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The expansion of textile and clothing firms of China to Asian Least Developed Countries: The Case of Cambodia

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Executive summary

Since the 1990s, the rapid expansion of China's textiles and clothing enterprises to Cambodia has been closely linked to the phenomenon of industrial clustering of textiles and clothing firms at the Yangtze River Delta, Pearl River Delta and Bohai Rim. The report adopts the case study approach to examine the pattern and features of overseas foreign direct investment (OFDI) of textile and clothing firms in Zhejiang province and Jiangsu province of the Yangtze River Delta to the least developed countries (LDCs) in the Asian and Pacific region, particularly Cambodia, and make the corresponding policy suggestions on the sustainability of South-South investment and cooperation.

The fieldwork in Zhejiang province for this study showed that the subsidiaries of Chinese textile and clothing firms in Cambodia had been gradually integrating into the vertically-integrated value chain of textile and clothing firms in China, thereby becoming an important node in global textile and clothing value chain. Interviews (see annex 1) by the authors in the Yiwu specialized wholesale market indicated that business linkages between the specialized wholesale market and the Asia-Pacific LDCs have been developing fast in the past decade, although the ratio of businessmen from the Asia-Pacific LDCs is relatively limited compared with those from the LDCs in Africa. The internationalization of specialized wholesale markets has promoted commercial activities between China and LDCs in the Asia-Pacific region and led to an increase of OFDI from Chinese textile and clothing firms to LDCs.

The fieldwork in Jiangsu province has demonstrated that Chinese textile and clothing firms have started to change their investment behaviour from voluntary overseas expansion by individual firms to the establishment of overseas economic and trade cooperation zones, such as Sihanoukville Special Economic Zone (SSEZ) (see annex 2) in Cambodia, which facilitates the collective expansion of Chinese textile and clothing firms and improves the textile and clothing manufacturing capability in Cambodia.

The OFDI from China to LDCs has not had a great impact on local employment. However, the global financial crisis has led to a rising number of unemployed textile and clothing workers in China. The factors constraining sustainable OFDI from China in Cambodia include poor infrastructure, relatively high labour costs compared with other LDCs, low efficiency of government assistance and inadequate financial services.

The policy suggestions on facilitating sustainable investment from China to the LDCs from the perspective of Cambodia are to: (a) encourage OFDI by Chinese textile and clothing firms in overseas economic and trade cooperation zones in the Asia-Pacific LDCs; (b) forge the regional production network between China and the LDCs; (c) upgrade the financial package to support Chinese textile and clothing firms' FDI; and (d) improve the infrastructure facilities and government efficiency in the LDCs.

Introduction

According to the United National Conference on Trade and Development (UNCTAD), the South-South FDI increased from US$ 2 billion in 1985 to 60 billion in 2004 (UNCTAD, 2006). The multinational companies from the South have become important investors in the LDCs. The LDCs that have the highest dependence on FDI from developing and transition economies include Cambodia, Bangladesh, Ethiopia, the Lao People's Republic, Myanmar and the United Republic of Tanzania (Fredriksson, T., 2008).One important phenomenon resulting from recent economic globalization has been the large-scale relocation of certain production processes to developing countries. Although the textile and clothing clusters in China can still take advantage of cheap land and low-cost labour, labour costs are nonetheless on the rise. At the same time, the clustered firms have to deal with more and more anti-dumping allegations and the appreciation of the Chinese currency as part of the globalization process. Some textile and clothing firms in the cluster have taken collective action by establishing overseas industrial parks in least developed countries (LDCs) to avoid the trade barriers and expand their production. For example, Chinese enterprises signed contracts with Cambodia for labour services and design consultation totalling US$ 380 million in 2005, US$ 320 million in 2006 and US$ 560 million in 2007, respectively. By the end of 2007, they had signed labour services, design and consultation contracts totalling US$ 1.97 billion, with a total realized turnover of US$ 860 million (Xinhua News, 2008).

However, few studies have been carried out on the formation of a production network between China and the LDCs in the Asian and the Pacific region in terms of the increasing intraregional FDI, the role of industrial parks that promote the sustainable FDI from China to the LDCs and the benefits arising from south-south FDI. More research needs to be done on the inclusive development of the LDCs with the deepening south-south cooperation between those countries and China.

Currently, OFDI by textile and clothing firms in China has mainly been made in Bangladesh, Cambodia, Myanmar and Viet Nam as well as some African countries such as Nigeria. This report focuses on the Sino-Cambodia economic linkage because Cambodia has overtaken Viet Nam as the best investment destination for Chinese textile and clothing enterprises in the Asia-Pacific region in recent years. After 10 years of development, Viet Nam has established its own economic system. Because it does not belong to the LDC group, the United States and European Union impose import tariffs and quotas on textile and clothing imports from Viet Nam. Due to border disputes, the Sino-Viet Nam relationship remains unstable. In addition, the financial instability of Viet Nam in June 2008 affected the confidence of Chinese investors.

