SOUTH ASIA AFTER THE QUOTA SYSTEM: IMPACT OF THE MFA PHASE-OUT



Edited by

Saman Kelegama

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Institute of Policy Studies of Sri Lanka

in association with

Friedrich-Ebert-Stiftung, Colombo





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Preface

Since January 1st, 2005, the world of textiles and garments has changed. The "Multi Fibre Arrangement" (MFA) which governed the trading in textiles and garments has expired by the end of 2004. For 30 years, the MFA had governed a comprehensive, worldwide system of bilateral agreements and unilateral import restrictions, known as the "quota system". Markets for textiles and garments are now subject to WTO (World Trade Organisation) rules as any other commodity. No member state of the WTO is entitled to discriminate against industries of another country by such kind of restrictions. UNCTAD has praised the expiry of the Multi Fibre Arrangement: "It would mean that both rich and poor countries would equally benefit from a future free trade in textiles and garments". But will this really happen?

Nowhere in the world will the phase-out of the MFA have a more dramatic impact than in South Asia. Analysts tell us that except China, India, Pakistan and Vietnam, there will only be losers. Textile and garments industries in Bangladesh, Sri Lanka, and Nepal will come under extreme pressure. According to the Asian Development Bank (ADB), Bangladesh, one of the poorest countries in the world, will face a severe structural crisis. The International Federation of Textile, Garment and Leather Workers Association (IRGLWF) estimate that more than 1 million jobs will be lost in the country. Social unrest is most likely as a consequence of such developments.

But the situation is complex: some countries and companies have anticipated the impact of the expiry of the MFA and have adjusted early by improvements in design, market access, transport logistics, etc. Other countries have continued to bank on low wages and low-cost working conditions. Taking into consideration the increasing competition on the international textile and garment markets there is a danger of a race to the bottom, leading to loss

of employment, increasing insecurity at the workplace, and the negligence of workers and trade union rights as well as core labour standards.

In order to examine these issues, the Institute of Policy Studies of Sri Lanka (IPS) and the Friedrich-Ebert-Stiftung (FES) organized a seminar during 26-27 April 2005 in Colombo on the subject "After the Quota System: Impact of the MFA Phase-Out". A number of academia working on the subject were invited to present their country studies, in particular, to discuss how these countries have prepared for the MFA expiry and what strategies they have adopted to address the post-MFA situation. The seminar was to commemorate the 40th anniversary of operation of the Friedrich-Ebert-Stiftung in Sri Lanka. The seminar brought together all relevant stakeholders - representatives of governments, the private sector, trade unions, international organizations as well as researchers.

This book edited by the Executive Director of the IPS, Saman Kelegama, contains the papers on the five South Asian countries that were presented at this seminar. There is a especial emphasis on Sri Lanka in Part II of the book where there are case studies of the Sri Lankan garment industry. The book will be useful for those who are actively involved in the industry, government officials, and academics working on the subject. The FES would like to record its appreciation to all those who were involved with the seminar and the IPS for bringing out this book.

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September 2005

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List of Acronyms

ACP	-	African, Caribbean and Pacific
AGOA	-	African Growth and Opportunity Act
AIP	-	Approval Industry Initiative
ASEAN	-	Association of South East Asian Nations
ATC	-	Agreement on Textiles and Clothing
BMR	-	Balancing, Modernization and Replacement
CACM	-	Central American Common Market
CBTPA	-	Caribbean Basin Trade Partnership Act
CITA	-	Committee for the Implementation of Textile Agreements
DWCP	-	Decent Work Country Programmes
EBA	-	Everything But Arms
EU	-	European Union
FTZ	-	Free Trade Zone
FY	-	Fiscal Year
GATT	-	General Agreement on Tariffs and Trade
GDP	-	Gross Domestic Product
GSP	-	Generalised System of Preferences
GTAP	-	Global Trade Analysis Project
HMGN	-	His Majesty's Government of Nepal
ICTD	-	International Centre for Trade and Sustainable Development
ILO	-	International Labour Organization
IMF	-	International Monetary Fund
ITC	-	International Trade Centre
JAAF	-	Joint Apparel Association Forum
LDCs	-	Least Developed Countries
MFA	-	Multi-Fibre Arrangement
NAFTA	-	North American Free Trade Agreement

NIEs	-	Newly Industrialised Economies
ODA	-	Official Development Assistance
OPP	-	Outward Processing Programmes
PRC	-	People's Republic of China
PRGF	-	Poverty Reduction and Growth Facility
RIS	-	Research and Information System for Non-Aligned and other Developing Countries
RMG	-	Ready Made Garments
ROO	-	Rules of Origin
SAARC	-	South Asian Association for Regional Cooperation
SAFTA	-	South Asian Free Trade Agreement
SITC	-	Standard Industry and Trade Classification
SMI	-	Small and Medium Industries
T&C	-	Textile and Clothing
TDA	-	Trade and Development Act
TIFA	-	Trade and Investment Framework Agreement
TIM	-	Trade Integration Mechanism
TRIPS	-	Trade Related Intellectual Property Rights
UNCTAD	-	United Nations Conference on Trade and Development
US	-	United States
USITC	-	United States International Trade Commission
WRAP	-	World-wide Responsible Apparel Production
WTO	-	World Trade Organization

Part I

Introduction

1

Impact of the MFA Expiry: An Overview

Denis Audet

International rules governing world trade in textiles and clothing have changed drastically when new regulation was enforced at the end of 2004. Countries are no longer able to protect their own industries by restricting the quantity of textile and clothing products being imported under the Multi-Fibre Arrangement (MFA). The World Trade Organization's (WTO) "Agreement on Textiles and Clothing" (ATC) is challenging decades of trade restrictions on global suppliers and implies considerable adjustments for all those involved in the supply chain. What are the drivers of change in textile and clothing markets and the main policy challenges in the post-ATC period?

1. What are the Key Market Trends?

Shifting Competitiveness

Import restrictions, initially imposed under the MFA, fragmented the international supply chain by encouraging the diversity of supplies. This process worked to the disadvantage of the more efficient and quota-constrained suppliers, many of which subcontracted clothing production to low-wage third countries. Hence, the rules benefited the least competitive suppliers, most of them located in small developing countries and Least Developed Countries (LDCs) that have specialised in producing clothing

products from imported textiles. Such countries are increasingly aware of their vulnerability and are seeking to improve their access to markets within developed countries in order to minimise the expected hardships. In the post-quota period, countries which have reliable access to high quality textiles and can produce and deliver within short cycles stand to gain market shares. Within the new competitive environment, time proximity is more important than low wages in defining competitiveness. It follows that countries should pay great attention to the logistical dimensions involved in their production and delivery chains.

Migration of Textile Capacity to the Most Competitive Developing Countries

Without quantitative import restrictions, there are no trade obstacles to developing stronger clusters of textile expertise in the most competitive developing countries. The recent surge in China's imports of up to date textile and clothing equipment bears witness to this trend and points to what will be the future sources of textile and clothing production and exports. The main beneficiaries are the Chinese clothing suppliers that can buy textiles directly from domestic sources and hence meet shorter turnaround delivery requirements. Access to high quality textiles is considered one of the most important determinants of the competitiveness of clothing suppliers. The migration of textile capacity will nevertheless be influenced by objective competitive factors and will be hampered by the presence of distorting domestic measures and weak domestic infrastructure in several developing countries and LDCs.

The Growing Importance of the Non-clothing Applications of Textiles or Technical Textiles

The textile industry is undergoing a major reorientation towards non clothing applications of textiles, *i.e.*, technical textiles, which represent the

fastest growing segment of total textile applications. Technical textiles are often defined as "those textile materials and products manufactured primarily for their technical and performance properties rather than for their aesthetic or decorative characteristics". They are used in many applications, including furniture, automotive, construction, environment, health and hygiene. It is estimated that technical textiles now account for more than half of total textile production. The processes involved in producing technical textiles are human and capital-intensive and, for the moment, production is concentrated in developed countries but like textiles for clothing applications one should anticipate increased capacity in the most diversified developing countries in the not too distant future.

Leadership Role of Large Retail Groups

Retail distribution is increasingly dominated by large retail groups in the main consuming countries, where the trend is towards greater product specialisation, brand name products and market segmentation. These large retail groups collect market information about the latest trends in styles and tastes, and their integration of this information gives them considerable leverage in dealing with suppliers. Nevertheless, offshore suppliers can benefit from working in close co operation with large retail groups as they learn to: manufacture quality products; apply the buyer's code of conduct; and deliver products in a timely fashion.

2. What are the Policy Challenges?

Liberal trade and investment policies play a key role in this adjustment process. They can help to restrain price pressures on imported goods and therefore encourage the emergence of firms that are able to compete on domestic and international markets. Trade policies, other than quantitative import restrictions, have had a major impact in developing geographical

patterns of trade in textiles and clothing. In particular, the elimination of import quotas has increased the appeal of preferential trade arrangements, such as regional trade arrangements and the Generalized System of Preferences (GSP). However, it has reduced the appeal of Outward Processing Programmes (OPP) under which textile materials are temporarily exported to lower-wage countries and then re-imported as clothing products under preferential provisions. Direct competition from integrated suppliers makes OPP business models less attractive, particularly between OPP partners that are geographically remote.

Vulnerable Developing Countries are Seeking Improved Access to Developed Countries' Markets

In order to minimise their expected hardships, vulnerable developing and least developed countries are seeking improved access to developed countries' markets. [Thus the challenge for policy makers in developed countries is to draft rules of origin for their preferential arrangements that will mainly benefit LDCs and the small developing countries that are most vulnerable to competition from large and integrated suppliers]. Recognising that there is, at present, virtually no production of high quality textiles in LDCs, preferential access arrangements in favour of LDCs must take into account that they have to use competitive textiles originating from third countries to compete on export markets. Under these circumstances, it seems inevitable that in providing LDCs with preferential access, there will be some collateral benefits for suppliers of high quality textiles.

Tariff Protection on Textiles and Clothing Remains High Everywhere

Average tariff protection on textile and clothing imports remains high compared to the protection afforded on manufactured products. In developed countries, the average tariff applied on clothing products is 16.1 per cent versus 6.2 per cent on manufactured products. In developing countries, the

average tariffs are 23 per cent and 13.5 per cent, respectively. Moreover, there are considerable differences among developed countries in the level of tariffs applied on textile and clothing imports and in the recurrence of tariff peaks, *i.e.,* tariffs exceeding 15 per cent. There are also similar imbalances among developing countries and LDCs.

Set up the Institutional Arrangement for Tariff Relief

Import tariffs on inputs, such as textiles and accessories, act as tax on clothing production and can deter creativity and innovation which are important drivers in the fashion industry. Appropriate tariff relief measures and institutional arrangements can help designers and suppliers in keeping abreast with rapidly changing fashion and consumer preferences. Countries seeking to maintain an export-led strategy should have in place the institutional arrangements to respond quickly to demand for tariff relief on inputs.

Remaining Obstacles in Retail Distributions Systems

Access to national retail distribution systems is crucial for large retail groups and brand-name marketers to pursuit business opportunities in countries with attractive growth prospects. In most developed countries, the establishment of retail distribution services is not hindered by restrictions on foreign ownership or obstacles to the right of establishment. In developing countries, access to retail distribution systems is less predictable and several countries have not taken commitments under the General Agreement on Trade and Services (GATS). In the context of the Doha Development Agenda, countries have an opportunity to improve access for wholly owned foreign distribution services to developing countries that still maintain obstacles to foreign direct investment and/or restrict the right to distribute foreign-made goods.

Recourse to Safeguard Measures

The post-quota environment is generating considerable anxiety about the emergence of more competitive suppliers in China and WTO member countries can invoke several WTO provisions to deal with their market disruption and dumping concerns (see Appendix I). The WTO Protocol on the Accession of China contains a transitional product-specific safeguard mechanism. The WTO Report of the Working Party on the Accession of China also contains a textile safeguard provision. Moreover, the provisions contained in the WTO Safeguards Agreement and Anti-Dumping Agreement can be invoked.

Consuming countries stand to gain significantly from improved competitive conditions whereby their consumers are reaping huge benefits in terms of lower prices and improved choices. However, consumer gains may not be perceived to offset the political cost of additional job losses and plant closures due to import surges from China – more than 4 million textile and clothing jobs have already disappeared in developed countries in the last 25 years. Developed countries have broad and wide production and trade interests in dealing with China and they will carefully weigh their overall economic interests at stake prior to engaging in restrictive trade actions. It remains that the mere reference to safeguard measures is often sufficient to create an element of sourcing uncertainty which encourages buyers to diversify their sourcing networks. This diversification of import sources is influenced by competitive cost factors in other supplying countries which are themselves affected by market access opportunities offered under regional and preferential trade arrangements.

Regulatory Challenges to Improve Production and Delivery Cycles

Countries whose regulatory framework is ill-equipped to deal with international competition will be vulnerable in the post-quota period. They stand to pay a high price for inefficient domestic regulatory regimes, obsolete

infrastructure in essential business services, cumbersome customs procedures and other distorted market structures.

A reliable transport infrastructure and efficient customs procedures complement each other in minimising transit periods for shipments involved in international trade and can make geographically remote locations more internationally competitive. Countries need to assess the logistical costs involved in export markets with a view to: setting up a competition enhancing environment in various port services; strengthening competition conditions in and between transport modes; addressing the terrorist risks in transport without losing sight of the benefits of frictionless transport systems; and better integrating the enforcement of national laws and regulations, *e.g.,* customs procedures, taxation, sanitary and environment protection, with other service providers in ports.

3. Action Plan for Countries Wishing to Maintain an Export-led Strategy in Textiles and Clothing

Developing countries seeking to maintain an export-led strategy in textiles and clothing should define a comprehensive programme to assist their national suppliers in adjusting to the new competitive environment and in particular they should focus on the following points:

- Shift the industrial cluster of expertise from manufacturing to the higher value-added segments of the supply chain by placing greater emphasis on education and training of services-related skills, such as design, material sourcing, quality control, logistics and retail distribution.
- Improve the regulatory environment for essential business services, in particular in modernising their customs procedures and their transportation infrastructure.
- Set up the necessary tariff relief institution for imports of quality inputs.

- Stimulate collaborative initiatives in the fields of technology transfer.
- Negotiate improved market access for exports.
- Pursue your WTO rights for a levelled-playing field in respect of trade-distorting domestic subsidies.

2

Impact of the MFA Expiry: A South Asian Perspective

Saman Kelegama

On January 1, 2005 the Multi-Fibre Arrangement (MFA) expired, adding an atmosphere of change to the already dynamic Textiles and Clothing (T&C) market. The MFA was a system of bilateral quotas which limited the importation of a variety of T&C products, to protect domestic producers of developed countries from low-wage foreign competition. Additionally, the MFA provided incentives for companies to build factories in multiple countries, creating new T&C sectors throughout the developing world. Large countries like India and Pakistan found their market access for T&C exports restricted in the developed world while small countries in South Asia such as Sri Lanka, Bangladesh and Nepal benefited from the assured market access by the MFA and their expanding T&C related exports generated more jobs for the poor people in these countries. However, in 1995 the Agreement on Textiles and Clothing (ATC) came into operation, starting a ten-year phase-out of the MFA.

Now, ten years later, the T&C industry faces the sudden roll-back of quotas throughout the developed world and must undergo a major re-partitioning of global market share. Smaller producers must prepare for the challenge of global competition and either thrive as an efficient producer or fold up. This Chapter presents the prospects of various South Asian T&C industries, focusing on Sri Lanka and is based on the findings of the remaining chapters of the book.

1. India

The T&C industry of India encompasses a substantial portion of the overall Indian economy. Providing direct employment to over 35 million people, it contributes about 4 per cent to Indian GDP. In 2001, textiles comprised 14 per cent of total exports while clothing comprised of 11 per cent of total exports. The rise of this industry has helped reduce poverty, fuelling an average annual per capita GDP increase of 3 per cent over the past six years.

The industry itself contains a variety of producers, creating a complete value-chain. This creates internal strength and the opportunity of centralized garment hubs where a single garment can have its entire value added within a single city. Such a structure becomes increasingly important as developed countries include Rules of Origin (ROO) clauses to trade agreements.

In terms of world installed production capacity, India currently ranks first, in weaving and shuttleless looms, along with Jute production. This provides the industry with the needed inputs and capital for increased T&C output.

Needed Reforms

Despite many rosy predictions, some reforms are required for the opportunities of the quota-free environment to be realized. The Indian T&C industry is fragmented with 80 per cent of its production coming from small firms. Additionally, a political bias against the organized manufacture of textiles and the use of synthetic fibres limits the variety of exports. A question of capital utilization also needs to be answered as India contains massive capacities but still produces only 3 per cent of world textiles in value. To reap the full potential of the industry the Indian government should consider reforming labour legislation. Also, the creation of clothing centres would be an important step towards utilizing the industry's self-reliance and capacity.

Post-MFA Implications

Conventional wisdom places India along with China as one of the big winners in the post-MFA era. While some studies show India's textile industry facing minor negative growth, they also predict India's clothing exports may increase by over 200 per cent. Such growth would continue to fuel the Indian economy and could possibly lead to sector-wide employment growth of over 300 per cent in 7 years. With the proper reforms, India can use its capital capacities to become a world class clothing producer. Expectations are high for the post-MFA era, but a history of under-achievement must be overcome for India to reap the potential benefits of quota removal.

2. Pakistan

The textile and clothing sector employs 38 per cent of the industrial workforce, and constitutes roughly 70 per cent of total exports in Pakistan. The textile industry accounts for 217,000 employees, while the clothing industry accounts for 700,000 employees. Textile manufactures have grown from below US $ 5 billion in 1998-99 to over US $ 8 billion in 2003-04. This growth sprung from a commitment to investment, with total investment amounting to US $ 4 billion over the last 4 years. Relatively cheap labour and locally produced cotton provides a price advantage to Pakistani firms. By purchasing domestic cotton, manufacturers lower the lead-time required to fill an order, instead of needing raw materials to be shipped from overseas.

Despite recent investment, all segments of the textile sector still lack modern technology. This has hampered productivity throughout the production chain. Additionally, a lack of research and development and skilled labour has negatively skewed production quality. This phenomenon comes despite increased demand for quality goods worldwide.

Needed Reforms

Despite its strength, Pakistan's T&C sector is in desperate need of vital reforms. Human resource development is required to produce higher-quality goods. Since the world market is trending towards higher-quality, synthetic fibres should be increasingly used in place of cotton. Technological upgrades and domestic incentives would also spur the industry towards higher value-added goods. Finally, the creation of textile cities would take advantage of a complete value-chain in Pakistan.

Post-MFA Implications

Given the existing structure of the T&C sector in Pakistan, there are numerous possibilities for growth in the future. Because of the government giving T&C top priority status, a long-term development strategy which aims to address industry-wide weaknesses has already created positive momentum. Given this vision, Pakistan is poised to carve out a healthy share of the world T&C market in the post-MFA era. The complementary nature of their textile industry and their clothing industry, will surely aid Pakistan's ability to reap benefits from the new quota-free markets. However, reforms must remain a priority. The long-term commitment to innovation cannot be discarded or the investment and planning of the past may come to nothing.

3. Sri Lanka

Since the beginnings of trade liberalization in the late 1970s, the Sri Lankan T&C industry has seen strong growth. Within ten years it was the number one exporter and later became the largest foreign exchange earner. By 2000, T&C accounted for more than 50 per cent of all exports and creates 6 per cent of GDP, 40 per cent of industrial production, and employs 5 per cent of the labour force.

Sri Lanka focuses on Ready-Made Garments (RMG), with more than 90 per cent of T&C exports being RMG. Sri Lanka gradually moved to expand into non-quota markets after the late 1990s. To help prepare for the end of the MFA and have a unified domestic vision, the Sri Lankan industry came together to form the Joint Apparel Association Forum (JAAF).

Additionally, both the public and private sectors lobbied hard for duty free-entry into the European Union (EU) and received exemption from quotas in March 2001. However, Sri Lanka still faces duties of 12 per cent in the EU but if the conditions governing the new Generalized System of Preferences (GSP)-Plus scheme that came into operation in July 2005 are fulfilled, Sri Lankan can qualify for duty free market acess to the EU.

Needed Reforms

The first reforms to be looked at come from JAAF's five year strategy. JAAF set the overall market goal of turnover growth at a 12 per cent yearly rate, leading to production of US $ 4.5 billion by 2007. The industry wants to provide "fully integrated services" which places a larger portion of the supply chain on the suppliers' backs. Next, the industry looks to have a greater focus on premium markets, leading to a reputation of Sri Lanka as a manufacturer of quality clothes. Finally, since 86 per cent of the market is comprised of small or medium firms, greater sector-wide consolidation is needed to provide the returns to scale that are crucial in global competition.

Post-MFA Outlook

Two schools of thought generally arise in regard to the future of the Sri Lankan T&C industry. The optimistic approach assumes a concentration of power will give the large firms the scale to compete with China in the RMG market. If such a consolidation occurs, a clear and focused plan via

the five-year strategy might provide these large firms with a stable market share and a positive outlook during post-MFA era.

The pessimistic attitude generally gives the T&C industry in Sri Lanka little hope of competing in the post-MFA era and predicts failure throughout the sector. This approach focuses on increasing production costs, low labour productivity, and low value addition as factors hindering global competitiveness. Future reforms in this scenario should address issues related to the impact of firm closures on the Sri Lankan economy.

Overall, it is still unclear which point on this spectrum will best represent the future of the Sri Lankan T&C sector. However, a concerted effort to address weaknesses by the government and private sector could help direct the industry toward long-term success.

4. Nepal

Nepal is a country whose T&C industry was jump-started by the MFA. On a per capita basis, Nepal received the highest quota in the region. When India's quotas were filled, Nepal was there to pick up any additional slack. This grew to the point where T&C became one of Nepal's leading non-agricultural exports.

Recently however, falling prices and Nepal's small stake in the market have led to hard times. Domestic manufacturers find it hard to compete with India and China especially when trying to obtain raw inputs. After 1067 T&C firms were registered in Nepal in 1994, the sector shrank to approximately 100 firms by the start of 2005. Low productivity plagued the industry along with little governmental help.

Needed Reforms

For Nepal to hold on to any of its export share in the post-MFA era, it must reconsider its marketing strategy. A first step would be to create a clothing-producing zone which would relieve strained infrastructure in Kathmandu. This would increase productivity and, if placed strategically, could help reduce lead-times. On the firm level, companies must invest in training workers and look to find niche markets where they can specialize.

On a macro level, the government must fight for free market access, so domestic firms can compete with foreign manufacturers who already have free-trade agreements with Nepal's trading partners.

Post-MFA Outlook

The scenario look bleak for Nepal's T&C industry in the post-MFA era. With India and China now able to flood markets with cheap clothes, there is little room for inefficiency. Unless Nepal's firms quickly overhaul their approach, the invisible hand will quickly move resources away from Nepal.

5. Bangladesh

In the past thirty years, Bangladesh has burst into the T&C industry quickly establishing itself as a player in the clothing market. In 1978, clothing exports barely topped US $ 1 million, but by 2004 they skyrocketed to US $ 5 billion. Clothing became the main export for Bangladesh, comprising 75 per cent of total export earnings, employing 1.9 million people by 2004.

Much of this growth was garnered by the MFA and its quotas. The ensured Bangladeshi clothing market in the US helped fuel the industry as it first began to grow. Additionally, the sector gained duty and quota-free access to the EU, compared to an average clothing tariff of 12.5 per cent. This

combined with a large low-wage labour pool gave the sector a major competitive advantage over other clothing producers.

Needed Reforms

The ascendance of the T&C market didn't come without major flaws which have yet to be addressed. Clothing production is concentrated in five categories of production and exports are concentrated in the US and EU. Additionally, while wages are extremely low, productivity is also low. In the EU, Bangladesh can export duty-free, giving it an advantage over its competitors. However, as the EU lowers tariffs with other countries, that advantage quickly dissipates. One answer to this problem is to work towards duty-free trade in the US, though seemingly that only diverts attention from the underlying productivity issues. What the T&C sector needs is improvement in transport facilities and general infrastructure to decrease lead-times. It needs better workers' rights and investment into human capital to create more productive factories producing better goods.

