

It's Not Just the
Economy, Stupid!
Trade Competitiveness
in the 21st Century

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By

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PREFACE

This book first began to take shape during my doctoral research and then with continued studies on the impact of reciprocal trade agreements on particular industries. The path-dependency model offers insight into importer behavior and industry competitiveness, but it only goes so far and therefore needs to be rethought, especially in terms of the cost of path divergence.

The book aims to complement existing scholarship on the behavior and decision-making of importers. The book evaluates current assumptions, particularly those from the rational school of thought and the focus on institutions. An alternative framework is proposed—path dependency—to encompass the process that shapes the decisions of importers. Furthermore, with respect to industry competitiveness, the book adds a complementary approach to the commonly accepted theory of competitive advantage, which focuses on an industry's ability to compete in the global market. The same framework—path dependency—is used to explain the process in which industries compete, not in global markets but, rather, specific markets.

The book also aims to contribute to policy debates over trade agreements. Some proposed trade agreements adopt provisions similar to those codified in the twentieth century. However, due to changes in the international trading system, some of these rules may no longer be the most useful in the twenty-first century. After analyzing specific trade deals between the United States and Latin American and Caribbean countries, the book offers recommendations for establishing mutually beneficial trade relations with other regions, in particular Sub-Saharan Africa.

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In addition, several organizations have been instrumental in providing the necessary funding for this project over the years. I extend my appreciation for financial support from the Fulbright Scholar/Lecture Award (Dominican Republic) during my tenure as an assistant professor at North Carolina A&T State University. Furthermore, previous graduate research support, such as the Belfer Family Graduate Fellowship and the Irene Diamond Fellowship, helped in the initial phases of the project. These fellowships made it possible to travel overseas, conduct extensive interviews and collect additional data required to complete this project.

I am also grateful to the numerous individuals in Washington, DC, Central America, and the Dominican Republic who shared their time, resources, first-hand knowledge, and networks in helping me to better comprehend trade negotiations and the textile and apparel industries

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INTRODUCTION

Free trade has inspired both support and a backlash, in particular in 2015 as the United States and 11 countries in the Asia-Pacific region signed the largest trade deal since the North American Free Trade Agreement (NAFTA): the Trans-Pacific Partnership (TPP) agreement. Questions have been raised regarding the benefit to countries and specific industries, as well as the environment, labor, and consumers. Debates have highlighted the benefit of market access, in which importers from a TPP signatory country can purchase goods and services from another TPP member country duty-free. As a result, the latter country would benefit from a competitive edge in other TPP markets. In the course of the debate, some analysts have questioned the validity of free trade theories and earlier trade deals, including those between the United States and countries in Latin America and the Caribbean.

A number of theories have emerged that offer insight into firm behavior and the ability of countries, industries, and firms to compete globally. As far back as the nineteenth century, economists have argued that the market determines a country's or industries' ability to succeed in the global market. More specifically, a country that specializes in those industries that is more efficient than its trade partner will experience economic growth. Some scholars have analyzed the ability of firms and industries to compete in the global market and found that factors such as government policy, quality, industry clusters, human capital, geographic concentration, technology, and strategy remain key (Freund and Wallace 2004; Porter 1990). Contrary to theories on firm and industry competitiveness, the globally less competitive U.S. textile industry has shown its ability to compete in specific markets throughout Latin America and the Caribbean. Competition is measured by an industry's share of any given import market.

Regarding firm behavior, business models assume that firms act rationally by seeking to maximize profits while keeping costs low. Seyoum (2010) asserts that importers determine the origin of goods based on cost. Again, counter to the rational choice argument for firms, some Latin American and Caribbean apparel manufacturers import mostly the more expensive U.S. textiles, specifically yarn and fabric, to use in regional apparel. The use of U.S. yarn and fabric by some Latin American

and Caribbean apparel manufacturers persists although lower-cost options from Asian suppliers exist.

The contradiction between the expected outcomes and the actual actions of many Latin American and Caribbean apparel producers, which give the U.S. textile producers a competitive edge in their markets, leads to the main question of this book: If the goal of firms and producers is to maximize profit while reducing costs, why do many Latin American and Caribbean apparel producers continue to import the more expensive U.S. textiles?

With this question in mind, the book focuses on two specific areas: (1) the determinants of importer decisions regarding the origin of inputs and (2) industry competitiveness at a specific market level. The book argues that, in addition to market-based explanations, factors such as history, trade rules, and bargaining power shape importer decisions and industry competitiveness in specific markets. More specifically, the path-dependency model offers deeper insight into the findings presented here.

