The impact of the Africa Growth and Opportunity Act and the phasing out of the Multi Fibre Agreement on the Mauritian economy.

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Abstract

The preferential market access Mauritius has benefited from the Multi Fibre Agreement (MFA) has been determinant in the development of the Export Processing Zone (EPZ) and the Mauritian economy. However, with the thrust towards an increasingly liberal world market, the preferential market access has been under threat as Mauritius has been called upon to compete on an equal footing with lower cost countries. Under such circumstances, the Africa Growth and Opportunity Act (AGOA) could not have been enacted at a more opportune time. The Act has the potential to overcome most of the losses Mauritius is likely to sustain in the wake of the phasing out of the MFA in December 2004. The island thus needs to adapt to the exigencies of the new economic era. The process of vertical integration within the textile industry should thus be accentuated, as should the thrust for higher value addition and productivity. This paper provides an analytical discussion of the impact of AGOA and the phasing out of MFA on the Mauritian economy. Data limitations, however, do not allow a quantitative assessment of this impact which is of a hypothetical nature.

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* *The views expressed herein are those of the author and do not necessarily reflect those of the Bank.*

List of Abbreviations

AGOA	African Growth and Opportunity Act
EPZ	Export Processing Zone
EU	European Union
FTA	Free Trade Area
FTAA	Free Trade Area of the Americas
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GSP	General System of Preferences
LDC	Less Developed Country
MFA	Multi Fibre Agreement
RMA	Reciprocal Market Access
SACU	South African Customs Union
SSA	Sub Saharan Africa
US	United States (of America)
WTO	World Trade Organisation

1.0 Introduction

The transition of Mauritius from a less developed monocrop economy to a middle-income developing economy with a diversified economic base owes much to the development strategy pursued since independence. Indeed, once it became clear that the import substitution strategy was not yielding the expected benefits, the country embarked on an outward-looking export-led growth strategy. Taking into consideration the constraints of the domestic market, the government came up with the Export Processing Zone (EPZ) Act and the first industrial zones were set up in the early 1970s.

Operating in an economy plagued by structural constraints and due to adverse international events emanating from the oil shock, the performance of the EPZ remained morose for most of the 1970s.The EPZ eventually took off in the mid 1980s and an unprecedented period of economic growth and development ensued. The credit for the development of the EPZ may be attributed to a combination of factors. On the local side, the array of business friendly policies provided by the government, stable industrial relations and the availability of a competitive labour pool were major factors in attracting investors to catalyse the industry in its embryonic stages.

Nevertheless, being a small open island economy with no bearing on the international arena, international events were and remain of significant importance for Mauritius. As such, the unique advantage Mauritius had under the Lomé convention also played an important part in attracting investors in the EPZ sector since Mauritian exports benefited from duty-free and quota-free access to the European market whilst other developing countries had quotas and tariffs imposed on their exports. Moreover, the scheduled retrocession of Hong Kong to China also led to some of the parting investors to invest in Mauritius.

Thus, a combination of local factors and international developments enabled the creation of mass employment and boosted exports significantly, thereby delivering economic betterment and prosperity. As at December 2002, 506 companies operated in the EPZ. At the same point in time, the EPZ's contribution to the economy stood at approximately 11.3 percent of GDP. It also accounted for 63.8 percent of exports and 17.8 percent of employment.

2.0 The evolution and structure of the EPZ sector

The evolution of the EPZ can be summarised in four phases:

1. The setting up in the early 1970s.
2. Its stagnation till the early 1980s.

3. The EPZ boom of the mid and late 1980s.
4. The slowdown of the 1990s.

Some of the main features of the EPZ sector are highlighted below:

1. Most of the initial investments were undertaken by foreigners
2. Over time, there has been a tendency for Mauritian investors to buy shares from foreigners in the local companies. Local investors now own majority shares in quite a few of the companies
3. Government has mostly played the role of a facilitator by developing industrial parks and providing incentives.
4. Textile mills with vertically integrated processing from spinning to weaving and knitting exist but mostly in the woollen sector (operators include Ferney Spinning Mills Ltd and Independent Spinning Mills Ltd). The Novel Group is the only fully integrated textile unit for cotton – but this is mostly for denims.
5. In the initial phases, the tendency was for firms to specialise in garmenting. Over time, some extent of backward integration has taken place in the textile sector by some of the big garmenting firms – mostly in the woollen sector.
6. Given the small size of the Mauritian market and the very nature of EPZ companies, firms have produced almost exclusively for exports.

By the end of the 1990s, there was a general sense of apprehension that the EPZ was running out of steam in that foreign direct investment (FDI) was at an all time low and companies were closing down or downsizing their workforce. This deceleration can be partly attributed to the fact that the preferential market access enjoyed by Mauritius, which had been very important during the embryonic stages of the EPZ, was subject to gradual erosion in the wake of the geopolitical changes that redefined market access rules.

The textile and clothing sector lies at the core of the EPZ. In 2002, 25 companies in the apparel sector closed down whilst 9 new ones came into operation. As at December 2002, the apparel sector employed 72,034 people whilst the textile sector accounted for 4,536 jobs – representing a combined employment of nearly 88 percent of the EPZ (and 15.6 percent of the national employment).

Since its inception, the textile and clothing sector has maintained the same type of workflow and manufacturing programme. However, with the emergence of low cost producers on the one hand and the loss of productivity growth coupled with rising costs of production on the other, it was no longer competitive to engage in labour-intensive production in Mauritius. To counter increased costs of production, prior to the political upheavals in Madagascar, many of the big EPZ companies had found the optimal production mix by maintaining the first phases in Mauritius and transferring

the labour intensive confectioning to Madagascar to benefit from cheaper labour costs.