Post-MFA Outlook

While Bangladesh was one of the most restricted countries by the MFA quotas, most experts seem to believe Bangladesh may be in trouble. The majority of Bangladesh exports align with the exports of India and China, which currently produce similar goods more cost-effectively. Unless producers diversify, find markets with duty advantages, or increase productivity, other Asian countries will quickly gobble up Bangladesh's T&C market share.

6. Sri Lanka: A Country at Crossroads

In the post-MFA world, Sri Lanka faces both opportunities and challenges regarding its T&C industry. If the private and governmental sectors work

together to foster growth in T&C, the wholesale closing of factories can be averted. Chapter 8 looks at Sri Lanka's T&C prospects and reiterates valuable recommendations that have recently been suggested, specifically looking at firm and governmental-level strategies, occupational safety issues, and the GSP Plus programme.

Firm-Level Strategies for Post-MFA T&C Production: The Edge

For a firm to be profitable and sustainable in a global market, it must have a competitive edge. This edge can be found through many avenues, but without it, a firm will quickly be overcome by competition. The first step for any firm is to either realize what its competitive edge is, or work to develop one.

Wages and Productivity

What is the competitive edge of the Sri Lankan T&C industry? The major advantage a company can have is price. Price is a function of the cost of inputs, and the biggest cost is traditionally, labour. Cheap labour is the driving force behind mass-production in the T&C industry, and the largest orders have always migrated towards the factories with the lowest wages. Bangladeshi firms, for example, paid an average T&C worker a wage and salary of US $ 400 in 1997, far below the wage levels in other Asian countries. Wage levels, cannot truly be adjusted in an open economy, so Sri Lankan firms must focus on enhancing productivity to compensate for higher relative wages. However, low labour productivity has plagued Sri Lankan T&C firms, hence an advantage through price must be gained through productivity initiatives or by other means.

Quality

The recent trend in the global T&C industry has been towards higher-quality goods. Due to the low-quality labour that is rife throughout the sector, a

firm which produces high-quality goods will immediately have an advantage. Unfortunately, firms cannot vacillate in regard to quality. Manufacturers and even country-wide industries quickly gain a reputation as being cheap, or as producing quality goods. This reputation, or brand, holds considerable inertia; therefore the firm's vision must include its desire to produce either cheap low-quality goods, or expensive high-quality goods. Considering relative wages, Sri Lankan firms should be encouraged to focus on high value-added goods, which require quality workmanship. This would raise productivity and hopefully allow domestic industries the opportunity to compete in a niche market.

Scale

In T&C, scale is a vital aspect of efficient production. Large firms can mass-produce garments to an extent that smaller competitors cannot. This allows for lowered prices and therefore an advantage over small firms. Unfortunately, the Sri Lankan industry is comprised of 86 per cent small and medium producers, employing 38 per cent of the T&C workforce. Therefore, to take advantage of scale efficiencies, the larger firms must look to expand, perhaps via acquisition. This consolidation can also help soften the blow of post-MFA factory closures. Large firms should be able to assimilate labour from smaller competitors and moderate an unemployment spike.

Lead-Times

Lead-times have become an important factor in T&C, especially when exporting to developed nations such as the US and the EU. In these markets, producers are being faced with shifting styles and need to be able to quickly adapt to the tastes of the day. That means more and more producers are looking for manufacturers that can immediately shift production to a different style and have new products on the shelves quickly.

The Sri Lankan industry has a couple of factors that create high lead-times. First, Sri Lanka is relatively geographically isolated. Compared to China, whose eastern ports can easily access the western US, transportation time to and from Sri Lanka is high. Additionally, Sri Lanka does not have the natural resources to meet the input demand of the T&C industry. Therefore, additional time is added for acquiring raw material. A third related issue surrounds the retailers' desire to consolidate their supply chain and lower lead-times by reducing the number of countries and manufacturers with whom they interact. Sri Lankan firms must look to take on a greater portion of the value-chain and forge strong relationships with retailers.

Labour Standards

Chapter 9 addresses the old problem of ethical workplace standards. Throughout the industrialized period, factories have been inhumane and dangerous, utilizing child labour, paying sub-subsistence wages, and causing numerous injuries and deaths. Today, thanks to movements around the world, the safety and morality of individual factories are being investigated and can be an advantage or disadvantage to a firm in global competition.

Decent Labour

The International Labour Organization (ILO) has recently adopted an agenda focusing on decent work. Decent work is a concept surrounding

> *"opportunities for work that is productive and delivers a fair income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom for people to express their concerns, organize and participate in the decision that affect their lives and equality of opportunity and treatment for all women and men."*

People around the globe face issues of unemployment, unsafe work, denial of rights, gender inequality, and exploitation. To help alleviate this tragedy, the ILO has created the "Four Pillars of Decent Work" framework. These pillars are the fundamental principles and rights at work, employment, social protection, and social dialogue.

The T&C sector has long been known to have the worst labour conditions. Producers are stuck between the desire to uphold labour standards, and the desire to produce low-priced goods. Therefore, governments have stepped in, requiring companies to meet labour standards, and providing tariff concessions to countries who meet those standards. Other incentives include some retailers investigating their manufacturing facilities to ensure that labour standards are met.

Decent Work Issues in Sri Lanka

Sri Lankan firms are known to restrict the rights of workers to associate and bargain collectively. This shortfall of a fundamental right needs to be addressed for the good of the workers and the firms. Governmental intervention might be called for if the industry refuses to acknowledge labour unions.

Gender discrimination is a second problem that should be addressed. A large majority of all Sri Lankan T&C workers are women, which makes this issue doubly pressing. Job security, forced overtime, occupational safety, along with a gamut of other issues need to be dealt with. These issues not only have moral implications, but quality implications as well. If a company desires to produce a quality product, workers must be motivated to do quality work.

The Sri Lankan T&C industry now must look at itself and decide whether it desires to hold an advantage in labour standards. Already, Sri Lankan

firms have qualified for reduced duties in the GSP Plus scheme of the EU. However, more progress is needed to take further advantage of an edge which firms cannot afford to relinquish.

The Sri Lankan Edge

Therefore, what must Sri Lankan T&C firms focus on in the quest to be competitive in the post-MFA era? The Five Year Strategy articulated by the JAAF is a prudent place to start. The strategy includes a vision of growth, consolidation, reputation/brand, market penetration, and production integration. A focus of catering to specialty brands, department stores and upscale clientele is championed, hopefully leading to a quality advantage. Some of the strategies, such as market penetration, are to be led by the government.

Tariffs, Duties and GSP Plus

In any export industry, a major part of getting a foothold into markets is having trade barrier advantages. Sri Lankan T&C firms export over 90 per cent of their goods to the EU or US. Therefore, a major part of industry-wide growth is facilitated by the government and its interactions with other governments. The GSP Plus scheme and a possible free-trade agreement with the US have both been pursued by the Sri Lankan Government.

The Generalized System of Preferences (GSP) has been part of the EU's trade and tariff scheme for over 30 years. The main goal of GSP is to provide developing countries with an opportunity to enter into the European market. GSP includes five arrangements under which countries can receive reduced tariffs.

- General Arrangement
- Special Incentive Arrangement for the protection of labour rights
- Special Incentive Arrangement for the protection of the environment

- Special Arrangement for LDCs
- Special Arrangement to combat drug production and trafficking

Sri Lanka has qualified for the General Arrangement and the Arrangement for labour rights. The Sri Lankan T&C sector has looked to benefit from this scheme, so as to face duty-free entry into Europe, as compared to the standard 12.5 per cent duty. In the clothing market, before 01 July 2005, Sri Lanka qualified for a 40 per cent duty concession, inclusive of an additional 20 per cent tariff reduction for meeting labour standards.

As of 1 July 2005, Sri Lanka can apply to be a part of the GSP Plus scheme and receive duty-free entry into the European market. The new GSP Plus system adds a more stringent incentive aspect to the GSP. GSP Plus only includes three Arrangements, keeping the General and LDC Arrangement but combining the other previous Arrangements into a sustainable development and good governance Arrangement. For a country to qualify for the new Arrangement, it must ratify 23 of 27 chosen international conventions and ratify the reminder by 31 December 2008. Sri Lanka qualifies not only for the General Arrangement of GSP Plus, but the sustainable development and good governance Arrangement as well. Sri Lankan clothing manufacturers look to gain considerably from this new scheme if they are able to satisfy the stipulated ROO.

In the US, Sri Lanka has had a difficult time in receiving trade protections. Until now, the MFA quota system has allowed Sri Lanka to maintain its market share in the US. However, now with cheap competition from India and China, Sri Lanka must explore other means to hold its market share. Since early in 2003, a free trade agreement has seemingly been in the works.

However, no progress has recently been made. The US often demands stringent ROO clauses to be added to such agreements, so even a free-trade agreement might not help the T&C industry given its supply-chain.

7. Conclusions

Most studies estimate a large increase in global welfare due to the MFA expiry. Some countries may be big winners such as India and Pakistan, while some may not fare as well such as Nepal. What happens to countries like Bangladesh and Sri Lanka is uncertain. A concerted effort by both the industry and government may still provide the edge the T&C industry needs to compete with the Chinas of the world. Otherwise, a major market reduction waits on the horizon.

The future for the Sri Lankan T&C industry receives especial emphasis in this book. It is shown that the industry must either learn to be more efficient or face the brutal reality of being at a competitive disadvantage. A coherent strategy of finding a competitive advantage is key to securing a long-term position in crucial T&C markets. The GSP-Plus system has given hope for EU market penetration, but in the US, Sri Lankan firms must be cost-competitive to retain their market share. Producing high-quality goods, decreasing lead-times, and meeting labour standards are all important aspects that firms should consider to be competitive in the global market. And above all, the industry needs to look at the entire supply chain and provide services to the buyer when looking towards the future.

Part II

South Asian Experience

3

Impact of the MFA Expiry on Bangladesh

Nazneen Ahmed

1. Introduction

Since 1 January 2005, quota restriction under the Multi-Fibre Arrangement (MFA) has been fully abolished. Starting in 1974, MFA governed the trade in textile and clothing until the end of the Uruguay round (31 December 1994). Since 1 January 1995 WTO's Agreement on Textile and Clothing (ATC) replaced the Multi-Fibre Arrangement (MFA). The ATC was a 10 year long transitional trade regime to fully integrate the textile and clothing sector into General Agreement on Tariffs and Trade (GATT) rules in 4 phases by 31 December 2004. Thus since 1 January 2005, the textile and apparel trade has entered in the free trade rules under GATT. This has posed both options and challenges to the world trade of textile and apparel.

Starting as a non- traditional export item in late 1970s, the apparel sector has become the main export industry of Bangladesh within a short span of time. While export earnings from this sector was barely US $ 1 million in 1978, it became more than US $ 5 billion in 2004 comprising 75 per cent of total export earnings and 80 per cent of manufacturing export earnings of Bangladesh.[1] Both domestic and international policies have influenced such

[1] Statistical Yearbook of Bangladesh (2000), Bangladesh Bureau of Statistics & Bangladesh Bank (the Central Bank of Bangladesh) web site http://www.bangladesh-bank.org/econdata/exprtrec.html (sited on 17- 02- 2005).

a rapid growth of the apparel industry. Moreover availability of cheap labour stimulated the growth. This industry employs nearly 1.9 million people comprising 40 per cent of manufacturing sector employment and 90 per cent of whom, are females (Razzaque, 2005; Mlachila and Yang, 2004). In the post –MFA world, the main export industry of Bangladesh is standing at a crucial stage of changes and challenges. Being the main export sector of Bangladesh and having close links with the rural economy, such changes may have large welfare consequences for those who are directly and indirectly dependent on this industry as well as for the economy as a whole. This chapter aims to provide an overview of the challenges and opportunities faced by the apparel industry of Bangladesh and estimate the possible consequences of MFA phase-out. Section 2 provides an overview of the apparel industry of Bangladesh, while Section 3 points to some of its weaknesses. Section 4 elaborates on possible impacts of MFA phase-out, while Section 5 points to some other challenges faced by the Bangladesh apparel industry; and finally, Section 6 presents discussions and conclusions.

2. Emergence, Growth and Significance of Apparel Industry in Bangladesh

Starting since early 1980s, the apparel industry of Bangladesh has grown at a very fast pace not only in terms of export value but also in terms of share of this industry in total exports (Table 1 and Figure 1). As a consequence, the jute-dominant (both raw and processed jute) export bundle of early 1980s has shifted to apparel-dominant export bundle by early 1990s. While apparel (woven garment and knitwear together) industry contributed only 0.4 per cent of export earnings in Fiscal Year (FY) 1980/81, it contributed 75.7 per cent of export earnings in 2003/04.

Table 1: Changing Structure of Exports of Bangladesh: 1980/81-1999/00

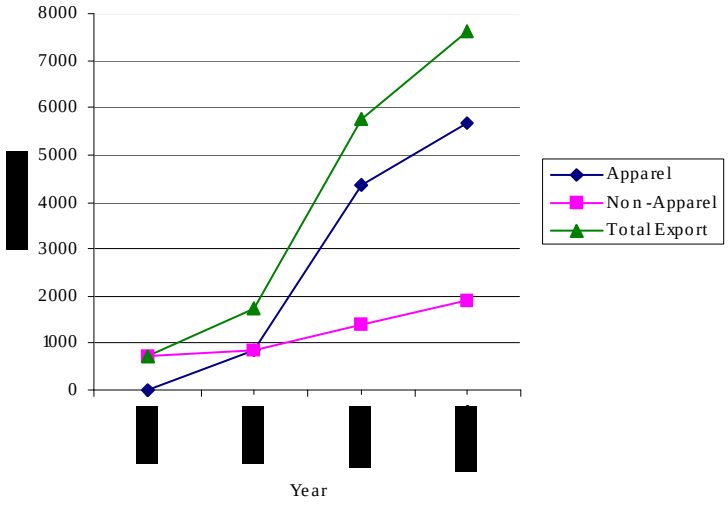
(in Million US $)

Item	1980/81	1990/91	1999/00	2003/04
Primary commodities	**209**	**306**	**469**	**485.8**
	(29.4)	**(17.8)**	**(8.2)**	**(6.4)**
Raw jute	119	104	72	79.7
	(16.8)	(6.1)	(1.3)	(1.1)
Tea	41	43	18	15.8
	(5.8)	(2.5)	(0.3)	(0.2)
Frozen food	40	142	344	390.3
	(5.6)	(8.3)	(6)	(5.1)
Other primary	9	17	35	n.a
	(1.3)	(1.0)	(0.6)	
Manufactured goods	**501**	**1411**	**5283**	**7117.2**
	(70.6)	**(82.2)**	**(91.8)**	**(93.6)**
Jute goods	367	290	266	246.5
	(51.7)	(16.9)	(4.6)	(3.2)
Leather & leather goods	57	136	195	211.4
	(8.0)	(7.9)	(3.4)	(2.8)
Woven garments	3	736	3083	3538.1
	(0.4)	(42.9)	(53.6)	(46.5)
Knitwear	0	131	1270	2148
	(0.0)	(7.6)	(22.1)	(28.3)
Chemical products	11	40	94	n.a.
	(1.5)	(2.3)	(1.6)	
Other manufactured goods	63	78	375	973.2
	(8.9)	(4.5)	(6.5)	(12.8)
Total Export	**710**	**1717**	**5752**	**7603**
	(100)	**(100)**	**(100)**	**(100)**

Note: Figures within parentheses show % share in total exports. A year is noted here as the fiscal year of Bangladesh, which starts on the 1st of July of every year.

Source: CPD, 2001 and Economic Data of Bangladesh Bank.

Figure 1: Apparel and Non-Apparel Export Trend



Over the years the number of apparel factories rose from 134 in 1983/84 (Zohir, 2001) to 3260.[2] A summary picture of significance of this industry in the Bangladesh economy is provided in Table 2. Directly and indirectly 10 – 12 million people are supported by this sector.

An obvious consequence of the rapid growth of the apparel industry is the growth of employment in this labour intensive industry. While the industry was employing 0.1 million people in 1985, it was employing nearly 1.9 million in 2003 (Razzaque, 2005). An interesting and well-known feature of employment in apparel industry in Bangladesh is that 90 per cent of the workers of the export oriented RMG industry are females. Moreover, 90 per cent of the workers have migrated from the rural area (Afsar, 2001).

[2] Members Directory, 2003 – 2004, Bangladesh Garment Manufacturers and Exporters Association (BGMEA).

Employment in this industry has made women visible in national employment statistics and has brought about a social change in Bangladesh.

Table 2: Bangladesh Apparel Industry– At a Glance (in US Dollars)

Number of companies currently operating in the sector	3093
Employment	
People directly employed in the garment sector (2003)	1.9 million (90% female)
People engaged in accessory industry (2002)	0.8 million
People indirectly dependent on sector (2002)	10 million
Share in Export Earnings (2003)	75%
Exports (2003)	
Total exports	$6.548 billion
Garment exports	$4.912 billion
Knitwear exports	$1.653 billion
Woven exports	$3.258 billion
Input Supplying Textile Units (2000/2001)	
Spinning mills	142
Weaving mills	109
Dyeing, printing, finishing, other	104
Key Export markets (for total exports in 2003)	
European Union	$3.4 billion
United States	$2.1 billion
Canada	$170 million
Japan	$108 million
Hong Kong	$90 million
India	$84 million

Source: Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and Export Statistics of Export Promotion Bureau of Bangladesh.

A closer look into the reasons behind such a rapid growth of the apparel industry reveals that there were both international and domestic issues. Internationally, the apparel industry of Bangladesh flourished under the umbrella of the MFA. Relatively less restrictive quota for Bangladesh under the MFA compared to traditional apparel exporters (Korea, Hong Kong, Japan, China, etc.) acted as a *blessing in disguise*, which ensured a market for Bangladeshi apparel in USA and stimulated the growth of this sector (Bhattacharya and Rahman, 2000a). Another important stimulator of the growth of apparel in Bangladesh is the duty and quota-free access in the European Union (EU) under the Generalized System of Preferences (GSP) scheme, which contributed to the expansion of apparel exports in the EU market. On average, the tariff rate of apparel products in the EU is 12.5 per cent, which becomes zero for Bangladesh under the GSP.

Apart from international issues, various national policies supported the growth of apparel industry in Bangladesh. These include facilities of bonded warehouse, duty drawback, back to back letter of credit, cash subsidy, priority of transport in the ports, etc. Moreover, availability of workers at a low wage is a major competitive advantage of Bangladesh. Wage per worker in Bangladesh is 20 per cent – 30 per cent and 30 per cent – 40 per cent lower than that in India and China respectively (Table 3).

3. Apparel Sector of Bangladesh – Behind the Bright Picture

i) Dependence on Imported Inputs

Most of Bangladesh's apparel export is made out of imported textiles. As a result of the heavy dependence on imported inputs, value addition of the apparel industry is quite low. In the woven apparel the local value addition is only 25 to 30 per cent of value of gross export (Bhattacharya and Rahman, 2000b). Because of lower dependence on imported inputs, the knitting apparel experiences higher value addition, between 40 per cent – 60 per

cent. Thus, although apparel industry earns around 75 per cent of the export earnings, the net export earnings is only 40 per cent (Rahman and Razzaque, cited in Bhattacharya and Rahman, 2000b). Dependence on imported inputs also prolongs the time for fulfilling an export order by Bangladeshi exporters.

Table 3: Wage and Productivity in Apparel Industries of Selected Countries

Country	Latest Year	Value Added Per Employee	Wages and Salaries Per Employee
		In US Dollars	
Bangladesh	1997	900	400
China	2001	5000	1600
Hong Kong SAR	1999	27600	14800
India	1998	2600	700
Indonesia	1999	2500	600
Sri Lanka	1998	2500	700

Source: Mlachila and Yang (2004).

ii) Product and Market Concentration of Apparel Export of Bangladesh

Apparel export of Bangladesh is highly concentrated on a few products. It is noted that only five categories (SITC code 8423, 8429, 8441, 8451 and 8461) compiled almost 85 per cent of total clothing exports in 1997 (Islam, 2001). Moreover, apparel export of Bangladesh is concentrated in two markets – the USA and the EU. These two markets together comprise 94 per cent of Bangladesh's total apparel export (Table 4).

iii) Productivity of Workers

Though the wage rate of the apparel workers in Bangladesh is low, their productivity is also low. Table 3 reveals that value added per worker in Bangladesh is lower than its competitors. One reason for low productivity

is lack of technical efficiency of the workers and the industry is thus over-manned.

Table 4: Markets of Apparel Products of Bangladesh (%)

Markets	Woven Garments		Knit Garments		Total	
	1999/00	2002/03	1999/00	2002/03	1999/00	2002/03
European Union	41.8	47.7	69.6	73	49.9	56.2
United States	54.2	46.6	25.4	21.2	45.8	38
Canada	2.1	2.9	2.8	2.9	2.3	2.9
Norway	0.5	0.5	0.6	0.7	0.5	0.6
Switzerland	0.3	0.5	0.6	0.6	0.4	0.6
Korea	0.1	0.1	0	0	0.1	0.1
Japan	0.2	0.4	0.3	0.2	0.2	0.3
Australia	0.1	0.1	0	0.1	0.1	0.1
Others	0.8	1.3	0.8	1.1	0.8	1.2
Total	100	100	100	100	100	100

Source: Bangladesh Bank.

4. Phasing-out of MFA and Bangladesh Apparel

After phasing-out of MFA, the booming Bangladesh apparel is standing at a cross road of various challenges. According to the 2003 statistics, Bangladesh is the 8th largest clothing exporter of the world supplying 1.9 per cent of the world's apparel exports (Table 5).

Removal of the MFA quota has generated doubts about the future growth or even survival of the apparel industry of Bangladesh and of many other least developed countries. Until the end of the MFA, Bangladesh was facing quota only in the USA market while quota and tariff restrictions in other restricted

Table 5: Leading Exporters of Clothing

(Billion US Dollars and %)

Exporters	Value	Share in World Exports			
	2003	1980	1990	2000	2003
European Union (15)	59.95	42.0	37.7	24.1	26.5
Extra-EU (15) exports	19.04	10.4	10.5	7.4	8.4
China a	52.06	4.0	8.9	18.3	23.0
Hong Kong, China	23.15	-	-	-	-
domestic exports	8.20				
re-exports	14.95				
Turkey	9.94	0.3	3.1	3.3	4.4
Mexico a	7.34	0.0	0.5	4.4	3.2
India b	6.46	1.7	2.3	3.1	2.9
United States	5.54	3.1	2.4	4.4	2.5
Bangladesh b	4.36	0.0	0.6	2.1	1.9
Indonesia	4.11	0.2	1.5	2.4	1.8
Romania	4.07	...	0.3	1.2	1.8
Thailand b	3.62	0.7	2.6	1.9	1.6
Korea, Republic of b	3.61	7.3	7.3	2.5	1.6
Vietnam b	3.56	...	...	0.9	1.6
Morocco a, b	2.83	0.3	0.7	1.2	1.3
Pakistan	2.71	0.3	0.9	1.1	1.2
Above 15	**178.34**	**71.3**	**77.5**	**75.9**	**78.6**

Notes: a) includes significant shipments through processing zones; b) includes Secretariat estimates.

Source: WTO Trade Statistics 2004.

markets had been removed already.[3] While Bangladesh received both quota and tariff removal in restricted markets (other than USA), many of her competitors were still facing the tariff restrictions. This preference gives Bangladesh an advantage over her competitors in those markets. Still, USA being the second big important market for Bangladesh's apparel and because there is no tariff preference in this market, quota free competition may move Bangladesh out of this market. Moreover, in the EU market phasing out of MFA has exposed the relative position of Bangladesh to challenges, as its competitors will be free from quota restriction.

Impacts of quota removal mainly depends on how restricted was the export of a country under the quota regime in absolute terms and relative to the competitors. Table 6 shows that Bangladesh was facing quota restrictions in 30 items (in 2001-02) and 69 per cent of apparel imports from Bangladesh were under quota. The average quota fill rate of Bangladesh is also very high.