The findings presented tell the often neglected story of how trade relationships, policies, and negotiation outcomes play a highly significant role in firm behavior and industry competitiveness.

Background

Countries such as Honduras, El Salvador, and the Dominican Republic import the majority of their yarn and fabric from the United States. U.S. yarn and fabric account for 50–90 percent of these markets. Costa Rica imports more yarn and fabric from the United States than from China. Therefore, U.S. yarn and fabric producers have a competitive edge over Asian suppliers, including those in China, in these specific markets.

In 2012, textile production in China comprised nearly 54 percent of the total world production. “Today, China’s textile industry has been crowned as the world’s largest in terms of output, due to the condition of plenty of resources and cheap labour force in this industry,” writes Huang (2012). In addition to being the largest manufacturer of textiles in the world, China is also the largest global exporter (Huang 2012). In 2014, China exported US\$112 billion worth of yarn and fabric to the global market or 38 percent of the total world textile exports, according to the United Nations Commodity Trade database (UN Comtrade). China is more competitive than the United States in terms of the cost and quantity of production.

In 2014, the United States was the fourth-largest textile exporter in the world, after India (no. 2) and Germany (no. 3). U.S. textile exports reached a value of US\$14 billion and make up only 5 percent of the world total,

thus the United States ranked far behind China in terms of both dollar value and global market share (UN Comtrade).

The seemingly obvious answer to the question as to why these Latin American and Caribbean countries import mainly from the United States is geographic proximity. A closer examination of other cases, such as Guatemala, Nicaragua, and Jamaica, in which yarn and fabric imports from China exceed those from the United States, shows that geography does not determine importer decisions. Nicaragua has imported mainly from China for a long time. Guatemala and Jamaica began to import mainly Chinese yarn and fabric in the past decade.

The different outcomes within the same region highlight the need to look beyond existing economic and business models and examine other factors that determine the decisions of importers and the specific-market competitiveness of the U.S. textile industry. To identify alternative factors, the process leading to the final results becomes important.

Methodology

The study relies on process-tracing qualitative research methods, just as scholars use qualitative research methods to address problems with more complex causes (Elman 2008). For instance, the cases selected for this study have a number of similarities in the areas of geography, economic size, apparel export markets, and production costs. The geographic proximity between the United States and the Latin American and Caribbean countries enables transport time between two and seven days. By comparison, Asian exports to the West Coast of the United States can take from 12 to 45 days (Freund and Wallace 2004). All the Latin American and Caribbean countries studied here are developing economies. Costa Rica is considered upper middle income, whereas the others fall in the lower income bracket. Each country's labor costs are around US\$1.00 to US\$2.00 per hour.

Despite these similarities, the outcomes differ. Guatemala, Nicaragua, and Jamaica import their yarn and fabric mainly from China. The other countries use yarn and fabric mostly from the United States. Therefore, the textiles from the United States are competitive in Honduras, El Salvador, Costa Rica, and the Dominican Republic, compared to those from China and Asia as a whole.

The method of difference calls for identifying a single causal variable. However, in the cases presented in the book, it is difficult to identify a single variable that explains the decision of the importers in some countries compared to the others. Doing so ignores a variety of possible

explanations. Scholars have pointed out the limitations of the method of difference, along with its counterpart, the method of agreement.

The methods of agreement and difference are outdated and inappropriate procedures for comparative or historical analysis based on a small number of cases. The methods cannot employ a probabilistic perspective, deal with data errors, use multivariate analyses, or take into account interaction effects. All of these are critical features in contemporary ways of thinking about social processes. ... This is not surprising since Mill himself recognized that these methods were inappropriate for the kinds of problems addressed in most social research. (Liebersohn 1994, 1225)¹

Process Tracing

Process tracing provides a better alternative and has been widely used in political science to study and comprehend complex decision-making as well as identifying causal processes (George and Bennett 2005). As Tansey writes:

[T]he goal of process tracing is to obtain information about well-defined and specific events and processes, and the most appropriate sampling procedures are thus those that identify the key political actors—those who have had the most involvement with the processes of interest. The aim is not to draw a representative sample of a larger population of political actors that can be used as the basis to make generalizations about the full population, but to draw a sample that includes the most important political players who have participated in the political events being studied. (2007, 765)

The book relies on information as it pertains specifically to trade initiatives and deals—the Caribbean Basin Initiative (CBI), Harmonized Tariff Schedule (HTS) 807A, the Dominican Republic–Central American Free Trade Agreement (DR-CAFTA) and NAFTA—that have created a historical trade relationship, set rules to define that relationship, and involved bargaining for the most beneficial rules. The outcome of these trade initiatives and deals shaped the decisions of textile importers and the ability of the U.S. textile industry to compete in these markets. Rather than trying to generalize about all importers and all industries in manufacturing, the book aims to offer a unique insight based on these particular cases that may be useful for understanding other cases with similar conditions.

