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Where Trade and Industrial Policy Converge: How Developing Countries Can Utilize Trade Preferences to Generate Sustainable, Local Growth in the Garment Sector

COLETTE VAN DER VEN*

Abstract

The rise of the textile and apparel global value chains and trade preferences has created unprecedented opportunities for developing countries to participate in trade in textiles and apparel. Yet, while some countries have managed to build backward linkages and engage in industrial upgrading, others remain locked in the lower echelons of the textile and apparel value chain.

This Article demonstrates that trade preferences and rules of origin alone do not explain countries' diverging experiences in the apparel value chain. Rather, a country's industrial policy is crucial in determining sustainable growth: is it solely export-oriented, or does it balance promoting growth of Foreign Direct Investment with encouraging the development of a parallel domestic industry?

This Article demonstrates the key role of industrial policy by engaging in a qualitative analysis of the experiences of six developing countries in integrating into the textile and apparel global value chain: Lesotho, Kenya, Madagascar, Sri Lanka, Bangladesh, and Cambodia. Based on the successes and the failures of the countries studied, this Article ends by providing specific policy options for a balanced industrial policy, at a national, regional and international level.

* Colette van der Ven is currently an associate in the Geneva, Switzerland office of Sidley Austin LLP. The views, analysis, opinions, and conclusions set forth in this article are solely those of the author and should not in any way be attributed to Sidley Austin or its clients.

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Introduction

Trade preferences, compounded by the geographic fragmentation of production, have created unprecedented opportunities for developing countries to increase their participation in international trade and grow their economies. In particular, trade preferences have played a central role in increasing developing countries' participation in textile and apparel manufacturing.¹ These products typically face some of the highest tariffs on manufactured goods, with the Most Favored Nation (MFN) tariff for textiles averaging 5.7 percent for the European Union and 7.5 percent for the United States, and 11.5 percent and 11.4 percent, respectively, for apparel products.² Trade preferences schemes have eliminated or significantly reduced these tariffs for eligible countries, facilitating developing countries to sell their garment exports globally.

Yet despite these preference-enabled opportunities, developing countries' experiences with international trade in the textile and apparel sector have been mixed at various levels. First, while a handful of developing countries has been able to take advantage of trade preferences by significantly increasing export volumes of specific products, other countries have not similarly benefited from preferential market access. Second, while preferences in specific industrial sectors like apparel have enabled economic growth, most growth has been ephemeral, spurred by foreign investment and rent seeking. Few developing countries have succeeded in translating preference-generated market access in apparel into a sustainable comparative advantage through skill transfer, upgrading in product sophistication and market diversification to "attain a level of competitiveness which make [preference-receiving countries] self-supporting economically and full partners in international trade."³

The international community has mainly, if not exclusively, responded to the first trade preference challenge: the lack of coverage and/or utilization of trade preference programs.⁴ In this regard, its response has been to advocate for expansion, enhancement and extensions of trade preference programs, and in particular, to liberalize restrictive rules of origin (ROOs).⁵ Expanding coverage of preference programs and relaxing ROOs is crucial and will most certainly increase preference-receiving countries' export volumes. Nevertheless, it does not automatically address the second challenge, i.e., encouraging sustainable economic development in the preference-receiving country. Indeed, the inter-

1. Stacey Frederick & Cornelia Staritz, *Developments in the Global Apparel Industry after the MFA Phaseout, in SEWING SUCCESS? EMPLOYMENT, WAGES, AND POVERTY FOLLOWING THE END OF THE MULTI-FIBRE ARRANGEMENT 41, 54* (Gladys Lopez-Acevedo & Raymond Robertson eds., 2012), available at http://siteresources.worldbank.org/EXT/POVERTY/Resources/SewingSuccess_FullReport.pdf.

2. *Id.*

3. *Developing Countries, International Trade and Sustainable Development: The Function of the Community's Generalized System of Preferences (GSP) for the Ten Year Period from 2006 to 2015*, at 3, COM (2004) 461 final (July 7, 2004), available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004DC0461&from=EN>.

4. *See id.*

5. This position has been advocated particularly forcefully in the apparel and textile sector, where there is strong evidence that preferences accompanied with liberal ROOs have increased trade volumes; see VIVIAN C. JONES, CONG. RESE. SERV., RL34524, INTERNATIONAL TRADE: RULES OF ORIGIN (2015); see e.g., *15 Senators Ask the President to Seek Flexible Rules on Apparel in the TPP Agreement*, RETAIL INDUS. LEADERS ASS'N (May 1, 2012), <http://www.rila.org/news/topnews/2012newsreleases/Pages/15-Senators-Ask-the-President-to-Seek-Flexible-Rules-on-Apparel-in-the-TPP-Agreement.aspx>.

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national community's focus on expanding trade through preference programs is based on the common, yet mistaken, assumption "that wealthy nations can materially shape development in the poor world, and that their efforts to do so should consist largely of providing . . . resources to and trading opportunities for poor countries."⁶

We need to start thinking about trade policy and international development differently. Rather than equating export volume and short-term GDP growth with economic development, it is imperative to analyze whether a country has actually embarked on a path of sustainable economic development. This means that we need to start asking different questions. For example, in addition to asking how to expand coverage of the African Growth and Opportunity Act (AGOA), or how to reduce restrictive ROOs, we also need to be asking questions such as: "How can preference-receiving countries benefit from increased market opportunities yet prevent preference—and market—dependency?" "What are the reasons that most factories in Cambodia are foreign owned while Sri Lanka's apparel and industry is mainly locally owned?" or "Why has Bangladesh been able to set up a textile base, while other countries still import nearly all garment inputs?"

Answering these questions warrants an approach that looks beyond the confines of the international trade preferences framework and analyzes the extent to which preference-receiving *domestic* policy measures have enabled or constrained sustainable economic growth. Such policy interventions that alter a society's industrial structure are known by the unpopular term "industrial policy." Yet the meaning of "industrial policy" continues to evolve and is no longer just associated with traditional market failure and protectionist concepts. Indeed, it now typically encompasses "interventions that help build systems, create networks, develop institutions and align strategic priorities."⁷ When using the term industrial policy, this Article refers to this dynamic, evolving definition, focusing on different governmental interventions that maximize sustainable economic growth. This includes measures aimed at diversifying production within the apparel sector, incentivizing linkages between Foreign Direct Investment (FDI) and local businesses, and creating specifically targeted training programs.

This Article analyzes how developing countries already active in the textile and apparel value chain can maximize developmental benefits in this sector. The choice to focus exclusively on trade in apparel has been made for several reasons. First, because traditionally apparel and textile products were subjected to high tariffs, the effects of trade preference programs and its accompanying ROOs have been particularly pronounced in this sector. As a result, this sector lends itself to a great overview of both the potential and limits of preferences on sustainable economic growth. Second, apparel is one of the oldest and largest export industries in the world and is often the "starter" industry in developing countries.⁸ Textile production—while more capital intensive than apparel and often absent in developing countries—is intrinsically linked to apparel production and is therefore, where is relevant, and included in this analysis.

6. Nancy Birdsall, Dani Rodrik, & Arvind Subramanian, *How to Help Poor Countries*, 84 FOREIGN AFFS. 136 (2005).

7. Ken Warwick, *Beyond Industrial Policy: Emerging Issues and New trends*, 2 OECD SCL, TECH. AND INDUS. POL'Y PAPERS (2013), <http://www.oecd-ilibrary.org/docserver/download/5k4869clw0xp.pdf?expires=1446221734&tid=id&accname=guest&checksum=4D35924297886E4FAA09A167156C45C6>.

8. *Id.* at 1.

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This Article does not assess whether developing countries have made the correct choice to focus on the development of their textile and apparel sector in the first place. Indeed, this Article recognizes that the sustainable development of textile and garment industry may not always be a worthy goal in any given country, given the opportunity costs of pursuing industrial policy in that area. That would be inherently a question for economists to address.⁹ Instead, this Article focuses exclusively on how developing countries that have already decided to focus on their textile and apparel industry can turn what is often ephemeral growth into sustainable development linkages.

Central to this Article are the experiences of six developing countries: Lesotho, Kenya, Madagascar, Sri Lanka, Bangladesh, and Cambodia. These countries were chosen because they all experienced a significant increase in their textile and/or apparel export volume during the last decade(s), mainly because of trade preferences compounded by the Multi-Fiber Agreement (MFA), which spurred foreign investment in the garment sector in these countries. Despite these initial similarities, however, Sri Lanka, Bangladesh, and Madagascar have been relatively successful in creating sustainable industrial growth, whereas preference-induced growth in Kenya, Cambodia, and Lesotho has been more ephemeral. These different paths of industrial development are due to a myriad of factors, including different levels of foreign investors' embeddedness in the host country, regional integration, and most importantly, different choices in industrial policy. Developing country governments that have adopted industrial policies that are solely export-oriented—e.g. through establishing export processing zones (EPZs) but not extending certain EPZ-specific benefits to local producers—have generally failed to generate sustainable growth in the apparel sector, whereas governments that adopted a balanced industrial policy aiming both to attract foreign investors to build up an export-oriented industry while providing incentives for domestic firms to engage in the apparel industry—e.g. through policies that encourage and require foreign investors to partner with local business—have generally experienced more sustainable growth.

Based on these case studies, this Article outlines policy options for governments interested in adopting a more balanced approach to growing their apparel industry. At a national level, governments can encourage local production by lowering entry barriers for entrepreneurs, providing special skills training, equalizing incentives for domestic and foreign enterprises, and promoting joint ventures and other collaboration between foreign and national businesses through tools such as tax benefits and limits on the percentage of foreign ownership. A balanced industrial policy should also encourage the creation of backward linkages, either locally or regionally. This can be done through input subsidies such as local-sourcing initiatives, or, where relevant, through regional coordinating industry bodies. Additionally, governments can help the industry move up the value chain by stimulating product upgrading and the development of niche products. Skill training for integrated/upward development, product promotion organizations and branding, and investment all contribute to this goal. The case studies also highlight the critical importance of strengthening regional market integration. One way to do so would be through lowering import and tariffs on apparel and textile at the regional level, e.g. the Southern African Development Community (SADC) and the Southern African Customs Union

9. See *e.g.*, RICARDO HAUSMANN ET AL., *ATLAS ON ECONOMIC COMPLEXITY: MAPPING PATHS TO PROSPERITY* (2014).

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(SACU), or to have more flexible ROOs. At a minimum, the same incentives provided for exporting outside of regional blocs should be offered to intra-regional trade.

Keeping these lessons in mind, the international community should move the focus of its trade and development dialogue away from increasing trade volumes and GDP towards encouraging the build-up of local industry through balanced industrial policy. Concretely, it could do so by consulting governments of preference-receiving countries on how to strategically use trade preferences given the country's endowments and industrial capabilities. It should also be explored how industrial policy goals can be taken into account in future trade agreements.

Above all, this Article demonstrates the importance for preference-receiving countries to begin thinking strategically with an eye to long-lasting sustainable growth. Trade preferences ought to merely be an enabling factor to unlock a country's potential for sustainable economic growth; not the dominant feature of a country's economic development.

I. Structure

This Article is divided in five parts. First, it situates trade preferences within the ideological debate between liberalism and protectionism and reviews the evolution and legal underpinnings of trade preference regimes. Second, it discusses the history and characteristics of the textile and apparel value chain, highlighting the regulatory context and in particular the European Union's and the United States' trade preference programs that have been instrumental in expanding apparel exports in the countries studied. Third, it contains six case studies of the countries on which this Article is based: Lesotho, Kenya, Madagascar, Sri Lanka, Bangladesh, and Cambodia, and analyzes whether these countries have been able to build up a sustainable apparel and textile industry. Fourth, based on these case studies, it summarizes the factors that have proven critical in determining industrial sustainability in the trade and apparel sector. Fifth and finally, it sets out national policy options for countries looking to engage in balanced industrial policy, and provides recommendations for regional and international levels.

II. Scope

As mentioned above, this Article focuses exclusively on how to develop long-term sustainability in the textile and apparel value chain. This means that while some of the recommendations are likely to be relevant in creating long-term sustainability across sectors, this Article does not explore and/or extrapolate the applicability of its policy recommendations beyond the textile and apparel value chain.

Moreover, this Article focuses exclusively on maximizing economic sustainability. Thus, issues directly concerning *social* sustainability, e.g., human rights, wages, labor conditions, and safety measures, are beyond the scope of this Article. While the ultimate aim of the approach discussed is to improve the lives of those living and working in developing countries, this Article operates on the underlying assumption that building *sustainable* local industries—which involves creating sustainable employment, skill development, wage increases and value-added—correlates with improving a country's social conditions.

Factors related to economic competitiveness and competitive advantage other than trade preferences are similarly beyond the scope of this Article. For example, this Article

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does not focus on labor costs, infrastructural context, efficiency, taxes, corruption, market proximity, and other factors companies typically look for when making outsourcing decisions. While critically important for developing countries' ability to participate in the trade and apparel value chain and attract foreign investment, the focus of this Article is on what happens after a developing country has successfully attracted foreign investment and is able to expand its apparel exports under a trade preference scheme. That said, should developing countries decide to alter their industrial policies, including through changing the terms of foreign investment, this may influence a country's ability to continue to attract foreign investment. The delicate and important balance of getting industrial policy and investment incentives right will be discussed below.

The analysis in this Article is limited to six developing countries: Lesotho, Kenya, Madagascar, Bangladesh, Sri Lanka, and Cambodia. These countries were chosen since they are (mostly) all situated at the *receiving* end of outsourcing—in contrast to the industry's main producers like Korea, Taiwan, and China. These Asian powerhouses operate at the top of the value chain, do not qualify for trade preferences, and face different legal obstacles. As such, an analysis of industrial sustainability and corresponding policy options for these countries will necessarily be different than for developing countries occupying lower echelons in the value chain. Consequently, the recommendations provided in this Article do not apply to these countries. Similarly, while some of these high-performing Asian countries are still considered developing countries, this Article's use of the term "developing country" will refer solely to low-income countries that are still mainly at the receiving end of the trade and apparel value chain.

Finally, this analysis is geographically limited to Sub-Saharan Africa (SSA), South Asia, and South East Asia. Latin America, Middle America, and Eastern Europe, which each have significant textile and apparel industries, fall outside the scope of this analysis like NAFTA, some of the excluded countries receive special trade preferences when exporting to the United States and the European Union. This would add an additional layer of complexity to an already complex analysis and is therefore excluded from the scope of this Article.

III. Background

A. TRADE PREFERENCES: THE LEGAL FRAMEWORK

The World Trade Organization (WTO) is built on the premise that a reduction in trade barriers accelerates economic growth. At the core of its workings lie the principles of non-discrimination and reciprocity. At the same time, WTO Members recognize that open market policies may not automatically lead to economic gains in countries that lagged behind from the start; i.e. developing countries with only nascent industrial development. As such, the WTO has adopted different provisions that facilitate developing-country growth by allowing developing countries to be treated more favorably than other Member States. This is known as special and differential treatment.¹⁰

10. See JEANNE J. GRIMMETT, CONG. RESEARCH SERV., RS22183, TRADE PREFERENCES FOR DEVELOPING COUNTRIES AND THE WORLD TRADE ORGANIZATION (WTO) 1 (2011), available at <http://fas.org/sgp/crs/misc/RS22183.pdf>.