Considering quota price data of the World Bank, Mlachila and Yang (2004) have noted that Bangladesh was the second most restricted Asian country after China. However, they further pointed out that in 2003 and in early 2004 the quota price of Bangladesh has fallen to a large extent compared to her competitors revealing less restrictiveness. This means that removal of quota might increase the import of apparel commodities from the competitors of Bangladesh like China and India, while that of Bangladesh might decline in relative or absolute terms. The competition in a quota free regime is predicted to be higher also because of a high rate of similarity in the product categories between Bangladesh and several strong apparel exporters of the

[3] The four quota restricting countries / regions were USA, EU, Canada and Norway. Under the GSP scheme, Bangladesh did not face any restriction in the EU; Norway's quotas have been removed for all exporting countries, while tariffs on exports from LDCs were removed in 2002; Canada allowed tariff and quota - free access to all LDCs since January 2003.

world. The export similarity index[4] calculated by Mlachila and Yang (2004) identifies China and India to be exporting similar products as Bangladesh in the US market and Pakistan in the EU market (Table 7).

Table 6: Textile and Apparel Quotas in the USA

(in million US Dollars and %)

			Imports Under Quotas		Total Imports		Imports Under Quota as a % of Total Import	
Countries	**Quota Categories**	**Average Quota Fill Rate**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**
Bangladesh	30	83	1453	1396	2235	2017	65	69
Cambodia	23	24	548	639	953	1062	57	60
China	90	76	4669	5315	9629	11476	48	46
Egypt	19	10	154	141	515	493	30	29
Hong Kong SAR	64	55	3848	3809	4461	4081	86	93
India	30	68	1497	1714	2912	3294	51	52
Indonesia	34	33	1109	1045	2586	2363	43	44
Pakistan	36	31	1066	1047	1958	2010	54	52
Philippines	42	32	1437	1460	2274	2060	63	71
Sri Lanka	38	26	1132	1065	1725	1552	66	69
Thailand	59	56	1468	1470	2534	2299	58	64
Turkey	28	23	850	990	1472	1702	58	58

Source: Mlachila and Yang (2004).

[4] The Finger-Kreinin Similarity index in Mlachila and Yang (2004) is calculated as $I^{AB} = \sum_{i=1}^{n} Min\,(S_i^A, S_i^B) * 100$, where S_i^A is share of product i in country A's exports to an export market, S_i^B is the share of product i in country B's exports to the same market and the number of products is denoted by n. The I^{AB} can range from zero to 100 and higher values indicate greater similarity in export between the considered countries. The index is sensitive to the product disaggregation level.

Table 7: Export Similarity (in %) Index between Bangladesh and her Main Competitors (2002)

Markets	USA	EU
Exporters		
China	71.5	22
India	57.1	39.1
Pakistan	34.8	67.6

Source: Mlachila and Yang (2004).

To understand the challenges imposed by the complete removal of MFA quota, it might be useful to understand the experience of Bangladesh during the first three stages of the ATC implementation period when 51 per cent of the quotas (compared to the 1990 quota level) were removed. It has been observed that most of the categories those are of concern (in terms of export) for Bangladesh were not integrated in the first two stages. Therefore, after the quota phase out in the third stage (January 2002), Bangladesh's export of products covered under this stage decreased by 46 per cent in the EU and by 41 per cent in the US market while export from China increased almost 200 per cent (Mlachila and Yang, 2004). The final stage just been implemented and the impact is yet to observe, because Bangladesh is still supplying the products which were agreed upon before the full phasing out of quota.

Assessing the Impact of Quota Removal

Yang et al. (1997) have mentioned that the MFA removal will result in a huge increase of textile and clothing export from South Asia. However, they also mentioned that there is a possibility that developing country textile and clothing exporters, with larger quotas relative to their production potential, may lose from the elimination of the MFA, because of the increased

competition from their more efficient competitors and deterioration in their terms of trade. Applied general equilibrium analysis of Islam (2001) also suggests that implementation of ATC would enhance the competitive positions of ASEAN, China, and South Asia in apparel at the expense of industrially developed regions such as the European Union, North America and Japan, and marginally competitors from Latin America and Rest of the World. Bangladesh will not only face higher competition from India and China, but also there may be a shortage in fabric supply in the post-MFA period as exporters of fabrics might use their fabrics for own higher production and export of clothing. Among others Mlachila and Yang (2004) have estimated GDP loss for Bangladesh as a result of removal of MFA quotas. This study has also shown that, depending on different scenarios, the export of apparel from Bangladesh might decrease from 6.2 per cent to 17.7 per cent. However, the study by Nordas (2004) does not point to any absolute decrease in export but decrease in the market share in the USA for Bangladesh's apparel. The study has forecasted a 2 percentage point decrease in the share of Bangladesh's apparel in the US market (from the current share of 4 per cent to 2 per cent share) while a 1 percentage point increase in the EU (from the current share of 3 per cent to 4 per cent). Market share of China's apparel in the EU market has been forecasted to increase from 18 per cent to 29 per cent and in the US market from 16 per cent to 50 per cent.

Ahmed (forthcoming)[5] assesses the impacts of MFA phase-out and other realities of apparel trade in a general equilibrium framework of Global Trade Analysis Project (GTAP). The paper considers two broad scenarios, which are presented in Table 8. Assuming unemployment of unskilled labour for SAARC members, China, and Turkey, the study finds that as a result of

[5] Chapter 3 of ongoing PhD thesis of the author titled "The Apparel Industry of Bangladesh in a Changing Global Economy" under University of Wageningen, The Netherlands.

implementation of ATC Bangladesh apparel will face substantial production and export losses (Table 9).

Table 8: Scenarios Considered

	Scenario
ATC	Agreement on Textile and Clothing (ATC) WTO Accession of China for Sectors Textile and Wearing Apparel EU Eastern Enlargement (No Tariffs between EU and CEEC) Preferential Agreement EU - Turkey
WTO	ATC Scenario + Worldwide Import Tariff Reduction of 36 per cent for Textile and Wearing Apparel

Table 9: Implication of Implementation of ATC and WTO on Bangladesh

	ATC Scenario	**WTO Scenario**
Change in output of wearing apparel (%)	-11.74	-11.74
Change in output of textile (%)	0.51	1.06
Change in aggregate export of wearing apparel (%)	-13.39	-13.73
Change in export of textile (%)	12.56	12.59
Change in export of wearing apparel to USA (%)	-8.07	-0.27
Change in employment of unskilled workers (%)	-1.15	-0.3
Change in real GDP (%)	-0.64	-0.32
Change in per capita Household Utility (%)	-1.5	-1.19
Equivalent variation (EV) ($US million)	-564.1	-440.6
Change in Terms of trade of wearing apparel (%)	-2.5	-2.7

Source: Own calculation of the author.

Though the results of the GTAP analysis should be taken with caution as these are based on some stringent assumptions, still it provides an overall idea of the possible direction of trade if the assumed background (other than the simulations) remain the same.

5. Other Challenges Faced by Bangladesh Apparel

i) High Tariffs in the US

Apart from quotas in the US market the apparel products of Bangladesh face high rates of import duties (15 per cent to 20 per cent). It is observed that in 2001 Bangladesh paid US $ 331 million as tariff revenue to the US while it received US $ 87 million as ODA. The estimates of Razzaque (2005) suggest that duty free access to the US market could increase exports of Bangladesh by US $ 530 million.

ii) The Rules of Origin (ROO)

Though Bangladesh enjoys duty free entry in the EU market under GSP, the stringent Rules of Origin (ROO) requirement in the EU often prohibit Bangladesh from enjoying the benefit. The ROO requires a 51 per cent domestic value addition, which is often difficult, especially for the woven apparel of Bangladesh (as the woven apparel is heavily dependent on imported inputs). The Everything But Arms (EBA) initiative under EU-GSP also contains the same ROO provision and therefore extends no extra benefit for the apparel sector of Bangladesh. EU has declared to soften the ROO criteria from June 2005 under the so- called *SAARC cumulation* rules. Under these rules, Bangladeshi products produced with inputs from the South Asian Association for Regional Cooperation (SAARC) region (i.e., Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka) will still be eligible for preferential treatment under the EBA if the regional value addition is of a certain required level. Bangladesh government is yet to decide on this issue, which should get serious attention.

iii) Preferential Trade Agreements

Various preferential trading blocs and preferential agreements are of especial concern for apparel trade of Bangladesh, posing both negative and positive impacts. Some important preferential agreements include the North American Free Trade Agreement (NAFTA), South Asian Free Trade Agreement (SAFTA) and Trade and Development Act 2000 (TDA 2000).

iv) Addressing Workers' Rights

Increased competition arising out of increasingly opened international trade compels the entrepreneurs to reduce the cost of production while maintaining the quality of the products. This is often done at the cost of violating the rights of the workers working in the export oriented manufacturing sector. However, consumers of the developed world have become concerned about this and importers are requiring the exporters to maintain certain codes of conduct in their factories to be eligible to export. This requirement often poses additional costs for the entrepreneurs and decreases the price competitiveness. Moreover, a problem arises when requirement by one importer contradicts with the other. Thus, there is a dilemma of how to address the rights of the workers in a reasonable way and at the same time maintaining the price competitiveness.

6. Discussions and Conclusion

The aim of this Chapter was to analyse the opportunities and challenges concerning the largest export industry of Bangladesh - the apparel industry, after phasing-out of the MFA quota. With that aim the Chapter has presented a comprehensive analysis of the nature of growth of this sector, the actors behind the growth and also various recent challenges faced by this industry. Both domestic bottlenecks and international market originated challenges are faced by this industry. It has been observed that Bangladesh's apparel

industry has grown very fast under the umbrella of MFA quotas and abundant supply of cheap workers, but without a strong backward linkage. Too much product and market concentration and imported input dependency have raised questions about the future of this sector in a quota free regime after the full implementation of ATC. In addition to ATC, trade diversion effects from various regional trading blocs are also of special concern for Bangladesh apparel.

The discussion in this Chapter reveals that the apparel industry of Bangladesh is standing at a cross-road and the challenges should be handled very carefully as the fate of 10 million people is associated with the success or failure of this large industry. Any possible shrinking will make a large number of workers unemployed. The domestically originated problems need immediate attention as the competitiveness in a quota free world would depend on quick delivery of quality products at a low price, which in turn requires better infrastructure, more investment and strong backward linkage industries. Improvement of transport facilities, especially improvement of port facilities is a must to maintain quick and timely delivery of the products. The rights of the workers have to be addressed which will help to improve the quality of apparel products. It is very important to provide skill-enhancing training to the workers.

Realizing these realities the government of Bangladesh (in association with Bangladesh Garment Manufacturers and Exporters Association) has already taken the following initiatives: i) organize training for workers of different levels, ii) improve port facilities by reducing administrative steps for transactions, iii) a special police cell has been formed to support the safe transport of goods from the factory to the port, iv) finalize a new labour code, etc. Still, Bangladesh needs to improve other infrastructural facilities like telecommunication and electricity, the duty on textile import should be reduced and Bangladesh should allow central bonded warehouse facility to speed up production and delivery time.

Bangladesh needs duty–free access in the US market to get an edge over its competitors. In this connection, all apparel producing LDCs can move together. Only 14 out of 49 LDCs are left out of the benefits of the USTDA2000. All LDCs should get the benefit. Bangladesh should also take the advantage of regional cumulating of origin in EU GSP (SAARC cumulation). The developed countries should also soften the stringent ROO conditions. For example, Canada has allowed duty and quota-free access to all LDC products where ROO requirement is only 25 per cent. Other developed countries may follow the same.

It is clear that the future of the apparel sector of Bangladesh shows uncertainty and this will generate negative chain effects to the economy as a whole. Since most of the workers in this sector are unskilled or semi-skilled and alternative employment opportunities hardly exist, it will cause greater job insecurity. As women make up most of the workforce in the apparel sector, they will bear the biggest brunt and will lose their economic independence, social mobility, participation in cash earning and empowerment. At this backdrop, the world should realize that it is very hard for an LDC like Bangladesh to gain expertise on certain economic activity. If 'survival of the fittest' rule of the free trade world decides the fate of the biggest industry of this country, then that ultimately forces a big portion of the population to drown in poverty again. As LDCs are different and have several LDC–specific economic, social and political problems, they deserve special treatment. Such preference works better than aid extended to these countries.

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4

Impact of the MFA Expiry on India[1]

Samar Verma[2]

1. Contribution of Indian T&C Industry

World trade in textiles and clothing constitutes more than US $ 350 billion – nearly 8 per cent of all trade in manufactured goods. A major proportion of these exports come from developing countries, including more than 70 per cent of all apparel exports, making the sector a vital source of employment, income, and foreign-exchange revenues.[3]

Indian textile and clothing industries occupy a unique place in the Indian economy. It contributes about 4 per cent of GDP and 14 per cent of industrial output. Second largest employer after agriculture, the industry provides direct employment to 35 million people including substantial segments of weaker sections of society. 11 per cent of workers in the sector are women. With a very low import-intensity of about 1.5 per cent only, it is the largest *net* foreign exchange earner in India, earning almost 35 per cent of foreign exchange. This is the only industry that is self-reliant and complete in value chain-producing everything from fibres to the highest value added finished

[1] This paper is not an original piece of research. Information and analyses here have been drawn from diverse sources, including the works done by this author on the subject. Select references are mentioned in the Appendix.

[2] Author is Regional Policy Advisor with Oxfam GB in South Asia. Views expressed in this paper are those of the author, and do not necessarily reflect those of Oxfam, unless specifically mentioned.

[3] Oxfam International Briefing Paper No 60.

product of garments. This sector's impact on poverty is also quite significant.[4] Its growth and vitality therefore has critical bearings on the Indian economy at large.[5]

Table 1: Role of Indian T&C Industry

India	Value 1995	Value 2001	Evolution 1995-2001 p.a
GDP billion US $	353	478	5%
GDP per capita US $	380	462	3%
Imports textile (million US $)	421	741	10%
Imports clothing (million US $)	8	21	17%
Exports textiles (million US$) Of which EU: 30%; US 17%	4244	5740	5%
Exports clothing (million US $) Of which EU: 41%; USA 34%	3958	4877	4%
% Textile in total exports	13%	14%	
% Clothing in total exports	13%	11%	
Inflation (GDP deflator in annual %)	8.7	6.0	
Cost of Capital (Lending rate source: IFS)	15.46	12.08	-4%
Population (million people)	929.4	1033.4	-2%
Textile and Clothing Employment		35 mln	
Textile investment as a % of world Investment 1999-2001: In spinning 24%; In weaving 1%; In knitting 4%			

Source: U.S. International Trade Commission, January 2004.

[4] Diao, Somwaru [2001] results indicate that a 1 per cent rise in apparel trade share in GDP would be associated with a 3.3 per cent rise in per capita incomes in the sector. Cited in UNCTAD India [2005].

[5] Data for this section has been obtained from Expert Committee-GOI [1999].

2. Expected Impact of Quota Elimination

The international trade in textile and clothing sectors has been an egregious exception to the *most favoured nation* principle of GATT and, since the early 1960s, has been a case of "managed trade through forced consensus". However, the WTO Agreement on Textile and Clothing (ATC) marked a significant turn-around. According to the ATC, beginning 1st January 1995, all textiles and clothing products that had been hitherto subjected to MFA-quota, are scheduled to be integrated[6] into WTO over a period of ten years. From 1st January 2005, therefore, all textile and clothing products would be traded internationally without quota-restrictions.[7]

MFA quotas in textiles and clothing are now history. Even though it is too early to assess the actual impact of the quota abolition on the sectors, numerous studies have been conducted on expected impact of quota abolition on international trade in this sector and there is a vast body of work available to choose from. The few common conclusions of almost all studies are that the quota phase-out would bring about a massive restructuring in production and exports, a price fall in clothing and textile products, and significant gains to at least two countries from the Asian region, viz., China and India.

A study recently conducted by Spinanger & Verma [2003] computes - using Computable General Equilibrium Model - the gainers and losers from the quota phase-out. The results of the model calculations on export growth in textiles and clothing can be summarized as follows (see Tables 2 and 3):

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[6] The term 'integrated into the WTO 'means that the quotas would be eliminated on the products.

[7] Though the tariff on these items would not be eliminated as part of the ATC, and hence the trade would not be truly free, but only quota-free. Moreover, to what extent the intent of the ATC is followed in spirit too by the importing countries who have imposed MFA-quotas, is a matter of debate. Spinanger [1999], for instance, prefers to believe in the importing countries' "Faking Liberalisation and Finagling Protectionism…".

Table 2: Impact on Textile Exports – Percentage Change

	Elimination of ATC[a] Quotas				Greater China Accession			
	WTO Members	China (PRC)	Chinese Taipei	Total	Tariff Cuts and Services Liberalization[b]		Total	Total (4)+(7)
					PRC	Taipei		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Hong Kong	-3.20	4.38	-0.12	1.06	1.87	-0.19	1.68	2.73
China (PRC)	**2.23**	**3.86**	**0.09**	**6.18**	**32.51**	**0.23**	**32.74**	**38.91**
Chinese Taipei	0.74	7.95	0.00	8.69	1.52	3.86	5.38	14.07
Japan	0.94	7.16	0.12	8.22	3.16	-0.08	3.08	11.30
Korea	2.10	3.08	0.07	5.25	-1.47	-0.17	-1.64	3.61
ASEAN5 [c]	7.95	-1.42	-0.08	6.46	-7.58	0.15	-7.42	-0.97
Vietnam	3.94	0.06	0.07	4.08	-9.83	0.64	-9.19	-5.11
India	**1.93**	**1.28**	**0.05**	**3.26**	**-4.26**	**-0.04**	**-4.30**	**-1.04**
Bangladesh	17.19	-0.18	-0.02	16.99	-1.45	-0.02	-1.48	15.51
Other South Asia[d]	12.35	0.87	0.13	13.35	-3.18	-0.02	-3.20	10.15
Australia	1.50	1.25	0.04	2.80	-4.48	-0.18	-4.66	-1.87
New Zealand	3.33	0.84	0.06	4.22	-6.68	-0.37	-7.05	-2.83
Canada	-5.08	-4.95	0.23	-9.80	-6.67	-0.11	-6.78	-16.58
United States	-2.86	-3.00	0.09	-5.77	-7.71	-0.04	-7.75	-13.52
Mexico	-6.26	-6.71	0.40	-12.57	-8.04	-0.09	-8.13	-20.70
Brazil	6.02	-2.38	-0.15	3.49	-5.24	-0.03	-5.27	-1.78
MERCOSUR, other	-0.67	1.59	-0.01	0.91	-2.15	-0.21	-2.36	-1.46
European Union (15)	-1.85	-1.97	0.04	-3.79	-6.67	-0.07	-6.73	-10.52
Turkey	1.94	-2.76	-0.05	-0.88	-6.43	-0.06	-6.49	-7.36
Africa, Mid-East	-3.30	-3.21	0.10	-6.40	-6.69	-0.07	-6.77	-13.17
Rest of World[e]	-2.66	-2.45	0.07	-5.05	-6.56	-0.08	-6.64	-11.69

[a] ATC = Agreement on Textiles and Clothing. – [b] For services a 50 per cent reduction in estimated protection was assumed. – [c] ASEAN5 = Indonesia, Malaysia, Philippines, Singapore and Thailand. – [d] Pakistan, Sri Lanka, Nepal. – [e] Rest of world does not include some parts of Latin America not elsewise list. It reflects premarily results for Central and Eastern European countries.

Source: Spinanger & Verma (2003).

Table 3: Impact on Clothing Exports – Percentage Change

	Elimination of ATC[a] Quotas				Greater China Accession			
	WTO Members	China (PRC)	Chinese Taipei	Total	Tariff Cuts and Services Liberalization[b]		Total	Total (4)+(7)
					PRC	Taipei		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Hong Kong	30.18	-19.54	-5.98	4.66	-7.66	0.68	-6.98	-2.32
China (PRC)	**-6.41**	**100.89**	**-6.66**	**87.81**	**79.35**	**0.67**	**80.03**	**167.84**
Chinese Taipei	-20.41	-24.63	12.73	-32.31	-30.51	9.76	-20.75	-53.07
Japan	-4.47	1.51	-0.07	-3.03	-16.28	1.65	-14.63	-17.65
Korea	-8.52	-16.09	1.33	-23.29	-21.45	1.33	-20.12	-43.41
ASEAN5 [c]	28.79	-20.97	-6.14	1.68	-23.98	0.23	-23.76	-22.08
Vietnam	26.92	-7.55	-2.05	17.32	-8.59	3.39	-5.21	12.11
India	**337.90**	**-21.69**	**-73.67**	**242.55**	**-24.86**	**-0.18**	**-25.04**	**217.51**
Bangladesh	20.87	-15.97	-3.40	1.51	-9.47	0.04	-9.42	-7.91
Other South Asia[d]	21.93	-18.67	-4.18	-0.92	-17.22	-0.08	-17.31	-18.22
Australia	-5.78	-5.60	0.30	-11.08	-16.29	-0.00	-16.29	-27.37
New Zealand	-1.13	0.06	-0.00	-1.08	-24.43	-0.39	-24.81	-25.89
Canada	-19.86	-24.38	4.75	-39.49	-28.56	-0.09	-28.64	-68.14
United States	2.15	3.90	0.11	6.16	-7.60	0.13	-7.47	-1.31
Mexico	-26.23	-33.73	8.74	-51.21	-36.26	-0.15	-36.40	-87.62
Brazil	12.45	-13.36	-1.71	-2.62	-19.67	0.37	-19.30	-21.92
MERCOSUR, other	-5.63	-5.92	0.32	-11.23	-15.12	-0.15	-15.27	-26.50
European Union (15)	-4.09	-5.14	0.20	-9.03	-18.19	0.10	-18.08	-27.11
Turkey	-4.57	-9.27	0.40	-13.43	-18.43	-0.06	-18.49	-31.92
Africa, Mid-East	-11.79	-12.55	1.46	-22.88	-18.53	-0.10	-18.62	-41.50
Rest of World[e]	-6.57	-11.34	0.73	-17.18	-18.98	-0.08	-19.06	-36.24

[a]ATC = Agreement on Textiles and Clothing. – [b] For services a 50 per cent reduction in estimated protection was assumed. – [c] ASEAN5 = Indonesia, Malaysia, Philippines, Singapore and Thailand. – [d] Pakistan, Sri Lanka, Nepal. – [e] Rest of world does not include some parts of Latin America not elsewise list. It reflects premarily results for Central and Eastern European countries.

Source: Spinanger & Verma (2003).

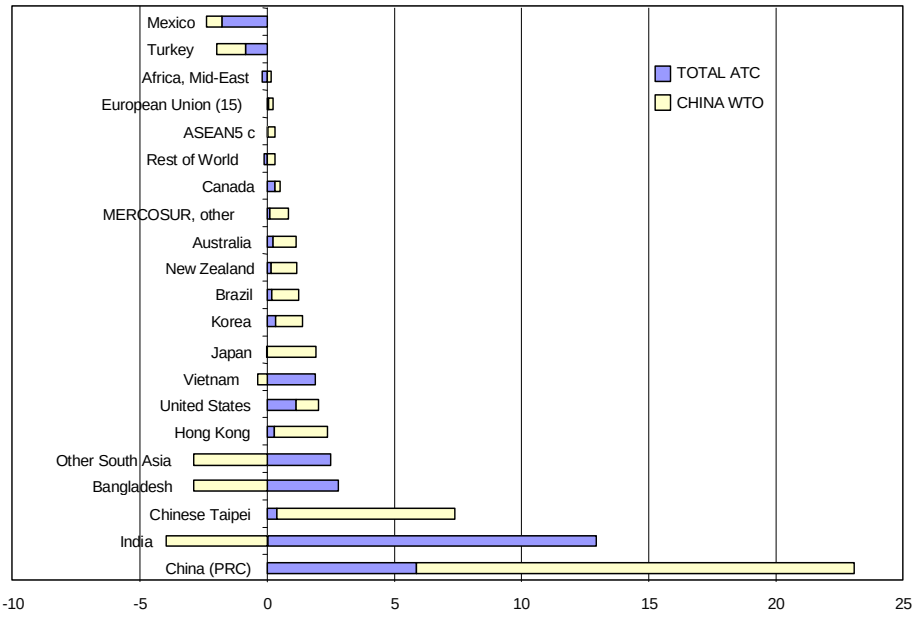
- Aside from the sizeable increases in textile exports registered by China (PRC) and Chinese Taipei, Japan and Bangladesh (and other South Asia) exhibit similar results. India like virtually all other economies experience losses, with the largest decrease shown by Mexico. In the latter case, the loss of preferential treatment because of the elimination of quotas severely affects Mexico and to a lesser degree Turkey.
- In the case of clothing exports, the massive shift to Chinese sources (+167.84 per cent) is overshadowed by an even larger increase in India's exports (+217.51 per cent). India's increase – which comes onto to a level of exports roughly one seven the size of China's (PRC) – can be explained to some extent by the highly restrictive quotas which prevailed on top of a large domestic industry which could begin to tap into the global potential. However, while India has almost always been viewed as having an export potential in numerous areas, its internal policies have usually been seen as keeping it from being successful. Among all other economies, only Vietnam shows that it too can profit from the ATC liberalization.