¹ The methods of agreement and difference were proposed by the philosopher John Stuart Mill in his 1843 book *A System of Logic, Ratiocinative and Inductive*.

Process tracing entails assembling a large amount of data from a variety of sources, such as interviews (Tansey 2007). Key textile and apparel industry representatives were interviewed over a 12-year period (2003–2015). The interviews serve two purposes: (1) to get a sense of industry preferences around the time that a trade agreement is actually being negotiated or shortly afterward, while details are still clear in the mind of interviewees² and (2) to show an evolution of apparel industry import preferences and U.S. textile industry competitiveness in select markets over a period. Personal interviews took place in Washington, DC, and the Dominican Republic. All the remaining interviews were conducted by telephone. These interviews fall into three separate categories: government representatives, trade negotiators on behalf of textiles and apparel, and industry representatives from the countries highlighted in the book. The selection of specific interviewees may result in the selection bias but also allows for the incorporation of key actors who might otherwise be ignored in a random sampling (Tansey 2007). These interviews were designed to identify particular processes and patterns that influence the import behavior of the Latin American and Caribbean apparel producers. The interviews have also been helpful in confirming information gathered from secondary sources.

Researchers have found that interviews offer benefits that other primary sources may not. Interviews present information at a much deeper and richer level regarding particular thought patterns and attitudes that one would not gain from restricted surveys with fixed categories. Furthermore, interviews allow researchers to go beyond the official version of any given event presented in documents and gain insight from participants about the nuances of particular events (Tansey 2007). The use of this type of primary data makes it possible for the book to reveal industry-level interests and some of the intricacies of the trade negotiations.

Interviews also present limitations of their own. One concern presented here is the reliability of all information, particularly with subjects even a few years after an event has taken place. Shifts in judgment and an inability to recall all events clearly may affect some of the data. However, that can also be supported by the collection of primary documents (i.e., notes) from an event, in this case, trade negotiations.

² Interviews regarding textiles and apparel during the 2003 U.S. trade negotiations with Central America (excluding Belize and Panama) took place during the last round of negotiations and a few months after talks concluded. Interviews pertaining to U.S.-Dominican Republic textiles and apparel trade occurred a year after the implementation of the DR-CAFTA in the Dominican Republic.

Process tracing also involves the use of documentary research (George and Bennett 2005). Information presented in the book also comes from local newspapers and government reports, which offer official data on trade flows, legislation, and the time frame of events.

Lastly, trade databases provide the data for the final outcomes—top markets from which to import for Latin American and Caribbean apparel producers and U.S. textile industry competitiveness in specific markets. For a comparison across cases, databases such as the United Nations Commodity Trade Statistics (UN Comtrade), the International Trade Administration (ITA) Trade Stats Express, and the Office of Textile and Apparel (OTEXA) trade data have been the most useful.³

Theoretical and Practical Contributions

The book presents a complementary framework within which to assess importer behavior and industry competitiveness—path dependency. In terms of importer behavior, path dependency looks deeper than existing theories, such as rational choice and institutionalism, which identify a single variable. The same goes for industry competitiveness, in which existing scholarship emphasizes specific variables, such as cost competitiveness, factors of production (land, labor, and capital), technology, and the state. Porter's model turns our attention to a combination of factors, such as government policy, firm strategy, interfirm relationship, demand conditions, and factors beyond the industry's control. These influential theories point mainly to economic conditions and business strategy, while also taking into account the role of technology and government policy. The path-dependency model brings to light other conditions, such as history, trade rules, and power relations, which can affect the decisions of importers, especially those that do not satisfy the expectations of these theories. Also, the path-dependency approach turns our attention to other variables that help a globally uncompetitive industry to compete in specific markets.

