Competition or Complacency? Can the Phase-out of the Multi-Fiber Arrangement Spur Domestic Policy Reform in Asian Countries?

by Sanchita Saxena, Ph.D.

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Saxena’s current research extends her earlier work on the Multi-Fiber Arrangement, and focuses on the effects of trade liberalization in garments and textiles on smaller South Asian countries like Bangladesh and Sri Lanka.

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One recent study estimates that a 20-percent improvement in transaction costs—including time to market—as a result of improved port efficiency, fewer days to deliver imported inputs, and improvement in customs quality and infrastructure—could increase apparel exports by 75% in Bangladesh… In the long run, domestic reforms will determine the future of developing countries currently threatened by competition with China and India” (Bhattacharrya and Elliot 2005)

Introduction

As you are browsing through racks of clothing, pick up any item and look at the label. Chances are that the garment is made in China or India or Bangladesh or El Salvador…one of several countries other than the United States. Many clothing retailers, including those with familiar American labels, have set up operations overseas where most of the manufacturing takes place. Several countries in Asia and Latin America became popular destinations for retailers in large part due to the Multi-Fiber Arrangement (MFA), a system of quotas that governed much of the global market for textiles and apparel for more than thirty years.

The MFA, which began as a protectionist measure used to prevent the loss of textile and garment jobs in the U.S., Canada, and Europe, led to both positive and negative impacts in the developing world. On the one hand, “As a result, the quota system has provided many developing countries with access to markets they otherwise would likely not have achieved on the basis of competition” (Appelbaum 2004). Through quota allocations, each country was guaranteed a certain percentage of the U.S., Canadian, and European markets. However, according to Saxena and Wiebe, “…without the incentive of competition (due to this guarantee of market share), industries in many of these countries have had only limited incentives to invest in their physical or human capital resources and, consequently are not as efficient as they could be…” (2005).

In 2005 this system of quotas was finally phased-out. Early studies predicted that once the quotas were lifted and all WTO members would have unfettered access to the developed countries’ markets,
many of the ‘smaller’ Asian countries would drastically lose market share. However, the initial data does not demonstrate this; in fact, many countries including Bangladesh, Cambodia, and Pakistan have actually increased their garment exports (measured in both value and volume) to the United States. These early studies and simulations also predicted that China would benefit the most from the quota phase-out, as a surge of garment and textile exports were expected at the detriment of the smaller exporting countries (Avisse and Fouquin 2001; Diao and Somwaru 2001; Terra 2001).[1] China, followed by India, is still the most competitive on cost and efficiency: “China, with its vast supply of labor, significant upstream capacity in textiles manufacturing, efficient garment factories, and well developed logistics infrastructure, has achieved breathtaking gains in exports in just the first few months of quota-free trade.” (Nathan Associates 2005). However, Figure 1 shows that after China and India, Bangladesh, Sri Lanka, and Cambodia all have a significant share of the global market. While the reasons for sourcing from China and India may be obvious, the decisions to source from some of the smaller exporting countries are not so apparent.

Studies also predicted that factors such as political stability and quality of infrastructure would be the most important when buyers are making decisions in a competitive market (Andriamananjara 2004). Have countries like Bangladesh, Sri Lanka, and Cambodia significantly improved their infrastructure or business procedures since the expiration of the quotas, or are there other factors that might be more important in sourcing decisions than was previously thought? For example, while Bangladesh ranks 68 out of 80 on Telecommunications Infrastructure and 76 out of 80 on Transportation Infrastructure,[2] by August of 2005, it had the third largest share of the U.S. garments and textiles market, following China and India. Are there other factors that are important that are compelling buyers to overlook political instability and other inefficiencies that exist? A report submitted to USAID by Nathan Associates, Inc., and international consulting firm, earlier this year speculates that, “For now, countries such as Bangladesh, Sri Lanka, and Cambodia are defying the odds…Other factors also influence buyers’ decisions…It remains to be seen, however, whether it can do so if its producers are not cost competitive…” (Nathan 2005).

This paper seeks to answer two questions: [1] How have the priorities of garment companies that have business operations in Asia changed after the quota phase-out, now that country quotas are not governing sourcing decisions, and [2] How have countries in Asia reacted or adapted to these changes? I will explore whether the onset of liberalized trade in textiles and garments can finally push Asian countries to undertake much needed domestic reforms, or whether the initial positive data will create continued complacency among Asian governments who may not see the need to make significant policy changes to infrastructure, business procedures, and labor standards. According to Salze-Lozac’h (2006), “With the end of the MFA providing a sense of urgency, many stakeholders in the region now recognize the need to develop competitive domestic economic environments to encourage investment and preserve employment in the post-quota era. The announced phasing-out of the quota system has not only given developed countries time to adjust, it has also provided smaller garment-producing countries an opportunity to better prepare themselves to face a quota-free world. Whether this opportunity has been fully seized, varies from country to country.”