Figure 1 illustrates the impact of quota phase-out and Chinese accession on the important T&C trading nations of the world. The winners and losers have been clearly identified, and India is certainly poised to gain in a big way owing to quota phase-out, although a part of this gain would be diluted due to Chinese accession into the WTO.

Some other studies[8] indicate that the removal of developed country tariffs and quotas on textiles and clothing would increase developing country exports by US$ 39.8 billion annually and increase their incomes by US$ 23.8 billion. Of these, about half the gains in garments and quarter in textiles would accrue to India.

[8] IMF, 2003. Cited in UNCTAD India [2005].

Figure 1: Percent Impact of ATC Phase-out and China Accession on Total Exports



Source: Spinanger & Verma (2003).

UNCTAD has done interesting analyses to understand the poverty alleviation impact of quota abolition. It has combined poverty-growth elasticities drawn from two studies [0.12 and 0.28] with Spinanger and Verma's GDP projections [0.97 per cent increase in 7 years] to compute poverty reduction impact of 0.11 per cent and 0.27 per cent, respectively. In other words, quota abolition could bring around 0.31 – 0.7 million people out of poverty. Similarly, UNCATD estimated that the projected 217 per cent rise in garment exports could increase employment in this sector by 324 per cent in 7 years!

Clearly therefore, the aggregate impact of quota elimination on the Indian economy is significantly positive. The distribution of these gains would,

however, determine the extent of benefits for different stakeholders in the production and trade of textile and clothing in India.

Impact on Workers

In the second half of 1990s - a period broadly corresponding to what may be called as post-liberalisation phase in India - while export of textiles increased by 143 per cent, employment increased by 113 per cent, and per capita incomes in the sector increased by a mere 20 per cent, pointing to the huge 'reserve army' of the unemployed, a situation of excess supply of labour. In apparels, during 1994-2000, the exports increased by 111 per cent, and employment went up by 165 per cent. These are formal sector figures, which constitute a very small part of the total sector. The share of unorganised manufacturing in the garment sector is between around 75 per cent – 80 per cent, depending on what estimates one would like to believe[9].

The situation in the informal sector is worth noting. In the unorganised sector, textiles employment grew by almost 9 per cent during 1994-2001. By definition, reliable data for the informal sector is difficult to come by. But several studies have pointed out the growing casualisation of the workforce under the impact including of quota abolition. A study by Kambham Panti and Howell [1998] found that trade reforms reduced employment in the formal sector through reduction in the number of firms and a shift towards more capital intensive technologies. Case studies from clusters such as Tiruppur have shown that this casualisation of the workforce has been associated with reduced incomes, insecurity and worse working conditions, a situation that Oxfam calls as increased 'precariousness' of the workforce, especially women. For instance, the proportion of workers engaged as

[9] Mazumdar, Indrani [2003].

'casual' workers in Tiruppur was 96 per cent, mostly engaged in exporting chains, working either as sub-contractors, or doing job work.[10]

However, while this does sound welfare reducing when compared to improving working conditions in the formal sector, it is not always and necessarily so due to the virtual absence of alternative employment for most of those engaged in informal sector activities as part of global commodity chains.

3. Structure of the Indian T&C Industry

The Indian textile industry is extremely complex and fragmented. Compared to the yarn-manufacturing sector, which is almost wholly in the organised sector, the cloth-manufacturing sector in India is almost wholly in the decentralised sector, with the share of organised composite mills in total cloth manufacturing just 4.4 per cent.[11] The share of decentralised powerlooms was 59 per cent in 1999-2000, up from 39 per cent in 1980-81. Hosiery, handloom and khadi, wool and silk accounted for the rest. Garments too is an extremely fragmented sector, with over 60 per cent of all garment units engaged only as fabricators- independent units engaged in sewing operations. Units employing over 50 machines accounted for a mere 6 per cent of all garment-manufacturing firms, whereas 80 per cent firms employed less than 20 machines.

On the domestic front, lop-sided government policy has been held to be the chief reason for this skewed industrial structure of both textile and garment

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[10] Annual Survey of Industries [1999-2000]. Cited in UNCTAD India [2005].

[11] In the year 1999-2000. The data includes the cloth production by Exclusive Weaving Units. The share of composite mills in total cloth manufacture was 36 per cent in 1980-81. Source: Office of Textile Commissioner [2000].

industries. "Apart from the serious implications of an 'export pessimistic' development paradigm… the textile sector in India has been subject to a degree of regulation and control which has few parallels in the non-socialist world…Government policy has expectedly played a fundamental role in shaping the growth, structure and technological evolution of the textile sector". The government policy in respect of textile and clothing has manifested two distinct biases. One, distinct policy bias against organised sector manufacture of textiles. Second, bias against the use of man-made fibres and yarns that severely limited the range of products that could be exported".

On the export front, Indian textile and clothing industries' performance is nothing to write home about either. The share in terms of production and capacities is notable, with India ranking first in terms of world installed capacity in weaving and shuttleless looms, and also jute production. In terms of machinery shipped during 1990-99 period, India received the largest number of shipments in respect of spindles and Draw texturing machinery. However, Indian exports' share in global trade is very poor. In the year 1999, while India exported only 3 per cent of world textile exports in value terms, its share in clothing was 2.6 per cent only. It has now increased to 3.4 per cent.

4. Conclusion

The main conclusions regarding the impact of MFA expiry on Indian T&C sector could be summarized as follows:

1. Despite their rhetoric of liberalisation, rich countries continue to abuse their power in the world trade regime to block exports from developing countries. This is evident from specific policies adopted by Northern governments: delayed quota phase-out, continually high tariff barriers, and abuse of measures [such as ant-dumping, safeguards and rules of

origin] ostensibly designed to protect domestic industries from unfair competition but in reality often used as protectionist tools.

2. Although China is expected to become the "supplier of choice" for most U.S. textile and apparel importers after quotas are eliminated, noting that U.S. imports from China soared by 125 per cent alone in 2002, India, along with Pakistan and Bangladesh may also emerge as "major suppliers," primarily in a "narrower but still significant range of goods."
3. Increasing importance of non-price factors: non-price factors of competitiveness are becoming more and more important. Worldwide Responsible Apparel Production (WRAP) and Apparel Industry Initiative (AIP), Clean Clothes Campaign are some of the global movements towards cleansing the global manufacturing and trade in textile and clothing sectors. And this post-consumerism demand has begun to force a large number of developing country exporters to adhere to such norms and get their factories and systems 'ethically certified' before they could be eligible to supply some of the world's biggest retailers. It is in this 'buyer-driven global commodity chain' that India has to position itself.
4. Organised sector employment has witnessed some positive trend in the private sector, which, in the current state of buoyancy of the industrial sector, should further accelerate if some of the rigidities in the labour laws are removed. The Industrial Disputes Act, 1947, Contract Labour Act, 1970, and Payment of Wages Act, 1936, are some of the legislative instruments that the government is considering for amendment. Simultaneously, the government is also proposing to bring forth a comprehensive legislation for the welfare of workers in the unorganised sector. Under the Minimum Wages Act, in January 2002, wages were raised for workers of mining and construction sectors in respect of scheduled employment in the Central sphere.
5. The large exporter on his part has already started investing heavily in modernisation, rationalisation and expansion of his capacities. As a matter of fact, in recent few years, investment to the tune of approximately

Rs 1.1 billion has come in this industry. "Innovative manufacturing techniques have helped Indian exporters be one up on their competitors. Indian apparel for BPO, unlike the software sector, it is still in the infant stage." However, in the coming years, there could be a good opening for Indian exporters to promote India as an outsourcing base to the Far-Eastern countries like Korea, Taiwan etc. where the labour cost has gone up sky-rocketing but they still have some very innovative fabrics.

6. India's domestic market for readymade apparel is estimated at $ 5 billion to $ 7 billion annually. Approximately 20 per cent of the apparel produced in India consists of branded ready to wear garments. There is a potential to expand the branded RMG segment through better marketing, brand building in the domestic industry and foreign investment in retail.
7. In the coming years, there will be a consolidation of supplying sources worldwide with marked preferences for vertically integrated production units. Markets will be dominated by global chains, and with fast changing consumer demand, fashion cycles will be shorter with more pressure on production runs and delivery times. 'We can see how the reigning development paradigm destroys traditional artisanal vocations and forces pauperized to seek alternative employment'.
8. The McKinsey study (2002) forecasted an increase in productivity from 35 per cent to 55 per cent with the removal of quotas in 2005. However, it emphasized the removal of barriers as a prerequisite for India to become a world class competitive producer of Apparel.

The domestic policy reform measures have been significantly undertaken through the recent Union Budget announcements, especially in respect of the need for fiscal reforms and modernisation in the industry. And except labour reforms- that needs careful and serious attention-, there remains little reform required in the sectoral policy issues. However, there remains a vast area of reform in areas not specific to the T&C sector, and they relate to improvement in infrastructure and micro-investment climate of governance.

In addition to these, what also needs to be urgently developed is a battery of skilled and trained trade lawyers who could enable Indian firms to fight out their cases through the WTO Dispute Settlement System. The government would need to carefully build up this machinery- including comprehensive, timely and reliable database- and do it quickly lest India loses the opportunity to exploit the increased trade prospects.

5. Oxfam's Recommendations

Oxfam, in its breifing paper titled 'Stitched Up: How Rich Country Protectionsim In Textiles And Clothing Trade Prevents Poverty Alleviation', enunciates the belief that poverty reduction in developing countries entails growing an industrial base, and that textiles and clothing manufacture is an essential step in the process. For many millions of women and their families, if they are treated fairly and granted minimum labour rights, this industry offers hope of a better life. Rich countries must therefore agree to open their markets, as well as help countries which will lose out from the damaging end-game for quotas. Specifically, Oxfam calls for:

By Northern Governments:

- A reduction in tariffs on textiles and clothing imports to the average for manufactured goods (4 per cent) by 2010, through WTO negotiations.
- A halt to protectionist abuse of non-tariff barriers, such as anti-dumping measures.
- Easing of EU and US rules of origin for LDC exports, and extension of US preferences to include textiles and clothing.
- Urgent financial and technical assistance to countries that will suffer as a consequence of sudden quota phase-out.

- Temporary preferences until at least 2010 for five non-LDC developing countries that are highly vulnerable to the lifting of quotas.
- More trade adjustment assistance for displaced Northern workers.

By Southern Governments:

- Enforcement of international labour standards with strict monitoring of corporate compliance particularly during MFA phase-out.
- Re-training and job-search assistance for displaced workers.
- Provision of better legal institutions, customs administration, marketing and infrastructure to increase industry competitiveness.

By Retail and Brand Corporations:

- Responsible sourcing strategies that integrate respect for labour standards.
- Corporate Social Responsibility commitments to consider the needs of current supplying communities: not abandoning their responsibilities to these communities.
- Ensuring that suppliers build reserves to meet severance payments for workers where factories close or many workers are fired.

By Manufacturers:

- Provision of 'decent work' through respect for workers' rights.
- Provision of adequate notice periods, compensation, and due wages to workers displaced during quota phase-out.

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5

Impact of the MFA Expiry on Nepal

Shyamal K. Shrestha

Overview

On 1 January 2005, the global Textiles and Clothing (T&C) industry underwent a fundamental restructuring due to the end of the three-decade old Multi-Fibre Arrangement (MFA). According to the rules of the Agreement on Textiles and Clothing (ATC) of the World Trade Organisation (WTO) — agreed upon in 1995 — the industry was to be completely freed from quotas provided in major markets like the European Union (EU) and the United States (US) by 31 December 2004.[1] The MFA assured all developing country exporters a foothold in the world market facilitating industrialization in many economies, including Least Developed Countries (LDCs) where T&C emerged as a vital export and source of manufacturing and employment.

The global T&C industry is in the initial months after the quota free regime and the new milieu has witnessed intensification of competition with ramifications for economic growth, employment and the labour force. Even prior to the quota phase-out, China and a few other developing countries had dominated the industry on account of economies of scale and higher levels of competitiveness. Large producers continue to consolidate their positions whereas smaller producers (mostly LDCs) have become

[1] The rules apply to only WTO members, including Nepal, which formally joined the multilateral trading system in April 2004.

vulnerable. This chapter assesses the impact of the expiry of the MFA in the context of Nepal.

1. Introduction

The T&C industry has played a significant role in the economies of both Newly Industrialized Economies (NIEs) and LDCs. Nepal — a low-income nation with a gross national product per capita of US$ 250 in 2004 — has emerged as one of the low-cost suppliers among Asian developing economies since the past two decades although its share in total global T&C exports is insignificant.[2] Along with hand-made woollen carpets, T&C emerged as one of the main non-agricultural exports of Nepal during the 1990s. The process of industrial deregulation initiated in 1992 opened up many sectors for private sector investment and the T&C sector witnessed a wave of new entrants. However, the industry's modern inception dates back to the system of item-specific quotas by the US for selected developing countries as a part of the MFA, constituted in 1974. While three other South Asian countries viz., Bangladesh, Pakistan and Sri Lanka were the immediate winners in terms of quota distribution, Nepal got the highest quota per capita in the region. The massive redundancy in the Indian garment industry brought about by the MFA was redirected to Nepal as its 'satellite' manufacturing unit (Shakya, 2004: 268). Table 1 presents the contribution of the industry to the Nepalese economy.

The T&C industry in Nepal depicts the characteristics of a 'buyer-driven commodity chain.' First, it is highly dependent on inputs: raw materials and accessories are imported from India and overseas. Second, export markets are limited with the US constituting nearly 80 per cent of all apparel

[2] Nepal's share in total world exports of T&C stood at 0.1 per cent in 1996-97. Bajaj (2004: 9) quotes these figures in his paper.

exports while other major markets are the EU and Canada. Third, retailers and wholesalers in industrialized nations — on whom producers are dependent on higher value-added activities including design and marketing — largely control the 'value chain' in terms of its governance. The dominance of T&C in the export basket peaked in 2002/03, accounting for 51 per cent of total export value. However, the share declined to 44 per cent in 2003/04. In 2000, foreign exchange from the industry peaked at US $ 182 million (WTO, http://stat.wto.org).

Table 1: Principal Indicators of Textiles and Allied Activities in Nepalese Manufacturing (by NSIC), 2001/02

NSIC	NSIC Name	Number of Establishments	Number of Persons Employed	Wages and Salaries (in '000 Rs.)	Census Input (in '000 Rs.)
1711	Spinning and weaving of textiles	60	5,074	198,110	786,746
1712	Finishing of textiles	68	3,293	137,645	483,535
1729	Manufacture of made-up textiles	16	809	17,550	70,558
1730	Manufacture of crocheted articles	59	2,861	159,916	411,113
1810	Manufacture of wearing apparel except fur	115	18,134	795,932	2,394,617
	Total	318	30,171	1,309,153	4,146,569
	Share in overall manufacturing (%)	10	16.5	20.48	13

Note: NSIC stands for National Standard Industrial Code. It may be noted that official figures have not been updated since 2001/02.

Source: HMG Nepal. 2004. *Statistical Pocketbook of Nepal 2004*. Kathmandu: CBS.

Global prices of T&C products have been declining due to the phenomenon of 'imimiserising growth' in producing nations. In addition, this is also partly due to the gradual end of quotas since 1995 and the rise of Preferential Trading Arrangements (PTAs) that has intensified competition and led to

the creation of an uneven playing field for suppliers. Unable to be competitive and facing discrimination in buyers' markets, Nepal's foreign exchange from the T&C sector has witnessed steady decline. Most domestic firms have also quit the industry, leading, in turn, to job losses. The number of registered firms rose from 58 in 1983, to 700 in 1990, to 757 in 1992, and to 1067 in 1994. However, there were 323 firms in 1995, 212 in 200 and around 100 by 2005. The exit of many firms thus depicts highly competitive markets.

Table 2: Value of Nepal's Textile Exports during 1997/98 – 2003/04

Year	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04
Value (US$ million)	176	152	175	182	165	157	136

Source: FNCCI and WTO.

Although a recipient of quotas under the MFA, Nepal's performance has been eroded by many factors, both domestic and external. Despite low costs of production due to the availability of cheap labour, its productivity is generally low. Other identified challenges are weak government policy to strengthen the T&C sector, low value added (as production is simply that of CMT or cut-make-trim); absence of strong backward linkages with the rest of the economy (including absence of ancillary industries); labour regulations that are inflexible (leading to lower productivity); high transportation costs (due to the country's landlocked nature and dependence on third countries for transit rights to the sea) and thus longer lead-time for deliveries; high transaction costs of doing business (characterized by 'red tape'); and poor marketing networks (depicted by inability to utilize quotas effectively and dependence on few export markets). The main external challenge is inability to compete due to trade arrangements like the African Growth and Opportunity Act (AGOA) and the Caribbean Basin Trade Partnership Act (CBTPA) — effective in the US since 2001 — and higher

tariff barriers in the US. These two treaties grant certain producers in Sub-Saharan Africa and the Caribbean preferential access to the US market, undermining Nepal's competitiveness (HMGN, 2003: 74).

2. Post MFA Scenario

Nearly five months after the expiry of the MFA, the scenario in the global T&C industry reflects what was, in both academic and policy circles, widely expected. The dominance of major players (and its attendant fall-outs that are threatening to result in trade disputes) stands in stark contrast to the marginalization and complete neglect of smaller players like Nepal. Restructuring of the industry has vindicated China domination and surge in its exports, prompting measures by major industrialized nations/groups like the EU and the US to take resort to WTO rules to stem imports from China.[3]

Data available from some developing countries regarding the impact of the elimination of T&C quotas reveal a mixed picture, depending upon country

[3] Rising imports from China to both the EU and the US has caused much debate. Earlier, US Commerce Department statistics released on 1 April showed that Chinese textile and clothing imports into the country were 63 per cent higher in the first quarter of 2005 compared to 2004. As a response, the US Committee for the Implementation of Textile Agreements (CITA) — an interagency US government group chaired by the Department of Commerce — announced that it was initiating 'safeguard proceedings' to determine whether certain Chinese textile and clothing imports were disrupting the domestic market. The EU also reacted sharply to rising Chinese textiles and clothing import levels, constituting 20 per cent of the EU market. It announced "an early warning system" that would allow Chinese imports of particular products to increase by 10–100 per cent before triggering investigations to determine their impact in terms of trade flows and possible injury to the EU industry. The Chinese government opposed preliminary moves by the US and the EU that could eventually lead to the imposition of import restrictions on Chinese textiles. Despite China's opposition, the US and EU enjoy the discretion to impose additional tariffs to offset further rise of imports, thanks to "Textile Safeguards Provision" included in China's Protocol of Accession to the WTO. This would make Chinese products more expensive and could undermine China's competitiveness in the main export markets.

cases. The major change is that buyers would now source from efficient suppliers who have an edge in competitiveness and economies of scale. This would relegate inefficient players to the periphery or out of the industry altogether. China — owing to its large production capacity — and some large developing countries (like India) continue to maintain their lead in the sector. The Geneva-based International Centre for Trade and Sustainable Development (a non-governmental organization specializing in trade issues) reported in early April 2005 that while some LDCs were faring satisfactorily, the situation in others are in jeopardy. For instance, Bangladeshi's overall exports rose by 35 per cent in February after a 13 per cent decline in January, with some kinds of garments registering healthy increases over the previous year. Six major textile factories shut down in Lesotho at the end of 2004 or early 2005, partially as a result of the quota elimination, although the government announced plans at the end of January to reopen one of the factories (ICTSD, http://www.ictsd.org).

However, Nepal is facing an adverse situation due to its inability to adjust itself to the new trade regime. Following the abolition of quota system on T&C, the country's export of apparel and textile has dipped by around 41 per cent during the first four months of 2005. Statistics of Garment Association - Nepal (GAN) reveal that the country was able to export readymade garments worth US$ 22.98 million during January-April since the termination of the MFA. The country had exported garments worth US$ 39.24 million during the similar period last year (*The Kathmandu Post*, 9 May 2005). The official figures showed that exports had dipped by around 46 per cent in January, 66 per cent in February, 41 per cent in March, and 16 per cent in April respectively, compared to that of similar periods in 2004. As per the statistics, only garments worth US$ 6.8 million were exported in January, US$ 4.4 million in February, US$ 6.2 million in March, and US$ 6.2 in April; compared to US$ 11.3 million, US$ 9.9 million and US$ 16 million of the first three months in 2004.

Various experts have attributed the causes for decline in export of T&C to the US, which absorbs around 80 per cent of the total garment exports of the country. It is certain that export of apparel and textiles to the US has dropped after the Nepali garment products were not able to compete with the cheap garments manufactured in Sub-Saharan African and Caribbean countries. Customs duties ranging from 18 to 23 per cent are imposed on Nepali goods whereas no such duties are imposed on products made in Sub-Saharan African and Caribbean countries due to the existence of PTAs with those countries and regions. However, the loss in competitiveness also arises from its inherent weakness, which Nepal has not addressed, thus leaving it more vulnerable.

3. Strategies in the Post MFA Era

Concerned actors have identified various strategies in order to make the T&C sector face up to the reality beginning in 2005 so as to enable Nepal to prepare adequately in the post MFA era.[4] There has been no dearth of suggestions and recommendations on how Nepal should restructure the industry. Interactions between various actors (viz., industry, government and civil society) have repeatedly stressed the need to move away from 'business as usual' approaches if the industry is to survive and compete. The areas identified for action include taking measures that optimizes production costs, enhance efficiency and productivity, and reduce lead-time for deliveries. They also include measures to gain preferential access to markets in the major importing countries although this issue is entirely exogenous to national policies.

[4] For instance, the *Nepal: Trade and Competitiveness Study* (2004) was conducted as part of the Integrated Framework for Trade—Related Technical Assistance.

Among the immediate steps that need to be taken to revive the national T&C industry, GAN had identified the creation of a garment-producing zone, near Nepal's first inland container depot near the Nepal-India border. Currently, an overwhelming majority of the firms are located in the capital Kathmandu and face various infrastructure bottlenecks. The prospect of industrial relocation would considerably lead to productive efficiency as enterprises could be provided the necessary provisions for undertaking production with assured infrastructure facilities, ancillary industries could be promoted, transport costs would be lowered, lead time for deliveries would be reduced and production would occur on a 'cluster' basis so as to enable the spillover of 'learning' processes among producers. The government had assured industry that it would take steps to strengthen the industry and finally in April 2005, some land was provided for such a purpose. The T&C industry has also been identified for foreign direct investment. This measure could go a long way to promote greater efficiency and competitiveness in view of low labour productivity and the need to usher technologies that would make the industry at par with its competitors. At the firm level, it is urgent to make the labour market flexible and induce investment in training of workers. These belated recommendations ought to be implemented without further delay.