The complementary approach to importer decision-making and industry competitiveness has practical significance as well. First, the book's focus on importers in specific markets that use inputs from a globally uncompetitive country shows that an industry can still succeed and contribute to its local, state, and national economies through employment. The U.S. textile industry has declined tremendously over the years due to

³ The International Trade Administration and the Office of Textiles and Apparel are both agencies within the U.S. Department of Commerce.

automation, outsourcing overseas in search of cheaper labor, and trade agreements that removed tariff barriers, making it easier to do business in countries such as Mexico. Living in North Carolina for six years gave me the opportunity to travel to areas that were once vibrant textile centers with job security and economic growth. In 1940, textile and apparel manufacturing accounted for 40 percent of North Carolina's employment (Mercer 2014). Now, those areas are merely a shell of their former selves. In 2013, only 1.1 percent of North Carolina's jobs were in the textile industry (Mercer 2014). In recent years, some textile manufacturing plants have experienced success due to their awareness of and willingness to take advantage of free trade agreements. The United States exports 65 percent of its textiles to countries that have signed a reciprocal trade agreement (RTA) or free trade agreement with the United States (U.S. Department of Commerce).⁴ Other factors have helped as well, such as increasing labor costs in China and the "Made in the USA" trend (Mercer 2014).

Second, the information in the book can be used to develop policies and business strategies that make these trade agreements effective and enable firms to take advantage of these agreements. One topic discussed, particularly in Chapter Seven, is the formulation of policies in the area of textiles and apparel that align with the realities of the twenty-first century so that U.S. textile producers can increase their exports to other markets and the apparel industry in these markets also benefits. The benefit to the apparel industry in the Latin American and Caribbean regions is not just in terms of increased exports to the United States but also in the producers' ability to compete in the U.S. market and, thus, contribute to employment and economic growth in their countries.

Chapter Overview

Chapter One presents the theoretical foundation of the study. The theories considered range from the classical liberal theory of absolute advantage and the free hand of the market to the neoliberal theory of comparative advantage to present-day competitive advantage. The chapter illustrates how the path-dependency model advances our understanding of importer decision-making and industry competitiveness.

⁴ The term "reciprocal trade agreement" (RTA) is used in the book instead of "free trade agreement," because, as many scholars and practitioners have pointed out, and I concur, there is no such thing as free trade in the pure sense. Rather, today, we have a regulated market economy that allows for the free flow of goods and services yet still involves government intervention.

Chapter Two describes the realities of the textile and apparel trade market. The chapter provides an overview of the apparel industries in the selected Latin American and Caribbean markets as well as the U.S. textile market. Official trade statistics demonstrate that in some of the countries, apparel manufacturers import the majority of their yarn and fabric from the United States although less expensive alternatives exist, and, in others, Asian suppliers of yarn and fabric are preferred.

Chapter Three offers a historical overview of U.S.-Latin American and Caribbean trade in general and in textile and apparel in particular. The trade relationship evolved from economic integration to economic isolation and then back to economic integration. The integration in terms of textile and apparel trade increased following trade initiatives that set a particular pattern, encouraging the use of U.S. textiles so that Central American and Caribbean apparel exporters could access the U.S. market duty-free.

Chapter Four explains the impact of the historical trade policies on the U.S.-Latin American and Caribbean textile and apparel trade within the context of path dependency. The argument is proposed in terms of the path-dependency model—crisis, critical juncture, institutions, and power. The Central American and Caribbean regions,⁵ in particular, faced political and macroeconomic instability in the 1970s and 1980s. As a result, U.S. policies emerged to address the political and economic crises, which, in turn, established the pattern that we see today in terms of the preference among apparel producers in these regions for mainly U.S. yarn and fabric.

As Chapter Five illustrates, some countries in the Western Hemisphere, such as Guatemala and Jamaica, diverged from the established path. According to the path-dependency literature, the cost of path divergence can be higher than pursuing an alternatively more efficient path. While this may be true in some cases, I argue that, as the larger context changes, so does the cost-benefit calculation in path dependency. In these two cases, diverging from the path has not been more costly. Rather, staying on it has not proven any more beneficial. To illustrate the point, the costs are broken down in practical, not theoretical, terms to show the true costs of importing U.S. yarn and fabric and exporting apparel to the United States, compared to importing from China. This chapter highlights the importance of developing twenty-first-century trade policies that also allow trade partners to enhance their industries' ability to compete.

⁵ The Central American and Caribbean regions were labeled the Caribbean Basin region. From this point forward, the term "Caribbean Basin" is used to describe the Central America and Caribbean countries combined.

