4 Textiles & Clothing Sector in South Asia: Coping with Post-quota Challenges

Ratnakar Adhikari

Chatrini Weeratunge*

1. Introduction

The complete phase-out of textiles and clothing (T&C) quotas as of January 1, 2005 was heralded as a new beginning for trade in one of the most dynamic sectors of the global economy.[1] The imposition of quantitative restrictions by several developed countries, by exploiting a loophole in the multilateral trading order, had severely restricted trade in T&C with the most competitive economies. Beginning in 1957 with the imposition of voluntary export restraints (VER) on exports of cotton textiles from Japan as a protective measure by the US to appease its domestic textile industry, the process of protecting this sector was institutionalized in 1974 with the introduction of the Multi-Fibre Arrangement (MFA). The MFA governed T&C trade for almost two decades. This arrangement enabled the developed countries to bilaterally negotiate quotas with various supplier countries, based on their competitiveness and the perceived threat to the domestic interests from T&C imports. During the Uruguay Round of multilateral trade negotiations (1986-93), it was decided to integrate the MFA into the new Agreement on Textiles and Clothing (ATC), with a clear ten-year time-line, starting January 1, 1995, for phasing out the quota system..

It was envisaged that the complete phase-out of quotas would create major structural dislocation in the developing countries. Despite several projections made by a number of credible institutions as well as the media hype, the phasing-out of T&C

* The opinions expressed in this paper are personal and do not necessarily reflect the official position of the UNDP or any other UN agency. Comments from Janaka Wijayasiri, Bryn Gay and two anonymous reviewers are gratefully acknowledged.

1 In the last two decades, T&C has been the second fastest growing segment of world trade after electronics (ADB, 2006a).

quotas has not resulted in complete free trade in this sector. Accordingly, the impact of the phase-out has not been as dramatic as projected and/or reported. The first few months saw a dramatic change in the country composition of exports, with China taking the lion's share of increased exports, particularly to the world's two largest markets – the European Union (EU) and the United States of America (USA).

However, this trend was relatively shortlived and changed soon after the quotas were re-imposed on China. But, a different scenario is likely to emerge after the phasing out of these re-imposed quotas in 2008. A major challenge for the T&C exporting developing countries starting from 2007 would be the entry of Vietnam to the World Trade Organization (WTO), which has so far been restricted by quotas.

In the heydays of MFA, many Asian countries, including South Asian countries such as India and Pakistan, considered competitive in the T&C sector, were slapped with quantitative restrictions (quotas) by the developed countries, thereby limiting their T&C exports. Since the quota-imposing host countries did not have the necessary production capacity to meet their domestic demands, they were compelled to import T&C products from countries other than those facing quota restrictions to clear the market.[2]

The T&C sector has been responsible for creating millions of jobs, increasing income levels and contributing to economic growth in six out of seven South Asian countries. Some of these countries (notably India and Pakistan) had an inherent competitive edge in this sector and soon became the major target for the imposition of quotas by the developed countries.

However, establishment of T&C[3] factories in other countries (Bangladesh, the Maldives, Nepal and Sri Lanka), particularly for the manufacture and export of readymade garments (RMGs), is considered a direct (albeit benign) effect of the quota restrictions.

The South Asian region is a region of extremes, for here the major gainers as well as losers of the post-ATC era could be found. However, even the gainers of the post-ATC era have not been able to fully utilize the available opportunities, and the losers are facing the disproportionate burden of adjustment. Therefore, the South Asian region as a whole faces several challenges, some of which can be overcome only through concerted efforts by various stakeholders. This we will discuss later on.

The objective of this paper is to discuss the scenario emerging in the global T&C trade, and the position of the South Asian countries vis-a-vis other global players. It also seeks to analyse challenges confronting South Asian T&C exporters as well as initiatives taken so far by the South Asian governments to support the sector. Finally, it proposes some recommendations for strategies to be adopted by these countries in a relatively freer world of trade in T&C.

2 Adhikari (2006a).

3 T&C products come under Harmonized System (HS) code 50 to 63, and HS codes 61 and 62 pertain only to apparel (also known as RMG in the South Asian region) products which are a subset of T&C.

2. Emerging Trends in T&C Trade

The global T&C trade, worth US$453 billion in 2004 and occupying a 4% share in the global merchandise trade, has been growing at an average rate of 9% per year over the past two decades.[4] However, the growth in 2005 slowed down to 5% and the figures available for the first few months of 2006 suggest that the growth rate has slowed down considerably.[5]

Globally, countries like China, India, Mexico and Turkey are the leaders in the T&C trade, but one can see a decline in Mexico's exports triggered by a rise in exports of countries such as Bangladesh, Cambodia, Indonesia and Vietnam.[6] A study by Nordas (2004) predicted that China's share of T&C exports would increase from 16% to 50% in the US market; and from 18% to 29% in the EU market. Similarly, the Indian share in the US market was projected to increase from 4 to 15%, and from 6 to 9% in the EU market.

China made considerable progress in the initial stage of the post-quota era, achieving 25% of the import share in the US market in volume terms by the end of 2005, and a 33% import share in the EU market. It was able to achieve an overall growth of 50% on US imports and 42% in EU imports in value terms during 2005.[7] However, such gains were only shortlived. The re-imposition of quotas on several categories of products in the US and the EU has a telling impact on China's exports in both the markets. According to import figures compiled by the ADB (2006a), during the first six months of 2006, the volume of clothing shipments from China fell by almost 15% and the value by almost 11%. In the EU market, however, the picture is different in the sense that despite a 2.4% decline in volume of imports from China in the first four months of 2006, an increase in value by 12% was recorded reflecting a higher export tariff equivalent (ETE) rate due to the re-imposition of quotas.

While India has done fairly well in the EU and the US, capturing 9% and 6% of the import shares of these two major markets, respectively,[8] its exports to Asian countries have been declining (see country discussion below). Mexico has seen its exports to the US market decline considerably despite its free trade agreement[9] as well as proximity to the US market. Mexico was unable to take advantage of the re-imposition of quotas on China. Its export to the EU is not considered significant. Another competitive country, Turkey, provides a mirror image of Mexico in that it is a major exporter to the EU market, but is not considered a significant exporter to the US market. As per the latest data available, Turkey's exports to the world market during one-year period (June 2005 to May 2006) amounted to US$19.382 billion, the majority of which was exported to the EU.[10]

T&C is a technologically humble sector with high labour intensity, thus it is not difficult for any country to get into this business. However, the T&C market is not likely to remain the same in the days to come. Given the complexity of factors involved in the T&C trade, it is not possible to make a prediction at this juncture. However,

4 WTO (2005).

5 ADB (2006a).

6 EmergingTextiles.com (2006a).

7 Adhikari and Yamamoto (2006).

8 Adhikari and Yamamoto (2006).

9 Mexico, which is a party to the North American Free Trade Area (NAFTA) along with Canada and the US, has seen its T&C exports to the US decline in the recent past. See EmergingTextiles (2006a; 2006b).

10 As per the available figures (January-September 2005), Turkey occupied second position in the EU's T&C imports in value terms, next to China, with 15%. See Adhikari and Yamamoto (2005).

countries such as China, India, Mexico and Turkey may lose their markets to countries like Bangladesh, Cambodia and Vietnam in the foreseeable future. The following intricate factors which are emerging in the T&C trade are likely to shape the future of trade in this sector:

2.1 Changing Buyers' Preferences

The T&C market has been transformed into a buyers' market with a smaller number of large retailers dominating the sector. The economic power of large retailers, predominantly in the developed countries, has increased substantially over the last few years.[11] The trend now is towards greater product specialization, branding and market segmentation. These large retailers collect market information on the latest trends in styles and tastes, and assimilation of this information gives them considerable leverage in dealing with suppliers.[12] Due to the sheer market power, it is the buyers' preference that will shape market response in the exporting countries. Although cost and quality used to be the only two variables in the earlier days, buyer preferences these days represent an interplay of various factors, of which four are critically important. They include: (a) possibility of spreading risk between countries of sourcing; (b) availability of critical mass of uninterrupted production capacity; (c) ability to provide complete solution, with the country being almost complete in value chain; and (d) ethical concerns.[13]

2.2 Proximity Factor

With the trend towards 'lean retailing', producers that can provide quick turnaround time enjoy an important competitive advantage. Most studies argue that proximity to large markets[14] is a key factor to ensure quick turnaround.[15] For example, Evans and Harrigan (2005) argue that timely delivery is important because it allows retailers to respond to final demand fluctuations without holding costly inventories, and timely delivery is possible only from nearby locations. Therefore, they opine that products where timely delivery is important will be produced near the source of final demand.

However, most of these studies conducted with the data from the 1990s now need to be re-examined in the light of a steep fall in exports of countries which are located in proximity to large importers of T&C products. For example, Mexico and the Caribbean countries have been losing market share in the United States recently. Moreover, several East European countries in close proximity to European markets have been losing share.[16] Given this scenario, it can be inferred that there is limited role of proximity in the T&C trade. It might continue to be important in a limited range of products, but the overall significance of this is gradually reducing. This could be attributed to decreasing communication costs as well as shorter shipping/transit time, and improved efficiency of trade-related services, which tend to erode possible advantages associated with proximity. This is shown by the impressive performance of the majority of Asian countries in the post-quota era.[17]

11 WTO (2005a).

12 Kelegama and Weeraratne (2005).

13 Kelegama and Weeraratne (2005); Adhikari and Yamamoto (2005).

14 For example, the proximity of Mexico, Central America and the Caribbean countries to the US, and Turkey, and Central and Eastern European Countries (CEEC) to the EU.

15 WTO (2005a).

16 Adhikari (2006b).

17 For example, non-preferential, developing Asian countries alone accounted for 62.1% of total US market share of clothing and 50.3% of textiles intermediate products during the first six months of 2006, and the market share of these countries for T&C products in the EU reached 60.4% during the first four months of 2006. See ADB (2006a).

2.3 Graduation and Loss of Competitiveness

T&Cs are among the first manufactured products from an industrializing economy. They played a critical role in the early stage of industrialization in the UK, parts of North America, and Japan, and more recently in the export-oriented growth of the East Asian economies.[18] Despite several technological innovations and their application in this sector, T&C remains a predominantly labour-intensive sector. As countries grow richer and wages rise, their comparative advantage in the T&C sector is eroded, and the focus shifts to high value-added T&C products or to other manufactured products with lower labour intensity. In the context of Asia, Japan was the dominant supplier of T&C goods to the world before the 1970s, but has since turned into a large net importer of clothing and a relatively small net exporter of textiles.[19]

Countries like Korea, Hong Kong, Malaysia and Taiwan were highly competitive in this sector until the early eighties, but now countries such as Bangladesh, China, India, Indonesia, Pakistan and Vietnam have taken over the labour-intensive segments of the T&C sector. Several studies[20] argue that even China is losing its comparative advantage on the highly labour-intensive T&C products.