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In 1965, the General Agreement on Tariffs and Trade (GATT) was amended to recognize the special economic needs of developing countries and establish the non-reciprocity principle.¹¹ In 1968, UNCTAD established the Generalized System of Preferences, the framework to provide such preferences to developing countries.¹² The non-reciprocity principle is in tension with the Most Favored Nation concept of GATT Article I, the Parties adopted an MFN waiver in 1971 for the Generalized System of Preferences (GSP), which allowed for developed countries to extend favorable tariff treatment to developing countries.¹³ As a result, in 1979 the Parties adopted the Enabling Clause, obfuscating the need for a waiver for GSP Programs that fall within the scope of the Enabling Clause.¹⁴ The Enabling Clause, which continues to apply as part of the GATT 1994, provides that:

Notwithstanding the [MFN] provisions of Article I of the General Agreement, contracting parties may accord differential and more favorable treatment to developing countries without according such treatment to other contracting parties.¹⁵

The provisions of the Enabling Clause apply to four specific situations: (1) preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with GSP; (2) differential and more favorable treatment concerning non-tariff measures; (3) regional or global arrangements entered into amongst less-developed contracting parties for mutual reduction of tariffs and non-tariff barriers; and, (4) special treatment for the least developed among the developing countries in the context of any general or specific measures in favor of developing countries.¹⁶ Thus, per the Enabling Clause, all preference programs that fall within its scope are legitimate under the WTO. The Enabling Clause also makes clear that trade preferences are not a right but rather a privilege, specifying that “contracting parties may accord differential and more favorable treatment.”¹⁷ Other provisions specify that preferences are unilateral, i.e. they do not require reciprocity.¹⁸

For preference programs that fall outside the scope of the Enabling Clause, waivers may be obtained from specific GATT obligations, which are permitted through GATT Article IX:3. The preference programs addressed in this Article other than GSP (which covers the EU’s “Everything but Arms” (EBA) program) have been established through waivers

11. *Id.*

12. *About GSP*, U.N. CONF. ON TRADE & DEV. [UNCTAD], <http://unctad.org/en/Pages/DITC/GSP/About-GSP.aspx> (last visited Dec. 3, 2015).

13. *Id.*

14. Bernard Hoekman & Çağlar Özden, *Trade Preferences and Differential Treatment of Developing Countries: A Selective Survey 6* (World Bank Pol’y Research, Working Paper No. 3566, 2005), available at, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2005/04/21/000012009_20050421124442/Rendered/PDF/wps3566.pdf. In addition to Generalized System of Preferences (GSP) programs, the enabling clause covers multilateral nontariff preferences negotiated under GATT. Grimmet, *supra* note 10, at 1-2. Multilateral arrangements among less developed countries and special treatment of least developed countries in the context of any general or specific measure in favor of developing countries.

15. GATT Contracting Parties, *Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* [Enabling Clause], L/4903 (Nov. 28, 1979), GATT BISD (26th Supp.), at 191, 191 (1979).

16. *Id.*

17. *Id.*

18. *Id.* at 192.

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rather than through the Enabling Clause. This includes AGOA and the Cotonou Agreement (which was preceded by the Lomé Convention).¹⁹ The European's Economic Partnership Agreements (EPAs) establish preferences not on the basis of waivers or the enabling clause, but rather as part of free trade agreements.

B. PROTECTIONISM, LIBERALISM, AND TRADE PREFERENCES

Since the beginning of the post-colonial era in the 1950s, development economists and scholars have engaged in ideologically-driven debates regarding which trade policies would be most effective in creating economic growth in developing countries: protectionist measures that focus on the development of domestic infant industries prior to opening-up to foreign markets—also known as import substitution industrialization (ISI)—or export-oriented industrialization (EOI) that facilitates market integration into the global economy.²⁰ ISI advocates adhere to the general idea that in order for developing countries to grow sustainably, they have to reduce import dependency and diversify their export market.²¹ The main way to do this is through an active industrial policy that encourages investments in non-traditional manufacturing industries through a combination of subsidies, high import tariffs, overvalued currency and barriers to FDI.²² In contrast, adherents of EOI believe that trade in goods in which a country enjoys a comparative advantage accelerates economic growth and leads to greater levels of development.²³ As such, EOI's advocates typically endorse policies that focus on opening borders through tariff reductions, subsidies for export-oriented industries, and attracting FDI.²⁴

While in the 1950s many developing countries opted for the ISI paradigm, the export-oriented strategies gained favor in the 1970s.²⁵ This shift occurred as a result of a myriad of factors, notably the powerful export-oriented counter-narrative provided by the “East Asian miracle,” debt servicing problems experienced by ISI countries due to the oil crisis of the 1970s, and pressure from the World Bank and the International Monetary Fund.²⁶ In addition to a shift in development policies, these changes led to an equally transformative shift in production strategies of transnational corporations.²⁷ An increase in industrial capabilities in developing countries triggered the geographic fragmentation of production to countries offering lower production costs, leading to the emergence of global value chains.²⁸ This trend accelerated the shift from ISI to EOI in developing countries.²⁹

19. For a detailed overview of the preferences addressed in this paper, please refer to Section V.B.

20. Ujal Singh Bhatia, *The Globalization of Supply Chains: Policy Challenges for Developing Countries*, in *GLOBAL VALUE CHAINS IN A CHANGING WORLD* 313, 315 (Deborah K. Elms & Patrick Low eds., 2013).

21. Hoekman & Özden, *supra* note 14, at 1.

22. *Import Substitution Industrialization*, WIKIPEDIA (last modified Sept. 3, 2015, 1:44 PM), http://en.wikipedia.org/wiki/Import_substitution_industrialization#Theoretical_basis.

23. *Export-Oriented Industrialization*, WIKIPEDIA (last modified Jan. 2, 2015, 1:25 PM), http://en.wikipedia.org/wiki/Export-oriented_industrialization.

24. *Id.*

25. Özlem Onaran & Englebert Stockhammer, *Two Different Export-Oriented Growth Strategies under a Wage-led Accumulation Regime*, (Pol. Econ. Research Inst. Working Paper No. 38, 2001).

26. Bhatia, *supra* note 20, at 315.

27. Gary Gereffi & Timothy Sturgeon, *Global Value Chains and Industrial Policy: The Role of Emerging Economies*, in *GLOBAL VALUE CHAINS IN A CHANGING WORLD* 329, 329-330 (Deborah K. Elms & Patrick Low eds., 2013).

28. *Id.*

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Open market policies thus became the norm, and remedies to poorly performing developing economies are these days generally sought in expanding market access through trade preferences.

Both ISI and EOI adherents have supported trade preferences, although they are generally associated with those in favor of open markets.³⁰ During the 1950s and early 1960s, protectionists supported special and differential treatment as such treatment allowed developing countries to keep up high trade barriers to protect their infant industries while being able to export to other countries.³¹ This was deemed necessary to foster industrial capacity in non-traditional manufacturers.³² At the same time, EOI adherents supported trade preferences as this would result in an increase in exports, enabling countries to accumulate foreign exchange and capture economies of scale.³³ Trade preferences could also lead to increased product sophistication in developing countries, and diversify both products and markets to the extent that a developing country would no longer require trade preferences to be competitive internationally.³⁴ Finally, it was believed that gains from trade preferences would spread to the rest of a country's economy through backward and forward linkages that result from exports input demands.³⁵

But trade preference programs have not always delivered. Indeed, the dominant view in the literature is that trade preferences are at best a marginal tool for development.³⁶ This is in part due to the limited coverage of most preference programs. While they have multiplied in recent years, they are often limited in scope. For example, some preference programs are limited to a certain geographic area (e.g., AGOA), products (textile and apparel products are typically excluded from GSP programs), and duration. More importantly, an eligible developing country can only take full advantage of preference benefits if it can demonstrate that an exported product meets the rules of origins (ROOs) requirements—conditions imposed on products in order for the product to be considered to originate within a specific country. ROOs stipulate the level of processing or value-added that must take place in a given country for a product to be considered to originate in that country.³⁷ This can be either a percentage of the total value of product (e.g., a minimum of 40% of value-added) or a number of production steps that have to be undertaken in the developing country (e.g., for textile and apparel, a requirement that the spinning of yarn and manufacturing takes place in the country). Given that developing countries mostly engage in value-added activities in the lowest segments of the value chain, they often do not have the capability to meet the minimum value-added or transformational require-

29. *Id.*

30. *What is the WTO*, WTO, https://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm (last visited Dec. 3, 2015).

31. Hoekman & Özden, *supra* note 14, at 1.

32. *Id.*

33. *Id.*

34. Lawrence Edwards & Robert Z. Lawrence, *AGOA Rules: The Intended and Unintended Consequences of Special Fabric Provisions*, at 4 (Nat'l Bureau of Econ. Research Working Paper No. 16623, 2010), available at <http://www.nber.org/papers/w16623.pdf>.

35. *Id.*

36. For an extensive literature review on trade preferences, please see Hoekman & Özden, *supra* note 14.

37. CAROLINA BJUGGREN & ELENOR HANSON LUNDSTRÖM, SWEDISH NATIONAL BOARD OF TRADE [SNBT], *THE IMPACT OF RULES OF ORIGIN ON TRADE: A COMPARISON OF THE EU'S AND THE US'S RULES FOR THE TEXTILE AND CLOTHING SECTOR 6-8* (2012), available at <http://www.kommers.se/Documents/dokumentarkiv/publikationer/2012/skriftserien/report-the-impact-of-rules-of-origin-on-trade.pdf>.

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ments. As a result, strict ROOs requirements reduce the efficacy of preference programs, especially in small countries where local sourcing is either limited or non-existent.³⁸

Other limits that scholars have pointed out include preference erosion. Over the last decade(s), import tariffs have significantly declined, both through reductions in MFN rates and through a surge in regional and mega-regional trade agreements. This means that for most products, tariffs no longer constitute a major market access barrier. And for products like apparel that continue to be subject to high import tariffs, the preference margin shrinks as more countries are eligible for reduced or zero tariffs. This will reduce the overall effect of trade of preference programs.

Given these limitations, reform efforts focus largely on how to further expand the scope of trade preferences. Particular focus has been placed on reform through more flexible ROOs. For example, the Center for Global Development recommends to “change program rules that raise costs and impede market access for Least Developed Countries (LDCs), especially rules of origin restricting input sourcing”,³⁹ and a World Bank publication states that “restrictive rules of origin constrain international specialization and discriminate against small, low-income countries, where the possibility for local sourcing are limited.”⁴⁰ The OECD argues for harmonization, simplification, and relaxation of the rules of origin in Trade Preferences For Development (TPFD) schemes;⁴¹ Tony Blair’s Commission for Africa calls on rich countries to tear down “finicky rules of origin.”⁴² Condon and Stern consider that:

The evidence strongly indicates that the liberal rules of origin on apparel exports from LDCs have been instrumental in explaining the surge in apparel exports to the U.S. under AGOA. Conversely, the evidence suggests that restrictive rules of origin on apparel exports from non-LDCs and the general rules of origin on non-apparel items have impeded the potential gains from AGOA.⁴³

A recent review of AGOA by the EPPI Centre of the University of London highlights that:

It is important that AGOA preferences cover all products. Tariffs on products excluded from AGOA . . . remain high and AGOA’s broader economic impact could be improved if preferences were extended to all products. Equally, products which are currently subject to tariff rate quotas should be fully liberalised. Consideration also needs to be given to making AGOA preferences permanent. These measures need to

38. PAUL BRENTON & ÇAĞLAR ÖZDEN, WORLD BANK TRADE & DEV. RESEARCH GRP., TRADE PREFERENCES FOR APPAREL AND THE ROLE OF RULES OF ORIGIN: THE CASE OF AFRICA 21 (2006), available at http://siteresources.worldbank.org/INTTRADERESEARHC/Resourcs/544824-1235150721870/ch10_Brenton_Ozden_Apparel_Preferences.pdf.

39. KIMBERLEY ANN ELLIOTT, CTR. FOR GLOBAL DEV., OPEN MARKETS FOR THE POOREST COUNTRIES I (2010), available at http://www.cgdev.org/files/1423918_file_OpenMarkets_Final.pdf.

40. Paul Brenton, *Preferential Rules of Origin*, in PREFERENTIAL TRADE AGREEMENT POLICIES FOR DEVELOPMENT: A HANDBOOK 161, 175 Jean-Pierre Chauffour & Jean-Christophe Maur eds., (2001).

41. Olivier Cadot & Jaime de Melo, *Why OECD Countries Should Reform Rules of Origin*, 23 WORLD BANK RES. OBSERVER 77 (2008).

42. *Tony Blair’s Commission for Africa: Erasing the Scar*, ECONOMIST (Mar. 11, 2005), <http://www.economist.com/node/3751118>.

43. NIALL CONDON & MATTHEW STERN, THE EFFECTIVENESS OF AGOA IN INCREASING TRADE FROM LEAST DEVELOPED COUNTRIES: A SYSTEMATIC REVIEW 43 (2011).

be coupled with non-restrictive rules of origin which will allow exporters in LDCs the flexibility to freely source inputs and exploit their comparative advantage in labour intensive products.⁴⁴

Professors Jamie de Melo and Alberto Portugal-Perez equally provide that:

Development-friendly policies consistent with the spirit of granting preferential access to low-income countries would benefit from relaxing the stringency of rules of origin requirements.⁴⁵

General dissatisfaction with the narrow scope and coverage of ROOs permit endless tinkering and has generated a debate focused on setting preferences rules just right. But this debate diverts attention from the more decisive role played by developing countries' domestic policy in generating sustainable industrial growth. While preferences are crucial to development as they provide developing countries unique opportunities to participate in international value chains, they are not, by themselves, sufficient if the aim is to generate sustainable industrial development.

While this restates the obvious, the brief overview above demonstrates that development reform efforts continue to be approached through the narrow lens of trade preference reform, without taking into account the more decisive role of a preference-receiving country's domestic policies. Indeed, as the next sections will demonstrate, industrial policy is often forgotten in the development-through-trade dialogue.

Thus, this Article differs from the dominant literature as it moves away from a fixation on trade preferences as an all-encompassing, determinative instrument to the policy tools preference-receiving governments can use to maximize local economic benefits generated through preference-induced trade opportunities. Simply increasing utilization rates and decreasing preference-related uncertainty, while important, does not automatically generate viable, self-sustaining economies.

IV. The Textile and Apparel Value Chain

A. THE RISE OF THE TEXTILE AND APPAREL GLOBAL VALUE CHAIN

During the last few decades, the textile and apparel industry has undergone major geographical shifts. During the 1950-60s, Western Europe and North American clothing production was displaced by an influx of imports from Japan.⁴⁶ Subsequently, clothing and textile production shifted to the "Big Three": Hong Kong, Taiwan, and South Korea, which dominated the industry in the 1970s and 1980s.⁴⁷ A third major shift took place in the late 1980s and 1990s, from the Big Three to other developing countries including

44. *Id.* at 3.

45. Jaime de Melo & Alberto Portugal-Perez, *The US African Growth Opportunity Act (AGOA): Preferences for African Countries That Do Not Deny Market Access*, VOX (May 29, 2012), <http://www.voxeu.org/article/trade-preferences-do-not-deny-market-access>.

46. GARY GEREFFI & OLGA MEMEDOVIC, U.N. INDUS. DEV. ORG., *THE GLOBAL APPAREL VALUE CHAIN: WHAT PROSPECTS FOR UPGRADING BY DEVELOPING COUNTRIES* 8-9 (2003), available at http://www.unido.org/fileadmin/media/documents/pdf/Services_Modules/Apparel_Value_Chain.pdf.

47. *Id.* at 8-9.