My hypothesis is that domestic factors (see Table 2), areas that require a policy change to make a country more efficient and business friendly, may be less important in sourcing decisions in the short term due to the presence of certain external factors that may be in place. These are factors that are already present in the country and do not require a policy change or reform to improve a country’s competitiveness. After 40 years of working under the quota system, garment companies may continue to work with countries where they have strong relationships with certain factories or with countries that have already developed a market for particular products, rather than wait for these countries to improve their domestic policies, even though this may be inefficient in the long run. As a result, Asian governments will continue to have little incentive to change uncompetitive policies, even after the quotas have been lifted, since they are able to maintain market share under these inefficient arrangements.

The danger of employing this type of strategy on the part of Asian countries is that retailers and brands may, over time, consolidate their business operations to only a few large factories in the most competitive countries. Not only will the uncompetitive countries experience closing of factories and job losses, but new companies will be reluctant to establish any new business operations in these countries because crucial reforms have not been undertaken.

Methodology and Organization

— To support my argument, I present the following evidence:
— Data that shows an increase in garment and textile exports to the United States of the smaller Asian countries, after 2005
— Data that demonstrates that countries that have increased their market share are not the ones that necessarily rank high in certain domestic

Figure 1: Percentage Share of U.S. Garments and Textiles Market (measured in square meters), August 2005

In addition, many countries like Mongolia and Nepal have not raised many families out of abject poverty in these countries.

opportunities for scores of employees, especially women, garment industry, by providing jobs and economic and textiles make up more than 50% of their total exports. The textile exports. For more than half of these countries, garments assembly role with limited other lucrative industries and export options.

The data in Table 1 demonstrate just how dependent many countries in Asia and Latin America are on garment and textile exports. For more than half of these countries, garments and textiles make up more than 50% of their total exports. The garment industry, by providing jobs and economic opportunities for scores of employees, especially women, raised many families out of abject poverty in these countries. In addition, many countries like Mongolia and Nepal have not

International trade of textiles and garments and globalization in this industry is not a new phenomenon. In fact, apparel is one of the oldest export industries and has often served as the “starter” industry for many of the export oriented countries, especially in Asia (Abernathy 2002; Gereffi 2002). Initially, garment and textile “outsourcing” began in Japan, Hong Kong, Taiwan, and South Korea. In the 1980’s, the industry shifted much of its production to Southeast Asia. In the last decade, South Asia and Latin America have come to the forefront as important locations for the production of garments and apparel that are sold throughout Europe and North America.

To quell the fear that garment and textile jobs would be lost to these lower wage developing countries, the Multi-Fiber Arrangement was established in 1974, and though it was only supposed to be a temporary measure, it was in effect for twenty years, until 1994. This arrangement restricted garment and textile imports to the United States, Canada and the European Union by allocating quotas to countries throughout the developing world. Garment and textile producing countries were assigned a maximum quantity they could legally export during a specific time frame (SOMO 2004). In 1995, The Agreement on Textiles and Clothing (ATC) was established under the WTO. The ATC mandated a phase-out of all quotas over a ten-year period.

Though the MFA originated as a protectionist measure to benefit developed countries, many developing countries did benefit as they were able to establish an industry and market share was guaranteed as a result of the quota system. However, as mentioned earlier, the quotas also created complacency and a lack of competitiveness because market share was guaranteed. “The quota regime forced the customers to move from the most productive factories in the most efficient countries, down scale…”[3] In addition, the quota system also contributed to corruption and political cronyism as quotas were often sold to politically influential firms:

“For low wage countries with excess capacity, quota volume into the lucrative U.S. or EU markets becomes a source of revenue as well as opportunity to attract additional companies seeking sourcing opportunities” (Abernathy 2004).

“The quota premiums seldom go to those directly involved in the production process but rather to parasites such as those who are politically connected” (David Birnbaum 2004 in SOMO).

The East Asian exporting countries used garment exports as a stepping stone to move into light manufacturing, then eventually moved into more sophisticated exports of electronic and other high capital intensive goods. In fact, the quota system actually constrained these countries, pushing them to move towards more sophisticated exports. However, countries like Bangladesh had no incentive to transition upwards nor did they build infrastructure which would allow for a full commodity chain. Under quota, countries like Bangladesh did not even develop other industries (like cotton, etc.) because it was more lucrative to use imported textiles to fulfill the garment product quota.