3. South Asia in the Post-ATC Period

3.1 Contribution of T&C Sector

The T&C sector is of paramount importance to countries in South Asia as can be seen from Table 4.1. In India, for example, this sector provides direct employment to almost 35 million people which include a substantial number of people from the socially excluded classes and/or tribes and women. It contributes approximately 14% to India's industrial production, 4% to its GDP, and 16% to the country's export earnings. The textile sector is the second largest provider of employment after agriculture.[21] Similarly, in the case of Bangladesh, 2 million workers are employed in the textile sector, and 80% of them are women. The sector accounts for close to 85% of Bangladesh's total export earnings. The sector's contribution to employment is significant in Pakistan with 2.3 million people engaged in the industry. The employment situation in Bangladesh, India and Pakistan remains more or less the same even in the post-quota era, with minor variations within multiple sub-sectors. However, the situation is quite different in the case of other countries in the region.

In Sri Lanka, the sector accounts for approximately 6% of GDP, 6% of the labour force, and nearly 40% of industrial production in terms of value. In 2003, the number of factories declined from 830 to 733, which may be partly due to structural changes within the industry where the number of small firms has decreased while the surviving large firms have merged with the smaller units.[22] Nevertheless, the number of directly employed workers in the RMG industry has dropped sharply from 340,367 in 2003 to 273,600 in 2005.[23] Although there have been genuine employment losses in some fac-

18 Yang and Zhong (1998).

19 Yamawaki (1989).

20 For example, ILO (2005) and Mayer (2005).

21 Ministry of Textiles (2006).

22 Ceylon Chamber of Commerce (2006).

23 Kelegama (2006).

tories, others are due to short-term migration of workers abroad. As documented by Kelegama and Wijayasiri (2004), 'Between 100,000 and 120,000 RMG workers – the majority of whom are skilled workers – have sought employment in foreign countries to seek better pay and better economic and social opportunities.'

In Nepal, the T&C sector comprised a major share of manufactured exports until 2003, but has shown a decline in the following years. During its peak, the RMG industry provided direct employment to 50,000 people, which accounted for 12% of total employment in Nepal's manufacturing sector. This figure has decreased to 5000 as of July 2006. As per a recent survey, about 82% of the retrenched workers have not been able to find other forms of employment immediately after leaving the garment industry.[24]

According to the 2000 Census, in the Maldives a majority of T&C workers came from abroad, of whom 2699 men and 5518 women were employed in the manufacturing sector as 'craft and related trade workers'.[25] While the latest figures are not available, employment, at least in the export-oriented segment, is believed to have reduced to nil because the country has not exported any T&C products so far this year.

Table 4.1 Contribution of the T&C sector in select South Asian countries

Country	Employment in T&C sector	T&C sector's exports as share of total exports (%)	Share of imports in terms of value in two major T&C markets of the world (%)			
			EU 2005	EU 2004	US 2005	US 2004
Bangladesh	2 million	84.50	5	5.6	2.6	2.3
India	35 million	16.77	7.5	6.8	5.4	4.6
Nepal	5000 (RMG sector only)	26.7	0.1	0.1	0.1	0.2
Pakistan	2.3 million (includes informal workers)	66.65	3	3.6	3.1	2.9
Sri Lanka	273,600	51.87	1.1	1.3	1.8	1.8

Sources: ILO (2005b); ADB (2006b); Adhikari and Yamamoto (2006); and SAWTEE/ActionAid Nepal (2006).

3.2 Recent Trend in Trade Flows

As noted above, South Asia cannot be treated as a homogeneous group as far as the T&C sector is concerned. The performance of the South Asian countries in the post-ATC era has exhibited mixed results, almost in line with the global trend. Tables 4.2a and 4.2b provide a snapshot of imports of these countries in the two major T&C markets of the world. Based on performance as well as the structure of the T&C sector, the South Asian countries can be divided into three categories. At one end of the

24 SAWTEE/ActionAid (2006).

25 Adhikari and Yamamoto (2006).

spectrum, countries like India and Pakistan, which are highly competitive in the T&C sector, were predicted to gain in the aftermath of the quota phase-out. The projection was mainly based on the presence of a vertically integrated production structure as well as established marketing networks. The prediction has turned out to be true, but not in its totality.

Table 4.2a US T&C imports from six South Asian countries

Country	T&C imports value (mn US$)						T&C imports volume ('000 kg)					
	2004	2005	% Change 2004-05	Jan-Jul 2005	Jan-Jul 2006	% Change Jan-Jul 2005-06	2004	2005	% Change 2004-05	Jan-Jul 2005	Jan-Jul 2006	% Change Jan-Jul 2005-06
Bangladesh	1986	2380	19.8	1294	1598	23.4	207,593	246,341	18.7	135,133	160,104	18.5
India	3946	4974	26	2913	3312	13.7	445,821	534,071	19.8	301,149	344,546	14.4
The Maldives	81	5	-94.2	n/a	n/a	n/a	1603	73	-95.4	n/a	n/a	n/a
Nepal	1326	98	-25.8	63	56	-9.7	11,308	6636	-41.3	4,409	3621	-17.9
Pakistan	2551	2888	13.2	1579	1882	19.2	454,075	529,550	16.6	288,732	349,097	20.9
Sri Lanka	1601	1694	5.9	979	987	0.9	110,043	106,099	-3.6	62,374	60,752	-2.6
Total	11,490	12,040	4.78	6828	7835	14.76	1,230,443	1,422,770	15.63	791,797	918,120	15.95

Table 4.2b EU's T&C imports from six South Asian countries

Country	T&C imports value (million Euro)						T&C imports volume ('000 kg)					
	2004	2005	% Change 2004-05	Jan-May 2005	Jan-May 2006	% Change Jan-May 2005-06	2004	2005	% Change 2004-05	Jan-May 2005	Jan-May 2006	% Change Jan-May 2005-06
Bangladesh	3895	3702	-5	1363	1932	41.7	564,805	558,733	-1.1	231,537	261,413	12.9
India	4434	5245	18.3	2209	2757	24.8	755,836	802,574	6.2	351,219	369,984	5.3
The Maldives	0.255	0.055	-78.5	n/a	n/a	n/a	25.1	6.7	-73.3	n/a	n/a	n/a
Nepal	78	73	-6.1	25	26	3.9	7613	6722	-11.7	2539	2426	-4.5
Pakistan	2321	2014	-13.2	792	946	19.4	493,245	471,310	-4.4	201,146	210,610	4.7
Sri Lanka	841	830	-1.3	307	410	33.5	102,254	100,497	-1.7	40,703	47,046	15.6
Total	11,570	11,864	2.55	4697	6071	29.25	1,923,778	1,939,843	0.84	827,144	891,479	7.78

Source: Adhikari and Yamamoto (forthcoming).

India, which has the strongest T&C sector in South Asia, has continued to grow in the post-quota era. The country has three major advantages compared to the rest of South Asia. First, it has a vertically integrated production structure, with up to 98.5% of value addition taking place within the country itself.[26] This has enabled India to have the shortest lead time as well as ensure availability of inputs at a relatively cheaper cost. Second, it has an interventionist government which does not shy away from using industrial policy as a tool for the development of national champions, and it has a reasonably good support mechanism in place for the T&C sector. Third, it has a well diversified production and export structure, and market concentration too is within an acceptable level, as will be discussed later. These factors have contributed to enhanced resilience of the industry.

Due to these factors, India has made several gains in the post-ATC era and continues to make advances in 2006. India's total exports to the world increased by 17.06% in 2005 compared to 2004.[27] As per the recent figures, the US imports of T&C products from India increased by 13.7% and 14.4%, respectively, in value and volume terms in the first seven months of 2006 compared to the corresponding period in 2005 (Table 4.2a). Similarly, EU imports of T&C products from India increased by 24.8% in value and 5.3% in volume during the first five months of 2006 in comparison to the corresponding period in 2005 (Table 4.2b).

However, this may not be considered as impressive as anticipated, particularly in a context where its major competitor (China) was subjected to quotas restriction in the two major markets of the world. While India's exports to the EU and US markets have grown rapidly, its exports to Asian countries including Japan have fallen sharply. According to Dev (2006), India's exports of T&C products to 38 Asian countries – excluding the Middle East – declined by 22% in 2005 in comparison to 2004. The largest drops in exports were recorded in countries like Bangladesh, Indonesia, Japan, and South Korea in absolute terms, while minor increases in exports were recorded in the case of China and Thailand. This indicates that some exports have been diverted to the EU and US markets to take advantage of the quota-free environment.[28]

One major factor responsible for India's inability to optimally utilize the market access opportunity is the lack of economies of scale, which prevents firms from gaining competitive strength in the international market. Indian T&C units are structured into small and cottage units which employ less than 11 workers, and these constitute 80% of the industry. Medium units, employing between 21 and 49 workers, account for 14% of the sector, while the remaining 6% consist of large units with more than 49 workers.[29] Contrast this with Cambodia, a rapidly emerging Asian LDC, where 7% of the garment manufacturing entities employ more than 5000 people.[30]

The T&C sector in Pakistan accounts for 60% of the overall exports and employs 35% of those engaged in the industrial sector. Pakistan has developed its industry in both textiles as well as readymade garments and specializes in textiles and made-up textile products such as bed linen. The country's industry is structured into the non-mill sector and the small and medium-sized plants. The non-mill sector, i.e. the

26 UNDP RCC (2005).

27 Dev (2006).

28 Adhikari(2006b).

29 Adhikari and Yamamoto (2006).

30 ILO (2005).

cottage industry, manufactures 90% of cloth and 80% apparel products, and through subcontracts, the small and medium-sized factories account for 90% of the work in T&C production.

Like other South Asian countries, the EU and the US are Pakistan's primary export markets and account for approximately 60% of its overall exports in the T&C sector. In 2005, the country was able to achieve a reasonable export growth in the US market; however, it was not as fortunate in the EU market. Based on the figures prepared by Adhikari and Yamamoto (2005), the overall imports by these two major markets from Pakistan increased in volume by 5.7%, but there was a slight decline of 0.8 % in value terms. However, the figures for 2006 are much better with the US imports from Pakistan increasing by 19.2% and 20.9 % in volume and value terms, respectively, during the first seven months of 2006 compared to the corresponding period last year (Table 4.2a). Similarly, EU imports of T&C products from Pakistan increased by 19.4% and 4.7% in value and volume terms, respectively, during the first five months of 2006 compared to the corresponding period in 2005 (Table 4.2b).