Chapter Six views the same argument in the context of a different case—U.S.–Sub-Saharan African trade in textiles and apparel. The chapter offers policy recommendations for twenty-first-century textile and apparel trade relations. The Sub-Saharan African region was selected because the United States implemented a unilateral trade policy with the region, the African Growth and Opportunities Act (AGOA), which is similar to its unilateral initiatives with Caribbean Basin countries. Additionally, AGOA contains important provisions governing U.S.–Sub-Saharan trade in textiles and apparel. However, the twentieth-century unilateral approach to U.S.–Sub-Saharan African trade has had disappointing results in the twenty-first century. The chapter ends with recommendations on how twenty-first-century trade policies could be implemented and strengthened.

Chapter Seven concludes with a summary of the theoretical arguments and policy recommendations presented in the book. The chapter also offers suggestions for future research.

CHAPTER ONE

INDUSTRY COMPETITIVENESS AND DECISION-MAKING: A CALL FOR A NEW PARADIGM

Economic theory contends that, as efficiency-seeking rational actors, people aim to maximize the utility of a product or service relative to its cost. Rational choice theory has been used to describe the behavior of individual producers and firms in the international market.¹ The theory assumes that firms enjoy perfect information and seek to maximize their profits. This assumption forms the basis of neoclassical economic theory and its focus on market competition. For instance, the economist Adam Smith writes:

It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own self-interest. ... [Every individual] intends only his own security, only his own gain. And he is in this led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest, he frequently promotes that of society more effectually than when he really intends to promote it. (1994, 15)

In other words, individual producers and consumers are self-interested. However, the self-interested behavior of producers and consumers results in a wider benefit for all involved, even if that is not the original intent of the individuals. More importantly, the benefit to society occurs due to market forces and without government intervention.

Game theory also maintains that firms act rationally. At the same time, game theory goes beyond individual calculation to argue that individual

¹ Government, which shapes the decision of individuals, political parties, and individual voters all behave in a manner that seeks to maximize output for a given input (Downs 1957). Almost two decades later, Becker (1976) explores rational decision-making in relation to a variety of issues, such as marriage and education.

decisions are based on what the other actor does in an effort to maximize wealth and be competitive (von Neumann and Morgenstern 2004).

Following the rational choice theory of decision-making, we would expect apparel producers in the Caribbean Basin to purchase most of their textiles from the lowest-cost suppliers, such as Bangladesh, Cambodia, Lesotho, Madagascar, or Nepal, in order to maximize their efficiency ("Textiles and Garments," n.d.). However, empirical evidence reveals contradictory real world practices, and the failure of the rational choice approach to explain such outcomes calls for deeper examination of other possible factors.

The path-dependency approach, which takes into account the role of history, power, and institutional rules, offers more insight into comprehending importer decision-making and export industry competitiveness in specific markets.

Importer Firm Decision/Behavior

The rational choice approach to understanding behavior in general has a number of limitations. This particular theory assumes perfect information in the decision-making process. Therefore, rational choice theory has minimal explanatory power for cases in which there is uncertainty or limited information. Another problem with rational choice theory is in the difficulty it has in adequately describing the underlying motives of human behavior. "There may, for example, exist several ways by which to reach the optimum position; they depend upon the knowledge and understanding which the individual has and upon the paths of action open to him" (von Neumann and Morgenstern 2004, 9).

Game theory has been commonly accepted as an adequate explanation of firm decision-making and behavior. The game-theoretical model emerged from a "logical analysis of games of chance rather than from a psychological analysis of risk and value. The theory was conceived as a normative model of an idealized decision maker, not as a description of the behavior of real people" (Tversky and Kahneman 1986, S251). Unlike rational choice theory, game theory takes into account imperfect information. According to game theory, actors behave rationally in terms of self-interest. However, individual actors also behave according to the information that they have at the time about the actions and behavior of another actor. In other words, one actor has the capacity to influence the behavior of another actor, and the game is noncooperative and zero sum, in which there is a winner and a loser (von Neumann and Morgenstern 1944).

The game-theoretical model has been applied to the study of international trade (see Abbott and Kallio 1996; Zhuang, Luo, and Fu 2014). Even in the game of international trade, both countries and firms either cooperate or compete based on the actions of other countries or firms. Game theory assumes that the Caribbean Basin garment firms in this study base their decisions to import textiles from specific countries on the actions, such as product pricing, of the textile firms in those countries. However, the Caribbean Basin apparel manufacturers do not appear to import based on price alone.