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China and Southeast Asia (including Indonesia, Thailand, Malaysia, and the Philippines) and also during the late 1990s to South Asia and Latin America.⁴⁸

The rise of Global Value Chains (GVCs) in textile and apparel has led to major geographical shifts in the production of textile and apparel, providing opportunities to developing countries to participate in international trade.⁴⁹ Whereas in the mid-1960s developing countries accounted only for around 25 percent of exports in textile and apparel, by 2000 this share had risen to over 70 percent.⁵⁰ The participation of developing countries also led to an increase in the total value of apparel exports. Between 2005 and 2011, apparel exports rose 48 percent to a total value of \$412 billion in 2011, 58 percent of which is comprised of developing countries, with Asian suppliers accounting for 52 percent in 2011 (China has 37 percent, Bangladesh 4.8 percent, India 3.5 percent).⁵¹

The Textile and Apparel GVC is a typical example of a buyer-driven value chain, in which lead firms in developed countries or emerging markets set the terms by which developing countries can participate.⁵² Lead firms control most value-added activities like design and branding but, motivated by cost-reductions, outsource most of the manufacturing process to developing countries.⁵³ As illustrated in Figure 1 below, the Textile and Apparel GVC consists of roughly four main production stages: (1) the supply of raw material (natural and synthetic) to textile companies; (2) the production and finishing of yarn by textile companies; (3) apparel production in garment factories; and (4) distribution and sales channels at the wholesale and retail level.⁵⁴

48. *Id.*

49. Frederick & Staritz, *supra* note 1, at 43.

50. *Id.* at 43.

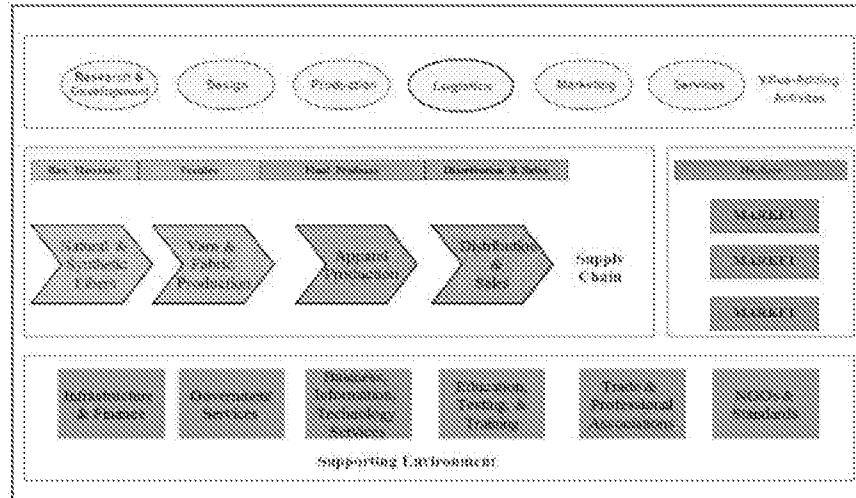
51. TAKAHIRO FUKUNISHI ET AL., AID FOR TRADE AND VALUE CHAINS IN TEXTILES AND APPAREL 5, 13 (2013), http://www.oecd.org/dac/aft/AidforTrade_SectorStudy_Textiled.pdf.

52. *Id.* at 22.

53. *Id.* at 22, 23.

54. Cornelia Staritz, *Apparel Exports – Still a Path for Industrial Development?* 5, 8-9 (C.F.S.E., Working Paper No. 34, 2012), available at <http://econstor.eu/bitstream/10419/98810/1/734851413.pdf>; Gereffi & Memedovic, *supra* note 46, at 8-9.

Figure 1⁵⁵

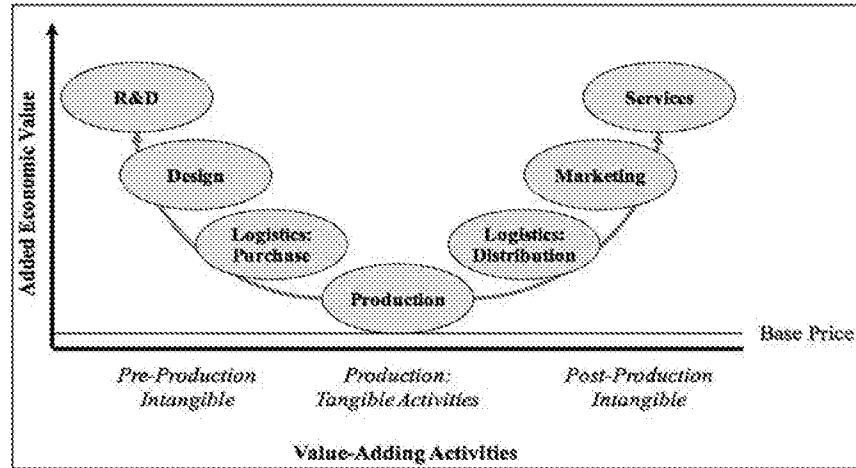


Given that most developing countries have a competitive advantage in cheap labor, they typically enter the Textile and Apparel GVC in the third stage of the value chain: apparel production.⁵⁶ As illustrated in Figure 2 below, the apparel production phase is not only the most labor intensive, but also the lowest in value-added, involving mainly sewing, cutting, and finishing activities, which are also known as “Cut-Make-Trim” (CMT).

55. Gary Gereffi & Stacey Frederick, *The Global Apparel Value Chain, Trade and the Crisis: Challenges and Opportunities for Developing Countries*, in GLOBAL VALUE CHAINS IN A POST-CRISIS WORLD 157-208 (Olivier Cattaneo et al. eds., 2010) (cited in Staritz, *supra* note 54, at 6-7).

56. Staritz, *supra* note 54, at 5.

Figure 2⁵⁷



Some developing countries manage to establish downstream linkages into the more capital and scale intensive textile sector, thereby increasing their developmental potential.⁵⁸

There are other ways in which developing countries can move to more value-added activities in the Textile and Apparel GVC, the most relevant of which are process and product upgrading.⁵⁹ “Process upgrading” refers to companies or countries improving their position in the value chain by creating new production efficiencies, through improved technologies or organizational forms.⁶⁰ “Product upgrading” occurs when a country begins to produce more complex goods that require more value-added, for example, when a country moves from manufacturing to textile production.⁶¹ Upgrading within and across the value chains can also happen.⁶² For example, individual producers can change their function in the value chain by moving to higher value-added activities like branding and marketing, or into entirely new value chains.⁶³

Trade policy, especially tariffs and quotas, has played a prominent role in shaping the textile and apparel global value chain.⁶⁴ In 1974, the Multi-Fiber Arrangement (MFA) was negotiated, subjecting established trade and apparel suppliers to quota restrictions on textile and apparel imports into the United States and the European Union.⁶⁵ As a result of these quota restrictions, leading apparel producers (mostly from Hong Kong SAR, China,

57. *Id.* at 9.

58. *Id.* at 12.

59. Raphael Kaplinsky & Watu Wamae, *The Determinants of Upgrading and Value Added in the African Clothing Sector: The Contrasting Experiences of Kenya and Madagascar* 15-19 (Open Univ., Working Paper No. 59, 2010), available at <https://www.open.ac.uk/ikd/documents/working-papers/ikd-working-paper-59.pdf>.

60. *Id.* at 15.

61. *Id.* at 18.

62. *Id.* at 28.

63. *Id.*

64. *Id.* at 52.

65. Kaplinsky & Wamae, *supra* note 59, at 52, 53.

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Japan, Korea, and Taiwan⁶⁶) began outsourcing clothing assembly processes to low-income countries in the Asian Pacific region and elsewhere that had unused MFA quotas.⁶⁷ In 1994, the MFA was replaced by the Agreement on Textiles and Clothing (ATC), which called for a phase-out of all quotas on trade in textile and apparel products by 2004.⁶⁸ With the abolition of apparel quotas production could be sourced to any country, providing new opportunities for large, competitive garment suppliers like China and India while exposing the vulnerability of low-income countries that had attracted FDI in part because of these quotas.⁶⁹

B. TRADE PREFERENCES WITHIN THE CONTEXT OF THE TEXTILE AND APPAREL
VALUE CHAIN

As mentioned earlier, trade preference schemes have significantly influenced trade flows in the textile and apparel value chain, given that textile and apparel exports typically face some of the highest tariffs on manufactured goods. This section provides a brief overview of the main preference schemes that cover textile and apparel products from the six countries studied, with a focus on the two major export markets for apparel: Europe and the United States.

The United States grants preferences to developing countries under its GSP program, with special provisions for Least Developed Countries (LDCs).⁷⁰ Most textile and apparel imports are not eligible for GSP preferences, as only 6 percent of textile and apparel goods from non-LDCs are covered,⁷¹ subject to demonstrating 35 percent of domestic value-added, in addition to “substantial transformation.”⁷² For LDCs, the product coverage is slighter greater, but the ROOs requirements remain the same.

While few apparel and textile products are eligible for United States GSP preferences, some regional agreements contain provisions that are specifically set up to increase textile and apparel trade flows between developing countries and the United States.⁷³ One of these programs is the African Growth and Opportunity Act (AGOA), which was signed in 2000, and recently extended until 2025. Under AGOA, eligible SSA countries receive duty-free and quota-free treatment for a wider range of products than the products covered under GSP, including previously excluded textile and apparel.⁷⁴ Until recently, AGOA preferences were subject to a minimum local value-added of 35 percent.⁷⁵ While countries were allowed to use U.S.-origin and regional inputs to be counted towards this

66. Frederick & Staritz, *supra* note 1, at 53.

67. Gereffi & Frederick, *supra* note 55, at 158-59.

68. Frederick & Staritz, *supra* note 1, at 53.

69. Kenta Goto, *Competitiveness and Decent Work in Global Value Chains: Substitutionary or Complementary?*, 21 DEV. IN PRAC. 943, 946 (2011).

70. BJUGGREN & LUNDSTRÖM, *supra* note 37, at 25.

71. *Id.*

72. *Id.*

73. *Id.* at 26.

74. Ralph Kaplinsky & Mike Morris, *Do the Asian Drivers Undermine the Export-Oriented Industrialization in SSA?*, 36 WORLD DEV. J. 254, 261 (2008), available at http://ac.els-cdn.com/S0305750X07002008/1-s2.0-S0305750X07002008-main.pdf?_tid=604e5d44-6315-11e5-bd59-0000aaab0f6b&acdnat=1443138096_b13143277993b7df04e9699906048ed5.

75. *Id.* at 261.

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requirement, still only few countries were able to take advantage of AGOA.⁷⁶ As a result, a special provision was added to AGOA, allowing AGOA-eligible SSA countries classified as “lesser developed countries” to receive duty-free and quota free market access without requiring a minimum percentage of local value-added.⁷⁷ In other words, under AGOA, LDCs in SSA are able to source their inputs from non-U.S. or non-AGOA members, and still receive preferential treatment. This is also called singled transformation, or the “third country fabric rule.”⁷⁸

Like the United States, the European Union has a general GSP preference scheme that provides for duty reductions. Textile and apparel products, which are considered sensitive products, are covered but receive less-favorable duty reductions compared to other products: “the MFN duty rate minus 20%.”⁷⁹ GSP-eligibility is different for LDCs and non-LDCs.⁸⁰ For non-LDCs, eligibility is contingent upon a double-transformation requirement, which involves demonstrating that both sewing of fabric and an input production process (e.g., knitting or weaving fabric) took place.⁸¹ Inputs from the European Union, however, can be counted towards this requirement—also known as bilateral cumulation—and in 2011, the rules were reformed to allow for regional cumulation as well.⁸²

For LDCs, single transformation rules apply, which means that a product made of non-regional and non-bilateral inputs can still qualify for GSP reductions.⁸³ Under GSP+, duty-free access is available for “especially vulnerable” countries that qualify, which is conditional on ratifying a select number of international conventions.⁸⁴ In 2001, the European Union passed the “Everything But Arms” (EBA) initiative, providing duty-free and quota-free access to LDCs, covering all goods except for arms.⁸⁵ While initially double transformation was required for textile and apparel goods, these rules were amended in 2011 to require only single transformation.⁸⁶

Until January 1, 2008, seventy-seven African, Caribbean and Pacific (ACP) countries received duty-free market access to the European Union under the Lomé Convention—which later became known as the Cotonou Agreement—including for textile and apparel products.⁸⁷ Similar to the GSP ROOs, preferential access was contingent upon double transformation.⁸⁸ However, it was easier to meet double transformation than under the GSP, as full regional cumulation between all ACP countries was allowed.⁸⁹ The Cotonou Agreement was found to be WTO-inconsistent and expired in 2008, when it was supposed to be replaced by bilateral trade agreements between the seventy-seven ACP countries and

76. *Id.*

77. *Id.*

78. BJUGGREN & LUNDSTRÖM, *supra* note 37, at 26.

79. *Id.* at 24.

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. BJUGGREN & LUNDSTRÖM, *supra* note 37, at 23.

85. Frederick & Staritz, *supra* note 1, at 55.

86. *Id.*, *supra* note 24, at 24.

87. *Id.*

88. *Id.*

89. *Id.*; Lorand Bartels, *The Trade and Development Policy of the European Union*, 18 EUR. J. INT'L L. 715, 749 (2007).

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the European Union, also known as Economic Partnership Agreements (EPAs).⁹⁰ As these agreements were not finalized in time, a handful of countries/regions signed interim EPAs that provided for duty-free and quota-free access to the European Union, and relaxed the ROOs to allow for third country fabric imports and require only single transformation.⁹¹

V. Case Studies

Before engaging in the case studies, it is important to clarify the term “sustainable economic growth” as it is used in this Article. While generally this term refers to socially or environmentally sustainable growth, in this Article it reflects exclusively the extent to which a developing country has been able to generate local industrial development that minimizes dependency on external factors, including changes in global demand for apparel or trade preference programs. In other words, when using the terms “sustainable economic development” this Article is looking into the question of whether countries have built up comparative advantages such that their industry can be competitive absent trade preferences schemes.

While the question of sustainability as approached in this Article is inherently qualitative, there are various factors that indicate a country’s level of industrial sustainability. At a macro-level, a good indicator is to look at whether an industry continues to perform at the same level after trade preferences have been taken away, similarly, post-MFA phase-out or after the 2008 global financial crisis. At a micro-level, this Article will focus mainly on five different categories that correlate with local sustainable industrial development. These include (1) the level of product sophistication attained, as high product sophistication reflects higher value-added and lower demand elasticity than more basic products;⁹² (2) transfer of skills to the local workforce, which indicates that a country is generating domestic capability to be self-sufficient; (3) market and diversification, as this reduces dependency on a single export market/product and that market corresponding trade preference schemes; (4) the establishment of backward and forward linkages in the apparel and textile value chain as they reduce a country’s dependence on imported inputs; and (5) the extent to which textile and apparel firms are locally owned or, if foreign owned, embedded in the country in which it has invested. Strengthening one or all of these factors will make a developing country less dependent on external factors like trade preferences, and less vulnerable to global market fluctuations.

A. LESOTHO

Trade preferences have enabled Lesotho to set up a major apparel export industry. But most of Lesotho’s apparel investment remains in the hands of foreign owners, reflecting Lesotho’s failure to build up a sustainable domestic apparel industry.

Lesotho began to build up its textile and apparel industry in 1980, when an influx of Taiwanese investors relocated to Lesotho from South Africa, mainly to avoid political

90. BJUGGREN & LUNDSTRÖM, *supra* note 37, at 24.

91. *Id.* at 24-25.