Despite predictions that Pakistan would be the number two gainer from South Asia in the post-ATC era, it has not been able to fully utilize its potential. Notwithstanding the fact that the country has a vertically integrated production structure and has carved out a niche for cotton bed linen in the global market, Pakistan has not been able to take advantage of the re-imposition of quotas on China. However, the Government of Pakistan has provided several incentives to the T&C sector in the past and has plans to provide more such facilities in the future (see Section 5 below).

At the other end of the spectrum lie countries like the Maldives and Nepal, which were the least competitive in the global market and were expected to be adversely affected. These countries have lost out dramatically with the T&C sector in the Maldives failing to record any exports in 2006. The loss for Nepal has been striking too, but this is hardly a surprise as the fall in T&C exports was more or less in line with what the country had been experiencing since 2003.[31]

As noted above, the establishment of T&C industry in the Maldives was a direct result of quotas under the MFA. Industries were mainly established through foreign direct investment (FDI) from Hong Kong and Sri Lanka. Apparel and clothing accounted for about one-third of total merchandise exports and half of merchandise exports by private sectors in 2003.[32] However, in anticipation of the quota phase-out, many foreign investors commenced scaling down their operations since 2003. While the Maldives' overall export in 2004 was US$81.4 million, it was reduced to US$4.8 million in 2005, representing a massive reduction of 94%.[33] As per the latest data, during 2006 there has been absolutely no export from the Maldives, which means that the entire country has been wiped off the global industrial map of the T&C sector.

As reported in Adhikari and Yamamoto (2006), according to one analysis the effects of the quota elimination on the Maldives' economy are expected to be negligible since the majority of garment workers were migrant labour; the value addition of the appar-

31 SAWTEE/ActionAid (2006).

32 Ministry of Planning and National Development (2004), cited in Adhikari and Yamamoto (2006).

33 Adhikari and Yamamoto (2006).

el industry was insignificant, and all inputs were imported.[34] However, as per another analysis, the negative impacts on the economy are clearly visible. Immediate negative impacts included loss of income and the fear of long-term unemployment since alternative job opportunities are hardly available.[35] Moreover, a 4% loss in government revenue derived from land rentals[36] and loss of foreign exchange are considered to be other implications of the quota phase-out.

Another South Asian country, considered to be a major loser from the quota-free regime is Nepal, which has seen its exports of readymade garments decline since 2003. This is ascribed mainly to the implementation of African Growth and Opportunity Act (AGOA) that provided preferential access to the sub-Saharan African countries in the US market, where between 80 and 90% of Nepalese garments used to be exported.[37] Nepal saw its T&C exports to the US and EU markets decline by 17.5% to US$189.3 million in value terms and 29.4% in volume terms. The decline in the US market was much more severe with the US imports from Nepal falling by 25.8% in value and 41.3% in volume in 2005 in comparison to 2004 (Table 4.2a). In the European market, the decline was 6.1% in value and 11.7% in volume (Table 4.2b). The only saving grace for Nepal was the increased import by the US of Nepalese woollen carpets which is a niche product of Nepal. Moreover, this item was never under the quota system and was therefore not affected by the quota phase-out.

In 2006, Nepal's T&C exports did not decline as sharply as in the previous year, and in some months of 2006 they in fact increased compared to 2005. This mainly can be ascribed to the China safeguards. However, Nepal's exports have not shown any sign of rebounding, which is due to several structural as well as institutional barriers facing the Nepalese economy. Lack of backward integration and distance from a sea port are the two most important factors that contributed to reduced competitiveness of this sector. Other factors that resulted in declining exports include low labour productivity, high transaction costs owing to inadequate transportation and logistics facility, high cost of compliance with customs procedures, and cumbersome administrative processes at ports (Dahal, 2006). Yet another factor that has not been adequately highlighted is the armed conflict and resulting political disturbances (including strikes, civil unrest and riots) which were at their peak during 2002 and 2005.

At the centre of the spectrum, two countries – Bangladesh and Sri Lanka, which were predicted to lose out in the quota-free era – have surprised the world by not only holding on to their past gains, but also by considerably improving their performance in the past 18-month period after the quota phase-out. Among the two, Bangladesh's performance has been spectacular by all counts. Sri Lanka also witnessed a reasonably good growth in 2005, which continues to date.

In 2005, the US imports of T&C products from Bangladesh increased by 19.8% in value and 18.7% in volume compared to 2004 (Table 4.2a). The figures for the EU were not as impressive since the imports decreased by 5% in value and 1.1% in volume (Table 4.2b). However, the year 2006 saw a surge in imports from Bangladesh in both the major markets of the world. The US imports of T&C products from Bangladesh

34 US Department of State (2006).

35 Wajdy (2004).

36 US Department of State (2006b).

37 Although this affected the other South Asian countries too, Nepal was severely affected due to its other weaknesses mentioned above.

increased by 23.4% in volume and 18.5% in value during the first seven months of 2006 compared to the same period in 2005 (Table 4.2a). The imports to the EU have also seen a dramatic surge of 41.7% in value and 12.9% in volume during the first five months of 2006 compared to the corresponding period in 2005 (Table 4.2b).

There are three plausible explanations for Bangladesh's unexpected and overwhelming success. First, Bangladesh has the advantage of cheap labour (cheapest in South Asia). Although the labour productivity is an issue, low wages have helped Bangladesh focus on high volume mass production of RMG items, competing directly with countries like China and Vietnam. Therefore, Bangladesh has been the major beneficiary of the re-imposition of quotas on China, but Vietnam is still restricted by quotas. Second, due to the enormous contribution of the RMG sector in the economy, the Bangladesh government has initiated several support measures specifically targeting this sector (see Section 5 below). Third, devaluation of the Bangladeshi currency (Taka) by more than 18%, over the past 20 months or so, has either enhanced or at least protected the competitiveness of Bangladeshi T&C exporters.[38] This has had a very limited positive impact on the export of woven RMG (Chapter 62 of HS code) because of the need to import major portions of raw materials, which tends to cost more due to devaluation. However, in the case of knit RMG exports, in which almost 80% value addition takes place within the country itself, this has had a major positive impact.

Bangladesh's successes still face difficulties, notably the sustainability of its positive gains as highlighted above. Due to inefficient infrastructure, particularly its port and transportation system, lack of adequate efforts to ensure improved trade facilitation, and the poor state of human capital, concerns arise about the sustainability of the positive trend after 2008, when the safeguards on China will be lifted.

As far as Sri Lanka is concerned, the country has made marginal gains in terms of imports by the two major T&C markets of the world. In 2005, the overall imports of T&C products from Sri Lanka by the US increased by 5.9% in value, but in terms of volume the imports declined by 3.6% (Table 4.2a). Similarly, in the EU market, imports from Sri Lanka declined by 1.3% and 1.7%, respectively, in value and volume terms (Table 4.2b). However, the performance has improved in 2006, with the imports by the EU having significantly increased. During the first five months of 2006, the EU imports of T&C products from Sri Lanka have increased by 33.5% in value and 15.6% in volume in comparison to the corresponding period in 2005 (Table 4.2b). However, the island nation has suffered a minor setback in the US market with the reduction in US imports by 2.6% in value terms despite a slight increase of 0.9% in terms of volume during the first seven months of 2006 compared to the same period last year (Table 4.2a).

However, Sri Lanka should be able to overcome these hurdles. Although its success has not been as impressive as that of the other three gainers from the region, a look at the country's industry structure, human capital, enterprising nature of the private sector, and government support suggests that Sri Lankan garments exports are mov-

38 Unnayan Shamannay (2006).

ing along a path of sustained growth. A major strategic intervention, mainly from the private sector, has been a key driver of export growth. Taking note of Sri Lanka's inability to compete effectively with low-wage economies, garment exporters have made a conscious effort to focus on niche products. For example, the island has been able to secure a sustained increase in exports of niche apparel, i.e., women's underwear and brassieres. This segment currently occupies only 11% of Sri Lankan exports of T&C products, but further potential for growth exists because competition is not likely to intensify in this sector.[39]

Recent efforts of a single firm to carve a global niche by penetrating even more lucrative markets – body armour, flak jackets and bullet-proof vests for troops in Saudi Arabia as well as the United Nations – shows that the Sri Lankan private sector is on the constant look-out for creating niche products.[40] Therefore, it is not surprising that Sri Lanka has the second lowest export concentration of T&C products only after India, suggesting that they have a well diversified exports basket in the T&C sector,[41] as seen from Table 4.4. Moreover, compliance with international labour and environmental standards has further benefited the country.[42]

3.3 Recent Trend in Export Prices

In line with simple economic logic, most studies conducted during the MFA period predicted that the increased competition in the T&C sector resulting from the quota phase-out would lead to a massive reduction in export prices. Countries restrained by quotas, enjoying quota rent, which is also referred to as 'export tariff equivalent' (ETE),[43] were actually in a position to reduce their prices to match those of their competitors. Price reduction immediately after the quota phase-out in the items liberalized in 2005 was severe with countries like Bangladesh and Pakistan witnessing a decline of 8.6% and 11.1%, respectively, in the EU market. However, this trend was not supported by the data for India as prices of the same categories of products increased by 8.6% in the case of Indian exports.[44]

Table 4.3, which provides a general trend in unit prices of T&C items based on the EU figures, shows a mixed picture with India, Nepal, and Sri Lanka receiving higher prices for their exports in both 2004 and 2005, while Bangladesh and Pakistan witnessed a decline in 2005. However, all the T&C exporting South Asian countries have noticed an increase in prices in 2006.

The increase in prices of T&C imports from India, Nepal and Sri Lanka is for completely different reasons. In the case of India, it is not only due to the premium quality of their products but also due to the fact that costs have been generally rising in India. In the case of Sri Lanka, there is a growing focus on the high value-added niche products. The price increase in Nepal is explained by its excessive reliance on non-quota items like shawls and carpets in the EU market. On the other hand, Bangladesh which produces low-value, high-volume RMGs observed a decline in its price in 2005, but has seen its export price increase by 23.4% in 2006. This could be due the re-imposition of quotas on China which is one of Bangladesh's main competitors. This could

39 Adhikari (2006a).

40 *Daily Mirror* (2006).

