INDUSTRY

A cosmetic job in Hongkong

By Philip Bowring 24 Sept 76

Hongkong: Few subjects in Hongkong produce as much sound and fury as its Textile Export Control System – better known as the quota system. Few subjects are as bafflingly complex. And few involve such big money. Acrimony between the haves and the have-nots is natural, though not necessarily a guide to what is happening.

Hongkong is the world's largest garment exporter, and all its major markets – the United States, European Common Market, Australia, Canada – enforce restraint. So, in a good year for textile exports, quotas are worth hundreds of millions of dollars. Their value is basically the difference between the cost of production plus a small profit, and the price for which those goods can be sold in major markets. As demand rises in importing countries, the scarcer and thus more valuable quotas become.

Probably only a relative few of the total amount of quotas are actually traded. But the prices at which they are traded are a good reflection of the notional value of possession, representing as they do the extra profit made available by the fact that the market is distorted by physical barriers to trade.

The latest storm over quota usage and allocation blew up early this year (REVIEW, Mar. 12), as real or assumed quota shortages developed, partly as a result of the strong upturn in demand and partly because additional items came under restraint in the Common Market.

There were accusations that quota "farmers" were making millions by selling quotas instead of clothing; that companies which long ago ceased manufacturing were still getting quota allocations. It was further alleged that the cost of quotas was making Hongkong products uncompetitive. The last was a preposterous complaint, as no competent businessman will take orders if the price of quotas on the market is so high as to involve him in loss. Nor is it possible to corner the market for quotas because quota holdings are so widely dispersed.

What seems to have happened was that some inexperienced firms took or placed orders without checking out the quota availability and cost. They got their fingers burned, and squealed loudly. Joining the chorus of criticism were all those who had insufficient or no quota allocation and thus no access to the profits quotas bring. Naturally, they wanted the system changed to suit them.

As a result of the fuss, Hongkong's Department of Commerce and Industry undertook an examination of the system. Last week it announced its conclusions in the form of some changes to the system. The changes are small and largely cosmetic. They may help reduce the abuses of the system, and slightly mollify the have-nots. But they in no way threaten the established interests in the trade.

The department claims it is now setting out to make sure that quota holders do not make a regular business of selling quotas rather than goods. In future, all quota transfers will have to be registered within seven days. This is supposed to eliminate hoarding by quota brokers. Furthermore, any holder who "temporarily" transfers more than 50% of a given quota for two years will have his quota allocation for that market reduced in the subsequent year by 25% of the amount transferred.

This is not much of a disincentive to selling quotas in good years when demand is high. The major abuse, however, is persistent and unrecorded transfer of quotas by firms that are doing little or any manufacturing or exporting. The firms can thus go on collecting and selling their allocation year after year. It is not uncommon here to see letters of credit with the condition "bills of lading showing third party as shipper acceptable" – meaning that the official exporter is not the one actually doing the business.

Unrecorded transfers of this sort are supposed to be illegal, but no prosecutions have been recorded, in the memory of Commerce and Industry head David Jordan. Now legal action is promised, but first the law will have to be tightened up. In what way this will occur has yet to be revealed.

A further improvement is that the names of quota allottees will in future be published, as will the amount of quota transfer registered and the percentages of quota utilisation. This may help remove some suspicions arising from the secrecy with which the Government has shrouded the quota system.

The most important aspect of the system for the trade as a whole is not the transfer system, but the way quotas are allocated in the first place. Here there is only one significant change. In future, any quotas made available as a result of holders forfeiting unutilised quotas will be classified as "free quotas." This means they can be allocated to anyone on a first-come first-served basis. At present, unutilised quotas are only distributed to existing quota holders, not to newcomers.

What remains totally unchanged is the system whereby quota holders who fulfil 95% of their quota in one year get the same quota for the following year, plus such growth as may be permitted under the particular restraint agreement.

This is the hub of the whole system – past performance. Its defenders say it is reward for both past and continuing export effort. Newcomers should await their reward by gradual accumulation of quotas. Or they should move into items where quotas are readily available – even in a good year like 1976, many quota categories remain unfilled. And there should be no rewards for quick in-and-out operators to move in and make big profits when times are good, then close up when times are bad.

The critics say the system is contrived to benefit the big, established interests. Thrusting newcomers, be they manufacturers or exporters (garment quotas are allocated on a 50:50 basis to both) are deterred. Certainly, it can be said that the Textile Advisory Board, the industry body appointed by the Government to advise it on textile matters, is largely composed of these entrenched interests.

There is something in both arguments. But there can be little doubt that the system as it exists now, and as it will continue to exist, primarily reflects the interests of the "old guard" who created Hongkong's textile industry. Any system, however, is likely to meet intense criticism from foreign buyers as long as it continues to keep the "extra" profits available from the quota system in Hongkong.

New buyers cannot readily get a piece of the action. And some major ones who had been buyers for years lost out by not having past performance when restraints were introduced. They had acted only as agents, and were not officially classed as exporters.

It would, of course, be in the interest of the importers if control of restraint arrangements lay with the importing country, not the exporter. That way, the importer rather than the manufacturer or exporter would reap all the extra profit that physical trade barriers can create. Australia has recently reverted to operating its own restraint system (REVIEW, July 9). But Hongkong would fight very hard to prevent European and North American countries doing the same.

This minor overhaul of Hongkong's system may even be seen as aimed at muffling the (self-interested) cries of "unfair," which could lead to pressure in the importing countries to take control of the administration of restraint agreements.