92. Lawrence Edwards & Robert Z. Lawrence, *supra* note 34, at 4.

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sanctions that had been imposed in response to South Africa's Apartheid regime.⁹³ While the total value of Lesotho's apparel industry was negligible in 1980, in 2008 it exceeded \$350 million, accounting for roughly 60 percent of Lesotho's total exports.⁹⁴ These numbers mainly reflect the rapid growth that took place between 1996 and 2008, when Lesotho's apparel industry grew more than 500 percent in response to unfilled quotas under the MFA as well as trade preferences.⁹⁵

During the 1990s, increasingly more East Asian investors began to relocate to Lesotho, attracted by the Lomé Convention under which Lesotho's apparel products received duty-free access to the European Union. While the Lomé Convention had strict ROOs, Lesotho received a temporary derogation from this requirement,⁹⁶ enabling apparel made of third country fabric to be imported into the European Union duty-free.⁹⁷ When this derogation expired, Lesotho's exports to the European Union plummeted, as it was unable to meet the Lomé Convention's double transformation requirement.⁹⁸

In 2000, East Asian apparel investors relocated to Lesotho because of Lesotho's participation in AGOA.⁹⁹ These investors took advantage of Lesotho's status as a "lesser developed country," enabling the country to sell textile and apparel products duty- and quota-free to the United States, irrespective of the percentage of third country inputs.¹⁰⁰ As a result, between 2000 and 2008, apparel firms in Lesotho increased from twenty-three to seventy.¹⁰¹ In 2008, Lesotho and the European Union signed an EPA, allowing Lesotho to get duty- and quota-free access to the European Union market through single transformation. Nevertheless, over 95 percent of Lesotho's apparel export continued to be shipped to the United States.¹⁰²

While trade preferences enabled Lesotho to attract foreign investment and grow its apparel export industry, it has generated little horizontal or vertical diversification.¹⁰³ Local sourcing continues to be low—between 5 and 15 percent—as the number of textile production firms in Lesotho is negligible.¹⁰⁴ Because East Asian investors were driven to relocate to Lesotho mainly in order to take advantage of trade preferences, they transferred only basic manufacturing/CMT operations to Lesotho such as assembly, packaging

93. *Id.* at 10.

94. Karina Fernandez-Stark et al., *The Apparel Global Value Chain: Economic Upgrading and Workforce Development*, in *SKILLS FOR UPGRADING: WORKFORCE DEVELOPMENT AND GLOBAL VALUE CHAINS IN DEVELOPING COUNTRIES* 75, 109 (Gary Gereffi et al. eds., 2011).

95. *Id.*

96. *Id.* at 111 (citing ANDREW SALM ET AL., *LESOTHO GARMENT INDUSTRY SUBSECTOR STUDY FOR THE GOVERNMENT OF LESOTHO* 11 (2002)) (Lesotho applied for an exemption to the double transformation requirement in the late 1980s, and received this exemption for a period of four years, which was renewed for another four years.).

97. Edwards & Lawrence, *supra* note 34, at 10–11.

98. *Id.* at 11.

99. Fernandez-Stark et al., *supra* note 94, at 110–11.

100. *Id.* at 111.

101. CENT. BANK OF LESOTHO, *AFRICA GROWTH AND OPPORTUNITIES ACT (AGOA): ECONOMIC IMPACT AND FUTURE PROSPECTS* (2011), available at http://www.centralbank.org.ls/publications/Monthly-EconomicReviews/2011/Econo_Review_June_2011.pdf.

102. Cornelia Staritz & Mike Morris, *Local Embeddedness, Upgrading and Skill Development: Global Value Chains and Foreign Direct Investment in Lesotho's Apparel Industry* 8 (Austrian Research Found. for Int'l Dev. (OFSE), Working Paper No. 20, 2013).

103. Edwards & Lawrence, *supra* note 34, at 13.

104. Fernandez-Stark et al., *supra* note 94, at 111.

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and shipping services.¹⁰⁵ Activities that generate more value, such as input sourcing, product development and design, merchandising and marketing, and logistics continue to be managed from the Asian, (mainly Taiwanese) headquarters.¹⁰⁶ In addition, Taiwanese firms have made little effort to train local workers to gain more advanced skills; a problem that is aggravated by the fact that the common managerial language in Taiwanese-owned factories in Lesotho tends to be Chinese.¹⁰⁷ As a result, benefits to the local economy through vertical or horizontal spillovers from East Asian investment have been virtually non-existent.¹⁰⁸

An interesting shift took place with the influx of South African investors. While in 2000, thirty-four out of forty-two apparel firms were Asian, in 2011 South African firms made up almost 50 percent of all apparel firms.¹⁰⁹ In contrast to transnational Taiwanese firms that were predominantly focused on “long production runs for U.S. customers,”¹¹⁰ South African investors’ relocation decisions were mainly motivated by Lesotho’s less rigid labor rules, its lower-cost operating environment,¹¹¹ and the introduction of duty-free market access to South Africa under the South African Customs Union (SACU).¹¹² Under SACU’s Duty Credit Certificate (DCC)¹¹³ scheme, apparel and textile firms/exporters are eligible for duty rebates on imported apparel in SACU that would be re-exported outside SACU.¹¹⁴ Different motives of South African investors compared to Taiwanese investors have generated different opportunities for Lesotho’s domestic industrial development.¹¹⁵ In contrast to Taiwanese-owned firms, some degree of industrial upgrading and local capacity building has taken place in South African-owned apparel firms in Lesotho with some Lesotho employees occupying managerial positions.¹¹⁶

Notwithstanding increased upgrading opportunities for employees in South African firms, Lesotho’s domestic apparel industry remains insignificant. Thirty years after Lesotho opened its first apparel firm, only two local firms have been formally engaged in apparel manufacturing.¹¹⁷ This may be explained in part by the fact that the Lesotho government created incentives to attract foreign investors but did not extend these privileges to domestic investors. For example, benefits such as “cheap rents for preconstructed factory shells . . . and a five-year tax holiday” were not extended to domestic investors.¹¹⁸ Similarly, the Central Bank of Lesotho provides financing opportunities for apparel ex-

105. *Id.*

106. *Id.* at 109.

107. *Id.* at 112.

108. Staritz & Morris, *supra* note 102, at 17.

109. *Id.* at 10.

110. Fernandez-Stark, *supra* note 94, at 109.

111. Staritz & Morris, *supra* note 102, at 12.

112. *Id.* at 8. Countries that are part of SACU include: Lesotho, Botswana, Namibia, South Africa and Swaziland.

113. While the DCC was terminated in 2005 as a result of WTO non-compliance, an interim extension was put in place. Kaplinsky & Morris, *supra* note 74, at 17.

114. Sean Woolfrey, *TRALAC Hotseat Comment*, MANUEL DE ARAUJO BLOG (Aug. 26, 2009), <http://manueldearaujo.blogspot.com>; Staritz & Morris, *supra* note 102, at 1.

115. Staritz & Morris, *supra* note 102, at 18.

116. *Id.*

117. *Id.* at 17.

118. HINH T. DINH ET AL., *TALES FROM THE DEVELOPMENT FRONTIER: HOW CHINA AND OTHER COUNTRIES HARNESS LIGHT MANUFACTURING TO CREATE JOBS AND PROSPERITY* 397 (2013).

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porters only, including credit guarantee assistance, more favorable domestic taxes, and a reduced corporate tax to exporters exporting outside SACU (as well as a 10 percent reduction for those exporting within SACU).¹¹⁹

Failure to create a viable local apparel industry has made Lesotho highly dependent on the continued existence of trade preferences.¹²⁰ The expiration of the MFA in 2005 and anticipated expiration of Lesotho's derogation of the double transformation rule led to the closing of eight Taiwanese firms and layoff of 13,000 people, a quarter of total employment in the industry.¹²¹ While the consequences of the MFA phase out were buffered by the imposition of safeguard measures on China's exports to the United States and the European Union,¹²² the 2008 crisis and subsequent reduced apparel demand led to increased unemployment in Lesotho.¹²³ This shock was exacerbated by the fact that, at the time, 98 percent of all Lesotho's exports were destined for the United States.¹²⁴

B. KENYA

Historically, the textile and apparel industry has played an important role for Kenya.¹²⁵ Import-substitution through heavy government protectionism post-independence enabled Kenya's domestic textile and apparel industry to blossom, growing from six weaving mills registered at independence in 1963, to fifty-two in mid-1980 and counting over 100 large-scale manufacturing units.¹²⁶ The growth rate began to fall in the 1980s and 1990s.¹²⁷ However, export-oriented policies in the 1990s, in addition to trade preferences and the MFA, helped revitalize Kenya's apparel export industry and helped Kenya become the second largest apparel exporter to the United States.¹²⁸

In the 1990s, Kenya began to create EPZs, which attracted foreign investors because of the many benefits Kenya provided to EPZ investors, including: 100 percent investment deductions, a ten year corporate income tax holiday;¹²⁹ unrestricted foreign ownerships and employment, freedom to repatriate unlimited amount of earnings; exemptions on duty- and value-added taxes on imported raw materials and equipment; exemptions from observing core labor laws and regulations; and freedom from exchange control.¹³⁰

While these policies helped to expand Kenya's apparel industry, it was not until 2000, when Kenya qualified for AGOA preferences, that growth was observed in its apparel exports.¹³¹ From a total export value of \$40 million in 1999, Kenyan apparel exports had

119. *Id.* at 400.

120. Staritz & Morris, *supra* note 102, at 19.

121. *Id.* at 9.

122. Edwards & Lawrence, *supra* note 34, at 16.

123. *Id.* at 8.

124. Staritz & Morris, *supra* note 102, at 8.

125. Robert J. Rolfe & Douglas P. Edward, *African Apparel Exports, AGOA, and the Trade Preference Illusion*, 5 *GLOBAL ECON. J.* 1, 10 (2005).

126. *Id.*

127. *Id.*

128. *Id.* at 10-11.

129. *Id.*

130. Rolfe & Edward, *supra* note 125, at 11.

131. *Id.* at 7.

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grown to \$270 million in 2005,¹³² peaking in 2003 with forty apparel firms employing roughly 37,000 people.¹³³ All firms, with one exception, were foreign, mostly Asian, enterprises and were established after Kenya had qualified for AGOA in 2000.¹³⁴ Almost all export production happened in the EPZs.¹³⁵ Prior to AGOA, Kenya was eligible for duty- and quota-free access to the European Union under the Cotonou Agreement upon meeting the double transformation requirement. Kenya's inability to meet these requirements led to little increase in exports under Cotonou.¹³⁶ While the Interim EPA changed this requirement to single transformation, it did not drastically change trade volumes.¹³⁷

When only focusing at increasing export volumes, Kenya qualifies as a success story. Looking beyond the numbers, however, a less rosy picture emerges: despite AGOA preferences and Kenya's existing textile infrastructure, Kenya has been unable to establish a viable domestic apparel and textile industry.¹³⁸

Kenya's voluminous apparel exports hide the little domestic value that is added in Kenya per product, which is as low as 3 percent.¹³⁹ This number reflects local contributions such as packaging, or the use of Kenyan-made thread.¹⁴⁰ The local value-added is so low, in part, because almost all fabric—which constitutes the highest added value component of garments—are imported from Asian suppliers, which are cheaper compared to Kenya's inputs.¹⁴¹ In addition, most of Kenya's exported apparel products are lower-end, basic commodity garments belonging to the commodity description "women and girls cotton knit apparel" and "women's trousers," which require only minimal value-added.¹⁴² Thus, the low unit value of Kenya's main apparel imports leaves little room for a higher domestic margin.

The majority of the apparel firms in Kenya's EPZ are foreign-owned and foreign managed. While some joint ventures with local firms exist, only one firm in Kenya's EPZ is locally owned—and this firm primarily works as a subcontractor for foreign-owned firms.¹⁴³ Generally, foreign investors in Kenya have little stake in the future of Kenya's apparel industry.¹⁴⁴ As a result, only the most basic production elements in the apparel value chain have been relocated to Kenya, while managerial decisions continue to be made in the multinational's headquarters.¹⁴⁵ Similarly, foreign nationals occupy most manage-

132. PAUL COLLIER & ANTHONY J. VENABLES, TRADE PREFERENCES AND MANUFACTURING EXPORT RESPONSE; LESSONS FROM THEORY AND POLICY 14 (2007), <http://users.ox.ac.uk/~econpco/research/pdfs/TradePrefs-Manufacturing.pdf>.

133. Kaplinsky & Wamae, *supra* note 59, at 7.

134. COLLIER & VENABLES, *supra* note 132, at 14.

135. Staritz & Morris, *supra* note 102, at 8–9.

136. Kaplinsky & Wamae, *supra* note 59, at 7.

137. Staritz & Morris, *supra* note 102, at 8–9.

138. Rolfe & Edward, *supra* note 125, at 10.

139. *Id.* at 18.

140. *Id.*

141. *Id.* at 19; Kaplinsky & Wamae, *supra* note 59, at 4, 7.

142. Kaplinsky & Wamae, *supra* note 59, at 7.

143. WORLD BANK, MAKING FOREIGN DIRECT INVESTMENT WORK FOR SUB-SAHARAN AFRICA: LOCAL SPILLOVERS AND COMPETITIVENESS IN GLOBAL VALUE CHAINS 230 (Thomas Farole & Deborah Winkler eds., 2014)

144. Nicholas Phelps et al., *Broken Chain? AGOA and Foreign Direct Investment in the Kenyan Clothing Industry*, 37 *WORLD DEV.* 314, 319–20.

145. *Id.* at 319.

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rial and technical positions, with high-skilled technical workers being imported mostly from China and India.¹⁴⁶

Unlike Lesotho, Kenya also has locally-owned apparel firms that operate outside the EPZ.¹⁴⁷ However, there exists practically no interaction between these firms and the foreign-owned firms in the EPZ.¹⁴⁸ While the lack of linkages between these local firms and foreign EPZ firms is caused by a myriad of factors, including different production standards and different end markets, it reflects Kenya's failure to incentive the creation of linkages between EPZ firms and local firms. Indeed, the Kenyan government did not establish a strategy for value chain integration and failed to create adequate incentives to create a viable local textile and manufacturing industry.¹⁴⁹ Instead, existing EPZ regulation hindered foreign-local firm integration. Firms in EPZs can sell only 20 percent of total sales to domestic consumers in Kenya, Uganda, or Tanzania (the East Africa Community members).¹⁵⁰ Moreover, any domestic customers are required to pay value-added and import tax from products that come from Kenya's EPZs, further disincentivizing domestic (and regional) linkages.¹⁵¹ Unsurprisingly, only 10 percent of their total sales have taken place in Kenya, and only 5.9 percent of apparel companies in Kenya's EPZs export to other African countries—compared to 73.7 percent of the non-apparel companies.¹⁵² Thus, existing regulation did not just extend tax and other benefits to foreign investors only—it actively discouraged creating local linkages.

In addition, the Kenyan government decided not to revitalize its moribund textile industry, consisting of thirty-five dilapidated mills.¹⁵³ While government subsidies may not have generated the most efficient outcome in this respect, private investment into the textile industry in Kenya has also been difficult to attract, in part because of the high risks involved in textile manufacturing in East Africa.¹⁵⁴

Relying almost exclusively on the export market, particularly the U.S. market, has made Kenya highly vulnerable to the MFA phase-out and the 2008 crisis. While Kenya's exports did not drastically plummet immediately after the MFA phase-out (Kenya's exports fell 5.1 percent compared with 26.2 percent for Madagascar), its economy proved much less resilient to the phase-out a few years later compared to similarly situated SSA economies.¹⁵⁵ Post-2006, Kenya's clothing exports fell by 24.4 percent whereas clothing exports by countries with more diversified end-markets, like Madagascar, increased by 7.6 percent.¹⁵⁶ Thus, Kenya has not managed to turn trade preferences-generated market access into building a self-sustaining, domestic apparel industry.