The fact that the industry maintained the same production pattern throughout those years is largely attributable to the fact that the main concern was to satisfy the rules of origin and thereby enjoy preferential market access to the European market under the Lomé convention. As such, the easy market access has to some extent inhibited further vertical integration in the textile and clothing industry.

With the fall in tariff and non-tariff barriers, Mauritian firms are being subject to further competition in an increasingly liberal market. Firms that have maintained their archaic production methods have been forced to restructure or close down. The fact that some of the existing companies are burdened with a high debt-equity ratio, which in turn is constraining their ability to modernise their plants, is weighing heavily on their competitiveness. This has resulted in job losses in the sector despite the fact that some of the people have been able to get jobs in the same sector. Nonetheless, since a majority of those people cannot be easily retrained, most of them have remained unemployed. Layoffs by EPZ firms over the past couple of years have resulted in unemployment taking the upward trend and latest unemployment figures tend to suggest that the unemployment rate stands at nearly 10 percent. Over the period 2000 – 2002, 73 factories closed down resulting in nearly 8600 job losses. For the first quarter of 2003, 4 factory closures resulted in 1745 job losses. In a bid to maintain their competitiveness, some big firms are contemplating relocating their activities in neighbouring countries. Such a situation may possibly give rise to further job losses in the apparel sector in the short to medium term.

3.0 The Africa Growth & Opportunity Act[1]

The Africa Growth and Opportunity Act (AGOA), which was enacted on 23 May 2000, is being considered as a panacea for the Mauritian apparel industry. AGOA provides eligible countries from Sub Saharan Africa (SSA) exporting to the US with the opportunity to benefit from an average 17.5 percent customs duty advantage relative to non-African suppliers. However, to benefit from AGOA it is of utmost importance that strict rules of origins be adhered to. Some of the conditionalities to satisfy the rules of origin are summarised in Table 1.

[1] The legislation pertaining to AGOA refers to the "African Growth and Opportunity Act." However, the Act is more commonly referred to as the "Africa Growth and Opportunity Act". Henceforth, Africa Growth and Opportunity and the African Growth and Opportunity Act are used interchangeably.

Table 1: Eligibility Criteria

	Material	Country of Origin		Access	
				Duty Free	Quota Free
Case I	Cotton Yarn		**USA**	**X**	**X**
	Fabrics		**USA**	**X**	**X**
Case II	Cotton Yarn	**SSA**	**USA**	**X**	Subject to capping
	Fabrics	**SSA**		**X**	
Case III	Cotton and fabric for LDCs[2]	Not applicable		**X**	Subject to capping
Case IV	Sweaters of cashmere or of 18,5 micron or finer wool, knit-to-shape in SSA			**X**	**X**

Source: AGOA website (www.agoa.gov)

3.1 Eligibility criteria

To qualify for benefits under AGOA, countries have to satisfy a range of normative and subjective criteria. Among others, it is important for countries to pursue “right” economic and political policies: reduce poverty; fight corruption; protect human rights and the rights of worker; and eliminate child labour. On another note, it is also necessary to maintain an effective visa system; legislation to permit US Customs Service access to the countries of export; reportage provisions; full cooperation with the US; complete record keeping and reports on manufacturing capabilities.

Once a country meets these conditions, AGOA offers duty-free access to the U.S. market for African apparel items made of fabric and yarns originating either in the U.S. or in eligible sub-Saharan African countries. In March 2001, Mauritius became one of first two countries (the other being Kenya) eligible to benefit from the preferential market access under AGOA.

[2] Countries with GDP per capita of less that US$ 1500 are eligible to import fabrics from any region in the world until September 2004. This is also referred to as “third country fabric concession”.

Under the initial AGOA, by 2008, SSA exports were subject to a capping of 3.5 percent of the aggregate square meter equivalents of all apparel articles imported into the U.S. in the previous year. With AGOA II, this capping has been raised to 7 percent. This represents a formidable opportunity to raise regional exports to the United States. From a Mauritian perspective, another no less important amendment under AGOA II is the termination on 30 September 2004 and the non-extension to higher developed AGOA beneficiaries of the third country fabric concession.

3.2 Opportunities

Although there is no limit on the export volume of garments assembled in beneficiary African countries from fabrics wholly formed and cut in the U.S., the volume of duty-free African apparel exports to the U.S. made of fabric sourced from regional (African) or world markets is subject to quantitative limitation. From October 2000 through September 2001, this cap was equal to 1.5 percent. This was to be filled on a "first come, first served" basis from all eligible African countries. Under AGOA II, the capping has been doubled to 7 percent.

While the cap may at first glance seem quite low, Africa's apparel exports to the U.S. were an extremely small portion of total apparel imports in 2000 (0.6 percent). Thus the cap actually offers substantial growth potential from current levels. To put things in perspective, six countries (Kenya, Lesotho, Madagascar, Mauritius, Swaziland and South Africa) account for more than 90 percent of Africa's apparel exports to the US.

3.3 Implications for Mauritius

With tougher competition in the European market, AGOA can be the engine to drive the apparel exports of Mauritius. Subject to satisfying the rules of origin criteria, the duty free and quota free export possibilities are significant advantages that Mauritius is compelled to capture to ensure the competitiveness and survival of the textile and clothing sector.

Of the six countries mentioned above, four (Kenya, Lesotho, Madagascar and Swaziland) benefit from LDC Status. As such, they are eligible to source their yarn and fabrics from any region in the world until September 2004. Hence, they have a relative advantage over Mauritius in the sense that for Mauritian exports to benefit from duty free access to the US market, it is imperative that the yarn and/ or fabric be sourced in eligible SSA countries or US. The US option can be ruled out because of the relatively high transportation costs that would be involved. Since Mauritian producers have traditionally sourced their yarn and fabrics from Asia, AGOA may foster greater regional integration in SSA.