41 Adhikari (2006a).

42 Kelegama (2006).

43 See, for example, Nordas (2004), Razzaque (2005), and ILO (2005).

44 Adhikari and Yamamoto (2005).

Table 4.3 Change in unit prices of South Asian T&C items in the EU

Country	Change in unit prices of South Asian T&C items in the EU (%)					
	2001	2002	2003	2004	2005	2006
Bangladesh	-78.3	341.9	-11.6	2.1	-3.9	23.4
India	-0.4	1.6	-7	2.2	11.7	18.2
The Maldives	20.8	-5.2	-5.8	-48.9	-17.4	n/a
Nepal	-7.3	-11.7	-12	1.2	6.7	9.8
Pakistan	-1.3	-6.5	-8.3	2.6	-7.7	7.9
Sri Lanka	-3.7	-8.4	-11.5	1.1	7.5	13.5

Source: ADB (2006a).

also explain the fall and rise in unit prices of T&C items imported by the EU from Pakistan. However, the Maldives, the country which has been worst hit by the quota phase-out, has been experiencing a continuous decline in unit prices of its T&C items since 2002. This explains the lack of competitive strength of the country in the T&C sector, mainly due to overall exports exhibiting a downward trend since 2002.

However, these figures should be read with caution because these are average figures derived from EU sources only. Prices indeed fell in some categories of products. However, the fall has not been as drastic as predicted. According to WTO (2006a):

> In the first nine months of 2005, US import prices for textile and clothing from all sources remained basically unchanged. This price information does not support the view that the lifting of the quotas had a marked downside impact on prices at an industry level. However, investigations at the detailed product level (at which the safeguard actions were examined) revealed that the unit price of products originating from China decreased sharply in 2005.

4. Problems Facing the South Asian T&C Sector

4.1 Structural Impediments

As noted above, India and Pakistan were the only two countries with natural comparative advantage in the T&C sector during the MFA era, and the other countries joined the bandwagon much later, taking advantage of the MFA quotas. Since the quotas were ‘binding’ on the labour-intensive, general category of products, it was natural for buyers to source these products from other countries in the region. Therefore, countries like Bangladesh, the Maldives and Nepal, and to some extent Sri Lanka, focused on manufacturing such items as men’s and boys’ cotton trousers and shorts, women’s and girls cotton trousers and shorts, cotton T-shirts, etc. Since not all these countries have been able to move away from the narrow range of products, their exports are highly concentrated on a limited number of products, with five product categories accounting for a very high percentage of their export portfolio.[45] In addition, there is the problem of market concentration, with two markets accounting for more than 90% in the case of Bangladesh and Nepal (Table 4.4).

45 In the case of Nepal, although the export concentration is high at 76%, two products: *woollen carpets* and *pashmina shawls and mufflers*, are considered niche products.

While some efforts have been made by Sri Lanka on product diversification by focusing on niche products (as discussed above), its market diversification efforts cannot

Table 4.4 Level of market and product concentration in five South Asian countries

Country	Major export markets (% of export)			Top five export products	
	USA	EU	Total	Items based on HS code (as of 2005)	Share in overall export (%)
Bangladesh (2002) [a]	38	56	94	Cotton T-shirts, Vests, Knitted/ Crocheted; Jerseys, Pullovers, Cardigans of Man-Made Fibres, Knitted/Crocheted; Men's/ Boys' Cotton Trousers, Overalls, Breeches, Shorts; Women's/ Girls' Cotton Trousers, Overalls, Breeches, Shorts; Cotton Jerseys, Pullovers, Cardigans Knitted/Crocheted	64.0
India (2004)[b]	24	33	57	Men's /Boys' Cotton Shirts; Women's /Girls' Cotton Blouses, Shirts; Cotton T-shirts, Vests Knitted/ Crocheted; Cotton Jerseys, Pullovers, Cardigans Knitted/Crocheted; Knotted Carpets, Floor Coverings of Wool/ Fine Animal Hair	26.0
Nepal (2004)[c]	80	18	98	Carpets, Floor Coverings of Wool/Fine Animal Hair, Knotted; Women's/Girls' Cotton Trousers, Overalls, Breeches, Shorts; Men's/Boys' Cotton Trousers, Overalls, Breeches, Shorts; Cotton Jerseys, Pullovers, Cardigans, Knitted/Crocheted; Shawls, Scarves, Mufflers, Mantillas, Veils of Wool/Fine Animal Hair	76.0
Pakistan (2004)[d]	31	32	63	Cotton Jerseys, Pullovers, Cardigans, Knitted/Crocheted; Toilet Linen, Kitchen Linen of Terry Towelling of Cotton; Men's/Boys' Cotton Trousers, Overalls, Breeches, Shorts ; Cotton Printed Bed Linen ; Knotted Carpets, Floor Coverings of Wool/Fine Animal Hair	56.3
Sri Lanka (2005)[e]	57	35	92	Women's/Girls' Cotton Trousers, Overalls, Breeches, Shorts; Brassieres ; Cotton Jerseys, Pullovers, Cardigans, Knitted/ Crocheted ; Men's/Boys' Cotton Trousers, Overalls, Breeches, Shorts; Cotton T-shirts, Vests, Knitted/ Crocheted	32.8

Notes: a. Razzaque (2005). b. UN Comtrade database. c. Dahal (2006).
d. UN Comtrade database. e. Ceylon Chamber of Commerce (2006).

Source: Adhikari (2006a).

be considered satisfactory, with only two markets still accounting for 92% of total exports of the country's T&C products. Other countries in the region lag behind on both fronts. Product diversification is a desirable goal worth pursuing by all South Asian countries. Some degree of innovative thinking and market survey could be instrumental in helping them achieve this objective. To overcome the problem of market concentration, the South Asian countries need to work hard and identify three major avenues for market diversification not only in the other developed country markets, but also in the developing countries, in general, and the countries within the region, in particular. This issue is further discussed in Section 6 of the paper.

The example of Thailand in relation to both South-South trade and regional trade is worth highlighting. Thailand was able to increase its garment exports to the United States, but its exports to the EU and Japanese markets declined during the first nine months of 2005. However, Thailand made a conscious decision to diversify into other markets, including the Association of Southeast Asian Nations (ASEAN) neighbours, to compensate for the loss suffered, particularly in the EU and Japanese markets, in the post-quota era. During the first eight months of 2005, Thailand's exports to ASEAN increased by 19.1% compared to the same period in 2004. Similarly, it managed to increase its exports to China by 10.2% and to 'other countries' (which may include the South Asian countries) by 8.4% to the absolute level of US$1.25 billion.[46]

4.2 Market Access Barriers

Given the protectionist tendency of the T&C sector in the developed countries, several market access barriers are still prevalent and are likely to continue. They are detrimental to the Asian developing countries in general, particularly the South Asian countries. Some major barriers are discussed below:

4.2.1 Tariff barriers

Asian countries in general face higher market access barriers in the OECD market, particularly in the US market. For example, US tariffs continue to be a major impediment for accessing the apparel market. While an extra cost of up to 22% is added to products from Asia, shipments from other regions are only subject to import duties averaging 0.1% to 3% of their original value.[47] Table 4.5 compares the tariff differentials for the South Asian countries vis-à-vis other countries which are the beneficiaries of various preferential arrangements with the US. Though Table 4.5 is self explanatory, some facts are noteworthy. For example, while Bangladesh, an LDC, is subjected to 17.12% tariff on woven RMG exports in the US market, Canada pays just 0.16%. Bangladesh is a country that pays a proportionately high tariff in the US market, even compared to other South Asian countries. Although Pakistan pays higher than 14% in tariffs, its share of value collected by the US customs is low. This is explained by the composition of woven RMG in the overall exports of Pakistan to the US, which is merely 12%. The corresponding figures for Bangladesh, India and Sri Lanka are 70%, 42% and 63%, respectively.[48]

46 See Adhikari and Yamamoto (2005).

47 Emerging Textiles.com, 2006c.

48 Adhikari and Yamamoto (2006).

Table 4.5 Discriminatory tariffs charged by the US on imports of woven RMGs

Countries/Groups	2005 Calculated duties as % of customs value	Jan-May 06 Calculated duties as % of customs value	2005 Customs value share *	Jan-May 06 Customs value share *
South Asian countries				
India	14.37%	13.38%	5.67%	7.34%
Bangladesh	16.00%	17.12%	4.48%	5.38%
Sri Lanka	16.39%	16.54%	2.84%	2.90%
Pakistan	14.30%	14.53%	0.93%	0.95%
NAFTA beneficiaries				
Canada	0.85%	0.16%	1.81%	1.94%
Mexico	0.49%	0.24%	10.25%	8.62%
CBTPA beneficiary				
Honduras	1.25%	1.90%	1.78%	1.58%
AGOA beneficiaries				
Kenya	0.13%	0.68%	0.52%	0.52%
Lesotho	0.05%	0.07%	0.41%	0.38%
Madagascar	0.32%	0.38%	0.38%	0.33%
Bilateral FTA beneficiary				
Jordan	0.31%	0.41%	0.97%	1.27%

Note: * Supplier share of the total customs value.

Source: EmergingTextiles.com (2006c).

The prospects for the South Asian LDCs are indeed depressing because they have to compete in the US market with countries like Jordan and Mexico, as well as with countries from Africa, the Caribbean, and Central America – which benefit from free trade agreements and or preferential arrangements with the US. What is even more worrying is that the proposal for duty-free-quota-free access for the least developed countries, of which Asian LDCs would be the major beneficiaries, seems to be heading nowhere.

During the Hong Kong Ministerial Conference, it was decided that the developed countries can satisfy this requirement only by providing duty-free-quota-free access to 97% of the tariff lines. Due to strong pressure from the textiles lobby, it is unlikely that T&C items would be included in the 'covered list'.[49]

49 Adhikari (2006c).

Some South Asian countries do enjoy various benefits in the developed countries' markets through the Generalized System of Preferences (GSP). This is a WTO compatible, generalized, and non-reciprocal arrangement whereby the developed countries can provide tariff preferences to the developing countries and deeper preferences to the LDCs without having to extend the facility on an MFN basis.[50] However, such arrangements tend to be applied in a discriminatory manner based on considerations other than 'trade-related'. While the US does not provide GSP facility to T&C exports from the South Asian countries, the EU provides different types of tariff preferences to these countries. However, the utility of these schemes is severely constrained by the stringent Rules of Origin (RoO) requirements (see Box 1).

50 The existing legal basis for this arrangement is Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, a decision taken by the Contracting Parties of GATT on November 28, 1979. This is also known as 'Enabling Clause'.

