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RMG Export Performance: Two Years after the MFA Phase-out

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Abstract

The multi-fiber arrangement (MFA) which facilitated growth of the readymade sector in many developing countries like Bangladesh was lifted in January, 2005. Although the full impact of lifting of quota is yet to be felt, many sign of fallouts are already visible in Bangladesh. Unlike some sub-sectors that have been showing their resilience and performing quite well despite stiff competition from the giant exporters like China, a few others have started receding grounds. The implications of this loss of market have indeed been quite significant particularly in terms of employment of the poor. The present paper basically focuses on both positive and negative developments in the readymade garments (RMG) sector during the last couple of years of post-MFA regime.

Introduction

Bangladesh is well known across the globe for its stunning success in the arena of ready made garments (RMG). Yet everyone is concerned about the country's RMG sector which now occupies a very significant position in the economy of Bangladesh accounting around 5% of the Gross Domestic Product (GDP). Though the RMG products were quite unknown even before 1980s, the export of this sector became prominent within a short span of time. According to the information provided by the Bangladesh Export Promotion Bureau (EPB), it is observed that the share of RMG export was 75.71 per cent (woven 38.80 per cent and knitwear 36.91 percent) in the total export earnings of the country during financial year 2006 – 2007 (Government of Bangladesh, 2007).

RMG expansion has also created ample employment opportunities for millions of women, who otherwise would have been left out as unemployed. At present, more than two million people -- 80 per cent of whom are females – are engaged in this sector for their livelihoods. Many more opportunities of employment have been created in other ancillary sectors like packaging, courier service, port handling, transport,

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insurance, marketing and banking as well. Both men and women have been employed in these related enterprises.

The development of Bangladesh's RMG industry has been due to the long restricted global trade in textiles and clothing (T & C) through which the developed countries constrained imports by the Multi-fibre Arrangements (MFA). The prime objective was to protect domestic manufacturers in the importing countries from competent producers of the developing countries. This in turn led to export opportunities in countries where textile and clothing were non-traditional export items. However, the governments in developed countries recognized the importance of widespread restraints as numerous developing countries began to develop their textiles and clothing sector. As a result, the MFA regime surfaced under which countries whose markets are disrupted by increased imports of textiles and clothing from another country were able to negotiate quota restrictions. With the full implementation of the MFA system, the developed country producers would have to compete with the established producers in developing countries.

The MFA which facilitated growth of the readymade sector in many developing countries like Bangladesh was lifted in January, 2005. Bangladesh's export earnings are overwhelmingly dominated by the performance of the RMG industry as no other export items have managed to show any steadfast trend and growth performance. There have been a lot of concerns on the adverse effects of the abolition of the MFA quotas on a number of countries. During the Uruguay Round, the developing countries advocated for the abolishment of trade barriers as the MFA was restricting their exports of textiles and clothing and the Agreement on Textiles and Clothing (ATC), a legal framework was provided for phasing out the trade regime of the MFA (Government of Bangladesh, 2004).

Being highly labour-intensive in nature, any opposing effects on RMG exports will lead to a loss of employment, particularly to women which is likely to have far reaching social implications. The macroeconomic balance and stability achieved by Bangladesh may be severely damaged due to any major shock emanating from the abolition of the quota system. The phasing-out of the quantitative restrictions on imports from developing courtiers in the developed country markets will expose Bangladesh to severe competition from countries whose exports have so far been restricted.

After the expiry of the MFA regime on January 01, 2005, it was anticipated that the RMG sector would face fierce competition from major players like China and India, whose exports have so far been severely restricted due to the quota system. The abolition of the MFA was, therefore, predicted to have far reaching implications for the national economy. It was feared that because of lack of product diversification, low productivity, shortage of skilled workers and limited backward linkage support, the MFA phase-out would considerably reduce the pace of expansion of RMG sector in Bangladesh. In reality, we however, witnessed a reversed picture.

What actually happened in the RMG export after the MFA phase-out? To explore the answer of this question, the paper draws a comparison on the role of RMG in the total export earnings of Bangladesh in both the MFA and post-MFA regime. Hence, the main objective of this paper is to make an assessment of the performance of RMG industry in both the MFA and post-MFA regime. It will help us understand the implications of the end of the quota system on the Bangladesh economy.