Given the fact that the Americans are among the most demanding buyers, relying on Africa as a source of raw materials may seriously jeopardise the aspiration of Mauritian exporters to capture the US market. Some of the main threats are:

- The African yarn is of medium quality and this is often reflected in the end product. This may inhibit the ability of Mauritian products to penetrate the American market;
- Improvements in the quality of yarn from Africa would be subject to lags since the current installed spinning capacity is outdated and productivity is poor.

Moreover, with the impending elimination of the third country concession, the demand for SSA yarn will increase manifold. Already, yarn of SSA origin is attracting a premium. With the expected increase in demand, the premium could increase further and this might crowd out the price advantage of Mauritian garments on the US market.

Given that the extent of vertical integration has been limited largely due to the fact that under the Lomé convention, a double transformation was sufficient to benefit from the rules of origin, the enactment of AGOA has, more than ever, made it imperative to further integrate the textile and clothing industry. More so, while most preferential trade agreements require a value addition to the tune of 35 percent, with AGOA laying emphasis on the origin of the raw materials, the conditionalities have become more stringent. Mauritius is further handicapped since, unlike other beneficiary countries, it is not in a position to exploit the third country fabric concession.

Based on the available figures for the first year of AGOA's existence, the emergence of the four LDCs along with Mauritius and South Africa can be noted. One of the main factors that explain the emergence of these countries is the third country concession that they are benefiting from until 2004. As such, massive investments have been undertaken in garmenting by Chinese firms in Lesotho, whereby they are only shipping the yarn and/ or fabric from China and doing the garmenting to qualify for AGOA benefits. Kenya is another country to have benefited massively from AGOA and the third country fabric concessions.

However, Mauritian exports have had to face the stringent rules of origin criteria – something that has prevented Mauritius from fully exploiting the benefits under AGOA. Another no less important factor is the ignorance by local exporters of the pipeline structure and behaviour of the U.S. clothing market as they have traditionally been "euro centric". Moreover, due to the administrative hassles over interpretation of the Act with the American customs, some major items of Mauritian exports, namely

the knit to shape – a sector where Mauritius has created a niche market - were refused duty free access[3]. This was a major blow to Mauritian exports.

Bearing in mind the new parameters that have been brought in the framework under AGOA, it is imperative for Mauritius to further backward integrate the textile and clothing industry by going into spinning. Over and above enabling the development of adequate supply capacity, it will help Mauritius to further consolidate its lead position in the region.

There remains some misinterpretation as to the fact that AGOA is basically concerned with textiles and apparel. There are nearly 6000 other products that are eligible under the GSP – which has been listed under AGOA. As such, there is the possibility of exporting other products duty free and quota free to the US under AGOA. Given the size of the island and the constraints on resources, it might not be feasible or it would be naive for Mauritius to consider too large an array of products for export under AGOA. The entrepreneurs should instead focus on those goods where they can create a niche. Some of the main products that Mauritius could focus on are jewellery and watches given that entrepreneurs already have some expertise in the manufacture of these. As such, this would help to further diversify the industrial base in the EPZ sector and shift to the light engineering sector where the value addition component is higher. It is of interest to note that Mauritius is emphasising the exports of higher value added products to the US that do not suffer from declining terms of trade as opposed to low skilled manufactured goods, which are being produced by other Sub Saharan nations, with declining terms of trade.

3.4 Backward integration: the way forward

Under the impetus of the Board of Investment and the proposed creation of the National Equity Fund, there has been much interest in the setting up of spinning units in Mauritius. Bearing in mind that spinning projects are very capital intensive, there are certain non-economic factors that influence the decisions of the promoters. Among others, there is a need for socio-political stability so that the investors feel secure about their investments. Given the excellent ratings of Mauritius, various promoters are considering the island as an investment destination.

[3] In a setback to Mauritian exports to the U.S., a sample order of lamb's wool sweaters was subject in February 2001 to duty by the Customs Service upon arrival in the U.S. The Customs Service argued that the knit-to-shape panels from which the sweaters were assembled are not "fabric," and thus not eligible for duty-free consideration into the U.S. market. The feud between Mauritian producers and the American customs has been ongoing.

As such, six investment proposals for cotton spinning [4] have been approved by the Board of Investment. The main benefits for Mauritius can be summarised as:

1. Local availability of high quality yarn that could be readily available to local garment manufacturers. It has to be noted that a local captive market of nearly 45000 tons already exists, albeit only about 13500 tons need to satisfy the SSA rules of origin criteria – the US currently representing about 30 percent of Mauritian EPZ exports (while the EU stands at around 65 percent). This would also allow for greater flexibility in so far as the supply of yarn is concerned – as opposed to current shipment time – and would also reduce the need for the manufacturers to have recourse to large inventories as they could use just-in-time inventory management techniques and thereby release some of their working capital for other use.
2. The process of backward integration from raw material stage would complete the integration process in the industry. This would allow greater flexibility in terms of compliance with changing consumer demands in the local context and would lead to shorter lead times/ faster response times for the final product. The supply chain within the sector would thus be completed.
3. An important aspect of AGOA is that over and above promoting greater trade flows, it requires countries to create supply capacity. Since, supply capacity is currently limited, there is a need to promote greater investment. The six projects represent a potential combined investment of nearly US$ 120 million. The realisation of these projects would yield the highest investment ever recorded for the EPZ sector and would be a timely boost since the country is currently experiencing relatively low levels of investment. Taking into consideration the fact that spinning projects are very “space intensive”, there would be benefits for the construction sector as floor capacity equivalent to nearly 1.2 million square feet would be required. Additionally, there would be benefits for other sectors of the economy as there would be direct and indirect multiplier effects via linkages with other sectors.
4. While the origin of the yarn is the main aspect of AGOA, it is fairly obvious that to export garments, fabrics would be required. As such, the spinning of cotton yarn in Mauritius would enable the full utilization of installed capacity in knitting, dyeing and finishing sectors. Hence, this may also entail a need for additional investment in high technology in these activities.
5. Although spinning projects are heavy on capital, the six projects under consideration would directly create nearly 1800 jobs. Moreover, temporary