Box 1

Requirement of 'Double Transformation' Nullifying Tariff Preferences

Sri Lankan GSP scheme

Based on considerable improvement in labour standards and its record of compliance with eight Core Labour Conventions of the ILO, Sri Lanka made a formal request to the EU seeking additional GSP benefits under the 'labour clause' of EU GSP. After an independent evaluation, the EU granted the incentives under the clause with effect from February 1, 2004. This scheme allows Sri Lankan T&C exports to enter the EU market with 40 to 60% less than normal GSP tariffs. However, the limited evidence available suggests that Sri Lanka has not been able to increase its exports to the EU market despite such preferences. While the depth of preference may be an issue, the major reason behind the slow utilization rate is the inability of a country to fulfil the stringent Rules of Origin (RoO) requirement imposed by the EU, which requires at least two finishing operations – a 'double transformation' – to occur in the exporting country to qualify for preferential market access.

Everything But Arms (EBA) initiative for LDCs

Since the LDCs have not been able to meet the 'double transformation' requirement mentioned above, their preference utilization rate for EBA, the duty-free-quota-free initiative of the European Union, was merely 37.8% in 2003, and the country-specific clothing preferences of the Asian LDCs in 2004 were: 33.8% for Bangladesh and 65.8% for Nepal.[a]

One way to ease the burden on LDC exporters is a process called 'regional cumulation', i.e. allowing countries within a regional trading arrangement to use raw materials from other countries within the arrangement. The EU has provided such facilities to ASEAN and the South Asian Association for Regional Cooperation (SAARC). This provision, for example, allows clothing producers from Bangladesh and/or Nepal to use fabrics from India and/or Pakistan, provided the required transformation has taken place in India or Pakistan – and still qualify for duty-free access under the EBA. This provides more freedom in sourcing decisions than is available under the basic RoO.

Despite such an arrangement, these countries are unable to enhance the rate of utilization of preferences. There are two plausible explanations: First, it could be that the costs of compliance, even with relaxed rules, are prohibitive. Second, there is a possibility of buyers dictating the terms of sourcing the inputs and providing little room of manoeuvrability for the producers. Therefore, exporters continue to pay the prevailing (MFN) tariffs.

Note: a. The measure was based on simple average tariff lines.

Source: Adhikari and Yamamoto (2005); Weeraratne (2005); and WTO (2005).

4.2.2 Non-Tariff Barriers

Trade Remedy Measures

Introduced in the global trading system as measures to protect domestic industry from unfair foreign competition, trade remedy or contingent protection measures have become tools in the hands of the domestic protectionist interest in the developed and developing countries. Three types of WTO-sanctioned trade remedy measures can be imposed by the importing countries without having to wait for a verdict from the WTO dispute settlement body. Of these measures, the anti-dumping measure is the most pernicious.

Due to ease in application, anti-dumping measures have become the favourite tools for protectionist interests. Moreover, anti-dumping measures can be applied to targeted firms in specific countries, almost with absolute impunity. T&C imports from the developing countries have been traditionally a major target even during the MFA period. T&C imports from relatively competitive countries like China, India, Pakistan and Turkey have been routinely subjected to anti-dumping investigations in the past. Bed linen has been one of the most targeted products by the EU, with exports from India and Pakistan already carrying the brunt (see Box 2).

The tendency to use trade remedy measures for protectionist purposes, if unchecked through clearly defined rules, can be accelerated with serious implications, among others, for trade in T&C products. The mandated review of anti-dumping and sub-

Box 2

Bearing the Brunt of Anti-dumping Duties

India: In 1997, the EU began imposing extra duties on Indian bed linen, claiming that it was being 'dumped' in the European market. The dispute at the WTO was finally decided in favour of India in 2001, but by that time exports of bed linen had fallen considerably – from US$127 million in 1998 to US$91 million in 2001. The Indian company 'Anglo-French Textiles', one of those affected by the EU action, saw its revenue fall by more than 60% in the three years in which the duties were imposed. It was forced to downsize by reducing its labour force by more than 1000, with a severe economic impact on the southern Indian town of Pondicherry where the company is located. Although the WTO ruled in favour of India in 2001, the EU merely altered the terms of the complaint and reapplied the duties. This highlights the effectiveness of anti-dumping measures as protectionist tools: they take a long time to resolve, impose heavy costs of arbitration, and can be prolonged by small changes to the case.

Pakistan: In the case of Pakistan, the Cotton and Allied Textile Industries of the European Commission – Euro cotton – lodged a complaint in November 2002, about the alleged dumping of bed linen resulting in 'material injury' to local industry, and demanded initiation of an anti-dumping proceeding. After necessary investigations, the EU imposed an anti-dumping duty of 13.1% on Pakistani bed linen in effect since March 5, 2004. According to Ahmed (2005), one reason for the decline in Pakistan's export under HS 63 to the EU market has been the continued imposition of anti-dumping duties on bed linen. It is estimated that the imposition of 13.1% anti-dumping duty by the European Commission (EC) on bed linen imports would cause Pakistan an annual loss of US$250 to 300 million. Recently, there have been some discussions on reducing the anti-dumping duty from 13.1% to 8.5%. However, no decision seems to have been made so far.

Source: Oxfam International (2004); *Pakistan Times* (2004); Adhikari and Yamamoto (2005); and Ahmed (2005).

sidies rules as part of the Doha Development Agenda (DDA) has not produced any result so far. The Hong Kong Ministerial Conference of the WTO concluded in December 2005 but could not achieve a major breakthrough due, in part, to the focus of Member delegations on other issues perceived to be of greater significance, such as agriculture liberalization. Given the recent suspension of the Doha Round and the absence of a strong constituency for the reform of trade remedy measures in general and anti-dumping in particular, there is every reason to believe that this issue may not receive the attention it deserves in the days to come.

Standards-related Barriers

It is the sovereign right of each country to impose regulatory or standards-related barriers, such as testing, certification and labelling, to achieve certain policy objectives. However, some of these barriers are not only arbitrary or unjustifiable discrimination but a disguised restriction on international trade. In other words, these barriers can be easily captured by protectionist interests, and there have been instances of this happening in a number of countries. Some analysts[51] even argue that as tariff and other traditional barriers to trade have fallen over the past five decades, the use of non-tariff measures, including standards-related and regulatory barriers, has been on the rise, gradually replacing the traditional barriers.

Imposition of regulatory and standards-related barriers on T&C products has been limited, but the future looks uncertain. Some examples of regulatory and standards-related barriers, such as on Indian T&C products as documented by Gupta (1997), include the following: (a) Recall of Indian-made *ghagras* (skirts) on the ground of non-conformity to flammability standards; (b) Targeting of Indian rayon scarves on the ground of non-conformity to flammability standards; (c) Ban on import of goods (textiles and leather) treated with azo-dyes and pentachlorophenol.[52] The latter was also the case with Nepalese woollen carpets in the German market, witnessed mainly in the first half of the 1990s.

A potential threat with stringent standards is an elaborate and complex trade-restrictive barrier called REACH (Registration, Evaluation and Authorization of Chemicals) proposed by the European Union. If adopted, the REACH legislation could subject textiles and clothing firms to a procedure of registration, evaluation, authorization and restriction for a large number of chemical substances. The EU trading partners, including the developed countries, are making efforts to convince the EU to modify the rules before a formal announcement in order to reduce the potentially disruptive impact of REACH on international trade and to improve its workability.[53]

The above mentioned governmental barriers would at least provide some element of predictability despite their inherent protectionist undercurrent. Private standards, differing from firm to firm, are difficult to comply. Due to pressures from consumer groups, the environmental lobby and trade unions, some of the major buyers in the developed countries have prepared their private 'codes of conduct' which they expect all their suppliers to follow. These codes are mainly environmental and labour standards which can significantly raise suppliers' costs.

51 See, for example, Maskus and Wilson (2000).

52 Gupta (1997).

53 The US mission to the EU (2006).

While it is desirable from a human development perspective to make gradual but sustained efforts aimed at reaching higher environmental and labour standards, an abrupt switch to higher standards could erode the competitiveness of the enterprises; the need to ensure compliance with multiple standards can further exacerbate the problem. Due to the immense market power of the buyers, who can dictate their terms, T&C exporters are left with only two choices. Either they have to custom tailor the working environment in the factory to fulfil different conditions imposed by their buyers, or they have to follow the lowest common denominator in terms of standards. Both these measures affect the competitiveness of their enterprises.

The Bangladesh RMG industry, which has been doing well despite these problems, is frequently subjected to such standards. A survey by Ahmed et al. (2005) found increasing pressure to meet the different codes of conduct and social standards set by different buyers for Bangladeshi garment producers. The problem, however, is that extra burdens fall upon employers' (and then on workers') shoulders without support from buyers or appropriate social infrastructure from governments. With the attention of the international community focused on Bangladesh due to recent strikes and riots with workers demanding higher minimum wages and better working conditions, the Bangladesh RMG sector is likely to face severe challenges in the days to come.

4.3 Supply-side Constraints

Even if the market access barriers are removed, all South Asian countries still face several supply-side constraints which impede their competitiveness vis-à-vis countries like China and Vietnam. The most common constraints for the South Asian countries are discussed below.

4.3.1 Poor Human Capital

Lack of skilled and/or trained human resources, which impedes productivity growth, is a major reason for most South Asian countries' inability to take full advantage of the market access opening and for others facing threat to their survival. While the wages paid to T&C workers in the South Asian countries are much lower than those paid in China, they are not as competitive as Chinese workers due to lack of skills. For example, labour productivity in the Nepalese garment industry is about 60 to 70% that of Chinese workers.[54] According to USITC (2004), the average hourly compensation for Chinese garment workers in 2002 was US$0.88 whereas the figures for Bangladesh, India, Pakistan, and Sri Lanka were US$0.39, 0.38, 0.41 and 0.48, respectively. However, the report points out that the productivity levels of T&C workers in these South Asian countries are significantly lower than their Chinese counterparts.