146. Paul Kamau et al., *Availability of Technical Skills in the Kenyan Clothing Industry and its Implications on Competitiveness in the Post-MFA Era* 13–14, 17 (June 24, 2013) (draft conference paper submitted for presentation at the June 2014 UNU-WIDER L2C Conference in Helsinki, Finland), <http://www1.wider.unu.edu/L2Cconf/sites/default/files/L2CPapers/Kamau.pdf>.

147. Farole & Winkler, *supra* note 143, at 230.

148. *Id.*

149. Phelps, *supra* note 144, at 322.

150. Farole & Winkler, *supra* note 143, at 233.

151. *Id.*

152. Rolfe & Edward, *supra* note 125, at 20.

153. Phelps, *supra* note 144, at 321.

154. *Id.*

155. Kaplinsky & Wamae, *supra* note 59, at 9.

156. *Id.*

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C. MADAGASCAR¹⁵⁷

Madagascar has had limited success in translating global export opportunities in the apparel and textile sectors into a sustainable domestic industry.¹⁵⁸ A combination of the MFA, preferential trade tariffs to the European Union (and later to the United States under AGOA), and host-country inducements like EPZs made Madagascar initially attractive to foreign investors, resulting in a boom of apparel exports.¹⁵⁹ Madagascar's apparel imports increased from \$118 million in 1995, to \$368 million in 2000, with 91 percent and 67 percent respectively destined to the European Union.¹⁶⁰ During this time period, the number of firms and employment opportunities similarly increased, from eight firms employing roughly 3,000 workers in 1990, to 150 firms employing almost 70,000 workers in 2000.¹⁶¹

The European Union has mainly been Madagascar's largest export market.¹⁶² Unlike Lesotho and Kenya, Madagascar was able to meet the Cotonou Agreement's double transformation requirement by taking advantage of the Agreement's full cumulation provision, which allowed imports from ACP countries to be counted towards the double transformation requirement.¹⁶³ In Madagascar's case, the vertical integration of its apparel industry with Mauritius—also an ACP country—enabled it to meet the double transformation requirement.¹⁶⁴ In 2008, as part of a regional bloc, Madagascar signed an EPA interim agreement with the European Union, which reduced ROOs requirements to single transformation.¹⁶⁵

Qualifying for AGOA preferences in 2001 resulted in a significant increase in foreign investment from Asia, mainly Hong Kong, China, and India, and a subsequent increase in export volumes to the United States.¹⁶⁶ In 1995, U.S. exports accounted for 6 percent of Madagascar's total apparel exports, increasing to 31 percent in 2000 and 62 percent in 2004.¹⁶⁷ But unlike Kenya and Lesotho, qualifying for AGOA did not divert all of Madagascar's apparel exports to the United States.¹⁶⁸ Madagascar's strong linkages with the European Union, as well as the E.U.'s relaxed rules of origin, enabled the country to build up a significant export industry in both markets.

Madagascar also began exporting apparel products to South Africa, mainly as a result of the duty elimination under SADC.¹⁶⁹ Again, Madagascar was able to take advantage of the elimination of duties, as vertical integration of its textile and apparel production with

157. See Staritz & Morris, *supra* note 102.

158. *Id.* at 10.

159. *Id.* The EPZs also contributed to this production increase. In 1988, Madagascar set up EPZs to attract more FDI. Firms located in EPZs are exempted from import and export duties, protected against depreciation, and have special access to foreign currency and unrestricted capital exchange controls.

160. *Id.*

161. *Id.*

162. *Id.* at 4.

163. *Id.* at 23; Bartels, *supra* note 89, at 749.

164. Staritz & Morris, *supra* note 102, at 10.

165. *Id.* at 9.

166. *Id.* at 10.

167. *Id.*

168. *Id.* at 4.

169. Staritz & Morris, *supra* note 102, at 11.

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Mauritius enabled it to meet the double transformation requirement.¹⁷⁰ Between 2006 and 2011, exports to South Africa rose from less than one million to over forty million.¹⁷¹

Madagascar's apparel industry is less volatile than Lesotho's and Kenya's analyzed *supra*, which is in part caused by Madagascar's ability to attract a variety of apparel investors, including some that are more embedded to the country. Initially, Madagascar's EPZs attracted French investors because of historical and linguistic ties. Mauritian investors followed, motivated by a combination of U.S. quota restrictions imposed on Mauritian imports, labor factors, and close proximity.¹⁷² Asian investors came in the 1900s as a result of preference-induced benefits.¹⁷³ These dynamics resulted in a high variety of apparel investors' nationalities in Madagascar's EPZ: in 2008, 29 percent of foreign investors in Madagascar's EPZ were French, 16 percent were Mauritian, 12 percent were Chinese, and, notably, 20 percent of investors were comprised of local Malagasy firms.¹⁷⁴

The various degrees of apparel firms' embeddedness in Madagascar demonstrates the correlation between ownership and upgrading. For example, more innovation takes place in Mauritian and Malagasy firms than in Asian firms in Madagascar.¹⁷⁵ Unlike Asian investors, local and regionally-embedded firms have generally invested more in product upgrading, and some have specialized in high value-added items like cashmere pullovers as well as hand-embroidered and smocked products.¹⁷⁶ Despite the fact that not all firms specialize in higher value products, the average unit value of Madagascar's apparel exports is high compared to other SSA exported apparel products.¹⁷⁷

Despite these and other positive benefits, market access generated through trade preferences has not been a panacea. For example, rather than generating more backward linkages, it has accelerated the demise of Madagascar's cotton industry.¹⁷⁸ While in 1980, Madagascar had six textile mills—including state-owned firms—they could not compete against cheaper inputs from Mauritius and Asia. Today, there is only one textile mill left, which supplies between 15 and 25 percent of inputs for firms in the EPZs.¹⁷⁹ European and African firms tend to use local inputs in addition to regional inputs, whereas Asian firms source nearly exclusively from Asia.¹⁸⁰

Similar to Kenya and Lesotho, relatively few Malagasies occupy managerial or technical positions in apparel firms.¹⁸¹ As government training initiatives are largely absent, training interventions have been left mainly to the private sector. While most foreign firms do not invest in training and instead import foreign workers to occupy higher-level positions in the firm, there are exceptions.¹⁸² For example, one Chinese firm has committed to

170. *Id.* at 17.

171. *Id.* at 11.

172. *Id.* at 16.

173. *Id.* at 10.

174. ANNA ANDERSON, MADE IN MADAGASCAR: THE IMPACT OF RULES OF ORIGIN ON THE TEXTILE AND CLOTHING INDUSTRY 17 (2009), <https://liveatlund.lu.se/intranets/LUSEM/NEK/mfs/MFS/193.pdf>.

175. Staritz & Morris, *supra* note 102, at 20-21.

176. *Id.* at 22.

177. *Id.* at 12.

178. *Id.* at 23.

179. *Id.* at 24.

180. Staritz & Morris, *supra* note 102, at 24.

181. *Id.* at 25.

182. *Id.*

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training a Malagasy worker for every imported worker.¹⁸³ In this firm, local merchandisers increased from one to twenty-two over the course of seven years.¹⁸⁴ In addition, the international community has established a successful training program called Textile Mada, which provides specialized training and generally assists firms to be more competitive.¹⁸⁵ While these training programs are all a step in the right direction, they cannot substitute large scale, government-funded training programs.

Madagascar lacks an industrial policy that balances attracting foreign investors with incentivizing domestic firms to enter the apparel industry. While it has some EPZ-related export incentives in place, such as tax concessions, depreciation allowances, and special access to foreign money, it has failed to implement relevant training programs for its domestic workforce or provide access to finance programs for local entrepreneurs, which is a major trade barrier in Madagascar.¹⁸⁶ According to a World Bank study, only 3 percent of exporters in Madagascar have received a loan from a bank, compared to 70 percent in Bangladesh and 64 percent in Mauritius.¹⁸⁷

Despite these and other shortcomings, Madagascar's export apparel industry has more local ties compared to Lesotho and has—to a limited extent—proved to be more resilient in the wake of crises. For example, as a result of diverse end markets, Madagascar was able to significantly increase its overall apparel exports after the MFA phase-out in 2005, with a 7 percent increase in 2006 and a 20 percent increase in 2007.¹⁸⁸ But the 2008 economic crisis and the suspension of its AGOA status as a result of political turmoil resulted in a significant decline in Malagasy apparel exports (with declines in 2009 and 2010 of 16 percent and 35 percent, respectively).¹⁸⁹ The number of firms declined from 120 in 2005 to between sixty and seventy in 2012, with employment dropping from 100,000 to 55,000.¹⁹⁰ While a suspension of AGOA benefits in a country like Kenya would probably have even more dramatic effects, Madagascar's apparel industry was not sufficiently robust to hold up in the wake of the triple crisis of political violence, the 2008 global financial downturn, and the suspension of AGOA benefits.

D. BANGLADESH

During the last forty years, Bangladesh has climbed to the top of apparel production, becoming the world's second largest apparel producer with exports reaching a total of thirteen billion in 2009.¹⁹¹ Bangladesh built up its industry from scratch, aided by trade preferences and government policies incentivizing local entrepreneurship and backward linkages.¹⁹²

183. *Id.*

184. *Id.*

185. *Id.*

186. Staritz & Morris, *supra* note 102, at 10, 14, 25.

187. *Id.* at 14.

188. *Id.* at 11.

189. *Id.*

190. *Id.*

191. UNCTAD & COMMONWEALTH SECRETARIAT, POTENTIAL SUPPLY CHAINS IN THE TEXTILES AND CLOTHING SECTOR IN SOUTH ASIA: AN EXPLORATORY STUDY 27 (2009), http://unctad.org/en/Docs/ditctncd2011d3_en.pdf; accord. GEREFFI & MEMEDOVIC, *supra* note 46, at 27.

192. Frederick & Staritz, *supra* note 1, at 43.

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Motivated by the MFA, preference schemes in the European Union, as well as domestic policy, Bangladesh became a platform for East Asian—mainly Korean—apparel producers.¹⁹³ Bangladesh flourished under the MFA because it was subject to less restrictive import quotas compared to China, Hong Kong, Korea, and Japan.¹⁹⁴ As a result, it attracted East Asian apparel investors—mainly from the Republic of Korea—that helped build up Bangladesh's apparel industry.¹⁹⁵ Bangladesh was also attractive because of its LDC status, which enabled it to qualify for the E.U.'s EBA, providing duty- and quota-free access to the European Union, subject to a double transformation requirement.¹⁹⁶ In contrast, Bangladesh did not benefit from trade preferences because the only scheme it was subject to was the U.S. GSP program—which excludes most textile and apparel products.¹⁹⁷ As a result, by the mid-1990s more than 50 percent of Bangladesh's total apparel exports went to the European Union.¹⁹⁸ The establishment of two major EPZs that generated special benefits for exporters boosted Bangladesh's apparel exports.¹⁹⁹

Bangladesh was able to engage in significant industrial upgrading. Whereas in the 1990s the majority of Bangladesh's apparel firms mainly engaged in CMT, most apparel firms located in Bangladesh evolved into full-package production, including sourcing and financing inputs, production services, and packing.²⁰⁰ Bangladesh was able to shift into the OEM stage mainly because it had managed to build up a domestic textile industry for knitted products, thus generating backward linkages.²⁰¹

The Bangladeshi government began subsidizing local textile production in an attempt to reduce dependency on textile imports and to meet the E.U.'s double transformation requirement. These subsidies included cash handouts to export-oriented firms using locally-produced inputs, subsidized interest rates, and reduced infrastructural costs for local textile firms.²⁰² In addition, until 2005, FDI in Bangladesh was conditional upon investing in backward linkages.²⁰³ These policies generated local entry into the textile and apparel industry. Out of 4,220 apparel and textile firms in 2006, only eighty-three were wholly or partially foreign-owned.²⁰⁴ As a result, in 2008 about 25 percent of Bangladesh's textile inputs were sourced locally.²⁰⁵

Bangladesh was able to make this shift to domestic ownership mainly because of the policies it adopted encouraging skill transfer and lowering investment barriers for local entrepreneurs in the apparel and textile sector. For example, until 2005 FDI was only allowed in EPZs, and on the condition that the firm made investments in Bangladeshi

193. *Id.*

194. Fernandez-Stark, *supra* note 94, at 109.

195. Frederick & Staritz, *supra* note 1, at 213.

196. *Id.* at 237-38.

197. *Id.* at 238.

198. *Id.* at 215.

199. Fernandez-Stark, *supra* note 94, at 34.

200. Frederick & Staritz, *supra* note 1, at 222.

201. Fernandez-Stark, *supra* note 94, at 35.

202. Frederick & Staritz, *supra* note 1, at 240-41.

203. *Id.* at 221.

204. *Id.*

205. Meenu Tewari, *Deepening Intraregional Trade and Investment in South Asia: The Case of the Textiles and Clothing Industry 7* (Indian Council for Research on Int'l Econ. Relations, Working Paper No. 213, 2008), http://icrier.org/pdf/Working_Paper_213.pdf.

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backward linkage industries.²⁰⁶ Thus, rather than undermining their growth, the presence of foreign investors gave a boost to domestic textile firms. Moreover, Bangladesh provided production incentives not only to foreign investors, but also to local entrepreneurs.²⁰⁷ For example, Bangladesh significantly reduced entry barriers into the apparel manufacturing industry by initiating a bonded warehousing system, which allowed a local garment exporter to import fabric with deferred payments until sales were finalized.²⁰⁸ Because textile comprised around 75 percent of the total value-added of a garment and was mostly imported, these policies were critical in enabling a local garment industry.²⁰⁹

In tandem with these policies, the Bangladeshi government also actively invested in formal workforce development programs. Toward the end of the 1980s, as a result of foreign donor initiatives and two private Bangladeshi industry associations, foreign investors in EPZs began to pay more attention to systematic skills training.²¹⁰ The government launched specific skill training programs through the creation of technical and vocational institutions.²¹¹ The flagship of these programs is PROGRESS, the Promotion of Social, Environmental, and Production Standards, which is jointly sponsored by the German and Bangladeshi government.²¹²

Bangladesh managed to build a relatively sustainable apparel industry with strong local ties to make it sustainable. As a result, during the post-MFA phase-out Bangladesh's exports did not diminish, but almost doubled (from \$6.2 billion in 2004 to roughly \$12 billion in 2007).²¹³ Similarly, the 2008 global crisis resulted in an *increase* in Bangladesh's share of global textile and apparel exports, with a 20.4 percent increase in 2008 and a 5.4 percent increase in 2009, mainly because Bangladesh was not solely dependent on the United States but also had strong export linkages with the European Union.²¹⁴

E. SRI LANKA

Sri Lanka's experience in the textile and apparel value chain stands out as it has achieved some of South East Asia's highest design and quality standards.²¹⁵ Prior to economic liberalization in 1977, Sri Lanka had "few locally owned [apparel] firms," all of which "produced . . . low-end apparel for the domestic market."²¹⁶ In 1977, Sri Lanka began to attract foreign investment in the apparel sector, predominantly from East Asia and the European Union.²¹⁷ East Asian investors were mainly seeking to invest in Sri Lanka be-

206. Frederick & Staritz, *supra* note 1, at 221. These restrictions were later removed, but there is no evidence that significant FDI is taken place outside the EPZs.