Post-MFA Implications

After the removal of MFA quotas since 1 January 2005, the developed country producers came under direct competition with the producers in developing countries. One of the concerns that surround the phasing out of the quotas is the likelihood of having some adverse effects on a number of countries. A number of studies based on a general equilibrium model have been undertaken in finding out Bangladesh's export projections in the post-MFA era. Mlachila and Yang (2004) forecasted a decline in Bangladesh's clothing and textile exports by approximately 18 and 5 percentage points respectively together with a reduction in GDP by 2.3 percent following the phasing-out of quotas. Lips et al. (2003) found the removal of MFA quotas to cause a decline in the production of Bangladesh's wearing apparels by 20 percent. This was due to the presence of larger quota rents in India and China which helped these countries to accommodate price shocks. Bangladesh enjoying quota-free access to the EU market would not have quota rents to mitigate price falls in face of severe competition due to the abolition of the MFA system which is likely to cause a downward pressure on prices. In another study, Nordus (2004) found Bangladesh's share in the EU clothing imports to increase by one percentage point. But, in the US, the market share for Bangladesh was likely to decline by two percentage points.

A number of studies carried out by the Ministry of Commerce, Government of Bangladesh also focused on trade reforms and export responses after MFA phase-out. Due to the abolition of MFA quotas, 83 percent of Bangladesh's export to the US market has been exposed to competition whose impact would likely to be felt in the near future (Government of Bangladesh, 2005).

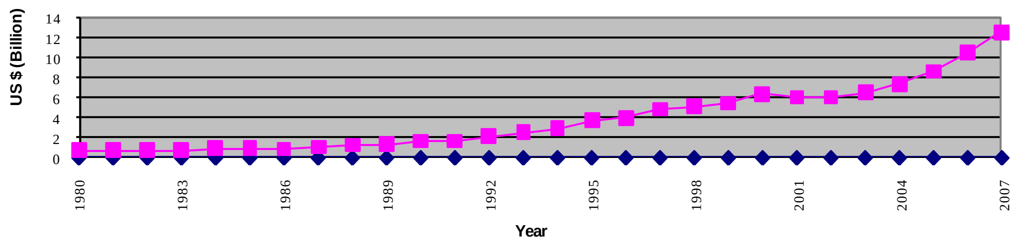
It has been argued, however, that the MFA may cut off access to major export markets for developing countries, thereby short-cutting their industrialization process at an early stage. In the long term the MFA discourages newcomers from becoming successful exporters of textile and clothing products. Although it also encourages foreign investment in unrestricted developing countries, in general the MFA may harmful to current and potential exporters of textiles and clothing in developing countries, and it benefits domestic producers of textiles and clothing in the importing industrial countries.

Following the MFA phase-out, Bangladesh started to experience considerable competitive pressure from China in a number of items of major export interest to Bangladesh (Rahman and Anwar, 2006). Despite a depressing picture for Bangladesh's export scenario in the post-MFA era, a number of encouraging developments have started for Bangladesh at the closing stages of the MFA period. Capital and machinery imports for RMG have gone up in view of the brilliant business prospects by the entrepreneurs in the quota free world. The restrictions placed on China by the US gave an indication that towards the end of 2008, importers would not entirely depend on China for importing textile and clothing products.

Export Performance between MFA and Post MFA Period

Over the last two and a half decades, Bangladesh experienced a positive growth in its export earnings. The export earning of Bangladesh, which was US$0.9 billion in the early 1980s, doubled in 1990. Due to the relative high export growth since the 1990s, Bangladesh's exports stood at US$ 10.5 billion in 2006 and US$12.6 billion in 2007 (Figure 1).

Figure 1: Total Merchandise Exports of Bangladesh (1980 - 2007)



***Source**: Razzaque and Raihan, 2008*

The annual average growth of real export was perceived as 12.5 per cent in the 1990s compared to 3.4 per cent in the 1980s. In the late 1980s, raw jute and jute products overwhelmingly dominated the export sector constituting 74 per cent of the export accruals. This was later replaced by a robust growth of the RMG sector accounting for around 75 per cent of the total export in 2006. Over the years, to encourage exports particularly in the RMG sector, Bangladesh introduced generous promotional measures like subsidized rates of interest on bank loans, duty-free import machinery and intermediate imports, bonded warehouse, back-to-back Letter of Credits (LCs), cash subsidies, duty drawbacks, exemption from value added and other taxes, retention of export earnings in foreign currency, etc. The sector responded positively to these measures.

Table 1 presents a comparative picture of the export performance between MFA and post MFA period with especial focus on the RMG export earnings.