Lack of skilled workers is a major disadvantage not only because additional workers have to be hired for a similar task, but because overtime wages (which are higher than normal wages) must be paid to workers sometimes to meet tight deadlines. Both these factors put additional burden on resource-strapped firms, which results in their reduced competitiveness in the export market. While a pool of more skilled

54 Shakya (2005).

workers can contribute to the process of manufacturing high-value products, firms or countries with only unskilled workers are locked into manufacturing the least skill-intensive items – precisely those in which competition tends to be highest.[55]

4.3.2 Poor Quality of Infrastructure

Poor quality of infrastructure, whether dilapidated roads or ports, or antiquated telecommunication networks or power supply, adds to the cost of doing business. Most South Asian countries face these problems, but the degree may differ from country to country. The costs of inefficiency in two South Asian countries, namely Bangladesh and India, are well documented. For example, the OECD (2004) cites a study by Verma (2002), which estimates that Indian companies suffer a 37% cost disadvantage in shipping containers of clothing products from Mumbai/Chennai to the east coast of the United States as compared to similar container shipments originating from Shanghai. This cost disadvantage arises from delays and inefficiencies in Indian ports. This highlights the importance of efficient port infrastructure, reliable and competitive modes of transport, and efficient customs procedures for maintaining an edge in the competitive, time-sensitive and fashion-oriented textile and clothing markets. Similarly, an Asian Development Bank technical assistance study in 2003 found that clothing producers in Bangladesh are likely to earn 30% more if inefficiencies were removed at Chittagong port.[56]

Ports in Bangladesh are plagued by labour problems, poor management, and lack of equipment. Bangladesh's main seaport, Chittagong, handles about 100-105 lifts per berth a day, which falls below the standard of 230 lifts a day as suggested by UNCTAD. A firm-level investment climate survey carried out by the World Bank and the Bangladesh Enterprise Institute (2003) shows that the ship turnaround time is five to six days compared to about one day in efficient ports thus causing severe congestion.[57]

The survey also shows that firms in Dhaka and Chittagong experience power interruptions for 247-250 days a year causing a 3 to 3.3% output loss. Most RMG firms have to rely on generators for uninterrupted power supply. However, as the electricity produced from the generators is more expensive than the supplies from the national grid, excessive costs undermine the competitiveness of exporters.[58]

4.3.3 Missing Trade Facilitation Measures

Trade facilitation is defined as the simplification and harmonization of international trade procedures, which encompass the activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade. Table 4.6 provides information on the procedural hurdles faced by importers and exporters in the South Asian countries.[59] These hurdles are testimony to the limited attention being paid to improve trade facilitation in South Asia.

55 Adhikari (2006a).

56 ADB (2006b).

57 Cited in Razzaque (2005)

58 ibid.

59 Procedural requirements for exporting and importing a standardized cargo of goods of a company with more than 100 employees. See World Bank and IFC (2006).

Table 4.6 Procedural hurdles faced by exporters/importers in select regions/countries

Region/Economy	Documents for export (number)	Signatures for export (number)	Time for export (days)	Documents for import (number)	Signatures for import (number)	Time for import (days)
East Asia & Pacific	7.1	7.2	25.8	10.3	9	28.6
Europe & Central Asia	7.7	10.9	31.6	11.7	15	43
Latin America & Caribbean	7.5	8	30.3	10.6	11	37
Middle East & North Africa	7.3	14.5	33.6	10.6	21.3	41.9
OECD	5.3	3.2	12.6	6.9	3.3	14
South Asia	8.1	12.1	33.7	12.8	24	46.5
Sub-Saharan Africa	8.5	18.9	48.6	12.8	29.9	60.5
Denmark	3	2	5	3	1	5
Bangladesh	7	15	35	16	38	57
Bhutan	10	12	39	14	12	42
India	10	22	36	15	27	43
The Maldives	7	4	24	12	4	29
Nepal	7	12	44	10	24	38
Pakistan	8	10	33	12	15	39
Sri Lanka	8	10	25	13	15	27

Source: Wickramsinghe (2006) based on World Bank and IFC (2006).

Compared to the rest of the world, the South Asian countries are marginally better than the Sub-Saharan African countries in terms of trading across borders. Even within South Asia there is a considerable variation with the time taken for import being the highest in the case of Bangladesh followed by India and Bhutan. While the time taken for export or import is influenced by several factors including the quality of transportation and other infrastructure, as discussed above, there are several areas in which delays can be considerably reduced. Reducing delays is extremely important; an empirical study by Hummels (2001) estimates that each day saved in shipping time is worth 0.8% ad valorem duty for manufactured goods. For example, a decision to reduce the number of documents and signatures required for import-export, which are significantly higher in Bangladesh and India compared to the regional average, can be made by the stroke of a minister's pen. This will have a significant payoff for the trading sector as a whole.

In the post-quota era, improved trade facilitation is even more critical for the survival of the South Asian T&C sector, not least because this is one industry that involves both imports of inputs as well as exports of finished products. Given the move towards vertical specialization and slicing up the value chain, each day saved could provide enormous benefits in terms of enhancing the industry's competitiveness. This is important as some RMG products are time-sensitive products and delayed consignments could lead to the order cancellation.

4.3.4 High Costs of Inputs

Except for India, and to some extent Pakistan, the South Asian countries do not have vertical integrated production structures for the T&C sector, and they have to rely on imported fabrics and accessories in the process of production. Absence of a vertically integrated production structure may not be a major disadvantage provided the inputs can be obtained in a short time period at international prices. However, due to the problems concerning infrastructure and trade facilitation, it is not possible for the South Asian countries to access inputs at short notice.

The best way to solve the problem of high cost of inputs is to reduce tariffs on inputs across the board. However, this may not be a desirable option given the reliance of many South Asian countries on customs for raising government revenue.[60] Therefore, many countries allow import of inputs to be used for export processing at reduced or even zero duty. To ensure that the inputs are actually used for manufacturing exportable items, several governments have made use of the bonded warehouse facility.

However, this system is riddled with bureaucratic problems as the example of Nepal shows. The exporters who have not exported for a year have faced administrative hassles in utilizing this facility. Even for regular exporters, refunds are not delivered in time. These are processed in more than 30 days from the date of exporters' claim. Moreover, it has become extremely difficult to get the bank guarantee released, particularly after the introduction of value-added tax (VAT)-related regulation.[61]

To reduce the cost as well as time, one option proposed by Bangladesh is to have a Central Bonded Warehouse facility, which involves two steps. First, the country can establish a facility (preferably through public-private partnership), which can import inputs duty-free and stock them based on potential market demand. Second, the exporters make duty-free purchases from such a facility by producing documentary evidence of the order (export letter of credit or confirmed order). While this option is yet to be widely debated and discussed within Bangladesh, the feasibility of its adoption by small exporters like Sri Lanka and Nepal is limited because of the lack of critical mass for the facility to become financially viable.[62] Moreover, there is a risk that frequent change in fashion could erode the profitability of the enterprise. This partly explains why neither the private sector nor the government is too keen on creating such an enterprise.

60 Adhikari and Yamamoto (2006).

61 See Dahal (2006) for further details.

62 See Adhikari and Yamamoto (2006) for further details.

4.3.5 Limited Access to Finance

Access to credit mainly for small and medium-sized enterprises, including T&C ventures, is a major problem in South Asia that hinders the prospect of unleashing entrepreneurial potential. Due to the time and hassles involved in recovering loans in the event of default, and generally the high level of non-performing assets, financial institutions exercise extra, often unwarranted, caution while lending. Accordingly, they do not consider small enterprises and/or those enterprises with limited ability to provide collateral security[63] as 'creditworthy'. Consequently, these enterprises have to finance the majority of their operations through internal resources or rely on informal sources of funding which tend to be extremely costly.[64]

For example, as stated in a study conducted by the International Business and Technical Consultants, Inc. (2003) for the Ministry of Commerce, Bangladesh, a large number of knitwear garment exporters with a capital of Taka (Tk.) 10 million to Tk. 20 million, and a workforce of 150-300, were forced to borrow from local moneylenders at a monthly interest close to 11%. Exporters are compelled to take such loans when they fail to obtain urgent bank financing.

In the case of Nepal, the story is slightly different. While small entrepreneurs' access to credit as well as other banking facilities is severely restricted by discriminatory interest rates and the need for collateral, exporters are facing new problems after the quota phase-out. Nepalese commercial banks are increasingly becoming reluctant to make new investments in this sector and are initiating stricter actions against debtors.[65]

4.3.6 Other Problems

Governance issues, though not specific to the T&C industry, figure prominently among other supply-side problems facing the South Asian countries. Lack of an enabling environment including consistency in application and interpretation of policies, laws and regulations, predictability and certainty in terms of their application as well as the 'controlling' rather than 'facilitating' roles of various government agencies are among the key governance-related problems.

Similarly, while labour rights should be implemented in earnest, it is equally important to address the implications arising from these issues. A high level of unionisation and politicisation of labour as well as rigidity of labour laws have been counter-productive for business growth in South Asia. Frequent labour unrest in undertakings such as ports and in T&C firms is common in the region.

The ripple effect could create even more serious problems. For example, when RMG workers went on strike in Bangladesh in May 2006, it created a ripple effect in the Nepalese RMG industry where the workers went on strike in June-July. Moreover, rigid labour laws in many of the South Asian countries have created problems for expansion of the industry. They also have created a perverse incentive to hire a limited

63 According to the World Bank and IFC (2006), as cited in Wickramasinghe (2006), 78.17% of loans disbursed in 2005 in South Asia required collateral security, the percentage for Sri Lanka being 89.45%.

64 According to the World Bank and IFC (2006), as cited in Wickramasinghe (2006), 56% of the funding requirement is met through internal resources. Reliance on informal sources of funding was 6.65%.

65 Shakya (2005).

number of workers or hire them as contract workers and/or substitute capital for labour as much as possible. For example, rigid labour legislation was cited as a factor responsible for hindering growth prospects in the T&C sector in India.

One way to overcome problems associated with governance, red-tape, poor quality of infrastructure, politicisation of trade unions, and rigid labour laws is through the successful operation of export processing zones (EPZ). The evidence suggests varying levels of success in operating EPZs. However, with the aid of suitable policy tools, it is possible to harness their potential for export growth.

5. Governments' Support to the T&C Sector

Government support to the T&C sector is widely prevalent in South Asia and often supplements the support provided to the export-oriented enterprises in general. The support measures provided can be broadly considered a 'survival strategy' for some players but a 'preparedness strategy' for others which are eager to take advantage of the potential market access opportunities. While some of these measures are common to all countries, other measures are unique and country-specific (see Chart 1).