207. Tewari, *supra* note 205, at 49. The Bangladeshi government also provided incentives to fuel the growth of the apparel industry. While not setting up an EPZ, Bangladesh lowered import tariffs from 65 percent to 30 percent, and also allowed for duty-free imports for products that would be re-exported.

208. *Id.*

209. *Id.*

210. Fernandez-Stark, *supra* note 94, at 35.

211. *Id.* at 36.

212. *Id.* at 37.

213. Tewari, *supra* note 205, at 7.

214. Frederick & Staritz, *supra* note 1, at 219.

215. *Id.* at 455.

216. *Id.* at 442.

217. *Id.*

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cause of the MFA, while European investors were attracted by Sri Lanka's liberal investment climate.²¹⁸

Similar to Bangladesh, the Sri Lankan government adopted policies to facilitate the transfer of knowledge from foreign investors to domestic firms. For example, businesses incorporated as joint ventures with foreigners received special tax reductions.²¹⁹ This allowed for a high level of skill transfer to take place between foreign and local entities. In addition, it incentivized local companies to work together with foreigners: upon reaching a certain minimum amount of foreign investment, a local company would receive tax exemptions on income for a period of five years.²²⁰ As a result, "in 1999, around 80-85 percent of apparel factories in Sri Lanka were locally owned."²²¹ Local firms began to dominate the sector in the early 1990s, and by 2000, 80 to 85 percent of apparel firms were locally owned.²²²

Textile and apparel investment thrived between 1999 and 2004, almost doubling the total value of Sri Lanka's initial apparel exports.²²³ In 2001, apparel exports to the European Union increased after Sri Lanka qualified for quota-free—but not duty-free—access under the GSP, subject to a double transformation requirement.²²⁴ Sri Lanka was also eligible for trade preferences under the U.S. GSP, but these covered only a small percentage of Sri Lanka's apparel imports. Because Sri Lanka did not have a well-developed domestic textile industry, its utilization rate of the E.U.'s GSP was only around 40 percent, and its use of GSP preference schemes to the United States was negligible.²²⁵ This changed in 2005 when Sri Lanka became the first South Asian country to qualify for E.U. GSP+, allowing for duty-free market access in addition to quota-free access and removing the double transformation requirement.²²⁶ As a result, Sri Lanka's share of apparel exports to the European Union increased from 33 percent in 2000 to 51 percent in 2009, while exports to the United States decreased from 62 percent in 2000 to 36 percent in 2009.²²⁷

While the initial investments in Sri Lanka consisted mainly of CMT operations, Sri Lanka has engaged in significant product and functional upgrading—going from basic to sophisticated products, and from apparel manufacturing to apparel design, respectively.²²⁸ Sri Lanka has moved away from producing basics like knitwear and T-shirts to higher value products for niche markets like intricate embroidery, stitch embellishment, and high-quality, eco-friendly garments.²²⁹ Investing in these high-end products for niche markets

218. *Id.*

219. *Id.* at 442–43.

220. Ananda, Jayawickrama & Shandre Thangavelu, *ASEAN+1 FTAs and Global Value Chains in East Asia: The Case of the Textile and Clothing Industry in Sri Lanka*, in *ASEAN+1 FTAs and Global Value Chains in East Asia* 232, 251 (C. Findlay ed., 2011).

221. Staritz & Frederick, *supra* note 1, at 449.

222. Fernandez-Stark, *supra* note 94, at 28.

223. Staritz & Frederick, *supra* note 1, at 443 (explaining that apparel exports increased from \$1,680 million in 1999 to \$2,975 million in 2004).

224. *Id.* at 167.

225. Jayawickrama & Thangavelu, *supra* note 220, at 253.

226. Staritz & Frederick, *supra* note 1, at 167.

227. *Id.* at 451.

228. Fernandez-Stark, *supra* note 94, at 29.

229. Kanchana N. Ruwanpura & Neil Wrigley, *The Costs of Compliance?: Views of Sri Lankan Apparel Manufacturers in Times of Global Economic Crisis*, 11 J. ECON. GEOGRAPHY 1, 6 (2010).

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has given Sri Lanka the reputation as “lingerie capital”, supplying to firms like Victoria’s Secret and Marks and Spencer.²³⁰ It has also made the unit values of Sri Lanka’s garment exports amongst the highest in the region. Between 2000 and 2008, many firms shifted from producing 80 percent of their total output of low-value added products, to 50 percent constituting higher value-added items.²³¹

Sri Lanka’s upgrading success has transformed the country into a sourcing hub. Large Sri Lankan apparel manufacturers have established factories in Africa and developed backward linkages with India and Bangladesh.²³² Sri Lanka has been able to establish some backward linkages to its local economy, with 40 to 50 percent of knit fabric being locally produced.²³³ All woven fabric, however, is imported, amounting to an average of 65 percent of all textile inputs.²³⁴

Sri Lanka’s success can be attributed to two main factors: early moving advantage that created strong ties with major international buyers like Nike and Victoria’s Secret, and proactive government policies in the wake of the MFA phase-out.²³⁵ In 2002, the government and the private sector established the Joint Apparel Associations Forum (JAAF), which, after identifying weaknesses in the apparel industry, produced an industry-wide response to growth in the apparel sector in its Five-Year Plan.²³⁶ The key objectives of the Five-Year Plan included increasing industry turnover to \$4.65 billion in 2007; transforming industry from a “manufacturer” to a provider of “fully integrated services”; focusing on high-value apparel instead of apparel high in low-costs; creating an international reputation in niche markets: sportswear, casual wear, children’s wear, and intimate apparel; and consolidating and strengthening the industry.²³⁷ Another key element of the Five-Year Plan focused on human resource development through initiatives to increase workers’ productivity and technical competence through training programs in areas such as marketing and design.²³⁸

While significant upgrading has taken place in Sri Lanka, the apparel industry remains heavily dependent on the United States and the European Union as its main export markets. This is in spite of the existence of South Asian regional agreements, such as the South Asian Association for Regional Cooperation and an India-Sri Lanka free trade agreement, which maintain high tariff and quota barriers on intra-regional trade.²³⁹ As a result, despite its sustainable local industry, Sri Lanka was still heavily impacted by the global economic crisis in 2008 and the phasing out of safeguards imposed on China toward the end of 2008. In 2009, apparel exports decreased by 7.3 percent, mainly as a result of a decrease in United States exports.²⁴⁰ Export earnings dropped by 15 per-

230. *Id.*

231. Fernandez-Stark, *supra* note 94, at 30.

232. *Id.* at 28.

233. Staritz & Frederick, *supra* note 1, at 457.

234. *Id.* at 456.

235. Fernandez-Stark, *supra* note 94, at 29–30.

236. Yevgeniya Savchenko, *The Rise of Small Asian Economies in the Apparel Industry*, in *SEWING SUCCESS? EMPLOYMENT, WAGES, AND POVERTY FOLLOWING THE END OF THE MULTI-FIBRE ARRANGEMENT* 163, 176 (Gladys Lopez Acevedo & Raymond Robertson eds., 2012).

237. *Id.* at 172.

238. *Id.* at 173.

239. Staritz & Frederick, *supra* note 1, at 460–61.

240. *Id.* at 443.

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cent.²⁴¹ Another challenge came from the European Union when it decided to cut Sri Lanka's GSP+ benefits in response to shortcomings with respect to its human rights record.²⁴² Thus, while the creation of Sri Lanka's apparel industry has been highly successful, it was—almost inevitably—affected by the global economic downturn and its subsequent consequences.

F. CAMBODIA

While Cambodia engaged in apparel manufacturing during the French Colonial era, its modern apparel industry was set up only in the mid-1990s.²⁴³ Between 1995 and 2000, its apparel industry grew from \$63 million to \$2,434 million, making apparel the country's largest export sector.²⁴⁴ This growth was the result of Cambodia's preferential market access, the MFA, and Cambodia's export-oriented industrial policy.

In 1999, Cambodia and the United States signed the U.S.-Cambodia Bilateral Textile Agreement (UCTA), which provided Cambodia preferential market access for apparel products.²⁴⁵ A unique feature of the UCTA was the Better Factories Cambodia Program, under which Cambodia would receive an increase in import quotas to the United States if it could demonstrate compliance with its labor laws and international labor standards.²⁴⁶ Cambodia also benefited from quota- and duty-free market access to the European Union under the EU's GSP program, and later the EBA, subject to a double transformation requirement.²⁴⁷ Failure to establish backward linkages in Cambodia resulted in a utilization rate of GSP preferences of a mere 10 percent.²⁴⁸ Preferential market access to the United States was not conditioned on meeting double-transformation. As a result, the United States became Cambodia's largest export market for apparel, peaking in 1999 at a share of 87.7 percent and 70 percent in 2008, employing roughly 325,000 workers.²⁴⁹

Industrial upgrading in Cambodia has been largely absent. Seventy percent of Cambodia's apparel exports are CMT, the lowest stage of the apparel value chain, and almost all fabric is imported.²⁵⁰ Cambodia's apparel industry suffers from a lack of competitiveness, as most of the equipment used is primitive and often second-hand.²⁵¹ This poor record in creating more value-added is caused in part by the fact that around 93 percent of Cambodian-based apparel factories are foreign-owned, led by Taiwan, China, and Hong Kong, with foreigners making up a majority of factory managers.²⁵² Cambodians own only 7 percent of apparel firms, which are mostly smaller factories.²⁵³ Foreign ownership and management control has not facilitated knowledge sharing and participation of local

241. *Id.* at 447.

242. *Id.*

243. Savchenko, *supra* note 236, at 176.

244. Staritz & Frederick, *supra* note 1, at 249.

245. *Id.*

246. Savchenko, *supra* note 236, at 187.

247. Staritz & Frederick, *supra* note 1, at 267-68.

248. *Id.* at 268.

249. *Id.* at 163.

250. Savchenko, *supra* note 236, at 163, 181-82.

251. *Id.* at 182-83.

252. *Id.* at 75, 170, 255-56.

253. *Id.* at 256.

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employees in strategic decision-making.²⁵⁴ According to a survey conducted of 164 garment firms in Cambodia, 30 percent of all managers came from China, followed by 21 percent from Taiwan, 15 percent from Hong Kong, and only 8 percent from Cambodia.²⁵⁵ Similarly, Cambodia has failed to establish backward linkages, importing over 90 percent of textile inputs.²⁵⁶

Cambodia's industrial policy, or lack thereof, has contributed to these unsustainable dynamics. In contrast to Bangladesh and Sri Lanka, the Cambodian government only focused on attracting FDI—not local businesses—to build up its apparel industry. For example, in 1994 “it approved the establishment of 100 percent foreign-owned firms in Cambodia.”²⁵⁷ In addition, foreign exporters are eligible for duty-free imports and other tax reductions for which local firms are ineligible.²⁵⁸ Meanwhile, training programs to allow for upgrading are largely absent, with only two formal training institutions in place.²⁵⁹ And while the government prepared a post-MFA transition strategy entitled the “Cambodian Garment Industry Development Strategy,” this strategy was never implemented.²⁶⁰

Cambodia's failure to build up a local apparel industry made it particularly vulnerable to the 2008 financial crisis that took place simultaneously with the phase-out on China's safeguard.²⁶¹ In 2009, total apparel exports declined by 14.1 percent, and seventy-two factories closed in 2009, with the remaining 241 factories operating at 60 to 70 percent of capacity, laying-off 20 percent of the workforce.²⁶²

VI. Implications

A. RULES OF ORIGIN DO NOT AUTOMATICALLY LEAD TO THE DEVELOPMENT OF A VIABLE LOCAL APPAREL INDUSTRY

The contrasting experiences of the six countries analyzed *supra* demonstrate that while trade preferences enable developing countries to increase apparel exports, they do not automatically lead a developing country onto a path of sustainable industrial growth. All six countries studied were able to generate significant volumes of apparel and textile exports, in part as a result of trade preferences. AGOA was a critical enabler for Kenya, Lesotho and Madagascar, the UCTA for Cambodia, and the EBA and GSP+ programs for Bangladesh and Sri Lanka. When preference programs were taken away—as we saw in the case of Sri Lanka and Madagascar—exports plummeted significantly. This demonstrates that trade preference programs have been, and continue to be, critical enablers for developing countries to become players in the trade and apparel value chain and partake in the benefits of globalization. Yet, from all six countries studied, only Madagascar, Sri

254. *Id.*

255. *Id.* at 256.

256. Savchenko, *supra* note 236, at 74, 171.

257. *Id.* at 173.

258. *Id.*

259. *Id.* at 176.

260. *Id.* at 175.

261. *Id.* at 253

262. Savchenko, *supra* note 236, at 253; UNCTAD Secretariat, *Integration of developing countries in global supply chains, including through adding value to their exports*, U.N. Doc TD/B/C.I/16, at 18 (Mar. 25, 2011).

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Lanka, and Bangladesh stand out as having been relatively successful in establishing a viable domestic industry, thereby capturing more local benefits, while Kenya, Lesotho, and Cambodia, generally, have not. Thus, preferences alone, while increasing exports, do not automatically generate significant, local, economic benefits for the exporting country.

The case studies also demonstrate that more flexible ROOs do not necessarily correlate with higher levels of sustainable, domestic industrial development. Rather, they generate higher preference utilization rates but also tend to create higher levels of vulnerability and dependency on export markets. For example, Cambodia qualified for both U.S. and E.U. preferences, but its utilization rate of E.U. preferences was only 10 percent.²⁶³ As a result, almost 90 percent of Cambodia's exports went to the United States, which, unlike the European Union, did not require double transformation.²⁶⁴ More importantly, more flexible ROOs have not facilitated sustainable growth in Cambodia's apparel industry. Rather, it is more closely linked with EPZ-concentrated growth, input dependency, and little or no vertical upgrading and skill transfer taking place.

Conversely, the case studies show that the countries that generated more local value-added, i.e., Bangladesh, Sri Lanka, and Madagascar, did not necessarily benefit from flexible ROOs. Madagascar grew its industry by taking advantage of the full cumulation option of the E.U.'s Cotonou Agreement, using textile imports from Mauritius to fulfill the double transformation requirement. Bangladesh was able to meet the E.U.'s preference program's double transformation requirement through backward linkages spurred by domestic textile production investments.²⁶⁵ Sri Lanka grew its industry in the 1990s despite only being able to take advantage of GSP preferences at that time. Nevertheless, Madagascar, Sri Lanka, and Bangladesh not only managed to foster their apparel industry, they were also able to generate significant domestic value capture by creating varying degrees of sustainable local growth.

It would be too easy, however, to conclude that less flexible rules of origin always result in more local value-added. While flexible ROOs make trade preferences accessible to low-income countries that do not have the capacity, they tend to trap low-income developing countries in lower echelons of the apparel value chain. On the other hand, stricter ROOs remain inaccessible for developing countries with little production capacity, thus precluding access to trade preferences for these countries and the opportunity to build up a sustainable apparel industry there from. For example, had Cambodia not benefited from relaxed ROOs, it would likely not have attracted FDI and would not have been able to build up an apparel and textile export industry.

As this Article will demonstrate below, ROOs represent only one factor that influences the industrial dynamics of developing countries and certainly do not *determine* the viability of a country's growth path. Irrespective of ROOs, developing countries have a choice and can determine the long-term viability of their growth path through developing a proactive industrial government policy that balances attracting FDI with incentivizing local enterprises to enter the garment industry.