[4] The **Shanxi Tian Li** is now operational. **Arvind Overseas** is setting up its spinning plant at La Tour Koenig and the promoters expect the unit to be operational in July 2003. The **CMT** project is under way and is expected to be in operation by early 2004. The other projects include the **Sanghi/ FUEL** (at Union Flacq); **Mauritius Spinning Mills** and **Amit Spinning Mills** (both projects at Goodlands) and the **Indocount Textiles Limited** (at Rose Belle).

jobs would also be created during the construction phase. Another non-negligible component could be the job creation that would arise as Mauritian exports expand in the American market as more of the products become eligible.

6. Moreover, since yarn would be available locally, this would reduce imports to some extent as cotton is much cheaper that yarn. As such, this would lead to foreign exchange savings. In the same vein, importing cotton and exporting yarn will also be beneficial in terms of foreign exchange. The balance of payments might thus benefit.
7. Four of the six countries (Kenya, Lesotho, Madagascar, Swaziland) enjoying the major chunk of exports to the US are doing so under LDC status. With 2004 looming and the demand for SSA yarn expected to rise manifold, there will be an opportunity to export to the regional eligible countries. In the same sphere, it has to be brought out that many of the eligible SSA countries do not have the necessary capacity to convert yarn into fabrics. As such, this might give rise to the opportunity to increase the current capacity in conversion of yarn into fabrics – thereby leading to further investment and therefore more benefits. Selling fabrics, which have a higher valued added component than yarn, would be more beneficial to the Mauritian economy and goes in line with the ambition of the island to graduate into a high value-added producer and become the hub of textiles in the region.
8. On another note, some American cotton yarn producers have expressed an interest in using Mauritius as a platform to supply yarn to African exporters wishing to gain duty free and quota free access. Given the strategic location of the Mauritian Freeport, this may engender a greater flow of goods through Mauritius with benefits for the development of trade and services.

3.5 The AGOA Forum and latest developments

Some critics suggest that AGOA is a clear manoeuvring of US trade policy bearing in mind the new trade dynamics after the elimination of the MFA in 2005 under the World Trade Organisation (WTO) Agreement on Textiles and Clothing. As such, there has been an overt questioning of the wisdom of investing massively in new spinning plants given that any advantage might be only temporary. Ultimately, super low cost producers like China and India are expected to dominate the market.

AGOA III to follow?

Given these legitimate concerns, the extension of AGOA II beyond 2008 has been raised in various quarters including by President Bush during the AGOA Forum held in January 2003 in Mauritius. The extension of AGOA II will provide an additional

thrust to the exports of Mauritius towards the US market bearing in mind the dismantling of the MFA in 2005. Moreover, the extension of AGOA may also reassure investors who may be more willing to consider some massive investments given that the time frame for AGOA would be lengthened. This augurs well for the country. Latest information from the US tends to suggest that the preparation of AGOA III is already under way.

Lobby to extend AGOA I beyond 2004

In the same forum, there was some timid lobby by certain other countries to extend AGOA I beyond 2004. One may recall that under AGOA I countries benefiting from LDC status can source their yarn and/ or fabrics from any region in the world and enjoy the benefits of AGOA – thereby reducing the need for vertical integration into the textile sector. It is under the assumption that AGOA I would give place to AGOA II after 2004 that Mauritius has accentuated the need for vertical integration within the textile industry and is increasingly emphasising the setting up of spinning units. If AGOA I were to be extended beyond 2004, this may affect the process of vertical integration process within the industry. Some local operators planning to invest in new spinning plants have already made it clear that they are against the extension of AGOA I as it may undermine the viability and strategic value of their project.

Free Trade Area of the Americas – will it undermine AGOA benefits?

Another development, no less important, that took place in February 2003 is the proposed creation of Free Trade Area of the Americas (FTAA) in 2005. In pursuance of its strategic trade expansion policy, the US is indulging in complex bilateral regional trade agreements with other developed and other developing countries. As part of the negotiations towards the creation of the FTAA, the US is proposing to eliminate all tariffs on textiles and clothing products from 34 nations in the Americas by 2010. This elimination of tariff will have to be reciprocal. The US is betting on a more efficient pan-American market to counter the increased competition in the wake-up to the post-MFA era. The FTAA is also powered by strong political motives of the Bush administration seeking to create a Free Trade Area linking all countries in the region, except Cuba, by 2005.

The removal of those tariffs on textiles and clothing will erode some of the competitive edge of the AGOA beneficiaries and also increase competition. Moreover, the FTAA countries will have an additional advantage over the AGOA beneficiaries in that they are closer to the US market and consequently may be able to respond faster. Furthermore, whether FTAA members will benefit from less stringent rules of origin criteria than AGOA beneficiaries may be another determinant factor.

While it is too early to gauge the full impact of the FTAA, it may reverse some of the benefits that would have accrued to AGOA beneficiaries.

US and SACU FTA: To join or not to join?