The support measures taken by the Government of Bangladesh to bolster the T&C industry include the provision of bonded warehouse facilities, technological upgradation (concessionary duty rates and tax exemptions for the import of capital machinery), cash subsidies for the use of local fabrics as inputs for exporting RMG enterprise and an Export Credit Guarantee Scheme (ECGS) covering risk on export credits at home, and commercial and political risks occurring abroad. The government also supports market promotion efforts of the RMG exporters and subsidizes utility charges.[66]

In 1999, the Government of India established a Technology Upgradation Fund (TUF) to support investment for upgradation of T&C machinery; it has decided to extend this until 2009.[67] The government also launched the Technology Mission for Cotton on February 21, 2000.[68] Likewise, the 'Scheme for Integrated Textile Parks' (SITP) was formulated to provide the industry with world-class infrastructure facilities for setting up textile units through public-private partnership. Moreover, additional measures in relation to import, customs and excise duties, development of the handloom sector and yarn production have been taken by the government.[69]

In Nepal, procedures on bonded warehouse facilities, levying duties and refunding VAT have been modified. To reduce transportation costs, an Inter-Container Depot (ICD) facility was established at the main transit point for international trade. The Readymade Garment Export Promotion Committee (RGEPC), Export Promotion Council and Export Promotion Fund have been established to provide further support to the export sectors. While there are no specific provisions in the current budget for reviving the RMG industry, it is stated that the Special Economic Zone, which is likely to benefit the RMG industry, will be established in the next fiscal year.[70]

66 WTO (2006b).

67 Ministry of Finance (2005) and Ministry of Textiles (2006).

68 Cotton Corporation of India (2006).

69 Ministry of Finance (2005); Ministry of Textiles (2006).

70 Ministry of Finance (2006).

Technology upgradation and modernization of the T&C sector have been the major thrust of the government support programme in Pakistan, as is indicated by the increased import of textile machinery[71] and budgetary support. While several tax incentives have been provided to the T&C sector, the key government initiatives include the establishment of the Federal Textile Board to assist the textile industry in the post-quota period, the Garment Skills Development Board through which training institutes have been set up under public-private partnerships (Ministry of Commerce, 2005), and a textile package to enhance the competitiveness of the industry.[72]

In Sri Lanka also, modernization of the T&C industry was a major support programme. To help ailing industries restructure themselves, a decision was taken by the government to write off the non-paid debt of the local textile manufacturers that have registered for restructuring the textile industry. Several incentives have been proposed for productivity improvement in the apparel industry through a grant of US$1 million. Realizing the need to promote backward linkages, a decision has been taken to set up an Industrial Park with a waste and effluent treatment plant to facilitate fabric manufacturing.[73] Moreover, a government-funded image building programme called 'Garments without Guilt' has been launched recently to position Sri Lanka globally as an ethical clothing producer.[74] A unique programme outlined in the Budget Speech of 2006 is aimed at developing a regional apparel hub in Katunayake, an area where both an EPZ as well as an international airport is located.

Based on the type and magnitude of support provided by various governments, the following pattern can be observed:

First, the support is a function of the ability as well as the willingness of governments to provide assistance. Therefore, better resourced countries seem to have provided more assistance. The governments that pursue active industrial policies tend to provide higher levels of support.

Second, duty reduction for the import of raw materials and machinery, and provisions for image building, quality improvement and market promotion, which are considered indirect support measures, are the two most widely used means of support.

Third, maintaining and improving competitiveness is the key to survive in the post-quota world. Four countries in the region have made investments in technological upgradation or modernization of the T&C sector. Some countries even provided preferential credit or cash support to help their firms modernize.

Fourth, two types of support, which are general and applicable to all exporting enterprises, are prevalent in all South Asian countries. They are the operation of Special Economic Zones (SEZs), Export Processing Zones (EPZs) or Industrial Zones (IZs), and refund of and reduction in excise duty, sales tax and value-added tax (VAT) for the inputs – goods and/or services – used in export processing. Similarly, duty reduction in the import of inputs is a prominent means of support provided to export-oriented industries.

71 Din (2005).

72 Ministry of Textile Industry (2006).

73 Ministry of Finance and Planning (2004).

74 Samarweera (2006).

Fifth, reduction in the prices of infrastructure, such as rebate/reduction in utility charges, is found to be the least used (or least reported) form of government support. Finally, income tax exemptions for the exporting sectors, an extensively used form of government support in the past, is not the norm anymore with some governments not providing such facilities and some recently discontinuing the same. Other governments charge income tax at reduced rates for export-oriented enterprises.

Chart 1 An indicative chart of governments' support to the T&C sector in South Asia

Support measures	Countries				
	BD	IN	NP	PK	SL
Support for technological upgradation	T&C specific	T&C specific	N/A *	T&C specific	T&C specific
Subsidized/preferential credit	T&C specific	T&C specific	N/A *	N/A *	T&C specific
Creation/designation of textile/garment cities/villages	T&C specific	N/A *	N/A *	T&C specific	N/A *
Special economic/export processing zones	All exports	All exports	All exports	All exports	All exports
Duty reduction for the import of inputs/machinery	T&C specific	T&C specific	T&C specific	T&C specific	T&C specific
Excise, sales tax, VAT refund/reduction	All exports	All exports	All exports	All exports	All exports
Income tax holiday/rebate/reduction	All exports	N/A *	All exports	All exports	All exports
T&C specific infrastructure support	N/A *	T&C specific	N/A *	N/A *	T&C specific
Incentives for use of local inputs/outputs	T&C specific	N/A *	N/A *	N/A *	T&C specific
Reduction in price of infrastructure	T&C specific	N/A *	N/A *	N/A *	N/A *
Export credit insurance	T&C specific	N/A *	N/A *	N/A *	N/A *
Subsidies to loss-making state-owned enterprises	N/A *	N/A *	N/A *	N/A *	N/A *
Writing off of unpaid debt/debt forgiveness	N/A *	N/A *	N/A *	N/A *	T&C specific
Human resource/skills development	T&C specific	T&C specific	N/A *	T&C specific	T&C specific
Image building/quality improvement/market promotion	T&C specific	T&C specific	T&C specific	T&C specific	T&C specific
R&D support	N/A *	N/A *	N/A *	T&C specific	N/A *
Strengthening domestic capacity to supply inputs	N/A *	T&C specific	N/A *	T&C specific	T&C specific

T&C specific   All exports   N/A *

Notes: Country abbreviations – BD: Bangladesh; IN: India; NP: Nepal; PK: Pakistan; SL: Sri Lanka.

* The areas indicated by this shade do not necessarily mean that the government support is not available, but that the information regarding existence or otherwise of such measures is not available.

Source: Adapted from Adhikari (2006d).

6. Regional Trade and Cooperation

In the post-quota world where market access in the developed nations is no longer guaranteed, the South Asian countries are forced to compete with each other to retain their share in two of their biggest international markets. At the same time they have to compete with highly competitive countries as well as preference-receiving countries outside the region. Their efforts to diversify their markets have been limited. Although there is a possibility to enhance South-South cooperation on trade, it is an area fraught with challenges, not least because the T&C sector is equally protected in the developing countries. Though protection is provided to the T&C industry as a whole, the textile sector is protected in particular to ensure vertical integration within the country.

The developing countries are making use of regional trading arrangements (RTAs) as a mechanism for reducing protection on the T&C trade, ASEAN being a prime example. At a general level, the South Asian countries, having realized the imperative to liberalize trade within the region, have signed the Agreement on South Asian Free Trade Area (SAFTA), which was supposed to have come into operation from July 2006. As per the Agreement, all tariffs except for those under the 'sensitive list' should come down to between 0-5% by 2016. However, it is this list that is likely to create a major barrier to trade within the region, as discussed later.

There are at least three compelling reasons for reducing trade barriers in the T&C sector within the South Asian region. First, sourcing of inputs from the neighbouring countries reduces the cost of inputs and lead time, as well as helps enhance competitiveness of the firms within the region by promoting vertical integration at the regional level. Second, most countries in the region allow duty-free imports of raw materials for the T&C industry, so they neither generate revenue nor protect the domestic industry by imposing customs on such imports. Third, to qualify for reduced or zero duty as per the EU GSP/EBA scheme, it is only sensible for countries such as Bangladesh, Nepal and Sri Lanka, without vertically integrated production structures, to source inputs either from India or Pakistan and obtain the benefits of cumulation rules.

To some extent, the sourcing of inputs from the region is already taking place and what is required is a further boost to this process. For example, as per the comprehensive export data available for India (Table 4.7),[75] T&C items exported to the neighbouring countries are predominantly raw materials, with exports to all countries except the Maldives and Sri Lanka, accounting for more than 90% of total T&C exports. Even within this category, cotton items (mainly yarn and fabrics) constitute major exports, reflecting India's comparative advantage in production of raw cotton as well as semi-finished products. The exports of apparel or other finished products are very limited with Pakistan importing the least, reflecting its own capacity to produce. The Maldives is the only exception because the majority of exports constituted finished products.

75 While the pattern of sourcing inputs is best analysed by the use of import data from the importing countries, the data on Indian exports have been used to make this analysis due to lack of import data for countries in the region.

Table 4.7 Distribution of Indian T&C exports to other South Asian countries in 2005 by category (%)

Export item (HS Category)	Distribution of Indian T&C exports in South Asia				
	Bangladesh	The Maldives	Nepal	Pakistan	Sri Lanka
Share of cotton items as percentage of total exports (HS 52)	71	8	63	85	43
Share of raw materials as percentage total exports (HS 50-56; and 58-60)	94	44	92	98.5	84
Share of finished products as percentage of total exports (57; and 61-63)	6	56	8	1.5	16

Source: Based on Dev (2006).

However, the level of exports from India to the South Asian countries has declined in 2005 compared to 2004.[76] For example, in 2005 T&C exports from India to Bangladesh, Nepal, Pakistan, and Sri Lanka declined by 14.77%, 18.65%, 62.65%, and 7.36%, respectively, in comparison to 2004. The largest decline of exports to Pakistan could be due to better harvest or improved capacity within the country to produce cotton items. Indeed, the export of cotton products from India to Pakistan has declined from Rs 2.36 billion in 2004 to Rs 767 million in 2005.[77]

The export figures from Pakistan to other countries in the region show that it has achieved an impressive growth as can be seen from Table 4.8. Overall, Pakistan exported T&C products worth US$348.67 million to the South Asian neighbours. Surprisingly, the greatest increase was seen in exports to India with a staggering figure of 146.70% in 2005 compared to the corresponding period in 2004. Growth in exports to Bhutan and the Maldives are in second and third place with 57.33% and 56.72%, respectively. Pakistan's export growth to Bangladesh and Sri Lanka has also been high at 20.3% and 36.23%, respectively. Pakistan's export to only one country in the region (Nepal) declined, which is in line with overall decline of exports from Nepal resulting in a lowered requirement of raw materials.

76 Dev (2006).

77 ibid.

Table 4.8 Pakistan's exports of T&C products to other South Asian countries

Export partners in South Asia	Exports 2004 (US$ '000)	Exports 2005 (US$ '000)	Change (%)
Bangladesh	162,892	195,960	20.30
Bhutan	152	239	57.33
India	19,253	47,497	146.70
The Maldives	175	275	56.72
Nepal	2105	1858	-11.74
Sri Lanka	75,485	102,834	36.23
Total	260,062	348,662	34.07

Source: UN COMTRADE Database.

Due to a lack of data for 2005 on exports to South Asia from Sri Lanka, Bangladesh, the Maldives and in the case of Nepal for 2004 as well, it has not been possible to evaluate the performance of these countries in the post-quota era.