263. Savchencko, *supra* note 236, at 268.

264. *Id.*; Jayawickrama & Thangavelu, *supra* note 220, at 253.

265. Kazi. N. Ahmed, *Changes in the Rules of Origin of EU-GSP Scheme & Bangladesh's RMG Indus.*, 1 FOR. AFF. INSIGHTS & RS. [FAIR] 1, 2 (2012), http://www.academia.edu/3785264/Changes_in_the_Rules_of_Origin_of_EU-GSP_Scheme_and_Bangladeshs_RMG_Industry.

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B. PRO-ACTIVE INDUSTRIAL POLICY

In the context of global value chains, an industrial strategy that is not solely export-oriented is key in generating domestic value.²⁶⁶ The case studies above demonstrate that the countries that have been least successful in establishing sustainable apparel industries, i.e., Kenya, Cambodia, and Lesotho, all had industrial policies in place that were exclusively oriented toward attracting foreign investors to produce goods almost exclusively for the export market. Some regulation even went as far as to discourage creating local linkages.

For example, the Kenyan government focused exclusively on building up a viable export-oriented industry, providing tax exemptions, 100 percent investment deductions, and freedom from exchange control to exporters in the EPZs, resulting in almost 100 percent foreign-ownership in the EPZs.²⁶⁷ Meanwhile, Kenya failed to provide incentives for local and/or regional apparel manufactures, having established almost no training programs and no strategy to generate backward linkages through its dormant textile industry. In addition, while Kenya benefited from the existence of local apparel enterprises, its EPZ regulation explicitly discouraged linkages between foreign and local enterprises by capping the percentage of total sales that could be sold locally and regionally, as well as by subjecting any local sales to an import and sales tax. Similarly, the Lesotho government adopted an export-oriented industrial strategy, incentivizing foreign investors through visa requirements waivers, EPZs, tax holidays, and cheap rents—benefits that were not extended to domestic investors.²⁶⁸ The Lesotho government also provided credit guarantee assistance to exporters and reduced corporate taxes for those exporting outside of SACU—and to a lesser extent to those exporting within SACU—with no programs in place to train workers or help local investors gain financial credit or become exporters. Cambodia's industrial policy in the apparel and textile sector similarly focuses solely on providing incentives to foreign investors through tax exemptions, EPZ benefits, and other incentives. It even passed a law allowing for 100 percent foreign-owned firms in Cambodia.²⁶⁹ Meanwhile, like Kenya and Lesotho, incentives for local firms have been largely absent, as are training programs for workers, an industrial upgrading strategy, or a niche-product focus.

In contrast to Kenya, Cambodia, and Lesotho, Sri Lanka and Bangladesh—the two countries that have been relatively successful in generating viable domestic apparel industries—have each implemented strong governmental policies that focus on encouraging participation of local enterprises in the textile and apparel sector in addition to attracting FDI. For example, Bangladesh set up EPZs with accompanying tax exemptions to attract foreign investment, but until 2005, foreign investment in EPZs was made conditional on investing in backward linkages in Bangladesh.²⁷⁰ This facilitated skill transfer and provided a boost to Bangladesh's domestic textile industry. Furthermore, Bangladesh invested heavily in financing programs that reduced entry barriers for local apparel firms,

^{266.} *Id.*

^{267.} Rolfe & Woodward, *supra* note 125, at 10-11.

^{268.} *Id.* at 397.

^{269.} DINH, *supra* note 118, at 359.

^{270.} Fernandez-Stark, *supra* note 94, at 33.

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which proved critical to attract local investors.²⁷¹ Bangladesh facilitated the growth of its textile industry through subsidies, including cash handouts to export-oriented firms using locally-produced inputs, subsidized interest rates, and reduced infrastructural costs for local textile firms.²⁷² Finally, the Bangladeshi government actively engaged in training its workforce through programs like PROGRESS.²⁷³

Similarly, Sri Lanka's success in establishing a viable domestic apparel industry has been the result of an industrial strategy that focused on how to engage foreign investment to best incentivize domestic apparel production.²⁷⁴ For example, Sri Lanka provided fiscal incentives to both domestic and foreign investors: businesses incorporated as joint ventures with local investors received special tax reductions.²⁷⁵ In addition, it created a Five-Year Plan setting out Sri Lanka's way to become a full-service provider of high-apparel products, focusing on training of the workforce, niche-product development, and worker productivity.²⁷⁶ This strategy proved highly successful and facilitated exceptional levels of upgrading.²⁷⁷

Thus, these case studies lend themselves to the conclusion that a country's industrial strategy determines in part whether it will embark on a path of sustainable development in the textile and apparel sector, or whether preference-induced growth will remain merely ephemeral.

C. REGIONAL INTEGRATION AND EMBEDDEDNESS

All six case studies demonstrate that firm embeddedness is a precondition for sustainable industrial development.²⁷⁸ Embeddedness, in the context of global value chains, refers to the extent to which firms and owners of firms are enmeshed in local relationships²⁷⁹ or "have roots in the social and economic fabric of the host country."²⁸⁰ Embeddedness correlates strongly with ownership: firms with local or regional ownership are more embedded in the host-country than transnational firms.²⁸¹

Kenya, Cambodia and, to a lesser extent, Lesotho, demonstrate the difficulty of building up a sustainable textile and apparel industry while relying mainly on foreign investment with a short-term vision. Multinational investors, attracted by trade preferences, tend to outsource only low value-added manufacturing operations. They restrictively control technological know-how and other high-information segments of the value chain, and tend not to invest in workforce-training programs. This dynamic makes one developing country easily replaceable with another, and does not, without proactive government interference, lead to local industrial linkages, process or product upgrading, or workforce training.

²⁷¹ *Id.* at 35.

²⁷² *Id.*

²⁷³ *Id.* at 51.

²⁷⁴ *Id.* at 28.

²⁷⁵ *Id.*

²⁷⁶ Fernandez-Stark *supra* note 94, at 27-28, 30.

²⁷⁷ *Id.* at 30.

²⁷⁸ Staritz, *supra* note 54, at 22.

²⁷⁹ Staritz & Morris, *supra* note 102, at 6.

²⁸⁰ Staritz, *supra* note 54, at 21.

²⁸¹ *Id.* at 22.

This dynamic is fundamentally different for foreign firms that have regional ties to the country in which they invest, the contrast of which is well illustrated by Lesotho's experience with Taiwanese transnational firms and South African investors.²⁸² While practically no upgrading took place in Taiwanese firms, South African investment provided opportunities for locals to occupy managerial positions in the value chain and allowed for some upgrading.²⁸³ South African firms are more invested in the future of Lesotho's apparel industry, in part because of proximity and strong ties between the South African and Lesotho markets.²⁸⁴ Similarly, in Madagascar, local firms owned by longstanding French residents and Mauritians engaged in more innovation and industrial upgrading than their Asian counterparts.²⁸⁵

Regional integration as demonstrated by Madagascar and South Africa has also proven to make a country less vulnerable to external market shocks.²⁸⁶ For example, Bangladesh was able to *increase* its share in global textile and apparel exports by 20.4 percent in 2008 and 5.4 percent in 2009, mainly because of its vibrant export market to the European Union.²⁸⁷ Similarly, Madagascar was able to withstand the effect of the MFA phase-out. While Madagascar's exports significantly dropped in 2005, a year later they *increased* by 7.6 percent.²⁸⁸ This was mainly the result of an increase in exports to the European Union and South Africa.

VII. Policy Options

This section analyzes industrial policy options for developing countries that aim to use trade preferences to grow their textile and apparel export industry while generating sustainable local growth. The policy options are divided in three different levels: first, and most importantly, the national level at which governments can implement an industrial policy strategy that is not just export-oriented; second, the regional level at which regional blocs can cooperate to gain more value-added from apparel and textile trade; and third, the international level at which developed countries can engage in strategies that will directly contribute to developing countries' level of sustainability, beyond focusing on expanding the scope of preference programs. Because each developing country has a unique set of political, legal, historical and economic parameters, industrial policy options and opportunities must necessarily be tailored to the specific situation of each individual country. Thus, it is important to keep in mind that the policy options presented in this Article provide a mere overview of possibilities for developing countries and should not be considered blueprints for industrial upgrading.

282. Staritz & Morris, *supra* note 102, at 4.

283. *Id.* at 25.

284. *Id.* at 8.

285. *Id.* at 4, 28.

286. *Id.* at 19.

287. Savchencko, *supra* note 236, at 219.

288. Kaplinsky & Wamae, *supra* note 59, at 10.

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A. NATIONAL LEVEL

As clearly demonstrated by the case studies presented in this Article, an industrial policy that goes beyond focusing on export markets is critical in determining the sustainability of a developing country's textile and apparel industry. International and regional trade and investment agreements have set up parameters limiting and defining the scope of a country's industrial policy space. Within this context, this section provides an overview of some policy options that a government may want to consider when aiming to establish viable domestic apparel industries.

1. *Encourage the Development of Local Production*

Given the correlation between local embeddedness and industrial upgrading, governments should adopt policies that encourage the development of local production while incentivizing foreign investment. This includes policies that lower entry barriers for local entrepreneurs, provide similar incentives to foreign and local investors, and create structural incentives to encourage foreign-local cooperation.

First, in order to encourage local textile and/or apparel producers, governments should lower entry barriers for local entrepreneurs. One way to do so is by providing access to low-cost and long-term financing, including accepting alternative forms of collateral. This is illustrated by Bangladesh's bonded-warehouse system, which allows local producers to import fabric with deferred payments until after sales are finalized.²⁸⁹ As 75 percent of the products are inputs that have to be imported, the bonded-warehouse system makes it possible for entrepreneurs to set up businesses with only 25 percent of the capital.

Second, governments should facilitate access to credit for foreign and domestic exporters, or exports destined to a market other than the United States or the European Union. Another way would be to enable local firms to use export-credit facilities, which could help these firms meet the costs associated with exporting to E.U. or U.S. markets, such as costs involved in conforming to market requirements.²⁹⁰ The absence of credit facilities has proven to be a real obstacle in Madagascar, where only 3 percent of exporters report having received a bank loan, compared to 70 percent in Bangladesh.²⁹¹

Third, a government should try to balance promoting foreign and domestic investment.²⁹² At a minimum, and as demonstrated by Sri Lanka and Bangladesh, this should involve applying the same incentives provided to foreign investors in EPZs to local firms.²⁹³ While extending tax exemptions to local business could deprive the government of much-needed tax revenues, extending these benefits only to local business that meet certain minimum requirements will minimize the cut in the tax revenue.

289. Savchenko, *supra* note 236, at 215.

290. Christopher Onyango & Moses Ikiara, *Reflections on Kenya's Experience Under AGOA: Opportunities and Challenges*, in *IMPROVING AGOA: TOWARD A NEW FRAMEWORK FOR U.S.-AFRICA COMMERCIAL ENGAGEMENT* 25, 26, 34 (Africa Growth Initiative at Brookings, 2011), http://www.brookings.edu/~media/research/files/reports/2011/6/01%20improving%20agoa/0601_improving_agoa.pdf.

291. Staritz & Morris, *supra* note 102, at 14.

292. *Id.* at 6-7.

293. Jayawickrama & Thangavelu, *supra* note 220, at 253.

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Fourth, local firms can be promoted by establishing structures that encourage collaboration between foreign suppliers and local firms.²⁹⁴ Especially in some African countries, firms in EPZs are disconnected from the value chain and only marginally integrated with local firms.²⁹⁵ This is the result of EPZ-specific policies that tend to see the EPZ as a separate ecosystem.²⁹⁶ Instead, countries should promote interaction between EPZs and local firms by encouraging local investment in EPZs, the transfer of domestic labor to the EPZs, and the use of domestic inputs.²⁹⁷ Sri Lanka has successfully encouraged such linkages by providing tax reductions to joint ventures between foreign and local firms, while Bangladesh has done so by making foreign investment conditional on establishing local linkages and local input.²⁹⁸

While keeping these options in mind, it is important to note that domestic content requirements for goods are not allowed under the WTO's Trade Related Investment Measures (TRIMS) Agreement, in addition to some bilateral investment agreements.²⁹⁹ This would mean that requiring inputs to be supplied from domestic enterprises as a condition for investment would not be in line with the TRIMS Agreement.³⁰⁰ In practice, governments can avoid WTO-inconsistency by attaching incentives to the use of local inputs rather than requiring a percentage by law. Local content restrictions under TRIMS do not extend to services and employment, unless they are prohibited through commitments made in the General Agreement on Trade in Services (GATS). This means that governments are legally allowed under the WTO to include local content provisions to maximize local employment opportunities. This may include provisions that require, all else being equal, priority given to nationals when recruiting workers, or provisions that specify percentage targets for local nationals, differentiated by category of employment (e.g., unskilled labor, and managerial positions), or through featuring on-the-job training requirements, including through minimum annual financial commitments.³⁰¹

Whatever methods are employed, it is worth pointing out that a government should aim to balance policies that stimulate promoting the domestic industry with those that attract foreign investors. If policies are collectively so cumbersome that they offset market advantages, foreign investors may look to invest in countries with less burdensome regulations, such as Cambodia, which allows 100 percent foreign ownership without conditions attached.

2. *Incentivize the Creation of Backward Linkages*

Another way for developing countries to proactively engage in industrial upgrading and move towards a sustainable apparel industry is through policies that support backward

294. John Page, *Can Africa Industrialise?*, 21 J. AFR. ECON. AERC SUPP. 86, 115-18 (2012), http://jae.oxfordjournals.org/content/21/suppl_2/ii86.full.pdf+html.

295. *Id.* at 118.

296. *Id.* at 116.

297. *Id.*

298. Savchenko, *supra* note 236, at 221, 442-43.

299. Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 186 [hereinafter TRIMS Agreement].

300. *Id.*

301. LORENZO COTULA, INVESTMENT CONTRACTS AND SUSTAINABLE DEVELOPMENT 47-48 (2010).

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linkages, whether local or regional.³⁰² Bangladesh was able to upgrade from CMT to full-packaging supply mainly because of its textile industry, while Sri Lanka developed backward linkages with regional textile industries in India and Bangladesh, which ultimately facilitated upgrading.³⁰³

Whether a country is attempting to revive a defunct textile industry, like Kenya, or build a new one based on domestic cotton production, the development of a vibrant textile industry generally requires significant investment—either from the government or the private sector.³⁰⁴ In Bangladesh, the government subsidized the textile industry by providing electricity reductions, support on land, infrastructure, and interest rates.³⁰⁵

Another way to create backward linkages is through incentivizing local sourcing. For example, Bangladesh provides a 25 percent cash incentive to apparel firms that use locally-produced inputs in their exports.³⁰⁶ Yet another way to do this would be through encouraging better regulation of the textile industry and by setting up an apex organization to coordinate between garment and textile producers and the private and public sector.³⁰⁷ As demonstrated by Kenya's failure to regenerate its dormant textile mills, a coordinated body that oversees seed quality and pesticides and provides a credit-system is critical for well-functioning textile industry.³⁰⁸

For many developing countries, creating a textile base may be infeasible or an undesirable use of public resources given the cost. Some have even questioned whether Bangladesh's heavily subsidized textile production presents a desirable model for self-sufficiency, given the facts that Bangladesh lacks a cotton base and the costs of capital are high while scales of operation are low. While a domestic textile base may be unfeasible, Sri Lanka and Madagascar provide examples that strong linkage with regional textile suppliers can also lead to industrial upgrading. In Madagascar, vertical integration with Mauritius has resulted in the closure of all but one of Madagascar's textile mills, yet the alternative of a heavily subsidized and uncompetitive domestic textile industry may not have been a sustainable strategy either. While backward linkages are a feature of a well-integrated industrial base, the extent to which a country should invest its resources is heavily dependent on country-specific factors.