Since FTAs rank high in the US trade lexicon, pursuing the same mantra, US will be negotiating an FTA with the South African Customs Union (SACU) members which, incidentally, includes South Africa[5]. Along with Mauritius, South Africa is one of the main losers from the stringent rules of origin criteria. Once the FTA with the US has been signed, South African textiles will get an undoubted boost. As such, Mauritius will be the only country in the SSA region that would be disadvantaged by the rules of origin of AGOA. While Mauritius has been invited to join the SACU, there has been some reluctance on behalf of the Mauritian Government to jump-in bearing in mind the Egyptian episode in the wake-up to the COMESA agreement. Low cost producers flooded the Mauritian market with a range of products and had remedial measures not been imposed, certain local industries would have had to close down. A similar situation might arise with South Africa in the context of SACU and this may engender severe revenue losses for the government. While the temptation to join SACU is high, since it will enable Mauritius to maximise the benefits under AGOA, the cost implications may dampen some of the zeal in signing a hasty agreement with the Union.

The textile sector is currently at crossroads, stuck between rising costs and increased competition, which threaten to undermine the viability of the industry in the medium to long term. The enactment of the Act has given a new lease of life to the textile and clothing sector. The setting up of spinning units would culminate in making Mauritian products fully compliant with the rules of origin of AGOA and would thus be a massive boost to the industry. Moreover, diversifying Mauritian exports market to the US would give rise to new opportunities for the traditional “euro centric” exporters.

4.0 The Pillar behind the development of the EPZ: The Multi Fibre Agreement

Conventional Ricardian theory on international trade suggests that a country should specialise in the production of a good in which it has a comparative advantage. By extension, the Hecksher-Ohlin model proposes that the origin of a country’s comparative advantage lies in the countries’ relative stocks of factors of production. As such, when the EPZ was launched in Mauritius, given the relatively abundant supply of labour, Mauritius found it cheaper to produce goods whose production

[5] The other members are Botswana, Lesotho, Namibia and Swaziland.

required much labour and little capital compared to a good calling for capital-intensive production process.

The MFA was put in place in 1974 by developed countries to protect their own textile and garment industry to prevent a flood of exports from less developed countries (LDCs). LDCs had a vast pool of labour and were consequently able to supply the EU and US market at a cheaper cost. As a countermeasure, the US and EU came up with quotas on the exports of the LDCs. Every year countries agree on quotas - the quantities of specified items which can be traded between them

Whilst the MFA came in place as a short-term measure, it was not until the 1994 Marrakech meeting that it was decided to phase it out over a period of ten years. One of the main aspects of the MFA is that it translates into a shift in production within LDCs whereby some lose at the expense of others. Countries like Bangladesh saw the demise of their garment sector following the imposition of the MFA. Similarly, South Korea was handicapped under the MFA but, since the quotas are imposed on quantity as opposed to value, South Korea was able to shift to higher value added garments and circumvent to some extent the MFA quotas. Hong Kong is another case in point.

With the quota system in place, there has been some reengineering in the way textiles production and trade take place. Countries like Korea and Hong Kong resorted to outward processing by profiting from the unused quotas of other countries or their LDC status. As such, they concentrated on the other South East Asian countries. Other illegal methods, such as transhipment, sewing of false "made in" labels and/ or the falsification of documents, had also been adopted. In 2002, containers of products made in Sri Lanka were found with the "Made in Mauritius" label. A similar case threatens to undermine the privileges Mauritius enjoys under the AGOA as these illegal methods have been used to ship to the US.

Bearing in mind the development of the Mauritian garment industry over the past two decades or so, it has to be reckoned that the producers have made full use of the benefits under the MFA. However, the decision at the GATT Uruguay Round to integrate the textile and garment sector under the mainstream rules and procedures of the WTO, has cast a cloud over the future of this sector in the Mauritian economy. Under the new WTO rules, it is clear that the protectionist policies of the MFA are not WTO compliant. The progressive removal of quotas over ten years (as from 1994) has given an extended lease of life to the sector. As such, as from January 2005, Mauritius will compete on an equal footing with other developing countries.

Some other aspects worthy of consideration along with the phasing out of the MFA are:

- The existence of a Transitional Safeguard Clause whereby developed countries like EU and US may restrain market access of imports from developing countries in order to avoid a sudden influx of imports that may damage their local industries. This may provide another short lifeline to local exporters to adapt to the exigencies of free trade.
- EU and US are pressing for Reciprocal Market Access (RMA) for textiles and upmarket clothing to developing countries. Most of the developing countries are agreeable to that clause as in return they would get free market access to the EU and US clothing market. However, for Mauritius, the phasing out of the MFA and the reciprocal market access requested will represent a set of both threats and opportunities.

  The reciprocal market access may not lead to major changes in the local garment sector, in that EU and US are targeting mostly the emerging middle class of countries like China and India. Since Mauritius is a relatively small market, it may not be of much interest to them. On another note, reciprocal market access could have some ramifications in the sense that should EU and US be able to export freely to Mauritius, some of the taxes currently imposed on the products would have to be lowered. Depending upon the volume of the imports, this could affect customs revenue.

  What might be of more interest to Mauritius is the fact that should US export textiles to Mauritius, it would represent further opportunities to produce AGOA eligible products. However, it might as well have an adverse effect on the proposed spinning mill projects in Mauritius since it might lead to a reduction in the price at which local producers may sell their yarn. Nonetheless, bearing in mind the distance between US and Mauritius, the transportation cost component may have a major bearing on their decision to export to the island and compete with local producers.