Game theory has been lauded for being an approach to decision-making that is “more careful and more precise than is typical in economics” (Friedman 1992, 355). However, game theory has also been criticized as having limited utility because of its emphasis on theoretical development rather than practical applicability and results (Ashford 1977; Fisher 1989; Friedman 1992; Tversky and Kahneman 1986). Fisher writes:

There is a strong tendency for even the best practitioners to concentrate on the analytically interesting questions rather than on the ones that really matter for the study of real-life industries. The result is often a perfectly fascinating piece of analysis. But so long as that tendency continues, those analyses will remain merely games [that] economists play. (1989, 123)

Additionally, the game-theoretical model is static, which means that it fails to take into account a variety of factors that can influence decision-making and the complexities associated with decision-making.

Lastly, the game-theoretical model assumes that all parties have the same information and belief systems. Such a restrictive, static approach limits the applicability and reliability of the final conclusions drawn about firm behavior. Perhaps, the bounded rationality model better addresses the differences in belief systems among decision-makers (Friedman 1992).

The bounded rational model argues that, while individuals behave rationally, they seek to satisfice or have a “good enough” outcome, rather than to maximize self-interest (March and Simon 1958). Much like individuals, firms to seek to satisfice results, rather than merely achieve profit maximization (Cyert and March 1963). In a discussion about firm decision-making behavior, Machlup writes:

Thus, behaviorism rejects the assumptions of marginal analysis that economic action is directed by the objective to maximize the attainment of ends with given means, and that business action can be deduced from a postulate that firms attempt to maximize money profits. Instead, we are directed to *observe* how businessmen really act and by what processes they reach decisions. (1967, 4)

The bounded rational model builds on cognitive psychology studies by showing the limits of individual decision-making due to uncertainty (Simon 1997). The bounded rationality explanation explores other motives that guide firm decision-making, which can help explain the decision-making behavior of the Caribbean Basin apparel firms that import more expensive textiles, thus cutting into their profit margin and ability to compete in the U.S. market. If the goal of a firm is to remain a step ahead of its competitors, then the question remains as to why Caribbean Basin apparel firms do not rely mainly on the low-cost textiles from Asian suppliers to reduce their costs in order to compete in the U.S. market. The rational and bounded rationality approaches focus on firm preferences at the expense of formal rules and institutions that also shape behavior.

Something larger than the individual firm may shape the decisions that these same actors make. For example, Brander and Spencer (1984) emphasize the decision-making of individual firms while also mentioning the role of export subsidies, which refer to a government policy under which exporters receive financial support. The two economists find that export subsidies bring about cooperation.

By the early 1970s, scholars began to take into account the role of institutions, as well as the power capabilities of those institutions, including in the area of political economy. For example, Galbraith (1983) examines the power relations between businesses and government and finds that economics is a function of power. Power is “the bending of the will of one person to another by straightforward purchase” (Galbraith 1983, 47).

Notably, Galbraith’s work focuses on the United States and examines the internal relationship between U.S. corporations and the government. Galbraith’s work lays the foundation for this study, which examines power relations among firms across borders and the foreign trade policies that are enforced.

Still, the shift toward the institutional approach was gradual. “Political scientists have been slow to develop an alternative paradigm for policy analysis, because they have mainly confined themselves to the economist’s basic unit of analysis, the individual,” writes Ashford (1977, 571). Institutional theory eventually emerged with the idea that institutions, not individual preferences, play a key role in behavior and are autonomous actors. Furthermore, the emphasis on institutions in the late 1970s, which has become known as old institutionalism, maintains that a single event in history shapes outcomes (Ashford 1977).

Old institutionalism adds value to the aforementioned economic models by shifting the focus away from individual-level preferences and outcomes

to a close examination of “the actual capabilities and characteristics of modern state institutions” (Ashford 1977, 573). This approach offers insight into additional factors, such as history, that drive decisions. Old institutionalism also assumes efficiency in history. “By ‘historical efficiency’ we mean the idea that institutions become in some sense ‘better’ adapted to their environments and quickly achieve a uniquely optimum solution to the problem of surviving and thriving” (March and Olsen 2009). However, old institutionalism’s recognition of the role of history was ephemeral. Additionally, the old institutionalist approach’s explanatory value has been limited because of its failure to address institutional change and outcomes. As a result, a revised version, new institutionalism, emerged to account for these fallacies.

New institutionalism highlights the fact that institutions do change and evolve over time.² Institutions may change because of new technologies and through the combination of existing and newly created rules (Neale 1987). Unlike its predecessor, new institutionalism finds that “[h]istory cannot be guaranteed to be efficient” (March and Olsen 1984, 737).