As mentioned earlier, preferences provided to T&C producers from Africa and the Caribbean have tilted the balance in their favour at the cost of other producers in Asia. Many textile-dependent developing and least developed countries in Asia have begun the process of lobbying to gain preferential market access in major export destinations like the US. In a bid to address their shrinking export performance, garment entrepreneurs from Nepal and Bangladesh met in Dhaka in June 2005 to jointly push for a Trade Act 2005 that promises duty free market access in the US for 14 LDCs of Asia and the Pacific. The commodity associations of both countries were taking initiatives to gather commerce ministers from the garment producing countries among those 14 LDCs, which are deprived of the facility in the US while others are

enjoying it in one form or the other.[5] The proposed Trade Act stands in line with the AGOA whereby the US government has been providing duty-free entry for the T&C of the beneficiary LDCs for 10 years (beginning 2001) with different set of periodic conditions applied. The PTAs granted to Sub-Saharan and some Caribbean T&C producers, however, come with a caveat: that of rules of origin requirements. Gaining such preferences could challenge the Nepalese T&C industry, which imports most of its raw material requirements from major producers like India. Such preferences could compound the problems of the already ailing sector.

Domestic interests in importing nations are believed to be strongly opposed to granting such preferences fearing job losses in their own countries due to competition from low-cost producers from abroad. However, the issue needs to be seen in the light of their perceived threat, which is minimal. Instead, the threat arises from larger producers like China and India. Barring entry to small producers has led to greater economic vulnerability due to terms of trade losses, unemployment and poverty. Therefore, preferential market access has become urgent to save the T&C industries in many LDCs who are facing the brunt of the MFA expiry. Absence of 'safety nets' in these nations would create havoc and disrupt economic growth in the near future.

Insertion into global value chains warrants undertaking industrial upgrading measures to maintain individual competitiveness. LDCs have to optimize resource allocation in the context of closer economic integration that calls for greater levels of efficiency and competitiveness. The focus should be on upgrading in the T&C value chain, wherein dislocation is not only prevented but the maintenance of market niche is also maintained. Through industrial upgrading, nations move from specializing in low-value

[5] The beneficiary countries of the Act would include Nepal, Bangladesh, Cambodia, Laos, Maldives, East Timor, Vanuatu, Afghanistan, Solomon Islands, Yemen, Kiribatii, Samoa, Bhutan and Tuvalu.

activities to relatively high-value activities in global production networks. This calls for developing country firms, hitherto suppliers in the global apparel value chain, to emulate the experience of industry leaders such as China and the East Asian NIEs in making a gradual but certain transition to higher value added activities by further specialization in manufacturing. Therefore, government policies, institutions, corporate strategies, technologies and workers' skills must be geared to improve product quality, maintain competitive prices and enhance reliability of delivery (Gereffi, 2004: 23).

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6

Impact of the MFA Expiry on Pakistan

Musleh-ud Din

1. Introduction

The textiles and clothing sector is the mainstay of Pakistan's economy. With a 24 per cent share in the value added of the manufacturing sector, the textile and clothing sector employs 38 per cent of the workforce in the industrial sector, and constitutes roughly 70 per cent of total exports. The expiration of MFA provides ample scope for Pakistan to expand its textiles and clothing exports. However, the extent to which the country can gain from improved market access opportunities crucially depends on the ability of its textiles and clothing industry to improve its competitiveness in all segments of the textiles value chain. This would require a coherent strategy, involving both the private and public sectors, to transform the textiles sector into an efficient and dynamic industry that is capable of meeting the challenges of enhanced global competition in the post-MFA scenario.

The present chapter seeks to explore the implications of MFA phase-out for Pakistan's textiles and clothing sector. Section 2 provides a brief overview of the textile and clothing industry in Pakistan, while section 3 presents a SWOT analysis for the industry. Section 4 highlights the strategic objectives and targets of the textiles vision, and spells out measures that have been initiated or proposed to enable the industry compete effectively in the global marketplace. Section 5 assesses the likely impact of MFA phase-out on textiles industry in Pakistan.

2. An Overview of the Textiles and Clothing Sector

The textiles and clothing industry plays a major role in Pakistan's economy: it accounts for roughly a quarter of the value added in manufacturing sector and is a major source of employment and foreign exchange earnings. The industry consists of a large-scale organized sector comprising spinning units, integrated textile mills, and independent weaving, finishing, and garments units. In addition, a significant number of weaving, finishing, garments, and hosiery units exist in the small-scale unorganized sector. Industrial production consists of a range of items including cotton yarn, cotton fabric, fabric processing, home textiles, towels, hosiery and knitwear and readymade garments.

Cotton ginning is the first process in the textiles value chain. There are 1221 ginning factories in Pakistan with a total capacity of approximately 20 million bales per year. Currently there is excess capacity in cotton ginning of about 10 million bales. The spinning sector consists of 453 units with 9.6 million spindles and 147,000 rotors (Table 1).

Table 1: Installed and Working Capacity in Spinning Sector

	Installed Capacity	Working Capacity
Spindles (000 Numbers)	9593	7963
Rotors (000 Numbers)	147	67

Source: Expert Advisory Cell, Ministry of Industries: Monthly Industrial Bulletin, Vol. 4, No. 4, April, 2005.

The weaving sector comprises of integrated textile units, independent weaving units, and power loom units with a total installed capacity of 259,159 looms (Table 2). Major products of the downstream industry in the textiles sector are hosiery, towels, bed-wear, canvas and tents, readymade garments, and fashion apparels. There are 700 knitting units with an

installed capacity of about 15,000 knitting machines and a capacity utilization rate of approximately 60 per cent. The garments sub-sector consists of large scale and small scale units with a capacity of about 200,000 industrial machines and 450,000 machines in the cottage industry.

Table 2: Installed and Working Capacity in Weaving Sector (Nos.)

Category	Installed Capacity	Working Capacity
a) Integrated Textile Units	10214	4356
b) Independent Weaving Units	23652	22000
c) Power Loom Sector	225258	190000
Total	259159	216947

Source: Pakistan Economic Survey 2003-04, Government of Pakistan, Finance Division, Islamabad.

The textiles and clothing industry continues to occupy a leading position in the trade structure of the country, with exports exceeding US $ 8 billion in 2003-04 per cent more than 65 per cent of the country's total exports (Table 3).

With a total investment of US $ 4 billion during the last 4 years, the industry has geared itself up to face the challenges of heightened global competition in the post MFA scenario. Roughly half of this investment has gone into the spinning sector (47 per cent), followed by weaving (26.3 per cent), textile processing (10.5 per cent), knitwear and garments (4.8 per cent), made-ups (7.7 per cent), synthetic textiles (5.2 per cent) (Table 4).

The import of textiles machinery has also picked up in recent years. In 2002-03, import of textiles machinery stood at US$ 531.0 million, up from 210.9 million in 1999-2000 (Table 5). During the period from July 2003 to April 2004, textiles machinery worth US $ 455 million was imported. The growing machinery imports indicate increasing modernization of the industry with greater focus on value addition.

Table 3: Structure of Pakistan's Exports of Textiles and Clothing

(Million US $)

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Textile Manufactures	**4,973.3**	**5,588.1**	**5,790.9**	**5,810.6**	**7,263.1**	**8,073.0**
	945.2	1,071.6	1,073.5	929.7	928.4	1,126.9
Cotton Yarn	(19.0)	(19.2)	(18.5)	(16.0)	(12.8)	(14.0)
Cotton Fabrics	1,115.2	1,096.2	1,032.5	1,130.8	1,345.7	1,711.5
(Woven)	(22.4)	(19.6)	(17.8)	(19.5)	(18.5)	(21.2)
	742.2	886.7	911.4	845.9	1,146.7	1,458.7
Hosiery (Knitwear)	(14.9)	(15.9)	(15.7)	(14.6)	(15.8)	(18.1)
	611.0	709.9	744.9	918.6	1,329.1	1,383.3
Bed Wear	(12.3)	(12.7)	(12.9)	(15.8)	(18.3)	(17.1)
	177.7	195.6	241.7	267.7	374.8	403.5
Towels	(3.6)	(3.5)	(4.2)	(4.6)	(5.2)	(5.0)
	651.2	771.7	826.8	875.0	1,092.6	993.3
Readymade Garments	(13.1)	(13.8)	(14.3)	(15.1)	(1.0)	(12.3)
	398.7	457.7	544.6	410.0	574.3	470.8
Synthetic Textiles	(8.0)	(8.2)	(9.4)	(7.1)	(7.9)	(5.8)
Other Textile Made ups	255.3	307.6	330.9	350.9	359.8	416.6
	(5.1)	(5.5)	(5.7)	(6.0)	(5.0)	(5.2)
	76.9	91.1	84.6	82.0	111.8	108.5
Others	(1.5)	(1.6)	(1.5)	(1.4)	(1.5)	(1.3)
Total Exports	**7,779.3**	**8,568.6**	**9,201.6**	**9,134.6**	**11,160.2**	**12,313.3**
Share of Textiles Manufactures in Total Exports	**63.9**	**65.2**	**62.9**	**63.6**	**65.1**	**65.6**

Note: Figures in parenthesis are the shares of textile sub-categories in total textile manufactures.

Source: State Bank of Pakistan.

Table 4: Sectoral Shares in Total Investment (US $ 4.0 Billion) (1999-2003)

1.	Spinning	47.0%
2.	Weaving	26.3%
3.	Textile Processing	10.5%
4.	Knitwear & Garments	4.8%
5.	Made-Ups	7.7%
6.	Synthetic Textile	5.2%

Source: Pakistan Economic Survey 2003-04, Government of Pakistan, Finance Division, Islamabad.

Table 5: Import of Textile Machinery

Year	Million US $	% Change
1999-2000	210.9	28.6
2000-01	370.2	75.5
2001-02	406.9	9.9
2002-03	531.9	30.7
2003-04 (Jul-Apr)	455.0	-

Source: Pakistan Economic Survey 2003-04, Government of Pakistan, Finance Division, Islamabad.

3. The Textiles and Clothing Industry: A SWOT Analysis

Strengths

- A well-established and leading sector of the economy. Its contribution in the economy in terms of exports, employment, and value addition makes it the single largest source of growth in the manufacturing sector.
- Domestic availability of cotton.
- Cheap labour.
- The industry is well-positioned to face the challenges of global competition, thanks to massive investment of US$ 4 billion (during the last 4 years) in all segments of the textiles value chain.

Weaknesses

- To a large extent, all segments of the textile sector from cotton picking and ginning to manufacturing of garments **lack modern technology.** Contamination in cotton resulting from improper picking and storage processes affects the cotton quality and is a major impediment in value addition. The technology deployed in cotton ginning is outdated, inefficient and based on local manufacturing by semi-literate mechanics. The production of fabric is dominated by the power loom sector, which accounts for almost 63 per cent of the total production. The manufacturing capability of these machines is limited to the production of low-density fabrics. The processing industry is characterized by inefficient production processes leading to high wastage percentages. About 50 per cent of the total installed processing capacity is more than fifteen years old and needs to be upgraded so as to enable it to cater to the growing demand of made-ups and high quality garments.
- There have been **little research and development** efforts in the private sector. There are a number of research institutions in the public sector in the area of textiles. However, their research output has not benefited the industrial sector not least because of the lack of effective links between research organizations and industry.
- **Shortage** of highly skilled and trained manpower.
- Production skewed towards **low end commodities**. Due to the capital intensive nature of the high tech machines in the manufacturing of woven fabric, the focus of the local textile entrepreneurs has, in the past, remained on the power looms; the quality has been ignored all along.
- Exports of textiles are **concentrated in low value added products** despite a rising share of higher value added textile products in global trade. In the category of blended fabrics with more than 85 per cent cotton, the value addition is very low as 54 per cent of the total fabric is exported

without any processing, resulting in a low unit price realization.[1] To capture a greater share in the rapidly expanding global market for high value added textile products, the textile industry must move up the value chain and increase the share of high value added garments and made-ups in its export portfolio.

- The textiles sector in Pakistan remains **largely cotton-based,** despite an increasing trend towards synthetic and blended fabrics. Current spindles utilization for man-made fibres is very low compared with its competitors. The overwhelming reliance of the textile sector on cotton makes it vulnerable to adverse shocks in the cotton market.

Opportunities

- The expiration of MFA offers tremendous scope for Pakistan to enhance its exports of textiles and clothing.

Threats

- Heightened global competition poses serious challenges for the textiles and clothing industry, as Pakistan would have to compete with giants like China and India to capture its share in the world market.

4. Development Strategy for the Textiles Sector: Objectives, Targets, and Actions

Pakistan has formulated a long-term development strategy to facilitate the transformation of the textiles sector into a strong, dynamic, and internationally competitive industry led by the private sector. The key objectives of this strategy are to:

[1] The extent of value addition is much higher in the case of blended fabrics with less than 85 per cent cotton: 92 per cent of exports of such fabrics are processed domestically.

a) Facilitate the textile industry to attain and sustain a pre-eminent position in the manufacture and export of high value added and high quality textile products in an era of freer international trade.
b) Revitalize the institutional structure to strengthen human resource skills and capabilities.
c) Encourage research and development to enable the industry to build cutting edge manufacturing capabilities.
d) Enable the industry to move into a higher technological orbit.
e) Liberalize controls and regulations so that the different segments of the textile industry are able to perform in a greater competitive environment.
f) Develop a strong multi-fibre base with emphasis on product up-gradation and diversification.
g) Encourage the active involvement of both the private and the public sectors in attaining these objectives.
h) Attain double digit growth in the production and exports of textiles on a sustained basis.
i) Achieve and maintain a position among the top five textiles exporters in Asia.

To achieve the above-mentioned objectives, the government has initiated a series of measures aimed at improving the regulatory and policy framework, human resource development, and providing institutional support and quality infrastructure. A separate textiles Ministry has been established to design and oversee the implementation of government policies aimed at creating an enabling environment for the private sector.

4.1 Improving the Regulatory and Policy Framework

The government has considerably streamlined the regulatory framework to reduce the costs of doing business. A liberal trade policy has been adopted

for the textiles sector to enhance its competitiveness. This has ensured the availability of imported raw materials at competitive prices to all segments of the textiles industry. To enable the industrialists to up-grade their technology, customs duty on import of machinery has been reduced to 5 per cent. It is expected that import of machinery will be made duty free in the near future.

4.2 Human Resource Development

The problems of low productivity and poor product quality can only be addressed by improving the quality of human resources. There are a number of institutions that are involved in imparting higher education in the field of textiles. The following measures have been proposed to improve their performance:

a) Attract highly qualified faculty through market-based rewards.
b) Revise curricula based on industry needs and recent advances in product and process technologies.
c) Upgrade the existing training facilities and equipment.
d) Introduce a strong system of quality control and supervision to ensure that minimum standards are being met.
e) Provide hands-on experience to the graduates by making it compulsory for them to serve as interns with the industry for at least 6 months.
f) Promote networking among the educational institutions.
g) Conduct regular surveys and public-private consultations to identify the manpower attributes required by manufacturing firms in terms of knowledge and skills, and then communicate their manpower needs, in quantity and quality terms, to the educational institutions.

To encourage entrepreneurs to invest in human resource development, it has been proposed that they may be provided tax credit for expenditure on

manpower training. Also, firms that establish technical or vocational training institutions should be eligible for tax deduction out of its taxable income.

4.3 Promoting Research and Development

Attaining competitiveness requires research and development activities focused on improving operation and maintenance of production facilities, product quality and designs, and process technologies. While there has been little research and development activity by the private sector, the public sector institutions have not been able to deliver either. To address these problems, a two-pronged strategy to promote research and development in the textiles sector has been proposed. First, the public sector institutions would be strengthened to provide market driven R&D support to firms. Second, the private sector would be provided incentives to invest in research and development. These may include tax exemptions on expenditure incurred on R&D activities as well as provision of matching grants for specific R&D projects.

4.4 Establishing New Institutions

Establishment of several new institutions has been proposed to provide support to the private sector. These include: ginning research institute; textiles processing institute; sample development and certification labs; garment technology centre; knitting technology centre; yarn research centre; and micro-fibre technology centre.

4.5 Technological Up-gradation

The objective of manufacturing high value-added and superior quality products that can compete in international markets can not be realized without the up-gradation of technology in all segments of the textiles industry. Since the lack of funds for investment in new technology has been identified as a major constraint in technological up-gradation, a technology up-gradation fund is proposed that would provide long-term financial support for the installation of modern machinery and equipment.

4.6 Rewarding Value Addition

To maximize the gains from the emerging global environment of increasing competition and lower trade barriers, it is imperative to move up the value chain both within and across all the sub-processes of the textiles sector. For example, there is a strong need to shift from the manufacture of low counts yarns to finer counts yarns on the one hand, and from clothing to garments and made-ups on the other. To reward value addition, incentives provided to the textiles sector are being linked with the extent of value addition, as, for example, access to subsidized credit to exporters of high value added products such as garments. Similarly, other incentives such as export refinance are proposed to be cascaded across the value chain within a sub-process e.g., lower refinance rate for the finer counts and other value-added yarns and higher rate for the lower counts. In addition, the import of modern machinery that is meant for achieving value-addition should be facilitated through the provision of subsidized credit.

4.7 Ensuring Quality Standards

The quality of final products depends on the quality of cotton and lint. A Quality Control Authority has been established to enforce minimum standards for *phutti* and lint. Also, the use of contamination detectors is being promoted to reduce the risk of contaminated yarn going into further processing.

4.8 Encouraging Joint Ventures

Joint ventures with foreign manufacturers are effective tools for the transfer of technology and managerial and marketing skills. The Export Promotion Bureau and the Board of Investment are playing an effective role in encouraging joint ventures in the textiles sector.

4.9 Marketing Support

As most of the textiles industry is export-oriented, the government has devised plans to assist the private sector in effectively marketing its products through improving the image of Pakistani products in foreign markets and developing brand names. Despite having a strong export base in textiles, Pakistani firms have not invested in developing their own brands, not least because of the high outlays involved. The Export Promotion Bureau is involved more actively in helping the private firms in their endeavours to build image and brand name. Also, it has been proposed to establish a Corporate Marketing Company to provide professional marketing support to the entrepreneurs. The company would be a joint venture between the private and public sector, and managed by the professionals.

4.10 Textiles Cities Project

The government has launched the "Textiles Cities Project" to set up three textiles cities in Karachi, Lahore and Faisalabad. These cities would be characterized by better infrastructure and support services. It is estimated that the establishment of these cities would generate 80,000 new jobs and additional exports of textiles and clothing worth US$ 1.5 billion per annum.

5. MFA Expiration: Impact on Pakistan

It is generally believed that MFA phase-out would have a positive impact on Pakistan's textiles and clothing sector. This assessment is based on three broad factors. First, the expiration of MFA has come at a time when the economy is on a healthy growth path with strong macroeconomic fundamentals. Thanks to a thriving and conducive economic environment, the textiles and clothing industry is better positioned to take advantage of the enhanced market access. Second, the government has accorded top priority to prepare the industry to face the post-MFA challenges. As discussed in section 3, the government has formulated a long-term strategy for the development of the textiles and clothing industry and a series of measures have already been initiated which are expected to help the textiles and clothing industry to increase its share in the global trade. Third, the private sector has invested heavily in Balancing, Modernization and Replacement (BMR) with focus on value addition and quality. The investment trend is expected to continue in the future, and this would help the industry to compete with major players in the world market.

In qualitative terms, analysts predict the following outcomes in the short to medium term, all of which are expected to result in better quality across the textiles value chain, shift towards higher value added segments, and enhanced export earnings:

- Improved cotton quality;
- Finer count yarn production;
- Improved fabric quality;
- Better processing and designing capabilities; and
- Diversification towards synthetic fabrics.

In quantitative terms, experts believe that Pakistan can achieve an export target of US$ 10 billion in the fiscal year 2004-05, and US$ 13 billion in 2005-06. The export expansion will translate into more jobs in all segments of the textiles and clothing industry. According to the Textiles Vision (2005), enhanced market access due to MFA phase-out would result in additional employment of about 1 million over a 5 year period (Table 6).

Table 6: Employment Creation

	2001	2002	2003	2004	2005	Total New Employment
Stitching	227,214	258,595	258,595	38,931	38,931	822,267
Processing	5,629	8,443	14,089	14,089	14,089	56,340
Knitting	1,353	2,331	4,463	5,126	5,889	19,161
Weaving	1,548	2,323	3,871	3,871	3,871	15,484
Spinning	12,360	18,540	30,900	30,900	30,900	123,600
Total Employment	**248,105**	**290,232**	**3,11,918**	**92,918**	**93,680**	**1,036,853**

Source: Textiles Vision (2005).

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7

Impact of the MFA Expiry on Sri Lanka

Saman Kelegama

1. Introduction

The Textile and Clothing (T&C) industry took off immediately after the opening up of the Sri Lankan economy in 1977. Sri Lanka is one of those developing countries that benefited from the assured market provided by the quota system governed by the MFA. By 1986, T&C became the largest export sector in the country, by 1992 it became the largest foreign exchange earner, and by 2000 the sector accounted for more than 50 per cent of the country's exports, earning US $ 2.9 billion. The sector now accounts for 6 per cent of GDP, 40 per cent of industrial production, and for 5 per cent of the labour force. It accounts for 859 firms, employs around 340,000 people (87 per cent females) and around 1.2 million people depend for their livelihood on the industry.

Unlike India and Pakistan, Sri Lanka does not possess a major export oriented textile sector and the bulk (more than 90 per cent) of the T&C exports constitute Ready-Made Garments (RMG). Over the last decade, Sri Lanka's dependence on quotas has reduced and by 2004, 55 per cent of Sri Lanka's RMG exports was to non-quota markets. There is heavy concentration of Sri Lankan garment exports in the markets of the US (63 per cent) and EU (30 per cent). Sri Lanka obtained quota free entry to the EU market in March 2001, thus quotas were mainly faced in the US market until 2004.

During the countdown to 01 January 2005, the debate on the post-2004 scenario intensified in the country. There are two schools of thought on the future of the RMG industry in Sri Lanka. One school of thought is based on control of export share by industries. Available data show that the first 12 per cent of the RMG firms control 72 per cent of exports. It is argued that these firms are well established and in a position to take advantage of a quota free regime. It is based on this assumption that the Five Year Strategy for the Industry initiated in 2002 forecasts a 12 per cent growth during the next three years. It is further argued that these firms will expand and consolidate themselves and in that process will be able to make use of some of the small and medium garment factories either by acquiring them or by using them for subcontracting activities. Such a process will contribute to some employment dismissals from the RMG sector but not a significantly large number.

The other viewpoint is that whatever the percentage of exports that is controlled by the top 12 per cent firms, the RMG industry as a whole is not competitive enough to show solid performance in the post-2004 period. From the global demand front, it is argued that the threat from China will be overwhelming because the global share of RMG controlled by China is expected to increase from the current 20 per cent to 50 per cent by 2010. Moreover, the share controlled by other Asian countries is expected to shrink from the current 32 per cent to 20 per cent by 2010. Consequently, there will be competition among Asian countries to capture part of this shrinking share and in that process Sri Lanka may not necessarily be a winner.

This viewpoint is augmented by highlighting the inadequate preparation by the RMG sector for the post-2004 period due to the back loading factor of the MFA phase-out. From the domestic supply side, the inadequate development of backward linkages (the value added of the RMG sector is about 30-40 per cent), weak forward integration (most RMG exporters do not have contact with the final buyer and remain as suppliers to RMG

stores via buying offices), low labour productivity, increasing cost of production, etc., are pointed out by the pessimists to highlight the lack of competitiveness. Those who argue on these lines show that there will be huge job losses and various new mechanisms will have to be devised to look into those displaced from the RMG industry.

2. Scope of Losses

In actual fact, the scenario in Sri Lanka will be something in between the two scenarios explained above. If one examines the composition of the Sri Lankan garment industry, one finds that 549 firms (64 per cent) are categorized as small and 204 (22 per cent) as medium. It is these two categories of firms that are highly dependent on quotas and on buying offices. These firms will lose orders after 2004 and face losses. Some of them would be acquired by the 12 per cent large firms (around 100 firms), some will be used by large firms for subcontracting activities, and some others will have to close down. Around 130,000 out of the 340,000 workforce of the RMG industry are employed in the small and medium scale industries. Based on the current trends of the closure of RMG industries, it can be stated that there will be at least 80,000 job losses consequent to the MFA phase-out. Most of those who will lose jobs will be female workers who belong to the low grade unskilled category.

