles and garments (%)	183.14	118.87

**Source:** Trella and Whalley, (1990). 'Global effects of developed country trade restrictions on textiles and apparel', *Economic Journal*, 100: 1190-1205, Table 3 and Table 4.

**Table 19. Partial equilibrium effects of removing MFA restrictions, Philippines**

	Effects
Change in production for exports	
Total exports (%)	31.70
Restricted exports (%)	44.40
Unrestricted exports (%)	-17.80
Producers gain (1987 US\$ million)	166.00
Rent loss (1987 US\$ million)	-105.00
Net welfare (1987 US\$ million)	56.00

**Source:** Cabalu, H., 1993. *Philippine Clothing Exports, Overcoming Domestic Policy Impediments and the Multi-fibre Arrangement*, Unpublished thesis, ANU, Australia.

## **Concluding Remarks**

The eventual phase out of the MFA by the year 2005 is a welcome development in the international trade of textile and garments since this would mean that trade in these products will now be integrated into the rules and disciplines of the WTO. The phase out, which will be carried out in three stages over a ten-year period that started in 1995, will involve two processes, namely, the gradual phase out of quotas and the accelerated quota growth for those remaining under quota in each stage of the phase out.

While it is true that the export quota system under the MFA has assured the country of markets for its exports of textiles and garments, it has also caused the waste of domestic resources because of the inefficiencies in the administration of quota allocation among exporters which not only affected the amount of export earnings but also the efficiency with which resources are used.

The abolition of the MFA, however, will increase the market access of the country in the world market, particularly in the industrialized countries. Studies have shown that the country will undoubtedly gain from the phase out not only in terms of an increase in production and exports but also in national welfare. Nevertheless, the abolition would also mean a regime of stiff competition since the global market will be up for the taking by the best suppliers who can provide quality and reasonable priced products.

It is a fact that the country's garments and textiles industries are not as competitive as the other major Asian garment exporters such that even during the MFA years, the country's competitive position has always been threatened. The ten-year gradual phase out is therefore a critical period for the government and the garments and textiles manufacturers to get their acts together and improve on the country's competitiveness to be able to survive in a quota-less world.

Appendix Table 1. Value of exports of garments, by country of destination, 1981-1995 (US\$ million)

Country	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995*
Quota market	481.3	442.1	472.4	547.8	566.4	647.4	974.4	1219.6	1424.2	1626.6	1464.3	1634.6	1713.7	1799.9	1760.5
USA	304.4	291.3	338.1	408.3	441.4	462.70	665.10	872.2	1090.2	1203.8	1000.0	1205.3	1291.6	1408.0	1417.4
Europe	155.0	135.8	113.8	114.6	98.9	159.5	276.4	299.7	286.9	364.0	415.7	373.7	361.6	337.6	295.3
EEC	141.4	123.5	105.9	107.3	90.3	152.40	265.70	288.5	275.3	352.8	402.7	363.4	354.2	328.5	285.8
Other Europe	13.6	12.3	7.9	7.3	8.6	7.10	10.70	11.2	11.6	11.2	13.0	10.3	7.4	9.1	9.5
Canada	21.9	15.0	20.5	24.9	26.1	25.20	32.90	47.7	47.1	58.8	48.6	55.6	60.5	54.3	47.8
Non-quota market	135.2	97.3	70.1	51.9	52.6	103.7	120.2	97.6	150.7	149.2	276.0	379.7	420.3	418.9	401.3
Japan (incl. Okinawa)	16.0	13.0	11.4	9.5	7.2	15.00	16.60	30.1	42.4	64.7	55.5	68.1	83.4	87.5	102.3
Australia	15.7	11.7	7.1	6.8	6.1	5.00	5.60	7.4	13.7	14.1	13.5	10.4	10.2	9.0	4.7
Hongkong	22.4	15.7	6.8	6.3	6.4	18.50	15.90	30.0	18.5	16.3	41.0	52.0	61.9	77.1	65.1
Others	81.1	56.9	44.8	29.3	32.9	65.20	82.10	30.1	76.1	54.1	166.0	249.2	264.8	245.3	229.2
Total Exports	616.5	539.4	542.5	599.7	619.0	751.1	1094.6	1317.2	1574.9	1775.8	1740.3	2014.3	2134.0	2218.8	2161.8

Note:

\* Figures are as of November 1995.

Sources:

(1). Foreign Trade Statistics, NSCB; (2). Bureau of Export Trade Promotion, DTI.

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