Table 1: Export Performance between MFA and Post MFA period

Mil. US $

Export items	Export performance MFA Period January 2003 to December 2004	Export performance Post-MFA Period January 2005 to December 2006	% Change of export performance Pre-MFA Over Post MFA
All products	15328.37 (100)	20950.13 (100)	+ 36.67
Woven RMG	6812.52 (44.44)	8163.25 (38.96)	+ 19.82
Knit RMG	4666.35 (30.44)	7547.8 (36.02)	+ 61.74

Source: *Authors' calculation based on Bangladesh Export Promotion Bureau (EPB) Data*

It is noted from the recent export performance of the country that the export earning from RMG sector stood at $20.9 billion after 24 months of the post-MFA regime (January 2005 to December 2006). This indicates a robust growth of 36.67 per cent over the same period of the previous 24 months of the MFA period (January 2003 to December 2004). Though RMG sector consists of woven and knit products, woven items (44.44 percent of total export earnings) was playing the lead role in the RMG export-earning during the MFA period. In the post-MFA regime, the growth of woven export increased by 19.82 per cent than that of the corresponding period of the MFA regime. On the other hand, knitwear export (36.02 percent of total export earnings) continued to increase quite sharply after the MFA phase-out. Knitwear demonstrated a robust growth of 61.74 per cent in the post MFA period compared to that of the MFA period. That means the knit sub-sector has been more efficient than the woven, which continued to increase sharply over the years.

Market Access during post MFA Regime

Bangladesh exports RMG items mainly to two principal markets -- the USA and the European Union (EU) countries. While the USA accounts for 38 per cent of the total RMG exports of Bangladesh, the share of the EU countries is 56 per cent. Comparing RMG export in the US market between MFA and post-MFA regime, it is observed that RMG export earning increased to $20.9 billion in the first 24 months of the post-MFA regime (2006) from $15.3 billion in the same period of the corresponding previous period (2004). The RMG export to the USA thus registered a growth rate of 24.22 per cent. A similar positive trend is also found in the woven and knit products separately. The woven and knit export to the US market in the post-MFA period rose by 17.82 per cent and 168.92 per cent compared to the same period of MFA regime. Woven products accounted for 51.95 per cent of total RMG receipts in the US market in the first 24 months of the post-MFA era while the figure was 48.05 per cent in the same period of the corresponding previous year. On the other hand, knitwear showed a robust growth performance contributing about 48.05 per cent in the RMG export earning in the same period of post-MFA period from only 30.44 per cent in the corresponding period of the MFA.

Reasons behind the Notable Achievement so far in the Post-MFA Regime

One of the important factors that contributed to the enhancement of export earnings of Bangladesh in the post-MFA regime is the imposition of the safeguard measures against the world's leading supplier, China which will continue up to the end of 2008 (Razzaque and Raihan 2008). In the first year following the MFA phase out, countries like Bangladesh, Cambodia, Indonesia, Pakistan, the Philippines, Sri Lanka and Vietnam had lost their market share to EU. But, due to the safeguard measures imposed in the latter half of 2005, China's growth in 2006 more or less stagnated. As a result, China's exports in terms of value grew only by 21 percent during the first seven months of 2006 as compared to 54 percent of the previous year in the US market (ibid.). In the same way, China's exports in all types of textile and clothing fell by 8 percent in volume to the EU. During January- July 2006, China managed to record a growth in the value of exports by only 6.5 percent compared to the same period of the previous year. Thus, Bangladesh seems to have benefited from the safeguard measured imposed against China.

Another significant factor that contributed to Bangladesh's export performance is due to the depreciation of taka, which coincided with the phasing out of the MFA regime (ibid). Floating exchange rate system has been maintained in Bangladesh since March 2003.

All the above factors contributed to the increased total export earnings of Bangladesh. The development of the knit products seems to have performed better than the woven products. In the post-MFA period, the increase in export earnings from woven products was slower compared to the corresponding period of the MFA period.