It is also important to note that around 150,000 Sri Lankan workers are employed overseas in RMG factories located in Jordan, Bangladesh, Kenya, Mauritius, Maldives, etc. Some of these workers will return with the closure of industries in those countries. The skilled workers who return will be absorbed by the large firms that already face a labour shortage, however, the less skilled workers would add to the unemployed reservoir. Thus, at least 50,000 workers will be added to the more than 80,000 job losses in the domestic market.

Many rural households depend to some extent on remittances from RMG workers based, in particular, in the Western Province of Sri Lanka. These income transfers are an important source of non-farm income in such households. These households are bound to get adversely affected with the emerging job losses.

The macro-level losses can be examined by comparing the impact on the balance of payments. As well-known, the ATC phase-out of quotas became end-loaded from being back-loaded at the beginning (1995). As a result, Sri Lanka's top 10 categories of exports to the US market came out of quota only in end-2004, and consequently there will be an adverse impact on the RMG sector after 2004. A preliminary study done by the IPS showed that the balance of payments will experience a loss due to the ATC amounting to US $ 85 million in 2005, which will increase to US $ 360 million in 2008 (IPS, 2004).

3. Domestic and External Strategies to Deal with the Situation

Domestic Front

A private sector driven domestic strategy to face the challenge came into operation in 2002, after the preparation of the Five Year Strategy and the formation of the Joint Apparel Association Forum (JAAF). The Five Year Strategy was prepared with the aim of giving some direction for the RMG industry in the post-2004 period. According to the strategy, the industry is required to achieve five major goals to survive global competition beyond 2005.

a) Industry turnover should increase from its 2001 level of US $ 2.3 billion to US $ 4.5 billion by 2007. Taking into account the existing growth rate of approximately 18.5 per cent over a twelve-year period (1989-2000) and the possible destabilization of the industry, a growth rate of 12 per cent is estimated for 2003-2009.

b) Transforming the industry from a "manufacturer" to providing "fully integrated services" because there is a general belief that leading buyers will focus on channelling their resources to consolidate brand image while leaving all other functionalities in the distribution chain to suppliers.
c) Market penetration to premium market segments of the global apparel industry needs to be increased.
d) To become internationally famous as a superior manufacturer in specific products. These products have been identified as sports wear, casual wear, children's wear and intimate apparel.
e) Consolidate and strengthen the industry in order to meet the challenges of the quota free era.

Currently, only 10 per cent of local manufacture ends up in specialty brands while 50 per cent are taken by department stores and the balance 40 per cent by discount stores. During the five-year period ending in 2007, the industry plans to increase penetration into specialty stores by 20 per cent, Departmental stores by 60-70 per cent and reduce dependence on discount stores by 10-30 per cent.

The plan outlines a format for achieving these objectives with a detailed discussion on: (a) a strategic framework for implementation, (b) strategic initiative and relevant action plans for the industry, (c) additional strategic initiative in support of Small and Medium-scale Industries (SMIs), (d) implementation plans, and (e) cost estimates of the strategic plan. The Report argued for the establishment of a special Research Cell for the industry to keep track of international trends in garment trading, and this came into operation in early-2003. Having realized the need for one voice for the industry to achieve a common goal, garment industrialists and stakeholders set up the JAAF in 2002, which is a combination of five different Associations.

The JAAF has formed eight committees to look into various aspects of the industry: (1) bilateral and multilateral issues, (2) marketing, (3) logistics and infrastructure, (4) backward integration, (5) SMIs, (6) human resources, technology and productivity, (7) labour, and (8) finance. The government has allocated Rs. 100 million to increase the productivity in the garment industry through the Five-Year Strategy.

External Front

Both the private sector and the government made a concerted effort to gain quota free entry to the EU and the efforts finally became effective in March 2001 when EU announced quota free status for Sri Lanka. This was obtained in order to gain an early-mover advantage in the EU market before the full phase-out of quotas in end-2004. However, Sri Lanka faces an average duty of 12 per cent in the EU market. The only scheme that permits some duty concession to the EU market is the Generalized System of Preferences (GSP). Under the GSP scheme, Sri Lanka enjoys a 40 per cent duty concession in the EU market for RMGs. [In February 2004, Sri Lanka qualified for a 20 per cent additional tariff concession for meeting EU labour standards — over and above the earlier 20 per cent concession for GSP. In fact, only two countries have so far been successful in achieving GSP concessions for labour standards (the other being Moldova)].

In 2004, the Sri Lankan government was pursuing the case for obtaining deeper duty concessions in the EU market under Labour-GSP by highlighting its unique position, i.e., Sri Lankan RMGs did not qualify for duty free entry to EU as LDCs did, neither did they enjoy deep duty preference like those of ACP (African, Caribbean, and Pacific) countries did. Given the fact that RMG exports accounted for more than 50 per cent of Sri Lankan overall exports, the case was presented to the effect that Sri Lanka needs an additional window – more duty preferences — to effectively compete in the EU market. In July 2005 the GSP-Plus scheme with duty free entry to EU

came into operation, however the duty free entry was conditional on meeting certain conditions and among them were the Rules of Origin (ROO).

The Sri Lankan government has put forward the case that GSP duty preferences in the EU market will be of little use if the GSP scheme related ROO cannot be fulfilled. Sri Lanka has been able to use only 32 per cent of the GSP quota for 'apparel knitted and crocheted' (Chapter No. 61) and 11 per cent for 'apparel not knitted and crocheted' (Chapter 62) in 2002 due to the existing procedure. As it stands, the ROO requirement of the GSP is fulfilling the Regional Cumulation criteria by using SAARC country inputs in the production process. However, if one looks at Sri Lanka's sourcing of fabrics for RMG production, 44 per cent comes from Hong Kong and South Korea (and if Taiwan is added, 58 per cent comes from these three countries). Thus, the case is put forward to relax the ROO to be Super Regional Cumulation (from the current Regional Cumulation), i.e., to cover SAARC and ASEAN + 3. It is argued that if this is the case, the utilization of the GSP scheme would become more effective (Weeraratne, 2005). That such a case is viable is shown from the ANDEAN Community and CACM (Central American Common Market) which successfully negotiated in gaining Super Regional Cumulation for their GSP scheme for the EU market.

The government is of the view that if poverty alleviation is the priority of all international financial institutions and donors, then it is vital to "make trade work for the poor". International trade can play a more effective role in combating poverty by giving better market access in the developed country markets for developing country products on which many livelihoods depend on, such as, RMGs. This is another line of argument that is pursued for providing medium-term support for the RMG industry after 2004.

The Sri Lankan government with the support of the JAAF is also pursuing the case for a bilateral Free Trade Agreement (FTA) with the USA. A Trade and Investment Framework Agreement (TIFA) was signed with the USA in July 2002 and thereafter substantial groundwork has been done by Sri Lanka

to clinch an FTA. However, the Sri Lankan government finds it difficult to fulfil some of the requirements of the US government, such as implementing TRIPS-Plus, liberalization of the service sector and the capital account of the balance of payments, etc., in order to clinch the FTA. In any case, an FTA with USA is unlikely to materialize for the next 1-2 years. Perhaps, by that time, the damage for the RMG industry would have incurred and the relevance for such an FTA may be less given the political economy governing it (Kelegama, 2004 ed.). However, the government is pursuing the TIFA discussion in the hope of some special deal soon.

Sri Lankan garments have not been successful in gaining a foothold in the Indian market using the existing FTA with India. This is mainly due to various non-tariff barriers in the Indian market and the strict rules of origin governing the agreement. Sri Lanka is pursuing the case with India to get some of these impediments removed so that a foothold could be gained in the Indian market for RMG exports.

At the macro-level, the government is exploring the possibility of activating the Trade Integration Mechanism (TIM) for Sri Lanka. TIM was announced by the IMF in April 2004 as a mechanism to provide additional IMF financing to developing countries (under the existing arrangements with the IMF – PRGF) when a country is experiencing a net balance of payment shortfall as a result of implementing trade liberalization measures by other countries that lead to more open trade and non-discriminatory market access for goods and services. The balance of payments implications for Sri Lanka as a result of the MFA phase-out were already highlighted. Once the TIM is activated for Sri Lanka, her access to funds under PRGF can be augmented by a certain percentage depending on the approximate losses due to ATC.

4. The Challenge Ahead

Sri Lanka's major strengths are as follows: it has a reputation of being a quality RMG manufacturer for the mass market; it has a good compliance record with International Labour Regulations; it has relatively disciplined and skilled labour and a trainable labour force; it has a reputed international customer base (Marks & Spencer, C&A, J.C. Penney, Liz Claiborne, etc.); and it has an on time delivery standard "all seasons" product.

Sri Lanka's weaknesses are many but some of them could be addressed in the short term:

1. The geographical location – quite far from the major markets in EU and USA, especially when 'turn-around time' is becoming a key factor in purchase of RMGs.
2. Limited knowledge among industrialists on the international environment and recent global developments pertaining to the industry.
3. Isolation from trade partners and heavy dependence on local buying agencies (60 per cent of exports).
4. Lack of geographical diversification in terms of overseas markets, and lack of product diversification.
5. Increasing cost of labour relative to other South Asian neighbours and competitor countries.
6. Inadequate focus on developing backward integration to support the RMG industry. (In 2002, the ratio of imported textiles and yarn to T&C exports was 60 per cent. Textile and yarn imports amounted to 23 per cent of overall imports to Sri Lanka in 2002).
7. Non-existence of product development and design.
8. Non-existence of Sri Lankan brand identity.
9. Lack of a focused marketing strategy for the industry.

10. Low productivity of labour, insufficient use of machinery and manufacturing processes.
11. Relatively high cost of utilities in Sri Lanka.
12. Lack of standardization of the RMG industry.
13. Procedural delays and trade documentation inefficiencies.
14. Poor domestic infrastructure.
15. Limited access to technology due to small scale operation by many firms.

Some of these problems were already addressed jointly by the government and JAAF. Both the private sector and the government had made all efforts to ensure a "soft landing" for the RMG sector after 2004. The Sri Lankan RMG industry has gone through turbulent times over the years – facing the 1988/1989 insurrection; encountering Countervailing Duties and Embargoes by the USA in 1993; paying war-risk premiums and surcharges after the bomb attack on the Colombo International Airport in 2001; – and come out well from these situations. Therefore, it does have the strength to go through hard times. It is hoped that this strength will re-emerge at the most critical time for the industry, i.e., after 31 December 2004.

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Part III

Case Studies of Sri Lanka

8

Survival Strategies for Sri Lanka's Garment Industry - Post 2004

Tilak Fonseka

Abstract

Heightened competition following the abolition of quotas after 2004 was a fact that was known to the industry, which acted proactively by crafting strategies for its survival. Enterprise-level efforts must be directed relentlessly at cost reduction, productivity improvement, market development, and building direct links with key retailers. Government efforts must focus on infrastructure development, reduction in the cost of utilities, labour reforms and improving the efficiency of State institutions. The progress achieved so far on the initiatives listed above cannot give comfort to industry stakeholders. The industry cannot afford to be complacent looking at the slow progress made by some competitor nations or praying for restraints to be imposed on more efficient producers. Enterprises as well as government must display a greater action orientation because speed has now emerged as a critical success factor for industry survival in the new environment.

1. Introduction

January 1, 2005 heralded the dawn of the quota- free era in the global apparel trade. The event is expected to have significant implications for industry competition. The global quota system that was in force until the end of 2004, protected certain countries from more competitive producers. Now,

unfettered by quotas, efficient producers can freely expand their output and buyers can procure their requirements from the most efficient producers. Manufacturing firms that were entirely dependent on quotas and had not cared to change would be forced to leave the industry.

The primary purpose of this study is to propose strategies that would enable the Sri Lankan garment industry to operate in the highly competitive quota-free era. For strategy to be effective, it must take cognizance of market realities. Therefore, the study first describes the vast transformation that is taking place in the global apparel trade and concludes by presenting some strategies for industry survival.

2. Changes in the Global Apparel Industry

The industry is undergoing far-reaching changes in several areas viz., consumer preferences, distribution arrangements, and competitor actions.

Changes in Consumer Preferences

Today's consumers or end- users are more knowledgeable about the market and enjoy wider choice. They expect better quality products at lower prices. It has been said that "consumers spend a smaller percentage of their income on clothing than in the past, although they shop more frequently and buy a larger number of clothing items than before" (Nordas, 2004: p.3). The producers' response to the slow growth in demand has been to build on consumers' love of variety and provide new fashions and a broad variety of sizes, colours and designs at a more frequent rate.

Changes in Distribution Arrangements

Several noteworthy developments are seen in apparel retailing. First, rapid changes in fashion discourage retailers from carrying large stocks that could

soon become obsolete. Sri Lanka's 5-Year strategic plan for the apparel industry observed that: 'Traditional pre- season orders are being replaced by speed sourcing (last minute orders) and more frequent replenishment of orders (within season ordering)'. Retailers place smaller, but more frequent orders for many different styles. In fashion wear, retailers now envisage lead times of 4- 6 weeks from order entry to the date of delivery, while for basic garments too lead times have reduced. Second, there is the trend towards direct sourcing of apparel by major US and UK retailers in order to obtain supplies speedily and at lower cost, which is done by linking directly with manufacturers. Third, retailers try to rationalize their supply base by reducing the number of countries and manufacturers they deal with and strive to forge close relationships with fewer, but highly reliable, manufacturers. This is partly to reduce business risk and partly to increase on-shelf product availability via speedy replenishment of stocks. Finally, there is the trend towards 'lean retailing' whereby retailers have delegated many activities that they had earlier performed to manufacturers. Manufacturers must now undertake several activities in the value chain from design development to delivery of the final product to the retailer so that the latter could concentrate on Customer Relationships Management (CRM). Except for the smaller retailers who would have to rely on buying offices to obtain their supplies for some time, the new imperatives of the marketplace are clear. Speed has become a key success factor for manufacturers.

The global apparel market is segmented. It includes customers who demand basic garments and those demanding fashion wear. With respect to basic garments, the key success criteria are low price, timely delivery and consistent quality. For fashion wear, excellence of quality, speedy delivery and manufacturing flexibility are the minimum criteria, while the order-winning criterion is creative and innovative design skill. In addition, reputed buyers require garment manufacturers to adhere to ethical labour practices.

Investors and buyers would also prefer to conduct business with countries that are politically stable.

Changes in the Nature of Competition

Competition has changed from pure price competition to competition on features (non- price competition). The trend has shifted from mass marketing to target marketing and, in some cases, from mass production to mass customization. In order to remain competitive, firms have re-engineered their internal business processes, encouraged team work and empowerment and displayed unwavering commitment to total quality management and continuous improvement. Sri Lanka supplies basic garments as well as fashion wear to the international market, the former destined to discount chains, while the latter goes to specialty stores with reputed brand names. Sri Lanka faces strong competition from countries such as China, India, Pakistan and Indonesia.

In the global apparel trade, a key development has been the rise of China to a position of supremacy with a 20 per cent share of world apparel exports and 11 per cent share of textile exports. China's apparel exports grew rapidly as soon as it qualified for quota-free entry in late 2001. During January-February 2005, China's garment exports to USA and EU increased by US $ 1.6 billion. Tables 1 and 2 show the phenomenal growth in exports recorded by China. China's dominance in the apparel trade is based on several factors. It is the largest producer of cotton and man-made fibres in the world. The gigantic size of the factories and production operations confer scalar economies that cannot be easily matched by competitors. The average factory is more than half a kilometre long, occupies six storeys, and employs 70,000 persons, with 85 per cent of the workforce residing in-house. Big manufacturers operate from 'supply chain cities' where the main company with designing and garmenting skills is sited in a city of backward integrated companies where all fabrics and accessories are made in a single location.

On account of the presence of these related industries, garment manufacturers reap the benefits of external economies. China has also been able to attract massive foreign investment flows and the industry has taken the initiative of large-scale modernization. China's geographic location gives her an advantage in shipping times to the West coast of USA. Government subsidies and an undervalued currency have also helped to boost the industry, but there is no denial of the fact that China has a highly productive work force. China is expected to be the 'supplier of choice for many US and UK importers because of its ability to make almost any type of apparel product, of any quality level, at a competitive price' (USITC, 2003: p.3-10). It is predicted that China could capture as much as 50 per cent of world exports by 2008 under a fully liberalized scenario (McKinsey &Co., 2004: p.4).

However, China's growth is likely to be restrained by rising domestic wages, external pressure to revalue its currency and more importantly, by the invocation of transitional safeguards by US to prevent a disruption of the global apparel trade. In addition, there is the understandable reluctance on the part of retailers to source all their requirements from a single country. Nevertheless, even under a protectionist scenario, China is expected to get 30 per cent share of world exports by 2008. This means that all other Asian countries will have to compete with each other in order to secure any growth and protect existing exports (ibid. p.4).

After China, the next big player is expected to be India. She is among the world's largest producers of yarn and fabrics, specializes in medium- finer count cotton, has a skilled workforce and significant design expertise. But she lacks quality garmenting skills (KSA Technopak, 2005). The implementation of the 'apparel city' concept is being seriously considered by India.

Table 1: China's Exports of Major Apparel Products to USA (Jan – Feb 2004 vs Jan – Feb 2005)

Item	Quantity (%) Change	Value (%) Change	Unit Value (%) Change
Brassieres	+ 139	+ 157	+ 04
Cotton Knit Shirts	+2120	+1266	- 34
Men's Woven Shirts	+ 346	+ 292	- 12
Cotton Trousers	+1398	+1034	- 24
Dressing Gowns	+ 117	+ 72	- 25
Underwear	+ 520	+ 223	- 48
Man-made Fibre knit shirts	+ 285	+ 102	- 47
Man-made Fibre Trousers	+ 339	+ 174	- 37

Source: www.fairtextiletrade.org

Table 2: China's Exports of Textile & Apparel Products to EU (Jan – Feb 2004 vs Jan – Feb 2005)

Category	Value (%) Change
Knit Apparel	+ 97
Woven Apparel	+ 73
All Textiles	+ 57
All Apparel	+ 82
All Apparel & Textiles	+ 73

Source: www.fairtextiletrade.org

Pakistan also has certain strengths. She has access to local supplies of raw cotton especially low count, a large and relatively inexpensive labour supply and is globally competitive for men's apparel (KSA Technopak, Feb. 2005).

Indonesia too has certain advantages vis-a-vis Sri Lanka. She has an abundant supply of skilled and inexpensive labour and a bigger raw material

base (synthetic fibre, fabric and yarn). Another advantage is its proximity to Hong Kong, which is the world's busiest textile and apparel hub. China, Thailand and Indonesia are the three key destinations for most retailers represented in Hong Kong.

Bangladesh has an abundant supply of low cost labour but relies heavily on imports for woven fabric requirements. It is a strong competitor for mass-produced, low-end apparel. It enjoys duty-free access to major markets, including the EU, Canada, and Norway.

The foregoing account described the far-reaching changes that are taking place on the global apparel scene. Consumers want better quality products at lower prices. Retailers have pushed many activities that they had previously handled (along with the associated costs), onto producers but are determined to preserve their margins. Meanwhile, industry competition has intensified. The abolition of quotas has encouraged producers to convert a portion of their fabric exports into garments resulting in increased supply which exerts downward pressure on prices. Finally, Asian manufacturers have to contend with the system of preferential trading arrangements that are in force between countries and the consolidation of Regional trading blocs. At present, USA offers duty- free access to apparel originating from 33 developing countries in America and Africa under the CBTPA and the African Growth Opportunity Act (AGOA).

3. Five Year Strategic Plan for the Sri Lankan Apparel Industry (2002 – 2007)

The removal of quotas in December 2004 came as no surprise to the industry as it was the culmination of a process that was taking place over a decade. The industry acted proactively by formulating a strategic plan in June 2002 that would guide the development of the industry until 2007. Several

stakeholders participated in the strategy making process and the plan was drawn up taking into account the vast changes occurring in the industry environment, particularly in retailing. The strengths and weaknesses of the local industry as well as the opportunities and threats facing it, as documented in the 5-Year plan, are listed in Table 3.

Taking note of the changes taking place in global retailing arrangements, the strategic plan envisions the transformation of the industry 'from a manufacturer to a provider of a fully integrated service'. The goal is 'to increase the Sri Lankan apparel industry turnover from its present level of US $ 2.3 bn to US $ 4.5 bn. by 2007 (5-Year Strategy, 2002: p.24). In order to accomplish this goal, the plan envisages initiatives at three levels viz., national, industry, and firm levels.

The report states that at a macro level, initiatives are needed in several areas viz., reduction in the cost of utilities, labour reforms, development of EDI facilities at the Port and at Customs, infrastructure development, and building strong lobbies in Sri Lanka's main markets such as USA, UK, Belgium and India.

At industry level, the document recognizes the need for focused branding and promotion, R&D, market intelligence, and greater market diversification. It also recognises the need for backward integration, technological upgrading, and building design and product development skills. Of special importance is the urgent need to enhance productivity and the reduction of lead times.

At the micro or firm level, the reduction of manufacturing cost, upgrading of technology and human resources and forging strong strategic alliances are envisaged. The Joint Apparel Association Forum (JAAF), is responsible for coordinating the implementation of the Plan.

Table 3: SWOT Analysis of the Sri Lankan Apparel Industry

STRENGTHS	WEAKNESSES
1. Reputation as a quality apparel manufacturer for the mass market. 2. Reputed international customer base. 3. Compliance with International Labour regulations. 4. Skilled and trainable labour force.	1. Geographic location – distance from end-market. 2. Limited knowledge about global industry developments. 3. High dependence on buying offices. 4. Limited market diversification. 5. Insufficient international and bi-lateral trade agreements to support the industry. 6. Increasing cost of labour. 7. Limited backward integration. 8. Non-existence of product design and new product developments. 9. Non-existence of a Sri Lankan brand identity. 10. No focused marketing strategy. 11. Low productivity of labour. 12. Limited access to technology. 13. The relatively high cost of utilities. 14. Poor domestic infrastructure. 15. Procedural delays and trade documentation inefficiencies.
OPPORTUNITIES	**THREATS**
1. Become a total service provider for the global apparel industry. 2. Removal of quota restrictions. 3. Promote Sri Lanka as a socially responsible manufacturer of apparel. 4. Free Trade Agreement (FTA) with India. 5. Transition to products that require a high labour content.	1. Rapid changes in the retailing industry. 2. Removal of the Quota System. 3. The former Socialist countries and East European nations' potential to become major suppliers to the EU Market. 4. Global formation of bi-lateral and multi-lateral trade blocs. 5. New entrants to the industry.

Source: JAAF (2002): pp. 15-16.

4. Strategic Options for the Sri Lankan Garment Industry

The rapid transformation that is taking place in the global apparel industry exerts tremendous pressure on individual firms to be more competitive, for 'it is firms and not nations that actually compete for market share' (Porter, 1985). There is heavy pressure on prices, with buyers demanding lower prices and more value added services. Ultimately, only quality garments offered at competitive prices combined with exceptional service would help manufacturers to remain in business.

In developing strategy, the key issues that come to the fore are the direction that a firm should take and its positioning in the competitive market place. The ensuing section describes some strategic initiatives that are needed first at firm/industry level, followed by national and regional level initiatives.

4.1 Formulating a Generic Strategy

For the purpose of crafting strategy, industry practitioners have a rich body of literature available to them in the area of strategic management. According to Porter (1985), a firm that operates in a competitive market must develop a basis of sustainable competitive advantage in order to be successful. This advantage could be anchored on one of two bases – low cost or differentiation, which may then be applied to the entire market or to a niche. Cost leadership is the ability of a firm to become the low cost producer in the industry enabling it to deliver the same value to the customer at a lower price. Differentiation is the ability of a firm to identify one or more attributes that buyers would value in a product, uniquely position to meet those needs and be rewarded with a price premium (Exhibit 1).