Since the start of the phasing-out in 1994, potential beneficiaries have accused the US and EU of not playing the game in that they (US/ EU) have restricted access to some of the main exports of the less developed countries. While the list of products has been extended, the items included therein do not represent the main exports of the developing countries. However, garments, the product most of the developing countries are betting heavily on, are not scheduled to be included until the final stages of the phase out. Consequently, many developing countries feel that they are being robbed of the opportunity to set the base for their garment industry and this may hamper their capacity to cope with a sudden increase in demand once the products are made eligible.

The MFA has been of utmost importance in the development of the EPZ in Mauritius. As a major beneficiary under the MFA, Mauritius stands to lose out in the long term since competition from low cost producers would be rife. Analysts in textiles and clothing believe that in the post-MFA era, the ability of a country to compete would be determined by the following factors:

1. Wage costs
2. Supply of yarn, fabric and other raw materials
3. Infrastructure for transport and marketing
4. Nearness to markets

Based on the above criteria, it has to be reckoned that the odds are being stacked against Mauritius. Over and above being geographically handicapped, the island has to compete with the low cost producers from Asia and the emerging markets of South-East Africa. Under such auspices, the ability of Mauritius to compete is low. However, some foresighted Mauritian producers have shown an increased resilience lately in that they are willing to export to the EU and US markets by air. Given the volume being considered, this represents an additional cost of only US$ 0.20 – 0.25 cents on the overall cost per unit. As such, some of the local producers have been able to cut the lead-time from four weeks to two weeks by using airfreight.

Moreover, following the enactment of AGOA which has sped up the vertical integration process in the textiles industry, Mauritius is gearing itself up to ensure that the supply of yarn and fabric would be available locally. Furthermore, the country already has an infrastructure for transport and marketing. To some extent, this reduces the handicap when compared to some of the other nations like Bangladesh and Sri Lanka. However, the competition from India, China and Pakistan would be unavoidable in that they already have a textile base and their cost of labour is very competitive by international standards. In the same vein, Korea has very high productivity and efficiency. Competitor countries like Thailand and Philippines are expected to lose since they do not have an industrial base while Vietnam is expected to emerge as a major producer.

It is clear that the phasing out of the MFA will act as a spur to freer trade which, theoretically, is beneficial to all engaging parties. However, countries like Mauritius that have developed their textile and garmenting industry on the basis of the MFA stand to lose out – and lose out significantly – unless they can review their trade strategies or renegotiate preferential trade agreements over the short to medium term. There is likely to be an overall reengineering of trade in the sense that the buyers in the US and EU will have more options to choose from. This may drive down prices as producers in developing countries compete with others to sell in the developed market. Many small or inefficient producers may have to close down. On the other

hand, producers in developed countries may subcontract a larger chunk of their production to lower wage economies, which although giving rise to business opportunities may exert greater pressure to reduce costs in the developing world.

4.1 Implications of the phasing out of the MFA

Since the advent of the MFA in 1974, there has been a change in the pattern of trade and commerce in industrialised countries. In the 1970s, most of the companies produced locally and sold to local or national retailers. However, the past decade or two has witnessed the emergence of Multinational Companies that rather than owning production facilities manage an international network of suppliers. Retailers like Walmart and brand-based names like Adidas and Nike to name a few control the industry on a global scale without government protection and have no interest in the imposition of quotas. Some critics suggest that the beneficiaries of the post-MFA era will not be developing countries but rather multinationals.

There will be additional job creation in new beneficiary countries. However, it is very likely that jobs would be shed in countries that can no longer compete. The possibility of the latter scenario is very much prevalent in Mauritius where wages and increases in production costs are binding constraints. With global completion engendering further downward pressure on overall costs, labour costs would be increasingly important and the trend is likely to be downwards. Similarly, workers may have to work longer hours and their rights may be further curtailed. This may have major implications for people joining the workforce and considering the EPZ sector as a possible option.

Taking into consideration labour market developments over the past decade, one might come up with the following conclusions with regards to the impact of MFA on the Mauritian economy:

- There might be more job losses for the local population
- Female unemployment may shoot up further in that any job loss in the EPZ is bound to affect the female workforce to a larger extent that the male workforce.
- Moreover, with more pressure on the working hours of the local workforce, there may be a need for longer hours. However, in the current social context, the locals may not be very keen in working extra hours. Even, if they choose to work, the socio-economic ramifications should not be ignored.
- Bearing in mind the possible reluctance of the locals to work longer hours, the solution for local producers might be to hire more foreign workers who are more flexible but not necessarily less costly.

The most apt response of Mauritius to the phasing out of the MFA could be one similar to Hong Kong's response when quotas were imposed on its exports. Mauritius could use its marketing and financial expertise while at the same time transfer the production of the labour intensive garmenting to Madagascar where the political turmoil is over and infrastructures are being rebuilt. The producers would thus be able to capitalise on the availability of the low cost labour force. However, relying solely on Madagascar would not be the cure-all. Two major problems that people who have invested in Madagascar have encountered are the low productivity and high absenteeism of the local work force.

Another possible response of Mauritius could be to create and consolidate an advantage in niche markets. When faced with quotas, Hong Kong specialised in goods with higher value addition and requiring more of capital and technical know-how. As such, export revenue was raised not by increasing quantity exported but instead by raising price through greater value addition.

5.0 The combined impact of AGOA and MFA

The enactment of AGOA and the phasing out of the MFA represent a unique set of threats and opportunities for the Mauritian economy more specifically to the textile and clothing sector. The preferential market access Mauritius enjoyed under the MFA provided the launch pad for the EPZ. However, its phasing out implies that Mauritius will have to compete on a equal footing with lower cost producers and thus brace itself to face the chill winds emanating from an increasingly liberal and competitive market. As such, the traditional exports may be under threat and Mauritius is bound to review its whole strategy to ensure its international competitiveness is not undermined.