Feenstra (1998) and Geretti (2002) discuss what is called “original equipment manufacturing” (OEM) which is then sold under corporate brand names. Feenstra (1998) gives the example of Nike, “About 75,000 people are employed in Asia in the production of shoes and clothing for Nike, though only a few hundred of these are actually employees of the company. The rest are employed in factories that have some contractual arrangement with Nike, possibly run by third parties, such as South Korean entrepreneurs.” Bangladesh and other South and Southeast Asian countries have stayed in the assembly model, while countries in East Asia transitioned into OEM production for garments and beyond. The real concern of the phase-out is the impact that it will have on these smaller countries that have essentially played only the assembly role with limited other lucrative industries and export options.

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diversified their export base as they were heavily reliant on exporting garments. According to a report by Nathan Associates, “In less diversified economies, apparel workers have few employment alternatives. Many of these workers are women supporting several family members. In Cambodia, for example, workers typically send one-third to one-half of their earnings to rural households. Thus for every job lost, several people fall deeper into poverty” (2005).

Research Argument and Theoretical Importance

The elimination of quotas will likely consolidate production in a smaller number of countries because of the economies of scale that can be achieved. In addition, “For each country, quota elimination represents both an opportunity and a threat: an opportunity because markets will no longer be restricted and a threat because other suppliers will no longer be restrained and major markets will be open to intense competition” (USITC 2004) Traditional trade theory predicts that after trade liberalization has occurred (defined by the removal of artificial barriers to international trade), countries that are not competitive on important factors, particularly cost and ease of doing business, will not continue to retain significant market share. Although there will be the removal of artificial barriers (i.e. quotas), even now, there are other trade restrictions that are in place (including free trade agreements with various countries and safeguards imposed on Chinese imports) which will not make international trade in garments and textiles completely “free.” However, even with these restrictions in place, buyers still have some choice when making their sourcing decisions.

In addition, because in many garment exporting countries, an artificial industry was created which employs many people in the country, governments will resist reforming policies that may be inefficient and uncompetitive, but that protect the domestic garment and textile industries from outside competition. [NOTES 4, 5, and 6 are marked 1, 2 and 3 in Table 2 below.]

I use the distinction between structural changes and policy changes as presented by Mlachila and Yang (2004). Structural changes are changes in the economic and political landscape that would benefit investors overall, both in and outside the garment sector, while specific policies are tools used by the government to ensure competitiveness specifically for this sector, but often leads to distortions: “The various policies to ensure that imported inputs for export production are not taxed are sound in principle but are very difficult to implement in practice, leading to revenue leakages and rent-seeking activities. The CCS is also onerous to administer…” (Mlachila and Yang, 2004).

Naushad Faiz, Consultant for the The Asia Foundation in Bangladesh discusses how the garment sector in Bangladesh has been helped by policy support provided by successive governments. These include measures like duty drawback facilities, tax holidays, cash assistance, income tax rebate facilities, zero tariff on machinery inputs, rebate on freight and power rate, bonded warehouse facilities, provision of import under back-to-back letter of credit, loans at concessional rate, and export credit guarantee scheme. [7] Though some of these policies may make the country competitive, many

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### Table 1. Apparel and Textiles as a Percent of the Country’s Total Merchandise Exports, 2001 (Selected Countries in Asia and Latin America)

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>85.8</td>
</tr>
<tr>
<td>Macao, China</td>
<td>84.4</td>
</tr>
<tr>
<td>Cambodia</td>
<td>72.5</td>
</tr>
<tr>
<td>Pakistan</td>
<td>72.1</td>
</tr>
<tr>
<td>El Salvador</td>
<td>60.2</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>54.3</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>50.9</td>
</tr>
<tr>
<td>Nepal</td>
<td>48.7</td>
</tr>
<tr>
<td>Honduras</td>
<td>41.3</td>
</tr>
<tr>
<td>India</td>
<td>28.1</td>
</tr>
<tr>
<td>China</td>
<td>20.1</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>18.7</td>
</tr>
<tr>
<td>Indonesia</td>
<td>13.7</td>
</tr>
</tbody>
</table>


### Table 2. Domestic vs. External Factors in Sourcing Decisions

<table>
<thead>
<tr>
<th>Domestic Factors</th>
<th>External Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factors that require a domestic policy change or reform [1]</td>
<td>Factors that do not require a domestic policy change and were already present in country during the MFA or out of the country’s direct control</td>
</tr>
<tr>
<td>Structural Changes [2]</td>
<td>Policy Changes</td>
</tr>
<tr>
<td>Labor costs</td>
<td>Limiting FDI</td>
</tr>
<tr>
<td>Political stability</td>
<td>Approving imports</td>
</tr>
<tr>
<td>Health and environment policies</td>
<td>Tax holidays and rebates</td>
</tr>
<tr>
<td>Quality of transportation infrastructure</td>
<td>Cash compensation schemes (CCS)</td>
</tr>
<tr>
<td>Quality of telecommunications infrastructure</td>
<td>Prior strong relationships with efficient and established suppliers (factories)</td>
</tr>
<tr>
<td>Tax policies/incentives</td>
<td>Loans at lower rates</td>
</tr>
</tbody>
</table>

See Endnotes for references and other details.

are difficult to implement effectively and uniformly.

