

Ready made garment industry of bangladesh

[Business](#), [Industries](#)



Abstract

Since the 1980s the export oriented readymade garment (RMG) industry of Bangladesh has experienced an extraordinary evolution: This trend was accompanied by a tremendous rise in the export share from 0. 2% in 1980 to nearly 75% in 1997-98. High concentration on low value-added products, strong dependence on imported textiles and high regional concentration of exports characterize Bangladesh's RMG sector.

The main policy framework is given by the WTO's Agreement on Textiles and Clothing (ATC) which follows the former Multifibre Arrangement (MFA). By 2005, the sector is to be fully integrated into GATT rules and existing quotas currently hampering trade will come to an end. Thus, it can be expected that worldwide trade in textile and clothing will expand and that production in now discriminated regions will increase. However, existing import tariffs for textiles, strongly supported by local textile producers, hinder the current RMG production in Bangladesh.

In this paper we will discuss how future policy developments may affect the RMG sector of Bangladesh. For the analysis we used the comparative static general equilibrium model GTAP. In this model quotas resulting from the MFA agreement are included as export tax equivalents. Compared to China and India, Bangladesh has less restricted access to the most important markets the EU and USA. The experiments simulate a full phase-out of the MFA quotas, as well as a reduction of import tariffs in the textile and clothing sector.

First results indicate an increase in RMG production in Bangladesh, but compared to China and particularly India growth rates are quite modest. It is shown that the effects resulting from textiles imports tariff reduction in Bangladesh itself are stronger than the MFA phase out. This demonstrates the importance of the existing tariff regime for textiles. Furthermore it can be shown that RMG imports from Bangladesh to NAFTA are reduced while China and especially India significantly expands their exports to this region.

Although Bangladesh can augment its RMG exports on the second large market, the EU, again it loses in competitiveness against China and India.

Introduction

The export oriented readymade garment (RMG) industry of Bangladesh has experienced an extraordinary evolution: having started with 9 enterprises in the late seventies, the number has now grown to over 3000. This trend was accompanied by a tremendous rise in the export share from 0.2% in 1980 to over 80% in 1998. With a value of about 4 billion US\$, the RMG industry has clearly become the dominant source for Bangladesh's export earnings.

However, Bangladesh's RMG sector is characterized by some unfavourable circumstances: the sector highly depends on imported fabrics. In 115 out of 127 categories of fabrics the share of imports exceeds 70% (CPD, 1999). Over the years about half the export earnings were spent on textile imports. Since natural conditions in Bangladesh hardly allow for a huge expansion of cotton production, this problem will continue in the future. Additionally, the added value in the apparel sector is quite low.

The sourcing of textiles for the Bangladesh RMG industry has changed dramatically over the last 20 years. In the 1980s, the dominant suppliers were the high-income Asian countries, led by Japan with an import share of more than 40%, and followed by Korea with a share of about 10%. Until the mid 1990s, Korea had taken over the position of Japan as the leading source for textile imports, with a share of around 30%. Since then, India has expanded its textile imports into Bangladesh, and more recently China has started to assume an increasing importance.

By 1998, 35% of textile imports were sourced from China and about 20% from India. Bangladesh's RMG sector is concentrated both in regards to export products and export markets: the concentration of products is much higher than for India and China, two important competitors on international markets, while 90% of Bangladesh RMG exports are going to two markets, the EU and the USA.

The main policy framework is given by the WTO's Agreement on Textiles and Clothing (ATC) which follows the former Multifibre Arrangement (MFA). By 2005, the sector is to be fully integrated into GATT rules and existing quotas currently hampering trade will come to an end. Bangladesh faces quota in two markets, the USA and Canada. Due to the Generalised System of Preference (GPS) the important EU market provides no quota restrictions for Bangladesh's textile and clothing products. With respect to other competitors on this market like India and Sri Lanka this presents a comparative advantage.

Nevertheless, some restrictions resulting from the Rules of Origin also apply for imports from Bangladesh. In the near future, the EU market for textile and clothing will not only be affected by changes in the ATC agreement, but by bilateral agreements connected to further enlargement processes of the EU as well as developments with regard to the EU's specific regional preferences. This will particularly influence the market access of the Central and Eastern European countries and Turkey. In general, the abolition of textiles and clothing quotas will initiate an expanded worldwide trade and production in now discriminated regions.