On the other hand, the benefits accruing under AGOA will to some extent reduce some of the handicap resulting from the phasing out of the MFA. The preferential market access to the US market is something Mauritius is compelled to take advantage of so that the EPZ remains a linchpin in the economic engine.

Since the majority of Mauritian exports have been done under the auspices of the MFA and the benefits of AGOA have accrued over too short span of time, it is difficult to quantify the impact of these agreements on the Mauritian economy. However, one can hypothesise the implications for the various economic aggregates and try to consider the implications for the economy as a whole. The next paragraphs deal with the main economic and non-economic implications of both accords.

- **Market access**

Market access has been one of the most important factors in the take off of the EPZ sector. However, ever since the implications of the geopolitical changes of the 1990s started to become clear, it was evident that one of the main advantages enjoyed by Mauritian products would be eroded over time. Moreover, the emergence of China as a global player and leader has complicated things further. China also has the additional advantage of a complete supply chain which gives it greater flexibility in the international arena.

More than ever, it is imperative for Mauritius to ensure it is cost competitive and its quality advantages can be consolidated. The phasing out of the MFA means that Mauritius will be at a disadvantage in its traditional markets and will have to create its niches where it can operate without creating much distortion.

On the other hand, the enactment of AGOA means that the American market is opening up to Mauritian exports thereby giving market access to one of the leading markets of the world. However, to benefit fully, it is important for Mauritius to ensure that the rules of origin are respected.

The results of the past two years tend to suggest that despite the yarn handicap, local producers have started to exploit the American market. Traditionally euro centric, the producers are giving increased recognition to the American market. Exports to the US as a percentage of total exports is nearing 30 percent compared to 10 percent in 2000. As such, as the rules of origin are exploited and the European access becomes more competitive, AGOA can be the panacea for the Mauritian textile and clothing sector.

- **Investment**

For Mauritius to benefit from preferential market access under AGOA, it is imperative that the rules of origins are satisfied and for this to happen, it is important to consolidate the backward integration process in the textile and clothing industry. To spin cotton yarns in Mauritius, it is important to build capacity in the cotton spinning sector and therefore, investments have to be undertaken.

It was pointed out earlier that spinning projects are highly capital-intensive and Mauritius is well poised to benefit since it enjoys high credibility and political stability. As such, investment in spinning is bound to increase under the impetus of AGOA. Moreover, it is expected that there will be one-off investments in other textile sectors such as the weaving of fabrics and dyeing of yarn.

However, it is unclear as to what will happen to investment in the garment sector where labour cost remains a binding constraint. More importantly, since local producers have started to exploit the benefits of low cost countries, it might well be that there is some disinvestment due to relocation in regional beneficiary countries.

On the other hand, the phasing out of the MFA has little implications for investment in the textile sector. At most, with greater competition and the cost handicap, producers may once again choose to relocate labour-intensive production to the regional countries and maintain capital-intensive production in emerging sectors like jewellery in Mauritius. In that instance, the overall impact on investment will depend on whether outward investment exceeds or falls short of inward investment.

If a decomposition of investment is undertaken in terms of labour intensity or capital intensity, then AGOA will increase capital-intensive investment in the spinning sector. The overall impact of MFA is still unclear in the sense that should there be a shift from textiles and garments to light engineering, there might be a shift towards capital-intensive investment.

- **Construction sector**

The setting up of the spinning units will lead to a temporary boom in the construction sector whereby the area to be constructed will be nearly 1.2 million square meters. As such, temporary jobs may be created in the construction sector. However, given the fact that several other construction projects are already under way at Ebene and other hotel projects are likely to come up in the South, construction workers may attract a premium or may not be available in sufficient quantities. Hence, the possibility of having recourse to workers for construction from foreign countries should not be completely discounted. AGOA is thus expected to bring a temporary boom in the construction sector as the spinning projects are put in place.

- **Job creation**

The capital-intensive nature of the investment undertaken under AGOA has already been mentioned. As such, employment creation should not be expected on the scale of the 1980s. However, that does not mean that jobs would not be created.

In the textile sector alone, about 1800 jobs would be created – mostly for manual workers. Given the fact that Mauritian workers do not have the necessary expertise in the spinning sector, most of the promoters have expressed an interest in having recourse to foreign workers in the initial phase at the operational level. These workers will also be responsible to train the local workforce.

Another non-negligible factor is the operational hours of the textile industry. As opposed to the garment industry, the textile industry needs to operate on a 24-hour basis to be cost-efficient. However, the trend of late in Mauritius has been towards workers choosing to work fewer hours and devote more time to social activities. Whether they would be willing to join spinning units thus remains to be seen.

While job creation for the locals at the textile level is expected to be relatively low, should the Mauritian exports towards the US Market shoot up, there may be some additional garmenting that will be undertaken locally and this may lead to the creation of jobs for the local workforce. There may be additional need for foreign workers in the garmenting sector to work the night shifts.

Since AGOA does not apply solely to the apparel sector, new opportunities are emerging in the light engineering sectors such as jewellery. There would be job creation and most of these would be for the local population. However, it might be naïve to consider that AGOA would be the panacea to the unemployment problem given the natural and economic constraints binding the production capacity of the island. Nonetheless, under the current state of affairs, any job creation would be most welcomed and contribute to socio-economic stability.

- **Imports**

The thrust towards greater vertical integration in the textile and clothing industry will cause some changes in the way products are imported for the sector. Until now, Mauritius has imported most of its yarns and fabrics from Asia and South Africa of late to benefit from AGOA. With the setting up of spinning units, there will be no need to import yarn. Instead, cotton will be imported and then transformed into yarn.