3. *Promote Product and Process Upgrading*

Governments also need to encourage industrial upgrading, including both product and process upgrading. They can do this by setting up specific skill-training programs, identifying new niche areas/products to develop, and through advertising and marketing these new products.

Product upgrading requires investment technology as well as an industry-wide promotion strategy. For example, Sri Lanka in its Five-Year Plan set out a deliberate and comprehensive strategy for moving from a manufacturing hub to becoming a provider of fully

302. Kaplinksy & Wamae, *supra* note 59, at 28.

303. Fernandez-Stark, *supra* note 94, at 28, 33.

304. Phelps et al., *supra* note 144, at 321.

305. Tewari, *supra* note 205, at 49-50.

306. *Id.*

307. *Id.* at 41.

308. *Id.* at 49.

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integrated services. More specifically, Sri Lanka shifted away from undifferentiated commodities like knitwear and T-shirts to higher value production for niche markets like intricate embroidery and stitch embellishment, and is known as the world's "lingerie capital."³⁰⁹ Madagascar has also managed to establish niche expertise in embroidery and stitching, allowing modest product upgrading. In Madagascar's case, however, this upgrading was less of a result of government policy than of private strategy. Other examples of potential specialty products would include investing in organic or environmentally-friendly products (made from organic cotton or environmentally-friendly cotton varieties).³¹⁰

Conscious consumption of a country's specialty products needs to be promoted, requiring investment in product innovation, branding developments, and the cultivation of markets and buyers for different niche products.³¹¹ Developing countries could increase visibility of their specialties by creating organizations to promote their wares.³¹² Again, Sri Lanka is exemplary in this regard.

A skill gap poses a major constraint to industrial upgrading. As such, for a developing country to successfully stimulate industrial upgrading in apparel, it is imperative to invest in basic education as well as specific skill training in technical and soft skills.³¹³ Training programs need to be developed to train the local workforce to gain managerial and supervisory skills in lines of Bangladesh's PROGRESS, but also to teach the workforce skills beyond CMT manufacturing, such as design and marketing.³¹⁴

One potential downside of investing in high-value apparel is that it could decrease employment as the industry consolidates and becomes more skill-oriented, requiring less labor at the lower echelons of the value chain. Again, developing country governments will have to consider their specific needs and capabilities in order to determine what strategy will be most beneficial for the development of a dynamic, domestic apparel industry.

B. REGIONAL LEVEL

Beyond their borders, developing countries should focus on creating stronger regional linkages, including both more intraregional investment and more vertical production linkages. These intraregional ties are critical to long-term sustainability because the resulting investments are generally more embedded and the diversification of end markets reduces foreign market dependency.³¹⁵

309. Ruwanpura & Wrigley, *supra* note 229, at 6.

310. Moses M. Ikiara & Lydia K. Ndirangu, *Developing a Revival Strategy for the Kenyan Cotton-Textile Industry: A Value Chain Approach*, 85 (KIPPRA, Working Paper No. 8, 2003).

311. PETER GIBBON & STEFANO PONTE, *TRADING DOWN: AFRICA, VALUE CHAINS, AND THE GLOBAL ECONOMY* (2005).

312. *Id.*

313. Fernandez-Stark, *supra* note 94, at 23-24; Page, *supra* note 294, at 109.

314. Fernandez-Stark, *supra* note 94, at 37.

315. A study by UNCTAD (2010c) supports the conclusion that "exports from Asian LDCs to other developing countries—which are mostly their neighboring countries—are higher in factor intensity," thus saying they may offer alternatives to upgrading. UNCTAD, *Integration of Developing Countries in Global Supply Chains, Including Through Adding Value to Their Exports*, ¶ 20, U.N. Doc. TD/B/C.I/16 (Mar. 12, 2011); Potential Supply Chains in the Textiles and Clothing Sector in South Asia, *supra* note 191, at 42.

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Currently, intraregional trade in SSA and South Asia is marginal at best.³¹⁶ Madagascar only began to export to South Africa when SADC reduced duties on imports from SADC countries and, similarly, Lesotho only began to export to South Africa after receiving a derogation on the SADC import tax. Sri Lanka, despite being part of the South Asian Association for Regional Cooperation (SAARC), exports less than one percent of its total apparel exports to South Asia.³¹⁷ In Kenya, only 10 percent of total sales took place in Kenya, and only 5.9 percent of apparel companies in EPZs exported to other African countries, compared to 73.7 percent for non-apparel exports.³¹⁸ Almost all of Cambodia's exports go to the U.S. market.

These low figures in intraregional trade can be explained by a number of factors. The small share of Lesotho's exports to South Africa was a result of SACU's high import tariffs. Lesotho and South Africa began to engage in apparel trade only after SACU introduced the Duty Credit Certificate, which provided a duty drawback scheme for imported clothing based on their export value.³¹⁹ Prior to this scheme, it was, ironically, cheaper to import textile and apparel to the United States under AGOA than to members of SACU as textile and apparel imports were subjected to a tariff of 40 percent.³²⁰ Similarly, intraregional trade in SAARC or under Sri Lanka's bilateral trade agreement with India is limited because of high tariff and quota restrictions that continue to be in place on textile and apparel goods. Furthermore, government policies extend more favorable tax exemptions to products traded outside of SSA regions than within. For example, the Central Bank of Lesotho provides credit guarantee assistance, more favorable domestic taxes, and a reduced corporate tax only to exporters exporting outside SACU, with only a 10 percent tax reduction for those exporting within SACU.³²¹

Developing countries that belong to an already established regional network may consider creating economic and political incentives to lower trade barriers and foster a greater volume of intraregional trade. At a minimum, developing countries should advocate for tariff reductions on textile and apparel products traded regionally and provide for more flexible ROOs. As long as regional import duties on textile and apparel are less favorable than preferences provided by the European Union or the United States, it will be very challenging to boost intraregional trade and create more industrial embeddedness.

Regional ties should also be fostered in generating vertical integration. For example, Africa has a large supply of cotton. Instead of importing all inputs from Asia, better regional cooperation could have Tanzania and Uganda supply cotton to Kenya, which has a comparative advantage in ginning the cotton given its history.³²² Alternatively, there should be more vertical arrangements such as exist between Madagascar and Mauritius, or Sri Lanka and India, whereby inputs are supplied by a trusted regional supplier, generating stronger regional linkages and enhancing industrial embeddedness.

Incentives to truly lower barriers in intraregional trade in many of the regions studied are lacking despite lofty aspirations and agreements. This is in part motivated by domestic

316. Savchencko, *supra* note 236, at 451-52.

317. *Id.*

318. Rolfe & Woodward, *supra* note 125, at 20.

319. Woolfrey, *supra*, note 114.

320. Edwards & Lawrence, *supra* note 34, at 11.

321. DINH, *supra* note 118, at 400.

322. Phelps et al., *supra* note 144, at 322.

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opposition from industry, as lowering intraregional trade barriers exposes the textile and apparel industry to increased competition from the region, which could significantly hurt a domestic industry, as was the case in Madagascar, which had to close most of its textile mills in part because of cheaper inputs from Mauritius.³²³ Similar reasons motivated Bangladesh's opposition to the EU's proposal to relax its ROOs and allow for regional cumulation to count toward the double transformation requirement. The Bangladeshi textile producers that worried about increased competition were the ones that led the opposition.

The difficulty to truly create free regional trading blocs in East Asia and SSA reflects remnants of the earlier debate between liberalists and protectionists. But as tariff barriers have been removed globally, failure to do so locally—despite some anticipated sector-specific losses—will keep the nascent apparel and textile industry in developing countries heavily dependent on developed countries' trade preferences and export market conditions. As such, countries are encouraged to lower intraregional trade barriers in apparel and textile through existing agreements like SADC and SAARC, and also through negotiating new agreements such as the Tripartite Free Trade Agreement between three of Africa's regional blocs (SADC, COMESA, and EAC)³²⁴ based on the mutual understanding that increased intraregional trade is imperative to building up a dynamic and sustainable apparel and textile industry in the region.

C. INTERNATIONAL LEVEL

Trade preferences and their accompanying ROOs are not sufficient for a developing country to embark on a path of sustainable economic development. Yet, as demonstrated by the case studies, they are critical to the future of the apparel industry in many developing countries. Madagascar and Sri Lanka illustrate that preferences, when taken away, can significantly reduce apparel exports, thereby decreasing a country's options of building up a sustainable apparel industry. Thus, developed countries should continue to give out trade preferences to developing countries and, where possible, lower restrictive ROOs requirements to enable a larger number of developing countries to utilize the preferences.

However, this Article has demonstrated that trade preferences per se do not provide incentives to developing countries to build up a viable domestic industry. The focus of the international community with respect to ROOs should reflect this. While this does not call for a change in preference programs—preferences programs have been and continue to be a key catalyst for market access in the apparel sector—it instead calls for a comprehensive dialogue that recognizes that without complementary and balanced industrial policy, the preferences will not help a developing country to sustainable growth. The international community should begin to focus on how, if at all, it can best assist developing country governments build up sustainable domestic apparel industries.

One way to do so would be through starting consultation sessions with government officials and the private sectors in preference-receiving countries. For example, countries eligible to receive trade preferences could be required to present a strategic industrial plan to the preference-giving country or international organization like UNCTAD, which

323. Staritz & Morris, *supra* note 102, at 23.

324. *Africa's Largest Free Trade Area Set to Launch in December*, INT'L CTR. FOR TRADE & SUSTAINABLE DEV. (Oct. 30, 2014), <http://www.ictsd.org/bridges-news/bridges/news/africa%E2%80%99s-largest-free-trade-area-set-to-launch-in-december>.

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would provide feedback on the plan's sustainability for purposes of domestic value creation, as well on the compliance of some of the proposed policies with international standards. In doing so, developing countries should be encouraged to collaborate with economists who can help identify dormant comparative advantages and engage in a dialogue with the private sector to increase their understanding of both the opportunities for rapid growth and regulatory and other bottlenecks. Preference-extending governments could facilitate such strategic thinking and planning through, for example, expanding on initiatives such as the USAID Trade Hubs. Under this initiative, some AGOA beneficiaries received help in developing National Investment and Export Strategies designed to identify comparative advantages and market gaps in order to boost exports under AGOA.³²⁵ While this is a start, it would be imperative for such advisory hubs to alter their focus from being exclusively export-oriented to comprehensive and balanced industrial policy engagement that include incentivizing domestic growth. While these initiatives may not have any direct effects on a country's industrial policy absent enforcement mechanisms, they will, at a minimum, encourage government officials to think about the long-term consequences of the industrial policy they have (or do not have) in place.

Additionally, the international community could support and motivate efforts to assist developing countries to establish the institutions or mechanisms that will help generate local entrepreneurship in the apparel sector. One way to do this is to support industry specific skill-training programs like Bangladesh's PROGRESS, or assist a country to set up a credit rebate system as Bangladesh has done through their bonded-warehouse system. In addition to funding some of these initiatives, the international community could also tie trade preferences eligibility to demonstrating the existence of training programs for the workforce, in light of the Better Factories Cambodia trade agreement.

Finally, as demonstrated by this Article, the link between market access and industrial policy is tenuous at best. The international community should start to think about a new model that consciously links market access, whether enabled through trade preferences, trade agreements or bilateral investment treaties, to a country's industrial focus and strategy and, as a result, allows developing countries to gain more local economic benefits from trade. What exactly such a framework should look like has to be explored in another Article, but at a minimum, the international community should be open to consider alternative models of trade and development.

VIII. Conclusion

This Article has demonstrated that trade preferences alone are insufficient to determine whether developing countries will translate access to the textile and apparel value chain into the development of a sustainable local apparel industry. The six countries studied all developed their export industries in part as a result of trade preferences, most of them from both the European Union and the United States. When solely looking at apparel export volumes, these countries are all success stories. Yet while preferences delivered in increasing trade, they did not in all cases generate development. At most, three of the six countries studied—Bangladesh, Sri Lanka, and Madagascar—may be considered to have

³²⁵ LEADERSHIP AFRICA USA/NEW MARKETS LAB, ISSUES AND OPPORTUNITIES FOR DISCUSSION: AGOA'S REAUTHORIZATION: BEYOND 2015, at 12 (2015).

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been (relatively) successful in translating the opportunity into local industrial development, while Lesotho, Cambodia, and Kenya have remained stuck at lower levels of value-added and industrial upgrading. While trade preferences are an enabler, factors like firm embeddedness, regional integration, and proactive industrial policies that balance a focus on developing an export-industry with establishing a domestic apparel basis have proven to be imperative in dictating a country's level of sustainable apparel development.

Based on these findings, this Article has put forth policy options for preference-receiving countries to consider. At a national level, developing country governments should aim to adopt a balanced industrial strategy that, in addition to encouraging foreign investment, reduces access barriers for local apparel producers and entrepreneurs, encourages backward linkages—either domestic or regional, strengthens public-private cooperation, and follows a strategy to engage in industrial upgrading and development of expertise in niche products. At a regional level, it is critical for developing countries to create stronger linkages and promote intraregional trade and investment flows. Lowering intraregional tariff barriers and cumbersome ROOs would be a prerequisite to accomplish this. At an international level, it is important to maintain trade preferences with flexible ROOs, but to recognize that they are not a panacea for sustainable development. The international community could do more to communicate this message and to provide assistance to developing countries by providing them with feedback on their strategic plans in addition to program-specific development assistance.

Balancing export-oriented programs and programs that incentivize local firms to participate in the apparel and textile value chain may not be easy to achieve. This is in part because of the inherent tension between short-term gains, which stem from an outward-looking economy, and long-term economic gain. Encouraging local ownership through making tax benefits conditional on creating a joint venture with a local firm may generate more industrial sustainability but may also drive away foreign investors who think such conditions may hurt their profit margins. This is especially the case when investors have options: when foreign investors are motivated by little more than trade preferences and cheap labor, and one developing country's manufacturing sector is undifferentiated from another, alternatives are easily found. In other words, developing countries need to engage in a careful balancing act between policies that attract foreign investors and policies that encourage the development of the local industry, as a shift too far to either side could upset the balance and risk losing everything.

Moreover, not all proposed policies will provide direct gains for a country's domestic apparel industry, and some may even result in losses. For example, increased regional integration results in more competition and may lead to closure of textile mills that are uncompetitive compared to textile inputs from a regional country. The same can happen for manufactured products: if imported apparel products are cheaper than apparel goods produced in the importing country, the apparel industry in that country will become uncompetitive. Again, here we see that measures that could lead to more sustainability in a country's apparel sector could simultaneously hurt the domestic apparel industry.

This problem goes to the heart of the earlier debate of liberalism versus protectionism. Liberal measures—exemplified by trade preferences with unrestrictive ROOs—provide a country with few industrial capabilities trading opportunities they otherwise would not have. This boosts the local economy by leading to an increase in GDP and by providing employment. Nevertheless, as the domestic apparel industry in many developing coun-

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tries has not been able to reach levels at which it can compete internationally, open borders do not automatically stimulate the development of a country's local industry, and may even undermine it. To avoid total dependency on international markets, developing countries are encouraged to engage in an industrial strategy that proactively stimulates domestic apparel industries while continuing to attract foreign investment—a balanced industrial policy.

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