In Porter's view, cost leadership and differentiation are mutually exclusive strategies as their implementation calls for very different capabilities. Cost

Exhibit 1: Porter's Generic Strategies

	Competitiveness Advantage	
	Low Cost	Differentiation
Broad Market	1 Cost Leadership	2 Differentiation
Narrow Market	3 A Cost Focus	3 B Differentiation Focus

Source: Porter, 1985: p. 12.

leadership requires a firm to have process engineering skills to reduce cost at each point in the value chain, while a differentiation strategy requires product engineering skills to add distinctive features to the product offer. Industry practitioners confirm that a successful move from the manufacture of basic to fashion garments does indeed call for very different operative skills, in addition to the many specialized machines and materials that have to be used (Fonseka and Fonseka, SLJM, 1998: p.286). Porter insists that a firm must make a fundamental strategic decision whether it should strive to become a low cost producer, a differentiator or a focuser. Failure to do so results in a firm getting 'stuck in the middle' and having to be content with low profitability.

The basis on which Sri Lanka intends to anchor its competitive advantage is not clear. Currently, only 10 per cent of the manufacture ends up in specialty brands while 50 per cent is taken up by department stores and the balance 40 per cent by discount stores (Kelegama and Wijayasiri, 2004: p.41). The bulk of the Sri Lankan factories supply basic garments to the lower end of the global apparel market which is characterized by a

proliferation of suppliers. It is a highly price-sensitive segment where manufacturers have little freedom to bargain on price. Manufacturers, often, have to contend with oversupply situations that exert strong downward pressure on price. The industry has already conceded that it cannot be a low cost producer, in the face of competition from countries such as Bangladesh, Vietnam and China. By aspiring to be a 'total service provider', the industry believes that it is pursuing a differentiation strategy.

Obviously, the extra activities taken on by firms add to their costs. Differentiation will be profitable only when the extra price the product can command exceeds the added costs of achieving differentiation. In addition, all firms including the ones supplying high value apparel, have to reflect deeply whether the above strategy can be easily imitated by competitors, in which case the advantage is not likely to be sustained. It is a well-known fact that unlike Sri Lanka, the Far East already has an established infrastructure to provide full package imports to US buyers.

In formulating strategy, it would be pertinent for apparel firms to reflect whether they are implementing their own strategies or whether they are merely implementing the strategy of foreign intermediaries. Unfortunately, there is no autonomous strategy development on the part of local firms. The relationship that exists between the local manufacturer and the foreign distributor is a weak one, where the latter would unhesitatingly switch his purchases to another supplier who offers better terms. Innovative design development and branding or setting up retail outlets are considered as non-feasible for the period under review. Firms need to think long term. Otherwise, they will continue as 'cut and sew entities', a position that would not be easy to defend in the new competitive environment.

4.2 Provide a Fully Integrated Service

The Sri Lankan industry aspires to be a 'total service provider' for reputed retailers which is a progressive step, although it falls far short of the more desirable state of moving towards autonomous design and brand development. Nevertheless, it is an important step forward because 'cut and sew entities' are attempting to undertake several additional activities such as product development, procurement of materials, and even shipping and delivery of merchandise to the retailer's store. It is also a challenging goal because apparel firms have to invest in supply chain management technologies. More buyers want manufacturers to integrate their production and shipping data with their own systems to facilitate easy tracking and inventory management. However, only a few firms have done so to date. Full package suppliers must be financially strong to assume these added responsibilities.

Furthermore, it is claimed that about 65 per cent of the country's apparel exports is still being handled by buying offices, which means that the development of direct links with retailers is taking place far too slowly. In the face of retailer concentration, it is necessary for local firms to forge strategic links with key retailers. Only a few excellent companies such as those coming within the MAS Group or Brandix Lanka could count on such a record.

In the strategy document, the industry goal is to increase the turnover from US $ 2.3 billion in 2001 to US $ 4.5 billion by 2007. This is tantamount to a doubling of the industry turnover within the 5-year period, proposed to be achieved through a 12 per cent growth rate each year. The industry achieved high annual growth rates of 18.5 per cent over a twelve year period from 1989- 2000 and so the revised target was considered to be pragmatic in the context of the fast-changing industry landscape. It certainly appeared to be more realistic than the industry target set in 1998 which was to increase the

turnover from US $ 2 billion to US $ 8 billion by 2005 (*Daily News*, 3 March 1998). However, export income earned over the past few years (viz., 2002- US $ 2.2 billion and 2004- US $ 2.6 billion) suggests that the target of US $ 4.5 billion set for 2007 would be difficult to achieve (Table 4). Good strategizing involves working out the details of prospective markets and the product mix in each market to achieve the target. A simple extrapolation based on past statistics is not a sound technique to adopt for an industry that is undergoing rapid transformation. The industry would find it useful to re-visit the strategic plan and examine why targets are not being achieved as planned.

Table 4: Sri Lanka's Garment Exports in Terms of Volume and Value 2000- 2004

Year	Qty Mn. Pieces	Value US $ Mn.
2000	468.38	2710.69
2001	436.03	2334.64
2002	422.92	2247.92
2003	446.00	2400.00
2004	479.00	2645.20

Sources: Sri Lanka Garments, No.80, 2002.
Central Bank, Annual Report, 2003 and 2004.

4.3 Developing a Unique Positioning Perspective

Sri Lanka as a country has gained a reputation as an ethical producer of apparel. In fact, the country received special duty concessions from February 2004 from EU under the Generalized System of Preferences (GSP) on her adherence to international labour standards. This provides a unique positioning perspective and a useful platform on which a strong industry

image could be built. International certification should be sought for the symbol which must then be promoted to the consumer.

4.4 Strategy of Market Diversification

A key objective set for the industry during the planning period is market diversification. Statistics show that 95 per cent of the country's apparel has been regularly exported to two principal markets viz. USA (61 per cent) and EU (34 per cent).Of the exports to EU, two- thirds has been going to UK. This heavy concentration and dependence on two markets has been a long-standing weakness of the local industry because any adverse developments in either market would have a strong negative impact on the industry and the national economy. However, export data presented in Table 5 show that the much-needed change is not taking place at the desired pace. Greater exertions must be made in EU countries to widen those markets as well as develop new markets. Also, with the Indo-Lanka Free Trade Agreement in operation, manufacturers of fashion wear and ladies' foundation garments in particular, must utilize the opportunity remembering that India has over 250 million people in the high and middle income groups.

Table 5: Major Export Markets for Sri Lankan Garments: (% Value)

Country	2000	2001	2002	2003	2004
USA	62.0	64.0	63.50	61.3	58.0
EU	32.8	30.2	31.25	32.4	37.0
Others	5.2	5.5	5.25	6.3	5.0
Total	100.0	100.0	100.00	100.0	100.0

Sources: Sri Lanka Garments, Vol. 80, 2002.
Central Bank of Sri Lanka, 2003 and 2004.

4.5 Strategy of Product Specialization

The industry could benefit by paying greater attention to product specialization. Bangladesh, for example, has large factories that specialize in shirt manufacture alone and this contributes to product expertise. The local industry too has recognized the need to focus its efforts on specific product categories so that it could achieve an international repute in the manufacture of these products viz., active and sports wear (gym wear), casual wear, children's wear and intimate apparel. It may be useful to add to this list, bridal wear, where there are not many manufacturers. The industry must strive to become internationally recognized in specific product categories. The move must be towards greater product specialization.

4.6 Factory – Level Initiatives

A great deal of work has to be done at factory–level in order to make them high-performing units. There is a need for continuous upgrading of technology. Several publications refer to the fact that overall cost structures are high and productivity levels are low relative to competitors (Central Bank Annual Report, 2002; Fonseka, 2002: p.131; Kelegama and Epaarachchi, 2002: p.207). These shortcomings have to be rectified as a matter of urgency if the firms are to survive in the new environment. Of special concern is the 'excess fat' that each factory carries by way of the large number of indirect workers in their cadres. Local factories are basically production facilities and do not undertake any design development or marketing activities. It is patently clear that most of the value added is created by factory operatives. Hence, carrying a disproportionate number of indirect workers only adds to cost, which could jeopardize the very survival of these firms. After being protected under the quota umbrella for many years, garment factories have added unnecessary overheads which would be difficult to trim quickly and would come as a rude awakening for manufacturers who have been assured of high prices to date.

5. Role of Government

Government has lent its hand to support the country's apparel industry. However, the government could further help the industry by seeking preferential access to markets, improving infrastructure, introducing labour reforms, streamlining the work of government institutions and controlling the rising cost of utilities. The progress achieved in these areas has been far too slow.

6. Re-position the Industry from a South Asian Context

A salient feature of apparel retailing, particularly in USA, has been the trend towards increasing concentration giving the retailer more buying power and greater bargaining power over producers. During the last decade, the share of discounters (e.g., Walmart) and vertically integrated specialty stores (e.g., Nike) grew by around 10 per cent, with the result that they command almost 40 per cent share in both US and EU (McKinsey and Co., 2004: p.7). At the same time, large and mid-sized retailers from USA are realizing that Asia is the region from which merchandise should be sourced because Mexico and Central American countries are relatively high- cost producers despite the duty concessions they have received from USA. KSA Technopak (2005) observes that India, Pakistan, Sri Lanka and Bangladesh have the potential to create the second largest trade bloc for apparel after East Asia.

Although they are competitors at present, they have several complementary strengths to draw upon to face the new competition. India has a large raw material base, a skilled workforce and significant design expertise. Pakistan has a large cotton base, and is globally competitive for men's apparel. Bangladesh has low wage rates and is competitive for mass-produced garments. Sri Lanka has skills in specialty and high-value garments like

lingerie and knits, but is dependent on imported fabric. A report by RIS (2004), states that the region as a whole could meet the challenge collectively if it pursued horizontal integration i.e., cooperation in the same or similar lines of production and exports. Such a South Asian strategy envisages a particular South Asian country that has gained export specialization in certain textile or clothing product lines acting as a host for relocated plants from other South Asian countries. In this way, the textile and clothing sector can become a regionally integrated sector as countries vacate certain lines of production and gain in other lines of production according to their relative competitive advantage in the global market.

As the above move is likely to take time, local manufacturers must attempt to forge partnerships with retailers who are making rapid progress in the market.

6.1 Brand Development through Joint Investment

In the global apparel trade, brand ownership and marketing arrangements have been closely controlled by buyers and much of the value addition in garments takes place at these two stages. The same report (RIS, 2004: p.36) states:

> South Asian countries should consider setting up South Asian level mega-companies to foster an integrated South Asian garment sector. In order to secure their market overseas and to realize a greater proportion of value added, the South Asian exporters should consider taking over a few marketing and distribution chains in their lines of production in developed countries. Given the scale of resources involved in such takeovers, it may be beyond the capacity of individual exporting companies or individual member countries. However, this could be done by forming a regional consortium of the South Asian exporters.

The writer's observation is that these two useful ideas contained in the RIS report will take long to materialize given the strong inclination of local players as well as other South Asian countries to resort to individualist play rather than collective action. The development of a shared vision with an implementation agenda is bound to be a time- consuming exercise.

7. Conclusion

This study described the intensely competitive environment in which the local industry has to operate and the daunting challenges facing it. Several strategic options that could be adopted for industry survival, both at micro and macro levels, were presented in the study. It has to be noted, however, that strategies that are easily imitable by rivals cannot ensure the long term sustainability of the industry. Implementation of the already identified strategies that have already been identified such as building strategic partnerships with key retailers, market diversification and productivity improvement has been relatively slow. The industry cannot afford to be complacent looking at the tardy progress registered by some nations or taking comfort in restraints imposed on China. In the final analysis, only quality merchandise offered at competitive prices coupled with exceptional service would enable manufacturers to remain in business. The Sri Lankan garment industry has achieved progress but has to act more speedily to develop its innate and inherent strengths in order to face the new competition.

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9

Social Protection and Decent Work in Textiles and Clothing in Sri Lanka

Esther Busser

Worldwide, 188 million people are unemployed. At the same time, half of the working population live on less than 2 dollar a day and work long hours for poverty wages. Eighty per cent of the world population has no adequate social protection. Over two million women and men die each year from unsustainable forms of work, and 160 million more become victims of work-related diseases. Over 250 million child labourers are being exploited for profit or are forced to work in order to survive. Whole generations of children are being deprived of the chance to take their rightful place in the society and economy of the 21st Century. Between 100 and several hundred trade unionists are killed each year. Several thousands more are imprisoned, beaten in demonstrations, tortured by security forces or others, and often sentenced to long prison terms. Each year, hundreds of thousands of workers lose their jobs merely for attempting to organise a trade union. Worldwide income inequalities have increased in most countries, both in developed and developing countries.

These figures show that there are serious shortcomings in the way globalization currently takes place. Therefore, the global economy has to be organised in a way that it contributes to more equality between developed and developing countries, and to more equality between groups within countries. Globalization has to become more inclusive and beneficial for those who are unable to share in its benefits. Therefore employment, and

more specifically decent employment, should be at the centre of national and international policies.

This chapter looks at the decent work agenda as being promoted by the ILO and the relevance for the textiles and clothing sector, in particular after the phase-out of quotas in textiles and clothing at the beginning of 2005. It argues that the decent work concept should be integrated into any adjustment process undertaken by the industry and into government strategies dealing with the phase-out.

1. ILO Decent Work Agenda

The ILO tripartite constituents (governments, employers and workers) adopted the decent work agenda in 1999 to address the decent work deficit. Decent work involves "opportunities for work that is productive and delivers a fair income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom for people to express their concerns, organize and participate in the decisions that affect their lives and equality of opportunity and treatment for all women and men". Decent work is based on a broad perspective that – in addition to fundamental workers' rights - includes not only decent wages, but also a sound working environment and fair working conditions, with a particular emphasis on women-friendly policies negotiated among the parties. Decent work is central to efforts to reduce poverty, and a means for achieving equitable, inclusive and sustainable development.

The Decent Work agenda is based on four strategic objectives or pillars: (i) Standards and fundamental principles and rights at work, (ii) employment, (iii) social protection, and (iv) social dialogue. In each of these areas people worldwide face deficits and gaps, such as unemployment, underemployment, poor quality and unproductive jobs, unsafe work,

insecure income, denial of rights, gender inequality, exploitation, lack of representation, inadequate protection in case of disease, disability and old age, etc. The ILO has committed to promote the Decent Work agenda through Decent Work Country Programmes (DWCPs) at the national level, and through mobilization of multilateral actors at the global level for policy coherence. The decent work country programmes[1] have two objectives: they promote decent work as key component of development policies and provide a framework for identifying priority areas for action. Their implementation should lead to decent work becoming a nationally shared policy objective for governments, social partners, other local actors and cooperating agencies. They derive their authority from being based on tripartism and social dialogue, and being formulated in gender sensitive terms.

2. Four Pillars of Decent Work

The first pillar of Decent Work is the promotion and realization of standards and fundamental principles and rights at work. These include, but are not limited to, the eight core ILO Conventions. (i) Freedom of association and the right to organise (Convention No. 87) and the right to organise and collective bargaining (Convention No.98); (ii) Non-discrimination in employment and occupation (Convention No.111) and equal remuneration (equal pay for work of equal value) (Convention No.100); (iii) Elimination of forced labour (Conventions No. 29 and 105); and (iv) eradication of child labour (Conventions No.138 and 182).

The second pillar is employment, under the objective to create greater opportunities for women and men to secure decent employment and income. Recently the ILO Governing Body has adopted the Global Employment Agenda as the implementing tool for achieving decent jobs: it promotes

[1] ILO circular No. 599, April 2004.

employment policies respecting fundamental principles and rights at work, the extension of social protection and the development of mechanisms for social dialogue.

The third pillar of the Decent Work paradigm is social protection with the aim to enhance the coverage and effectiveness of social protection for all. The various elements include: sound working conditions, occupational health and safety, respect for human dignity, family and social values. It also includes provisions for adequate compensation for lost or reduced income in case of unemployment or illness, pension provisions, access to adequate social and health services, and respect to free time and rest.

The fourth element of Decent Work is social dialogue and the strengthening of tripartism. Social dialogue, and in particular collective bargaining, is beneficial for both workers and management who can decide jointly on issues such as productivity or working conditions. Social dialogue is a basis for restructuring and change and one of its core components is the willingness from the different partners to share concerns and information.

3. Social Protection

In order to attain a sustainable globalization, the social protection coverage needs to be improved and extended in all its dimensions, including income security, pensions and retirement, health and safety at work, and working conditions. In many countries the priorities are safety and health at work, health insurance, reinforcement of existing schemes and wider coverage, in particular extension to small enterprises and the informal economy. Social protection objectives need to be included in development policies, and it is clear that social protection comes with a cost.

The main area of social protection is social security,[2&3] which includes income security, employment security, job security, labour market security, occupational health and safety security, and skill development security. These insecurities can be addressed by establishing among others minimum income schemes, unemployment benefit schemes, care work regimes, pension schemes and health insurance.

Social security is not only very important for the well-being of workers and their families, but it also enhances productivity, it supports economic development and can prevent or reduce poverty.

Social security coverage is low. Only twenty per cent of the population worldwide receives adequate social security. Therefore improving and extending social security coverage is a main challenge. Existing schemes can be extended to a larger part of the population, whereas new schemes can improve the coverage of insecurities that were not covered so far. Access to health care and related health insurance is one of the most urgently identified needs.

The way such schemes are developed depends largely on the existence of government resources. While small insurance schemes (including micro-insurance) have been developed to cover at least part of the population, universal schemes however are preferable as they allow coverage of all those in need. Unemployment benefits are also considered very important and are linked to addressing the more short-term needs in case of job losses,

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[2] ILO Social Security Conventions include the Social Security (Minimum Standards) Convention (No. 102), the Equality of Treatment (Social Security) Convention (No. 118), the Employment Injury Benefits Convention (No. 121), the Invalidity, Old-Age and Survivors ' Benefits Convention (No. 128), the Medical Care and Sickness Benefits Convention (No. 130), the Maintenance of Social Security Rights Convention (No. 157), the Employment Promotion and Protection against Unemployment Convention (No. 168), and the Maternity Protection Convention (No. 183).

[3] Social Security, A New Consensus, ILO, 2001.

and they are particularly necessary in light of increased flexibility and casualization of labour. Many of these social security schemes exclude informal economy workers and the self-employed. Small schemes are often introduced to address the needs of these groups, which ideally should be covered by universal schemes.

The social partners (employers and trade unions) have a strong role to play in the management of social security and governments have to create a regulatory framework that encourages tripartite consultations.

Social security also has to include gender equality. Some social security systems directly discriminate against women, whereas others indirectly increase inequality. Measures aimed at equitable outcomes have to take into account for example a lifetime of lower pay for women, and career interruptions for maternity, childcare and elder care. Women receive less education and training than men and are more likely to be engaged in part-time or casual work. Because of these factors, benefits based on employment result in poorer outcomes for women and also impact negatively on their pension entitlements. The right to social security needs to be an individual right, and some positive action is needed as well to redress these inequalities. Social security payments should also be made during maternity leave and periods of childcare and elder care.

The main objective therefore is to increase decent employment in the formal economy, to increase the number of protected people, and to increase the financing basis for social security.

Another area of social protection is labour protection. It is important that basic protection is available for all workers and, that workers in hazardous conditions are protected. Governments need to design and implement effective prevention programmes. Protection is not only a rights issue, better protection pays off as well.

The conditions of work include working time and work organization and it is clear that increased competition has led to flexibilization of contracts (part-time, shift and night work, "on-call" work). Other concerns include issues such as work and family, maternity protection, improving working conditions of rural workers and workers in small enterprises as well as sexual harassment and violence at work.

4. Textiles

The textiles and clothing sector is characterised by a set of players[4], including retailers and brand companies on the one end, and a large number of producers such as factories, sweatshops and homeworkers on the other end. In between, one finds the traders of textiles and clothing such as buying offices, buying houses, and agents. Production is organised along the so-called supply chain, where orders are placed with intermediaries, which place them with producers and which outsource them to smaller factories and on to sweatshops and homeworkers for the more simple actions such as CMT (Cut Make Trim). This way of subcontracting orders makes it difficult to trace clothing and to verify respect for labour standards along the supply chain. It therefore offered an opportunity for companies to make use of cheap labour in developing countries and to disregard respect for labour standards. At the same time the supply of unskilled and cheap labour is huge in developing countries, and therefore puts a downward pressure on wages.

Several initiatives have been taken to improve working conditions and wages in textiles and clothing through pressure on companies by consumer or

[4] ITGLWF Africa / IRENE, Asian Multinationals in Africa, Information and Strategy guide, 2005.

stakeholder action, however, there exists a tension between requirements of textiles and clothing companies on the one hand and producers on the other. Producers are asked to respect labour standards and provide decent working conditions to its employees, but at the same time they are asked to deliver quality goods at very tight deadlines and at very low costs. Producers have therefore tried to cut costs through lower wages, through the use of regular overtime work to meet deadlines, and by cutting wages in case of mistakes or illness (wage penalties). At the same time, the reality in textiles and clothing is that relocation of companies depends on a number of factors, not just on production costs, investment climate, and political and economic stability, but also on criteria of social nature, such as flexibility and good governance.[5] Delivery targets are tight, quality needs to be high, brand companies need to preserve their image, and consumers increasingly demand products that are produced under decent conditions.

The MFA, which had distributed quotas among countries for exports of textiles and clothing, has led to production in countries that were not necessarily competitive in a liberalised environment and has prevented many of these industries from becoming competitive, even during the phase-out period. Therefore, the current quota phase-out is likely to rearrange some production around the globe. Those countries that are competitive will take up a larger share of exports, whereas those that are not will lose some. The exact impacts are difficult to estimate, but in 2004 and the first three months of 2005 have shown quite some shifts already. The share of China in imports in developed countries is growing and attains quite impressive numbers. A number of countries are looking into possible safeguards, such as the US and the EU, whereas others have set up the legal framework for the application of safeguards, such as Argentina. Turkey has already set up safeguards in 42 categories.

[5] ILO, Decent work pilot programme, country brief Morocco.

Furthermore, many company closures and declines in orders have been announced in many countries already. Other companies expect orders to dry up later in 2005. This of course has a major impact on workers employed in these companies, on their income, but also on those that remain employed, as pressure will increase to be more competitive. And even if companies are not immediately threatened with closure, employers put increasing pressure on workers and use the phase-out to undo the little bit of protection there often is in this sector. Employers also pressure governments to make legislative changes, which have already taken place recently, such as the exclusion of textiles and clothing industries from regular labour legislation, the exclusion of the textiles and clothing sector from minimum wages, and the adoption of legislation that increases the maximum number of legal working hours.

This is clearly not a sustainable way of producing, and instead of cutting wages, and increasing working hours and overtime work, companies should start increasing productivity of workers, improving social dialogue, preserving and creating jobs, developing human resources, strengthening social protection, and developing new patterns of management and labour relations. Tripartism is a key in improving the competitiveness of the sector. All stakeholders, government, employers and workers have to work towards the same objective of industry-upgrading, including improvement of skills, social protection and working conditions, in order to remain competitive in the long run. In other words, the decent work agenda in textiles and clothing needs to be promoted. The demands for quality products and quick delivery, together with the pressure from consumers for respect for workers' rights will in itself demand improved working conditions, an increase in productivity and dialogue amongst employers and workers to put up with these demands.

But this will not be enough. There is also a need to look at the issue of preference erosion in tariff liberalization in textiles and clothing, which is

the only possibility left to provide preferential access for textiles and clothing imports from a number of smaller developing and least developed countries to developed country markets. The NAMA negotiations in this regard should not lead to complete tariff elimination in this sector, nor lead to substantial tariff reductions if any benefits for those countries are to remain. In addition, the strict rules of origin need to be addressed that are part of those preferential agreements in order to increase the utilization rate of preferential access. Thirdly, developing countries are also facing large increases in textiles and clothing from some of the larger countries, in particular China, and should therefore be enabled and assisted in using safeguards[6] to prevent the closure of their textiles and clothing industry and to increase competitiveness. So a number of measures could be taken both in the area of trade policy and in the area of labour and social policies.