Cotton will be imported mostly from West Africa. As such, the composition of imports is expected to change as follows:

- Reduced imports of yarns and fabrics from South East Asia
- Increased cotton import from Africa

Since cotton is cheaper than yarns and fabrics, this should lead to a slight improvement in the balance of payments. However, it should be borne in mind that cotton, as opposed to textiles and clothing, is a commodity and as such, its price may be subject to fluctuations which in turn, may impact not only on the value of the imports, but also on the cost of production. On the other hand, there will be a one-time increase in imports of construction materials and machinery for the setting up of the spinning units.

Another factor that might need to be considered is the Reciprocal Market Access for high quality clothing under the MFA. EU and US are emphasising on the RMA as part of the phasing out that will be to the benefit of the developing countries. Since Mauritius stands to lose out in the long term due to the phasing out of the MFA and the relatively small size of the local market, the overall impact of RMA is not expected to be significant.

- **Exports**

AGOA and the phasing out of the MFA will have opposite impacts on exports and the overall impact will depend on which of the forces is greater. AGOA has already provided some positive results for Mauritius since its enactment in 2000. With the knit-to-shape episode set to be settled shortly, the expectations on AGOA are high. Mauritian exports to the US are increasing – highlighting the change in the euro centric approach of the exporters.

Should things go as planned and the spinning units enable Mauritian products to adhere fully to the rules of origin, exports to the US are bound to increase further. However, there may be a change in the composition of exports in the sense that as Mauritius loses its advantage in its traditional exports, it may refocus on products with more value addition. As such, the composition of exports might change but the value of imports may increase significantly.

On the other hand, the share of the European market is beginning to shrink and this trend is expected to be accentuated as exporters try to export more to the American market and the impact of the MFA phase out starts to bite. Under such auspices, whether Europe remains the main market for Mauritian exports in the long term is debatable but it is likely to maintain a large share in the short to medium term.

As Mauritius adapts to the geopolitical changes that are reshaping the trade opportunities, given that a large chunk of the process of vertical integration is likely to be implemented by 2004, there is a possibility that Mauritius becomes a key player in textiles in the region. With the phase-out of the third country fabric concessions under AGOA, countries benefiting from the LDC status would be compelled to source yarn from the region to continue benefiting from the duty free access to the US market.

Since the industrial base in most of these countries is shallow and they suffer from a credibility deficiency as regards their political and policy stability, they are not well poised to attract the high capital-intensive spinning investments. At present, supply capacity is almost non-existent or of poor quality. In these circumstances, they will have to source their yarn from the region. Mauritian yarn consumption was about 45

000 tons in 2001. With six operational spinning units, supply capacity is expected to be in the region of 60 000 tons.

With Mauritius exporting about 30 percent of its EPZ products to the States, it can be assumed that about 13 500 tons of yarn would be required to benefit from duty free access to the US market. As such, the remaining yarn can be used to produce for European market if the price compared to Asian imports is right. On the other hand, the African demand for AGOA eligible yarn is bound to increase as from September 2004. In that case, African countries will be compelled to source their yarn from the region or America. Since the stakes would be much higher, the price of yarn may attract a higher premium in which case the profitability of local exporters will rise and making the current projects more viable.

As such, Mauritius could end up being an exporter of yarn in the region. Moreover, the possibility of exporting fabrics is also present. While importing cotton and converting it into fabrics, the value addition component will rise significantly and this is very much in line with the strategy of Mauritius. The overall impact would be beneficial for the balance of payments. The composition of exports would change as follows:

- Contraction of exports share to the EU
- Expansion of exports share of the US
- Increased exports of yarn and fabrics to the regional countries

- **Trade and Transport**

It is quite likely that AGOA will increase intra-regional and international trade. More trade will take place between Sub Saharan African nations that want to benefit from AGOA. Greater trade also implies greater need for transportation and storage. As such, the Freeport is well poised to take advantage of the increased flow of goods. Moreover, the shipping companies and flights are also likely to benefit. Shipping would still be used in the initial stages while airfreight would be used for the transportation of finished goods to meet delivery deadlines and overcome the geographical barriers faced by Mauritius.

6.0 Conclusion

Based on the above analysis, it can be seen that AGOA and the phasing out of the MFA have far reaching ramifications for the Mauritian economy. While Mauritius stands to lose out under MFA, it can make up for some of the losses via AGOA. The overall effect on the economy will depend on which of the two counteracting forces is greater. To mitigate any serious adverse consequences emanating from the phasing

out of the MFA, it is imperative that Mauritius harnesses the benefits accruing under AGOA. For this to happen, the vertical integration process in the textile and clothing industry must be sped up. Otherwise, the viability of the EPZ sector, more so the textile and clothing industry, might be seriously jeopardised. Since AGOA also engulfs nearly 6000 products other than textiles and clothing, Mauritius can maximise some of its benefits from niche markets like manufacturing of watches and jewellery.

The phasing out of the MFA and the benefits under AGOA are clearly redefining the future of the textiles and clothing industry. The days of labour-intensive manufacturing are gone. The response to mitigate any negative effect might be a combination of the following:

1. Complete the vertical integration process in the textile industry
2. Shift towards production with greater value addition
3. Shift labour-intensive production to regional countries with cheaper labour cost like Madagascar
4. Accentuate the process of diversification in the EPZ sector

The overall impact of these two counteracting agreements will depend on the response of the Mauritian stakeholders to the exigencies of the external factors being imposed. In this WTO era, where trade barriers are falling and producers are being called upon to compete on an equal footing, the future of the EPZ depends on its ability to deliver on the following fronts: price, quality, response time and product. Competitiveness is of essence.

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