This of course will lead to country specific effects depending on regional idiosyncrasies. Concerning Bangladesh existing import tariffs for textiles, strongly supported by local textile producers, hinder the current RMG production in Bangladesh. In the recent past the pure existence as well as the rate of these tariffs has been under heavy discussion in Bangladesh (e. g. The Independent, 2002). Therefore, we will discuss how different future policy developments may affect the RMG sector of Bangladesh.

This includes the changes in the global ATC agreement, further developments on the huge import market EU as well as changes in the national tariff regime of Bangladesh. DATA and SIMULATIONS The analysis was done using the comparative static general equilibrium model GTAP. Since the GTAP framework is well known and documented (see Hertel, 1997 and <http://www.gtap.agecon.purdue.edu>), we will not elaborate on its theoretical background here. However, it is important to note that import

barriers resulting from the ATC agreement are calculated into tariff equivalents (see Francois & Spinanger, 2002 and table 2).

For the experiments the GTAP database version 5. 1 was used, which contains 66 countries and 57 sectors. The selected aggregation can be obtained from 1.

If exports are constrained under the MFA export quota regime, there are lower exports and higher prices than in a free-trade situation. The effects of this constraint can be measured in terms of an implicit export tax or tariff equivalent of the quota rent.

Not all countries are facing quotas on each export market. The tariff equivalents described here result from the estimation of rents and thus include not only direct but also indirect effects originating from the ATC agreement. The estimated value of the export tax equivalent for Bangladesh is 190 million US\$ in 1997, which amounts to 8% of the domestic value of total RMG exports. Exports to the North American markets from China and India apparently face higher quota restrictions, as the estimated ad-valorem tariff equivalent of the quota shows. For example, Indian exports to the USA would be more than 50% cheaper without the quota.

The current RMG production in Bangladesh is affected not only by export measures but also by existing import tariffs. Although the country has experienced some liberalization in the recent past, tariffs for intermediate inputs and especially textiles are high compared to other products entering Bangladesh (see table 3). In international comparison Bangladesh levies

relatively high import taxes on its textile imports (table 4). Tariffs of more than 30% of the import value are not uncommon. On (trade-weighted) average, textile imports into Bangladesh face a tariff equivalent of 29%, which is three times as high as the world average. According to the GTAP database, the tariffs on textiles have contributed approximately 420 million US\$ to tax revenues in Bangladesh.

Since the RMG sector of Bangladesh is restricted on the export side as well as on the imports the simulations analyzed in this paper include two experiments. Experiment 1 (EXP 1) focuses on the export market. It simulates firstly a complete phase-out of the ATC agreement and secondly specific relevant developments on the EU market such as the Eastern Enlargement and a preferential agreement with Turkey. Experiment 2 (EXP 2) additionally describes a reduction of import tariffs in the textile sector of Bangladesh by 20%.

Results

Experiment 1: Abolition Of Mfa Quotas

What can be expected for Bangladesh if all quota restrictions on textiles and garments trade are abolished by December 31st, 2004, as foreseen in the ATC?

The main competitors of Bangladesh's RMG sector, located in India and China, are relatively more restricted by the ATC agreement than Bangladesh's producers. On the North American markets, Mexico and Central American countries have increased their market positions over Bangladesh as a result of closer regional integration in the Americas. On the European

markets, exports from Turkey and Central and Eastern European countries are competing with exports from Bangladesh. The Eastern enlargement and trade preferences for Turkey imply that the GSP (and Everything but Arms, EBA) preferences supporting Bangladesh on the EU market are losing their importance.

In order to capture the latter issue we incorporated the enlargement of the EU as well as zero-tariff access to the EU for Turkish producers in our simulation.

Obviously, the highly quota constrained exporters from India and China are able to dramatically expand their exports. In the case of China, the model predicts a 60% increase in export volumes. However, exporters now face a price that is on average 11% lower. [2] For India the picture is even more impressive, as exports are simulated to expand by more than 260%, albeit at 20% lower prices. Bangladesh is simulated to maintain its export volumes, but would face a 7% lower price.

Columns (3) and (4) in the table compare current world market shares in RMG with post-MFA shares. Clearly, China and India are increasing their world market shares.

Obviously, Bangladesh is losing ground in North American markets, where China and India are out-competing all other suppliers, including Mexico and Central America. Only on the European market does Bangladesh have positive growth rates. The granting of preferences to suppliers from CEEC countries and from Turkey enables those regions to double their sales

volumes to the EU, which leads to a diversion of imports from all other sources.