Challenges Ahead

For continued success in the quota-free world, the RMG industry in Bangladesh which is characterized by lack of proper infrastructure as well as labour unrest should be properly taken care of. Cheap labour is one of the base of Bangladesh's performance in the apparel trading. Lack of safetyness at workplace and refusal of the minimum wages led to frequent vicious demonstrations by the workers. The minimum wages of the workers should be ensured at all levels. As a result of the labour unrest, a Commission appraised the minimum wages of the workers in the RMG industry. However, this may lead to some difficult connotations for Bangladesh's competitiveness. Bangladesh will have some time to adjust the rising labour cost through other cost cutting measures till the end of 2008. Only after the complete removal of restrictions on China from the beginning of 2009, Bangladesh will be facing the real challenging situation. Besides, political unrests, regular power crisis, ineffective ports and local transportation, lack of investment fund and working capital, shortage of skilled workers are also likely to have far reaching implications on the country's ongoing export success. Proper steps should be taken in developing the backward linkage industries necessary for the continued export growth of RMG in Bangladesh.

Knit products have been found to perform better than woven products in overall export earnings of Bangladesh. The weak performance of the woven items is an area where there is scope for improvement. The woven products exported from Bangladesh to the EU declined by 12 percent for the year 2005. Due to low domestic value added content, most woven garments of Bangladesh do no qualify for EU GSP facilities. The GSP facilities were considered to beneficial for Bangladesh in the EU market prior to expiry of the MFA quota. But preferences for woven garments are not assured due to the non fulfillment of EU rules of origin.

One of the constraints to Bangladesh's export-oriented RMG sector is the tariffs faced in the US which affects Bangladesh's relative competitiveness. Countries enjoying duty-free access in the US have been able to enlarge their market share at the cost of Bangladesh's share due to discriminatory tariff preferences. Therefore, Bangladesh should advocate for duty-free access to the US market. Since in the post-MFA era, high tariffs on textile and clothing items are likely to be continued at least for some time, the preferential treatment to some countries may lead to foreign investment in these countries at the cost of the excluded countries. The existing high tariff barriers on textile and clothing can harmfully affect Bangladesh's RMG export prospects. On the other hand, the phasing-out of MFA quotas is likely to adversely affect Bangladesh's exports to the EU as most LDCs need to fulfill the EU rules of origin (ROO). In knit-RMG, the rate of GSP utilization is higher compared to woven-RMG due to strong backward linkages. Bangladesh may be in disadvantageous position compared to China, India and Pakistan in expanding exports in view of the inadequacy of backward linkage industries.

The average lead-time for Bangladesh's export delivery fluctuates between 90 and 120 days compared to an ideal average of 30 to 45 days. This is due to Bangladesh's geographical location requiring long time to ship its products to the principle markets of US and EU. In addition, most of the raw materials which have to be imported through back-to-back letter of credit (L/C) also contribute to longer lead time. However, countries like Bangladesh which are located in geographically disadvantageous position cannot ignore the importance of reduced lead time as the Western markets are not interested in retaining large stocks. Instead of depending on the existing back-to-back system for obtaining raw materials for the exporters, the operation of centrally bonded warehouses might be encouraged. This will enable the exporters to store the required raw materials for future export orders which in turn can also significantly reduce the lead time. The inefficiencies in ports and inland transportation contribute to higher costs of conducting business in Bangladesh. Besides, the poor physical infrastructure of Bangladesh is responsible for the longer time required in the procurement of inputs as well as getting the products to the market. This is turn weaken the competitiveness of the exporters. On the other hand, availability of funds in expanding a business and introducing new products is scarce. This also creates obstacles in attaining latest technology which is essential to increase competitiveness. Finally, a weak backward linkage exists in the RMG sector. The local value addition in knit-RMG sector is higher than the woven-RMG sector due to its heavy dependence on imported raw materials. The support from the government which may encourage the private sector in setting up backward linkage industries is crucial. Unless proper attention is paid to these problems, the exporters are likely to face difficulties in competing in the global market.

Conclusion

The strong growth rate of Bangladesh's exports is dependent to a large extent on the safeguard measures imposed on China both by US and EU. The actual situation will be visible from the beginning of 2009, when all sorts of restrictions will be removed from China. The first six months of 2005 were the period when China was permitted to export freely and during that period Bangladesh's exports declined in the EU market. Bangladesh seems to have performed much better in the presence of quantitative limits forced on China. Due to similarity of the exportables of Bangladesh and China in the US market, free trade will open up severe competition between the two suppliers. There are genuine concerns about the formidable challenges Bangladesh will have to face along with other countries including China. In addition, the recent increase in minimum wages is also likely to wear down the competitive margin. However, despite all the challenges ahead, if present trend of RMG export growth continues the RMG industry of Bangladesh will notably contribute to new employment and investment opportunities in future, which will ultimately has a positive effect on the overall export earnings of the country.

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