The emphasis on an event in history that sets in motion certain behavior can bring us closer to understanding the decision of some Caribbean Basin garment manufacturers to import higher-cost U.S. yarn and fabric. History cannot be ignored in these cases, because many of the firms that export apparel to the United States are taking advantage of the opportunities offered by the historical trade programs that exist with the United States. These trade programs offer Caribbean Basin apparel exporters special access to the U.S. market in exchange for the use of U.S. inputs.

The new institutionalist approach also provides a more systemic definition of institution. Institutions are autonomous actors that shape individual preferences (Krasner 1984; Levi 1981; Nordlinger 1981; Skocpol 1985). Some scholars dig deeper to explain how institutions shape people’s behavior through a repeated system of rules.

An *institution* is identified by three characteristics. First, there are a number of *people doing*. Second, there are *rules* giving the activities repetition, stability, predictable order. Third, there are *folkviews*—most certainly what Walton Hamilton meant by a “bundle of intellectual usages”—explaining or justifying the activities and the rules. (Neale 1987, 1182)

Furthermore, new institutionalism explains how institutions form in the first place. Institutions are created by “some peculiar historical conjuncture

² For a detailed overview of new institutionalism, see March and Olsen (1984).

rather than contemporaneous factors” and, in following a branching model, “once a particular fork is chosen, it is very difficult to get back on a rejected path” (Krasner 1984, 225).

Institutions play a key role in decision-making and firm behavior. Specific government policies can change the rules of the game, which, in turn, shapes the behavior of firms in the international market. For instance, although many neoliberal economists decry export subsidies, Brander and Spencer (1984) find that “export subsidies can appear as attractive weapons because they improve the relative position of the domestic firm in non-cooperative rivalries with other firms, and allow it to expand its market share” (19).

Institutions also affect the distribution of resources (Korpi 1985; Steinmo, Thelen, and Longstreth 1992). “In interdependent decision-making the distribution of power resources among rational actors is likely to be crucial for their choice of strategies,” according to Korpi (1985, 40). Korpi goes on to argue that the type of power resource an actor uses shapes the behavior of other actors. For example, if both actors use pressure to reach their ultimate goal, the probability of conflict is high. If the same two actors use rewards as a mean to an end, there is a greater chance for a mutually beneficial exchange. However, when the stronger actor exerts pressure while the other weaker actor offers rewards, the stronger actor will exploit the weaker one. As Korpi writes:

[P]ower resources can be used to structure the conditions and the situations in which action and decision-making take place as well as to create institutional structures for decision-making and conflict resolution. By determining the context and conditions as well as the methods, principles, and structures for decision-making, power resources can have major consequences without being directly or continuously exercised in decision-making. (1985, 38)

These power resources are invested in institutions that constrain the behavior of others, including in market relationships.

The Nobel laureate in economics Douglass North later incorporated the rules of the game and history into the following definition of institutions:

Institutions are the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction. In consequence, they structure incentives in human exchange, whether political, social or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change. (1990, 3)

Pénard (2005) does not throw out game theory altogether either. Rather, in his essay titled “Game Theory and Institutions,” Pénard (2005) purports that game theory explains the purpose behind institutions. Rather than looking at institutions as outside factors that shape the decisions of economic actors, Pénard looks internally to define institutions as the interaction between one player and other players in a game, in which those players holds a “specific status” and are able to directly affect the rules of the game and the final outcome (2005, 2). Institutions facilitate coordination, commitment, information sharing, and cooperation.³

Van de Ven and Lifschitz (2013) propose the reasonable behavior approach, which also looks endogenously at economic actors within markets and institutions as well as their ability to constrain behavior and promote collective action. The reasonable behavior approach shifts the focus back to individual behavior within institutions but also highlights the good in economic actors. Reasonable behavior is defined as “a socially constructed set of norms and standards of what society considers prudent, fair, and just behavior” (Van de Ven and Lifschitz 2013, 157).

The problem with the reasonable behavior approach is its predominantly theoretical premise. Van de Ven and Lifschitz’s piece gives an elaborate account of the various theoretical models used to explain individual behavior in the market context. However, the scholars’ work lacks empirical evidence that would be useful in comprehending what actually happens in the global market. Consequently, the reasonable behavior model provides little in terms of explaining exploitation in the global market and the 2005 collapse of multilateral trade talks such as the Free Trade Area of the Americas (FTAA) and the Doha Round of the World Trade Organization (WTO).