Experiment 2: Lower Textile Tariffs In Bangladesh

The phase-out of the MFA is an external event that Bangladesh producers and policymakers will have to deal with in some way, but on which they have little influence.

In contrast, there are also a number of national policy instruments available that Bangladesh could use to further its RMG industry. One of these instruments is the lowering of import taxes on textiles. It has been seen in section 2 that import barriers on textiles – a vital input in RMG - are relatively high in Bangladesh. The tariffs lead to an average increase of the price of imported textiles by about 30%. Clearly, a lower tariff would reduce the cost of imported textiles to the Bangladesh RMG industry, and this will decrease production costs in the RMG sector.

While expansion of RMG production and exports under the MFA phase-out is rather limited, the unilateral reduction of textile import tariffs has notable positive effects on output and trade. In fact, the 20% tariff cut results in a simulated RMG output growth of more than 7%. Not surprisingly, this output effect turns out to be mainly export driven.

The lower price for imported textiles in the wake of the tariff reduction drives down the price for textiles that the RMG industry in Bangladesh uses. Table 8 summarizes the important effects. The 4.5% lower price for imported textiles is combined with a very slight drop of domestic textile prices to yield a drop of the composite textiles price by -1.5%. Given the large 70% cost

share of textiles in RMG production, the supply price of RMG products can drop by -0.9%. This drop is sufficient to lead importers to substitute towards Bangladesh RMG products. The GTAP model has an Armington import structure with an elasticity of substitution between domestic and foreign RMG varieties equal to 8. For all importers such that the substitution effect alone results in an almost 8% rise of Bangladesh RMG exports. Since Bangladesh is a small player on global RMG markets (market share around 1%), global import levels are not affected by Bangladesh's cheaper supplies. The conclusion from this exercise is that lowering tariffs on textile imports does indeed boost the competitiveness of the Bangladesh RMG industry. At the same time, the domestic textiles industry experiences some competition from abroad, resulting in lower domestic textile prices and a slight drop in output, but this is more than compensated by increased export earnings in the RMG industry.

The equivalent variation welfare indicator provides a summary of effects on the total economy. According to this welfare measure, the main beneficiary of the MFA phase-out is the USA. The importing regions Canada and the EU also benefit, as do India, China and Central and Eastern Europe and Turkey. The latter two regions mainly due to the EU-preference effect. This picture makes clear why not all countries always support the abolition of the MFA. For Bangladesh a slight negative welfare effect of the MFA phase can be observed. The unilateral reduction of textiles tariffs somewhat improves this outcome, but is insufficient to tip the balance.

The terms of trade for Bangladesh – and indeed for all the quota-restricted exporters - are negatively affected as world prices for garments drop. In contrast to, for example, India, the terms-of trade loss is not compensated by allocative gains in Bangladesh. Closer inspection of the underlying data shows that the negative allocative result in the MFA phase-out scenario is mainly due to the expansion of the domestic textiles industry which is currently subsidized.

Expansion of a subsidized activity receives a negative welfare evaluation, because it pulls resources into an activity that could be more effectively used elsewhere in the economy. With lower textiles tariffs, the domestic textiles industry shrinks somewhat and the negative allocative effect is turned in to an allocative gain, as less subsidization is required.

Conclusions

The phase out of the MFA changes global patterns of trade. India and China are the biggest winners in terms of output and export growth. In terms of welfare, the importing countries gain most, as the import prices drop. At the same time, this means terms of trade loss for exporters. Bangladesh can only mildly benefit from the MFA phase-out, and loses ground on North American markets.

Since the EU grants preferences to CEECs and Turkey, Bangladesh exporters face increasing competition on the EU market. On balance output volumes are expected to be unchanged from Bangladesh, implying a drop in market share in the expanding RMG market. A counteracting policy option for Bangladesh is the unilateral lowering of import tariffs on textiles. This

reduces costs to the RMG industry and improves exports through lower supply prices. Macro-economically, increased export revenues easily compensate the loss in tariff revenues.

Reference Source

1. Office of Textiles and Apparel, United States Department of Commerce.

Abbreviations: MMF: man-made fibre; S/V: silk and vegetable; MB: man and boy; WG: woman and girl.