This report deals with the following three research questions:

(a) How are the firms in Chinese textile and clothing clusters making the spatial expansion to the LDCs in the Asian and Pacific region, particularly Cambodia?
(b) How can the governments of LDCs in Asia and the Pacific improve their investment environment in order to make south-south investment sustainable?
(c) What effective means exist for facilitating the integration of the textile and clothing industry in China and LDCs into the global value chain (GVC)?

I. Change in the global textile and clothing regime, and its impacts on China and least developed countries in Asia and the Pacific

A. Evolution of the global textile and clothing trade regime

Under the auspices of the General Agreement on Tariffs and Trade (GATT), in 1962, the developed countries and developing nations reached a Long-Term Arrangement Regarding International Trade in Cotton Textiles and Substitutes. In 1974, it was replaced by the Multi-Fibre Arrangement (MFA).

1. Multifibre Arrangement, 1974-1994

The MFA provided for the application of selective quantitative restrictions when surges in imports of particular products caused, or threatened to cause, serious damage to the industry in the importing country. It was an explicit attempt to protect developed country producers by restricting exports of textiles and clothing from developing to developed countries. Theoretically, it sought to provide temporary protection to textile and clothing firms in developed countries to enable them to undertake the necessary changes for competing against lower cost producers in developing countries. In practice, the MFA not only provided an effective framework for extending the protected position of garment manufacturers in developed countries, but also gave some LDCs preferential quota access to the leading markets around the world. However, the MFA was a major departure from the basic GATT rules, particularly the principle of non-discrimination (World Trade Organization, 2008).

2. World Trade Organization Agreement on Textiles and Clothing, 1995-2004

On 1 January 1995, the MFA was replaced by the World Trade Organization (WTO) Agreement on Textiles and Clothing (ATC), which sets out a transitional process for the ultimate removal of quotas outside GATT rules. The 10-year transitional programme has been applied in four stages under the agreement, allowing those countries affected by the MFA to make adjustments to a new “free trade” environment. It was designed to terminate the series of trade-distorting regimes that had governed the textile and clothing trade over some four decades.

3. **Post-**Agreement on Textiles and Clothing **era, 2005-present**

On 1 January 2005, all special quotas on textile and clothing were finally eliminated for WTO member countries. However, there is still a mixed picture in textiles and clothing trade in a quota-free environment (Mayer, 2005).

B. Development of the textile and clothing industry in China in the post-Agreement on Textiles and Clothing era

In the post-ATC era, China remains a major players in the global textile and clothing industry, accounting for 22.3 per cent of world textile exports and 30.6 per cent of world garment exports in 2006 (tables 1 and 2). In 2005, China signed Memoranda of Understanding with the United States of America and the European Union on restricting the rapid growth of Chinese textiles and clothing exports to these markets; however, in 2005, 2006 and 2007, overall exports of textiles and clothing from China to the world increased by 21 per cent, 25 per cent and 18.9 per cent, respectively (World Trade Organization, 2008).

However, the textile and clothing firms in China still face many challenges including industrial upgrading and new forms of trade protectionism. Although a large number of labour-intensive clustered firms have strong international competitiveness, they rely principally on low-price competition. The constant low-price competition not only affects the bargaining power associated with export earnings, but has also resulted in constant international trade friction over Chinese textile and clothing exports from both developed and developing countries since 2005. Therefore, more and more textile and clothing firms in China have chosen to make OFDI in other developing countries including the Asia-Pacific LDCs.

Table 1. Leading exporters of textiles, 2007

(Units: US$ billion and percentage)

Exporters	**Value**	**Share in world exports**			
	2007	**1980**	**1990**	**2000**	**2007**
European Union (25)	80.62	-	-	36.2	33.9
Extra-European Union (25) exports	23.72	-	-	9.9	10.0
China[a]	55.97	4.6	6.9	10.3	23.5
Hong Kong, China	13.42	3.2	7.9	8.6	5.6
Domestic exports	0.46	1.7	2.1	0.8	0.2
Re-exports	12.95	1.6	5.8	7.8	5.4
United States	12.39	6.8	4.8	7.0	5.2
Korea, Republic of	10.37	4.0	5.8	8.1	4.4
Taipei, Chinese	9.72	3.2	5.9	7.6	4.1
India	9.45	2.4	2.1	3.6	4.0
Turkey[b]	8.73	0.6	1.4	2.3	3.7
Pakistan	7.37	1.6	2.6	2.9	3.1
Japan	7.11	9.3	5.6	4.5	3.0
Indonesia	3.83	0.1	1.2	2.2	1.6
Thailand	3.11	0.6	0.9	1.2	1.3
Canada	2.32	0.6	0.7	1.4	1.0
Mexico[a]	2.21	0.2	0.7	1.6	0.9
United Arab Emirates[b]	4.02	0.1	0.0	2.0	1.7
Total for above 15	**217.67**	**-**	**-**	**91.7**	**91.4**

Source: World Trade Organization, 2008

[a] Includes significant shipments through processing zones.