Overall, institutionalist literature addresses complex aspects of decision-making through the focus on history and the use of methods such as process tracing. This aspect of institutionalism becomes useful when studying the decision of Caribbean Basin apparel exporters to import the more expensive U.S. textiles. Furthermore, institutionalism takes into account the role of institutions in distributing power resources that eventually shape the decisions that economic actors make. While useful, institutionally based arguments also face an important challenge—their failure to distinguish among the types of firms, the resources available to

³ See March and Olsen (1984) for a broad overview of studies that look within institutions to study the processes and capabilities of the institutions themselves, rather than external factors that determine the ability of institutions to have any influence.

them, and their interests. As a result, the new institutionalism is limited in its ability to explain the differences between importer and exporter behavior.

Some scholars have examined the behavior of importer versus exporting firms, thus filling this gap. Many studies of international trade focus on exporters as driving international trade while importers behave as passive actors. However, as Liang and Parkhe (1997) argue, importers are actually the strategic actors that drive exporters through their selection of particular countries and products as well as forming joint ventures with exporters. A number of factors influence the behavior of firms that import, which may help shed light on the decisions of Caribbean Basin garment producers that import textiles.

Costs are one factor that shape a firm's decision to import (Hallen 1982; Liang and Parkhe 1997; Scully and Fawcett 1994; Swamidass 1993). The cost of material becomes more important than direct labor cost for importers seeking to compete in the international market. As a result, firms use global sourcing to access lower-price goods (Scully and Fawcett 1994).⁴ However, cost is not the only reason that firms import.

Other determinants of importer decisions include advancing one's competitive position in the international market (Frear, Metcalf, and Alguire, 1992; Swamidass 1993). In their study of large and small U.S. firms, Frear et al. (1992, 2) consider "international sourcing to be an important element of competitive strategy. Likewise, purchasing from foreign suppliers to achieve lower cost is an effective competitive action." Although firms' desire to compete drives their decision to import, cost still plays a role. Cost competitiveness is key to "winning" in the global market.

Firm size and geography also explain importer behavior. Larger firms import more than smaller firms (Birou and Fawcett 1993; Carter and Narasimhan 1990; Mittlstaedt, Raymond, and Ward 2005; Scully and Fawcett 1994).⁵ Furthermore, urban firms and geographically concentrated industries are more likely to import (Mittelstaedt, Raymond, and Ward 2005).

Studies of importer behavior offer useful insights into the decision of some Caribbean Basin apparel producers to import the more expensive U.S. textiles. These studies vary from previous ones, because they focus on the firm as the unit of analysis. Furthermore, the literature contributes to theory development and practical application (Swamidass 1993). Lastly,

⁴ Scully and Fawcett (1994) study small U.S. firms.

⁵ Firm size is defined by both revenue and the number of employees.

yet just as important, is the fact that the literature recognizes the significant role of importers in international trade.

At the same time, studies of importer behavior fail to recognize the exogenous factors that influence decisions, such as trade rules. Examining such external forces requires an emphasis on the exporter side of the equation, since the trade rules govern the interaction between exporters and importers.

Export Industry Competitiveness in Specific Markets

Countries compete in the global market by specializing in goods that they are able to produce most efficiently (i.e., more output per worker), according to Adam Smith's classical liberal economic theory of absolute advantage. The economist David Ricardo's comparative advantage theory argues that a country can compete by exporting products in which it has a lower opportunity cost than its exporting partner (Ricardo 1996). That country should import goods for which the opportunity cost is much higher, even if the partner country is not able to produce anything efficiently. Other models build on Ricardo's neoliberal economic approach. For instance, the Heckscher-Ohlin theorem highlights a country's inherent factors, such as land, labor, and capital, all of which contribute to its ability to compete in the international market. Thus, a country should export products that use its most abundant resources and import goods that use its scarce factors.

The classical and neoliberal theories highlight one important factor for competitiveness: lower costs. These theories assume that textiles from the United States are at a comparative disadvantage relative to the many low-cost textile suppliers around the world, such as those in Asia. However, the opposite remains true when U.S. textile competitiveness in specific markets is closely examined. Perhaps, other factors must be examined to understand how an industry in any given country can compete against much lower-cost suppliers in specific markets.

Many studies in the second half of the twentieth century shift the focus to the exogenous factors that can determine a country's ability or inability to compete in the international market. The development economist Hans Singer (1964) maintains that underdeveloped countries specialize in primary commodities, that is, agricultural goods and raw materials that are exported to industrialized countries at a very low cost. By contrast, industrialized countries manufacture goods that can be sold at a higher price to the less developed countries and earn a higher profit. This type of