Nonetheless, the data for 2004[78] shows that Bangladesh exported T&C products worth US$63.73 million to the South Asian region. Out of this figure, exports to India were US$32 million and exports to Pakistan were US$27 million. Similarly, Sri Lanka exported products worth US$46 million to other South Asian countries. Of these, exports to the Maldives represented 73%. Sri Lankan clothing manufacturers operating out of the Maldives during the quota regime explain the high trade value of clothing and textile exports to the Maldives in 2004. However, as the Sri Lankan manufacturers withdrew from the Maldives after the quota abolition, this value is most likely to have decreased significantly in 2005.

Although raw materials are among the highly traded T&C items within the region, nearly all these products have been included in the Sensitive Lists[79] of each country under SAFTA. This implies that countries have the flexibility to maintain the current level of tariff on these products (Table 4.9). While the example of the Maldives and

78 Data downloaded from United Nations COMTRADE database.

79 Except India, the other countries included the same set of textile and clothing products in their Sensitive Lists for LDCs as well as non-LDCs.

Table 4.9 Textile and clothing products included in the Sensitive List under SAFTA

HS Code	Bangladesh	India	The Maldives	Nepal	Pakistan	Sri Lanka
50	•		•			
51						
52	•	•	•	•		
53	•			•	•	•
54	•	•	•	•	•	
55	•	•	•	•	•	
56	•		•	•	•	•
57	•	•		•	•	
58	•	•	•		•	•
59	•	•		•	•	•
60	•	•		•	•	
61	•	•	•	•	•	
62	•	•	•	•	•	
63	•	•	•	•	•	

Note: India's Sensitive List for LDCs includes only items under HS Code 50, 61, 62.

Source: Authors' calculation based on countries' sensitive lists downloaded from the SAARC Secretariat website <www.saarc-sec.org>

Sri Lanka, which are least restrictive, is worth emulating, Bangladesh and Nepal are among the highly restrictive markets. Elements of high tariffs and unpredictability associated with lack of commitment to reduce tariffs hinder the prospects of enhancing regional competitiveness as well as trade flow within the region. Examining the tariff structure, it can be seen that the tariffs seem to be imposed on T&C products in an indiscriminate fashion. Apparently, some tariffs have been imposed keeping in mind 'future' comparative advantage.

A more useful strategy would be to eliminate all tariffs on textile and clothing products manufactured in the region or to eliminate the tariffs imposed on products for which there is no domestic industry. This would allow manufacturers to import the necessary raw materials from within the region. Moreover, the removal of tariffs would enable the free availability of raw materials in the domestic market, which would encourage exports of low-volume, high-price niche products even from the smaller suppliers in the region.

Reduction in trade barriers is a necessary but not sufficient condition in the move towards a more liberalized trade regime within the region. It needs to be complemented by a host of other flanking policies such as investment and skill development policies.

Foreign investment can play a major role in the T&C sector, particularly in the LDCs within the region, because such investment can provide necessary resources to enterprises reeling under financial constraints. Foreign investment also can become a catalyst for technological upgradation: first, because enterprises can get additional resources to invest in the latest technology, and second, because FDI is considered a window for the transfer of technology to the developing countries. Moreover, because of superior managerial skills and a tendency to invest in human resource development, FDI can be an instrument to increase total factor productivity at the enterprise level.[80]

The rationale for increased intra-regional flow of investments in South Asia can be two-fold. First, due to several beneficial effects of FDI it would help enhance the competitiveness of the enterprises within the region as a whole through creation of vertical integration. It can also promote specialization within various countries in the region so as to enable these countries to 'slice up' the value chain. Second, countries without a meaningful GSP facility can invest in creating backward linkages in the countries with GSP (including EBA) facilities. This is already happening, but it needs a major boost in the days to come. For example, an investment zone in Sri Lanka that is specifically targeting exports to the EU is apparently attracting Pakistani investment in textiles. Consequently, large textile mills are being built in Sri Lanka by Pakistani firms.[81]

However, the second category of investment discussed above can be considered 'footloose investment' akin to the investments made by India in Nepal on the one hand, and by Sri Lanka in the Maldives on the other during the quota era. These countries

80 Adhikari and Yamamoto (2006).

81 As per information received from All Pakistan Mills Association (APTMA), the Sri Lankan Government has launched a package to attract investment in the country. Such incentives include a 10-year tax-free period on income for investments over US$ 10 million. See EmergingTextiles.com (2006d).

withdrew their investments in the wake of the quota phase-out. These investments can vanish when the specific opportunity (such as GSP/EBA facility) is not available anymore.

The importance of human capital for enhancing the productivity of workers cannot be over-emphasised. However, the institutions providing skill development training or career-oriented courses are either non-existent or not functional in the least developed countries such as Nepal and Bangladesh. There have been limited efforts so far both from the government as well as the private sector in this direction. Therefore, it is necessary to harness the potential of regional, sub-regional or bilateral cooperation in this area.

7. Conclusion and Recommendations

Data available for the 18-19 month period after the T&C quota phase-out show that the phase-out did not bring drastic changes in the export composition and production structure as envisaged earlier. The primary reason is the imposition of safeguards on China both by the US and the EU which contained the runaway growth of Chinese exports to these two major markets. While its impact is felt all over the world including in countries like Bangladesh, Cambodia, Indonesia and Vietnam, which benefited from this, majority of countries which survived mainly on preferential trading arrangements have not been able to take advantage of the safeguards.

Among the South Asian countries, the performance of India and Pakistan has been reasonably good, but there is room for improvement. While the Maldives seems to have moved out of the industry, Nepal clings on with the hope of improved competitiveness and duty-free-quota-free access to the US market. Bangladesh has achieved an impressive growth, particularly in low-cost labour-intensive categories of the RMG sector, but its sustainability is not guaranteed. Sri Lanka is likely to make sustained progress by focusing mainly on niche products.

Despite the varied level of performance, some problems are common to most of the South Asian countries, even though their magnitude may differ. While the government support provided so far has partly helped offset the increased cost resulting from a host of supply-side bottlenecks, it is desirable to identify the root cause of the problem and make targeted interventions. Market access barriers continue to inflict insurmountable losses on the South Asian countries, and a gradual transformation is taking place due to the ingenuity of the protectionist interests. Tariff and non-tariff barriers co-exist in many countries, with the latter form of protection becoming more pronounced in recent years. For example, the emergence of private codes of conduct mainly in relation to environment and labour standards and the requirement to comply with such 'shifting goalposts' have eroded the competitiveness of the South Asian T&C exporters.

Although the South Asian countries compete with each other in the developed countries' market for T&C exports, there exists a potential to establish the region as the global hub for the T&C trade through regional cooperation in trade, investment and skill development. Given the fact that creating a vertically integrated production structure in countries like Bangladesh, Nepal and Sri Lanka is not feasible, the possibility of creating regional vertical integration to ensure a certain degree of specialization in countries within the region should be explored. As a starting point, the mutual suspicion prevalent within the region should give way to rational decisions on what needs to be genuinely protected, and what should be liberalized.

Given the resource endowment of South Asia, the vision for creating a global T&C hub is well within reach. To make this vision a reality, a collaborative effort is required from the private sector and governments of the region at national, regional and international levels in the following areas:

First, it is important that the initiatives for removing structural impediments and supply-side problems be taken at the national level itself. International and regional cooperation could only supplement the national efforts. Given the resource crunch facing most countries, it may not be possible to create infrastructure overnight, but the decision relating to other trade facilitation measures such as reducing the number of signatures required for export and import should be implemented immediately.

Second, labour productivity can be increased only by providing training opportunities to the workers and managers. Since the government may not have resources to fully fund such programmes, a mode of public-private partnership and cooperation should be followed. Regional cooperation in this area is of vital significance. For example, given that the countries like India and Sri Lanka have already made advances in this area, it should be possible within the framework of regional cooperation for existing training institutions in Bangladesh and Nepal to establish partnerships with institutions in India and Sri Lanka. Host governments will have to provide necessary incentives for facilitation of such collaboration. This could be supplemented by encouraging students from the LDCs willing to pursue a career in the T&C sector to follow courses in textiles and fashion designing from more advanced countries in the region.

Third, enhancing access to credit is a purely domestic issue, which should be achieved by infusing a greater degree of competition in the financial sector. This can be achieved through enactment/implementation of competition laws in countries like Bangladesh and Nepal, where it is non-existent, and active enforcement of existing legislation in India, Pakistan and Sri Lanka. Another option is to empower the regulatory institutions to play a more active role in promoting competition in the financial sector. If both the instruments mentioned above are not possible to implement, governments may have to resort to directed lending. However, this should be conditional on performance requirements and should have a credible 'sun set' clause to prevent the same from being captured by vested interests.

Fourth, given the fact that domestic resources may not be sufficient for creating infrastructure which requires long-term investment, it is necessary to make use of international assistance including the enhanced Integrated Framework for Trade Related Technical Assistance (IF) and Aid-for-Trade, which are currently being discussed at the WTO.

Fifth, there is a need to conduct a serious cost-benefit analysis of the government support provided to the export-oriented sector in general and T&C exports in particular to see if marginal benefits of such measures justify the costs in terms of actual support provided as well as revenue forgone. It is also necessary to see if such investments have a 'crowding-out' effect on other sectors which offer better human development potential. Moreover, whenever such support is provided, it is necessary to ensure that it does not run foul of the WTO Agreement on Subsidies and Countervailing (ASCV) Measures.

Sixth, despite the existence of bonded warehouse facilities, cheap and timely sourcing of inputs can only be achieved through regional cooperation on trade. Liberalization of trade in T&C products within the region is necessary for creating regional vertical integration and ensuring a certain degree of specialization in each country. The starting point for this would be to have a serious thought on revising the Sensitive List prepared under SAFTA by countries other than Sri Lanka and the Maldives. This also will help achieve the goal of market diversification to a significant extent.

Seventh, it is important for the countries in the region to adopt more favourable policies on investment in their neighbouring countries and create and an enabling environment for transfer of technology and skills. While unilateral measures can provide quick results, a comprehensive proposal for liberalization of investment and technology transfer in South Asia should be included in the economic cooperation framework within SAFTA to make such reforms more credible.

Finally, at the global level, it necessary for the South Asian countries to have a common position on removing trade barriers, particularly non-tariff barriers on T&C products. On tariff barriers, the South Asian countries have slightly different interests and their positions could be a bit nuanced. For example, the issue of duty-free-quota-free market access to the LDCs might become contentious. However, once the tariff barriers within the region are removed, duty-free-quota-free access to the LDCs will mean more exports of raw materials from countries such as Pakistan and India. Therefore, all the countries in the region have an incentive to support this objective.

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