[b] Includes Secretariat estimates.

Table 2. Leading exporters of clothing, 2007

(Unit: US$ billion and percentage)

Exporters	Value	Share in world exports			
	2007	1980	1990	2000	2007
China[a]	115.2	4.0	8.9	18.2	33.4
European Union (25)	103.4	-	-	28.4	29.9
Extra-European Union (25) exports	24.8	-	-	6.5	7.2
Hong Kong, China	28.8	12.3	14.2	12.2	8.3
Domestic exports	5.0	11.5	8.6	5.0	1.4
Re-exports	21.7	0.8	5.7	7.2	7.0
Turkey[b]	14.0	0.3	3.1	3.3	4.1
India	9.7	1.7	2.3	3.0	2.8
Bangladesh[b]	10.1	0.0	0.6	2.1	2.8
Mexico[a]	5.1	0.0	0.5	4.4	1.5
Indonesia	5.9	0.2	1.5	2.4	1.7
United States	4.3	3.1	2.4	4.4	1.2
Viet Nam[b]	7.2	...	...	0.9	2.1
Romania	4.4	...	0.3	1.2	1.4
Thailand	4.1	0.7	2.6	1.9	1.2
Pakistan	3.8	0.3	0.9	1.1	1.1
Morocco[a]	3.6	0.3	0.7	1.2	1.0
Tunisia [b]	3.6	0.8	1.0	1.1	1.0
Sri Lanka [b]	3.3	0.3	0.6	1.4	1.0
Total for above 15	**298.1**	**-**	**-**	**79.2**	**86.3**

Source: World Trade Organization, 2008.

a Includes significant shipments through processing zones.

[b] Includes Secretariat estimates.

C. Textile and clothing industry development in Asia-Pacific least developed countries in the post-Agreement on Textiles and Clothing era

The textile and clothing industry play a very significant role in the economic development of some LDCs in the Asia-Pacific region, which account for 37 per cent of the world's total LDC population. It was widely predicted that the main winners would be the larger exporting countries, such as China and India, which were previously constrained by quotas; the losers were expected to be some of the smaller countries that took advantage of quotas within the MFA after the removal of all special quotas on textile and clothing (United Nation Development Programme, 2006). However, following the termination of the quota regime in 2005, the situation has not been so clear-cut among LDCs in Asia and the Pacific.

Some LDCs in the Asia-Pacific region, such as Bangladesh and Cambodia, have increased their ready-made garment (RMG) exports to the developed countries since the termination of ATC. In terms of value and volume, Bangladesh's RMG exports grew by 35.4 per cent and 37.4 per cent in 2005, and 32.0 per cent and 31.87 per cent in 2006, respectively (table 3). Cambodia also maintained significant growth of garment exports to the United States, with its RMG share in the United States rising from 2 per cent in 2003 to

2.9 per cent in 2006 (Yamagata, 2007). Nonetheless, Bangladesh is likely to face fiercer price competition in the United States market, particularly in the woven garments segment, which accounts for more than 60 per cent of its total garment exports(table 4). Meanwhile, Bangladesh is still facing funding and implementation constraints in improving its infrastructure, which is essential to attracting additional FDI and strengthening its competitiveness (World Trade Organization, 2006).

Table 3. Growth of ready-made garment exports from Bangladesh, 2000-2006

(Unit: Percentage)

Year	Value	Volume
2000	17.8	15.90
2001	-2.5	20.80
2002	13.3	9.10
2003	29.9	32.40
2004	31.3	31.10
2005	35.4	37.40
2006	32.0	31.87

Sources: Export Promotion Bureau of Bangladesh; and International Monetary Fund, 2007.

Table 4. RMG shares of some Asian low-income countries in the European Union and United States markets, 2003-2006

	European Union				United States			
	2003	2004	2005	2006	2003	2004	2005	2006
Bangladesh	6.6	7.5	6.6	7.7	2.8	2.8	3.2	3.8
Cambodia	0.9	1.0	0.9	0.9	2.0	2.1	2.4	2.9
India	5.0	5.0	6.0	6.3	3.3	3.4	4.3	4.4
Pakistan	1.7	1.8	1.4	1.5	1.6	1.7	1.8	1.9
Sri Lanka	1.5	1.6	1.5	1.6	2.3	2.3	2.3	2.3
Viet Nam	1.1	1.3	1.3	1.7	3.7	3.7	3.8	4.3

Sources: Eurostat; United States Department of Commerce; and International Monetary Fund, 2007.

However, some smaller LDCs, such as Nepal and Maldives, were affected severely by the removal of quotas in 2005 due either to being landlocked or small island economies, or to supply-side problems. Foreign investors relocated production bases after the expiry of quotas. For example, Nepal's textile and clothing exports in 2005 and 2006 to the European