In the WTO a number of requests have been made last year by the LDCs, by Turkey and by a group of countries including Sri Lanka[7] to look at adjustment related issues and to set up a working group to deal with these concerns. However, a number of countries opposed the proposals, in particular China, and it was decided to undertake just a study that looks into ways to increase competitiveness of LDCs in textiles and clothing. The other initiative relates to the use of national technical seminars for the purpose of dealing with the adjustment of the phase-out. These seminars will be organised at the request of a developing country that faces adjustment problems in textiles and clothing, and addresses ways of dealing with adjustment, such as the use of safeguards, focus on rules of origin, coherence with World Bank and IMF, including the Trade Integration Mechanism (TIM).[8]

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[6] Such safeguards are provided for in China's WTO accession document.

[7] Document numbers: WTO: G/C/W/496/Rev.1 and G/C/W/497.

[8] The TIM was presented by the IMF last year and is a financing mechanism that allows for additional lending under existing loan arrangements to address the issue of adjustment due to trade liberalization.

At the same time, the ILO is undertaking Decent Work country programmes, focusing on decent work in specific sectors. A pilot programme is currently undertaken in Morocco, in textiles and clothing, which addresses the decent work deficit in this sector in Morocco. Three other countries have just started a similar programme, also focusing on textiles and clothing, the Dominican Republic, the Philippines and Romania.

The Moroccan programme[9] focuses on a number of decent work aspects that are particularly relevant for the textiles and clothing sector in that country, which is an important sector in Morocco. 70 per cent of employment in this sector is informal and child labour is prevalent. Precarious jobs are common in the sector with no job security. There is discrimination against women and a high illiteracy rate among workers. Working hours are long and include night work, short breaks, poor temperatures and noise conditions. Transportation time to the workplace is long. There is poor communication within enterprises and inefficient management. Minimum wages are a reference rather than an obligation, and female wages are 25 per cent lower than men's. Disputes in which unions take part have decreased or have become easier to resolve. Disputes without unions have increased and have become more hostile. And there is a lack of social protection.

In December 2003, a national action plan was adopted by the tripartite constituents with the aim to improve competitiveness of the textiles and clothing industry through the promotion of decent work, by responding to the challenges that globalization and trade liberalization impose. Activities have been launched to promote decent work through social dialogue, thus improving the quality and quantity of employment. These activities include: (i) Training on collective bargaining and dispute resolution; (ii) Training on productivity and occupational safety and health; (iii) The development of a

[9] Decent Work Pilot Programme, country brief, Morocco.

gender strategy by the social partners; (iv) The review of existing training programmes with a view to maximizing their impact and improving their coordination; (v) A rapid assessment of the prevalence of child labour; and (vi) The development of a social management upgrading project in a selected number of enterprises.

Social partners are increasingly aware that there is a close linkage between raising economic efficiency to meet the demands of global competitiveness on the one hand and social progress on the other. Improving the social climate is an important factor in raising productivity structurally and it is through empirical work that the concept of decent work can be developed.

5. Decent Work Deficits in Textiles[10]

Decent work deficits in textiles and clothing are generally widespread and include a lack of freedom of association, the right to organise and collective bargaining. Trade unions are often not allowed or repressed, and trade union membership is discouraged through intimidation of trade unionists and unfair dismissals on the basis of trade union membership. In addition, law enforcement is absent in many cases, and complaints are not dealt with at all, or very slowly. In many cases there are deficits in safety and health provisions and protection, with poor ventilation, hazardous working conditions, no safety protection, limits for toilet visits, limited breaks, and forced overtime. Sometimes workers are locked up in factories to finish orders. The work pace is generally very high, leading to injuries and chronic illnesses in some cases.

[10] Behind the Brand Names, Working Conditions and Labour Rights in Export Processing Zones, ICFTU, 2004.

Often, there are no social security benefits such as health insurance, pension payments, sickness benefits, and maternity benefits or, in some cases, payments made by employees through wage deductions "disappear". Employment policies are often based on attraction of foreign investment and provides for law exemptions or non-enforcement of labour laws. Discrimination of women is frequent, both in terms of wages and in terms of access to higher skilled jobs. Skills development is often absent. Furthermore, harassment of workers, including sexual harassment, occurs in many cases. In some cases women are dismissed in case of pregnancy. These conditions tend to be worse further down the supply chain, in particular among home workers and in the informal textiles and clothing companies that supply to the larger companies.

6. Decent Work Deficits in Textiles and Clothing in Sri Lanka

Quite a number of deficits can be identified in the textiles and clothing sector in Sri Lanka.[11]

First of all there is a problem with freedom of association and the right to collective bargaining in textiles and clothing in Sri Lanka. This is a serious shortcoming, as the right to organise and collective bargaining is a fundamental right, an enabling right, and the basis for any progress on working conditions, wages and social protection. The existing reluctance of employers in particularly in FTZs to recognise trade unions and to negotiate with trade unions is a major problem. Both employers and the government have an active role to play in changing the current situation. In addition the Board of Investment in Sri Lanka, which is particularly anti-trade union, should stay away from labour issues, as this should not be their task as

[11] Based on a field visit in September 2004 and "Rights Denied" by Kelly Dent and Anton Markus, May 2002.

promoter and regulator of investments in Sri Lanka. Other problems such as those related to trade union certification polls for collective bargaining have to be addressed, and there is also a need to address the slow judiciary process and to ensure that complaints are handled in an expedite manner.

Secondly, there are clear indications that discrimination in employment and wages are common, paying women less than men for work of equal value.

With regard to the available employment there is no job security and wages are low. Overtime is often required to make a decent living. Workers are frequently penalized through wage reductions for reasons such as sickness, being late, refusing compulsory overtime or not reaching production targets.

With regard to social protection the production of textiles and clothing is characterised by substantial use of overtime work, in many cases forced overtime, of up to 60 hours per month. Labour laws are often not implemented, legal entitlements denied, and leave is difficult to take. Occupational safety and health practices are almost non-existent or very poor. There are time limits for toilet use. Harassment of women workers is frequent, both in the workplace and on their way to work.

Social dialogue has been poor in Sri Lanka, in particular in textiles and clothing, and especially in the Free Trade Zones in Sri Lanka. The EU-GSP road map has contributed to make a start on this so much needed tripartite dialogue and this process should therefore continue.

And finally, living conditions around FTZs are rather poor, with a lack of transport facilities, water, and energy. Housing is poor and ventilation and sanitation inadequate.

7. Some Recommendations with Regard to Decent Work in Sri Lanka

This section will provide some areas that need to be addressed in Sri Lanka in dealing with the challenges posed by the phase-out of textiles and clothing quota. First of all, the freedom to set up independent trade unions and the right to collective bargaining will be key elements in Sri Lanka in any attempt to move to a more competitive sector. While it is clear that tensions are present, the start of tripartite consultations as part of the EU-GSP Road Map consultations, which started at the end of 2004 – and which include Government (relevant ministries), employers and trade unions - could form the basis for a focus on the textiles and clothing sector and the challenges that are faced here. It is therefore important that trade unions in textiles and clothing are recognised and respected, which are necessary conditions to move to a decent work agenda in textiles and clothing. Recognition and confidence have to be developed and have to be reciprocal. Assistance (from the ILO) has to be provided that allows the stakeholders to participate effectively in consultations and negotiations. Existing conflicts have to be analysed and put into broader perspective. Communication and information sharing within companies, between the employers and workers, has to be improved. Furthermore, mechanisms for internal conflicts have to be improved, with the involvement of trade unions.

Employment policies should first of all try to prevent any retrenchment, through employment in a subsidiary, retraining of staff, shorter working hours or extended leave periods. Alternatives could also include voluntary (but it has to be really voluntary) termination with appropriate compensation. Retrenchment policies should be developed on the basis of dialogue between the employer and trade union, and on a model retrenchment policy, based on good practice, with national legislation providing a minimum basis.

The Termination of Employment of Workmen Act provides for compensation for workers who have worked for 6 months or more in Sri Lanka. This should be lowered, and compensation should be extended to as many as workers as possible. Important is also to monitor pension payments and employees contributions. Sometimes these are not paid (especially in the case of overtime work).

Overnight closures have to be addressed and the government should trace down such overseas investors, while at the same time establishing a fund to pay compensation to the workers.

The legal machinery in Sri Lanka needs to be reinforced in order to enforce effectively the existing legislation and to address adequately disputes that arise.

Another important strategy is to improve the image of the sector at the international level and to include the international buyers in dialogue at the national level in identifying strategies to improve competitiveness through decent work.

The existing relation with the European Union under the GSP has an important role to play as well, and one of the objectives should therefore be to aim for continuation of GSP benefits through compliance with core labour standards. This would include a continuation of tripartite consultations within the framework provided for by the Road Map.

More links between the formal textiles and clothing sector, and the informal and unprotected workers in textiles and clothing in Sri Lanka have to be made in order to improve working conditions in the informal economy. Partnerships and increased productivity through improved working conditions are some examples in this respect.

Given the large proportion of women employed in textiles and clothing in Sri Lanka, their challenges have to be addressed in particular. Not only in terms of equal access to employment (in particular higher skilled jobs in textiles and clothing) and equal payment, but also specific training needs have to be addressed, equality in training has to be ensured (including in higher level programmes), social protection needs of women (including maternity benefits and equal pension and health insurance provisions), sexual harassment in the workplace and on the way to work needs to be addressed. The position of women in trade unions and employers organizations has to be reinforced. And the image of apparel workers needs to be improved.

Social protection should be improved, including in the informal textile and clothing companies. Specific social protection and social security needs have to be identified in both formal and informal economy and appropriate mechanisms have to be developed. These can include the need for example, for unemployment benefits for unprotected workers and health insurance.

Safety and health deficits at the workplace need to be addressed and the contribution of their improvement to productivity should be stressed. Importance should be given to prevention of accidents, but also to improvement of hazardous existing situations. Workers have to be involved in decision making that affects the conditions in the workplace.

Retraining of retrenched workers has to be provided as well as placement of retrenched workers in other apparel industries or other industries and in self-employment. This requires the registration of workers and vacancies and involves job matching and training. Concerning training,[12] the government provides training through its Industrial Training Authority,

[12] ILO, Labour Practices in the Footwear, Leather, Textiles and Clothing Industries, 2000.

including an apprenticeship programme, and a skills development fund for the private sector. These training programmes would be an important tool to improve productivity and competitiveness, and workers should be consulted with regard to their needs. Many training programmes are offered by companies, so-called in-house training and are developed by employers. This training is often financed by trading partner countries, and focus on management skills, technical staff, quality control and production staff. It would be beneficial to give a more tripartite structure to such programmes, to improve skills of lower skilled staff and to ensure that gender equality is assured in such programmes.

8. Conclusions

- The current challenges in textiles and clothing demand increased productivity in an extremely competitive environment, which will depend on motivation and commitment of workers. This is only possible if workers receive adequate stability and security through decent wages, social protection and possibilities to improve. Strategies that focus on lowering wages and working conditions are not sustainable in the long term. At the same time, there is an increased need to promote the respect for fundamental workers' rights more widely, to avoid the undercutting of decent work efforts made by some countries and some companies.
- Freedom of association and collective bargaining, together with social dialogue will be the key determinants for upgrading the textiles and clothing industry in Sri Lanka, and to move into a path of sustainable production. Without such dialogue, consultations, respect for workers rights and trade unions, it will be difficult to improve working conditions, productivity and quality in textiles and clothing companies.
- Given the large number of women working in the textiles and clothing industry, the discrimination of women workers in employment, wages,

maternity protection and health and safety has to be addressed and specific measures have to be taken.

- Social protection (safety and health, unemployment benefits, health insurance, pensions) has to be extended and improved, and has to include unprotected workers in the informal textiles and clothing economy.
- Progress on the EU-GSP so-called Roadmap has to continue, with involvement of the relevant Ministries, employers and trade unions, in addressing in particular the existing problems in the area of core labour standards such as freedom of association and collective bargaining, the interfering role of the BOI, trade union certification polls and the filing of complaints. Success in these areas will form the basis for the introduction of a Decent Work agenda in textiles and clothing, as several of the problem areas that are addressed in the Roadmap are directly linked to decent work deficits in textiles and clothing.
- Two international initiatives to improve competitiveness in the textiles and clothing sector exist, one by the ILO, through Decent Work country programmes, and another one by the WTO, through national technical seminars. In order to address the phase-out of quotas, the government of Sri Lanka should ask for assistance, both from the ILO and the WTO, to deal with adjustment problems in the trade related area and the social area, and set up a programme with the assistance of both multilateral institutions, but also World Bank and IMF, and all relevant national stakeholders (in particular the relevant Ministries, employers and trade unions in the textiles and clothing sector) in order to move forward the decent work agenda, whereas at the same time addressing issues such as rules of origin and safeguards. Such a comprehensive programme with coordination among all actors involved will be able to bring benefits to all stakeholders concerned and address the need for policy coherence, which is recognized by all international institutions.

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Appendices

Appendix I

Impact of the Expiry of the MFA on the EU Industry: A Note

Roshan Lyman

Chinese textiles and garments have flooded the EU market following the expiry of the MFA. A comparison between the first quarter of 2005 with the corresponding period in 2004 shows a dramatic increase of up to 534 per cent in Chinese exports to the EU of certain garment products. Percentage increases in exports to the EU of specific items were as follows:

- 64 per cent increase for flax and ramie yarns;
- 63 per cent increase for women's lingerie;
- 164 per cent increase for T-shirts;
- 413 per cent increase for men's trousers;
- 534 per cent increase for pullovers.

The European guidelines for permissible annual increases for the above categories were between 10 to 100 per cent.

Such increases in imports from China to the EU resulted in the loss of tens of thousands of jobs in the EU, leading EU Member States to believe that the European Industry should be protected from unfair competition. The general feeling among the European companies was that they cannot compete with China mainly due to unfair competition. Some of the reasons pointed out were:

- That artificially favourable exchange rates were applied;
- The low labour costs of its non-unionised workforce;

- State subsidies to industry;
- A lax copyright regime.

According to the European Commission, the excessive exports on the part of China to the EU is not only a problem for European industry but other garment exporting developing countries as well, due to the following reasons:

- Most wholesalers and retailers are bound to give their orders to a handful of countries that have a competitive advantage therefore China could grab most of the business of the garment-exporting developing countries.
- A substitution effect will eventually take place where the buyers will prefer to work with suppliers who are able to offer a full range of products, hence China again will benefit due to its manufacturing structure.
- Only countries that have economies of scale will get the orders and here again China has a major advantage due to its capacity to produce large quantities.

As per April 2005, the possible options that EU intended to explore were as follows:

- Plan for a formal investigation into this dramatic increase in exports through a market impact assessment;
- Conduct informal consultations with China before taking formal action;
- Remind China about the specific safeguard clause that is foreseen in China's protocol of accession to the WTO;
- Highlight that safeguard measures were permissible if products imported to the EU in increased quantities caused or threatened to cause market disruption to industry in the EU;

- If the investigation proved that market disruption has in fact taken place then formal consultations with the Chinese will be launched asking them to remedy the situation through quantitative export restrictions.

If at the end of 90 days no remedy is found the Commission could propose safeguard measures against China, and such measures would most likely be in the form of quantitative import restrictions.

Safeguard measures are permissible when:

- There are excessive imports into the EU market
- There is material injury or threat to domestic producers
- The Community interest is affected under the WTO plus system.

The legal basis for trade defence instruments is that:

- WTO regulates trade defence actions of its members;
- The WTO legislation is transposed into EU law;
- EU law goes beyond the WTO legislation in certain aspects;
- If the increase in imports to the EU market causes material injury or threat to domestic producers the EU is able to apply the safeguard clause.

Due to the above reasons the European Commission is confident that it has a clear legal basis to restrict the imports into the EU of excessive quantities of Chinese garment products and it will not hesitate to get to the bottom of this issue to ensure that there is fair competition.

Finally, it is the view of the European Commission that China should benefit from quota elimination but this has to be done progressively in order to have an orderly development of trade.

Appendix II

EU Scheme of Generalized System of Preferences (GSP)

Roshan Lyman

Background

The Generalized System of Preferences (GSP) is a scheme of the European Union which offers preferential access to products from developing countries entering the EU market by providing additional reductions in the import duty on the Most Favoured Nations (MFN) rate applicable to WTO member countries. As it is a unilateral arrangement, the developing countries are not required to provide any concessions in return to the EU. It is estimated that the new GSP scheme which became operational on 1 July 2005 will result in additional annual loss of customs revenue to the EU in the tune of Euro 2.2 billion.

How to Benefit from GSP

The benefits enjoyed by developing countries vary from product to product and from country groupings to country groupings. Once the correct benefit applicable to the particular country and the product is identified then one needs to check if the products qualify under the specific Rules of Origin (ROO) criteria. If it does, documentary evidence need to be produced by duly filling in the certificate of origin form A which needs to be authenticated by the Department of Commerce. This document, along with the standards shipping documents, need to be produced at the EU customs to benefit from the eligible reduced duty rate under the GSP scheme.

The Current GSP Scheme has five different Arrangements

- General Arrangement
- Special Incentive Arrangement for the protection of labour rights
- Special Incentive Arrangement for the protection of the environment
- Special Arrangement for LDCs
- Special Arrangement to combat drug production and trafficking

The General Arrangement is enjoyed by all eligible developing countries. The Special Incentive Arrangement for the protection of labour rights is applicable only to those countries that have complied with the core ILO labour standards. Moldova and Sri Lanka are the only countries who have qualified to benefit under this Arrangement. The Special Incentive Arrangement for the protection of environment is an arrangement available for countries that comply with the standards on tropical forest management. The Arrangement for LDCs offers duty-free access to most products originating from least developed countries (as categorized by the United Nations). The Arrangement to combat drug production and trafficking is available for countries that have been producing drugs and have taken steps to abandon it by moving into other sectors.

The New GSP Scheme came into operation by 1 July 2005 and it intends to reduce the above five Arrangements to just three. These are:

1. General Arrangement
2. Special Arrangement for sustainable development and good governance
3. Special Arrangement for least developed countries

1. The General Arrangement will offer the basic preferential treatment to beneficiary countries (close to 150 countries and 25 independent territories). Under the General Arrangement benefits differ according to sensitivity of products:
   - Close to 3300 non-sensitive products can enter duty-free;
   - Close to 3700 sensitive products enjoy import tariff reduction with no quantitative limitations.

2. The Special Arrangement for Sustainable Development and Good Governance will be given to countries that ratify and implement 16 international conventions (from Part A – see below) and 7 out of 11 international conventions (from Part B). By 31 December 2008 all 27 conventions will have to be ratified.

The conventions to be ratified and implemented under **Part A - Core Human Rights and Labour Rights UN/ILO Conventions** are as follows:

1. International Covenant on Civil and Political Rights
2. International Covenant on Economic, Social and Cultural Rights
3. International Convention on the Elimination of All Forms of Racial Discrimination
4. Convention on the Elimination of All Forms of Discrimination Against Women
5. Convention Against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment
6. Convention on the Rights of the Child
7. Convention on the Prevention and Punishment of the Crime of Genocide
8. Minimum Age for Admission to Employment (N° 138)
9. Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour (N° 182)

10. Abolition of Forced Labour Convention (N° 105)
11. Forced Compulsory Labour Convention (N° 29)
12. Equal Remuneration of Men and Women Workers for Work of Equal Value Convention (N° 100)
13. Discrimination in Respect of Employment and Occupation Convention (N° 111)
14. Freedom of Association and Protection of the Right to Organise Convention (N° 87)
15. Application of the Principles of the Right to Organise and to Bargain Collectively Convention (N°98).
16. International Convention on the Suppression and Punishment of the Crime of Apartheid

Part B – Conventions related to Environment and Governance Principles are as follows:

17. Montreal Protocol on Substances that Deplete the Ozone Layer
18. Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal
19. Stockholm Convention on Persistent Organic Pollutants
20. Convention on International Trade in Endangered Species
21. Convention on Biological Diversity
22. Cartagena Protocol on Biosafety
23. Kyoto Protocol to the UN Framework Convention on Climate Change
24. UN Single Convention on Narcotic Drugs (1961)
25. UN Convention on Psychotropic Substances (1971)
26. UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988)
27. Mexico UN Convention Against Corruption

3. With regard to the Special Arrangement for Least Developed Countries, traditionally the Least Developed Countries have received more favourable treatment than other developing countries. Accordingly, the EU's new GSP scheme will also continue to provide more favourable treatment to LDCs. 50 Least Developed Countries, as classified by the United Nations, will continue to benefit from this special treatment by receiving duty-free access for all products, except arms and ammunitions, without any quantitative restrictions. Some exceptions to this would be products such as banana, rice, sugar, etc., which will be eligible for reduced tariffs even if they originated from least developed countries.

Rules of Origin

To qualify for benefits under any of the above schemes under the GSP the products have to acquire originating status. Originating status is acquired if the product is wholly obtained from a beneficiary country or has undergone a required amount of value addition in the beneficiary country. Such value addition requirements vary from product to product.

Other variations or opportunities under the Rules of Origin are Bilateral Cumulation and SAARC Regional Cumulation. Bilateral Cumulation applies when components or raw materials are sourced from EU countries and processed in the beneficiary country beyond the minimum processing requirement, thus enabling the raw materials to also obtain origin status of the beneficiary country. For example, in the specific case of Sri Lanka under the SAARC Regional Cumulation, raw materials obtained from one of the SAARC countries (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka) and processed or value added in the Sri Lanka obtains the origin status of that Sri Lanka and thus will enjoy the benefits applicable to Sri Lanka.

Some countries in the SAARC and ASEAN regional groupings have shown interest in a super-regional cumulation enabling raw material from any of these two regional groupings to enjoy origin status in a beneficiary country upon the product undergoing the required amount of processing. In order for this proposal to be accepted by the EC all countries in both these regions need to agree on this. So far, this has not happened and no progress on this is expected in the near future.

The current procedures to determine Rules of Origin are complex, and since many countries also find it difficult to comply with the minimum value addition requirement provisions of ROO, the EU has decided to make the rules of origin more user friendly, and has already begun the revision process and is exploring the possibility of identifying a new system based on a system with a single, across-the-board criterion with a threshold of value-added in the beneficiary country. This new system intends to rebalance the rights and obligations of operators and administrations and develop instruments to ensure that beneficiary countries comply with their obligations (measures to improve evaluations, information flows and co-operation between EC and preferential partners).

Graduation

A beneficiary country will stop enjoying the benefits of the scheme when it is graduated. Graduation would occur when a particular country during 3 consecutive years is classified by the World Bank as a high income country or when the 5 largest sections of its GSP-covered imports to the EU represent less than 75 per cent of the GSP covered imports of the beneficiary country to the community. The removal of a country from the scheme will take place upon entry into force of this new regulation.

It is believed that following the abolition of MFA, graduation will regulate trade flows.

Sri Lanka is expected to gain considerably from the new scheme because it already qualifies for the special incentive arrangement for sustainable development & good governance.

SOUTH ASIA AFTER THE QUOTA SYSTEM:
IMPACT OF THE MFA PHASE-OUT

The quota system that was the basis of the Multi-Fibre Arrangement (MFA), and which governed trade in textile and clothing (T&C) for the last four decades came to an end on 31 December 2004. The MFA artificially repressed the exports of competitive larger countries that had the capacity to supply T&C in large quantities like India and Pakistan in South Asia. At the same time, by providing a guaranteed market access, the MFA assisted several smaller countries in South Asia like Sri Lanka, Bangladesh, and Nepal to build up their export-oriented T&C sectors. The T&C sector gradually occupied a key position in these economies accounting for large foreign exchange earnings and generating a large number of jobs.

The dawn of 2005 brought trade in T&C fully into the normal discipline of the WTO. Most studies have shown that the new regime will bring global welfare gains, but it is believed that the gains will be unevenly spread — smaller countries in South Asia will face an uphill task to reap the gains while the larger countries will gain without much difficulty. This book shows the preparatory work done by the South Asian countries for the quota phase-out period and measures taken by them to face the global challenge. It also highlights the new issues in global trade in the context of maintaining competitiveness of T&C of the South Asian region.

The book consists of nine chapters which include five South Asian case studies (India, Pakistan, Sri Lanka, Bangladesh, and Nepal). It also covers new market access issues such as social protection, decent work, Generalized System of Preferences-Plus scheme, and many others. The material in the book will be of interest to policy makers, academia, and those actively engaged and working in the T&C industry.

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