Many countries need to make significant changes in the area of structural reform including infrastructure, labor policy, and tax policy. Changes
in these areas will not only make the country more competitive in garments and textiles, but will impact the investment climate for other industries as well. In addition, some countries have particular policies in place that favor domestic garment industries by restricting international competition. However, although changes in many of these areas are needed, I argue that at least in the short term, certain external factors will be more important to buyers making sourcing decisions rather than changes in many of these domestic factors.

Analysis of Results

Market Share of Smaller Countries

“In the main, however, many countries’ fears of being squeezed out of the U.S. market—by a combination of the rising strength of the PRC on the one hand and the proliferation of U.S. preferences with non-Asian suppliers on the other—were not realized” (Asian Development Bank 2006).

“Our strategy has always been to remain a diversified source base from a risk management perspective...we never took the view that the MFA phase-out was going to drastically alter our sourcing strategy... Mexico still remains our number one sourcing location, but there has been an overall shift in terms of total volume from sourcing in the Americas...to sourcing in Asia...China is not the destination for all of that shift, it’s spread out in other countries in Asia and the Middle East and Africa...that reflects our strategy to maintain a diversified source base...” (Vice president of Global Conduct from a leading brand).[8]

Figures 2 and 3 do not tell a depressing story, in fact, most of the Asian countries including Pakistan, Cambodia, and Bangladesh witnessed increases in garment and textile imports to the United States after the quota phase-out.

A survey of the private sector conducted by Business for Social Responsibility in 2004 actually predicted that quotas were only one factor in influencing sourcing decisions, and the phase-out would not dramatically impact sourcing patterns. The data so far has proven this to be the case.

Figure 3: Percentage Share in U.S. Market by Value

Source: U.S. Department of Commerce, Office of Textiles and Apparel (otexa.ita.doc.gov/mrspoint.htm)

Domestic Reforms Are Important but Not Connected with Market Share

Many studies argue that domestic policies will be crucial factors in post-quota sourcing decisions. The following are the top ten factors influencing investment and sourcing decisions in 2003, based on the work by Andriamananjara (2005):

1. Labor costs
2. Policies affecting trade and investment
3. Politics and stability in host country
4. Policies affecting labor, health, and environment
5. Quality of transportation infrastructure in host country
6. Lack of restrictions on capital/profit transactions
7. Quality of telecom infrastructure in host country
8. Host government tax policies/ incentives
9. Potential for exports to USA
10. The “culture” of host country

However, when we analyze the data, we see that countries that rank high on certain domestic policy areas are not necessarily the ones with the largest market share.

The data above shows that many of the “unexpected” countries (i.e. those ranking low on factors that are important) seem to do well in terms of maintaining U.S. market share. Indonesia,
Cambodia, Bangladesh, and Pakistan are doing well even though these countries are characterized by a difficult business environment and political instability. There does not appear to be a clear pattern connecting these “important” factors like ease of doing business and changes in garment exports to the U.S.

**External Factors More Important**

If the predicted domestic factors like business environment and political stability are not necessarily the most important when buyers are making sourcing decisions, then perhaps there are other factors influencing the decision making. [Notes 9, 10, 11, 12, 13, 14, and 15 are marked 1, 2, 3, 4, 5, 6, and 7 in Table 3 below.]

### Table 3: Selected Domestic Factors of Garment Exporting Countries

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>6.2%</td>
<td>584</td>
<td>15</td>
<td>153</td>
<td>78</td>
<td>0.22</td>
<td>0.88</td>
</tr>
<tr>
<td>India</td>
<td>13.83%</td>
<td>264</td>
<td>4</td>
<td>155</td>
<td>112</td>
<td>-0.64</td>
<td>0.38</td>
</tr>
<tr>
<td>Indonesia</td>
<td>26.69%</td>
<td>560</td>
<td>-4</td>
<td>131</td>
<td>140</td>
<td>1.37</td>
<td>0.27</td>
</tr>
<tr>
<td>Pakistan</td>
<td>17.28%</td>
<td>560</td>
<td>-8</td>
<td>89</td>
<td>126</td>
<td>1.26</td>
<td>0.37</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>23.01%</td>
<td>640</td>
<td>-7</td>
<td>67</td>
<td>75</td>
<td>0.61</td>
<td>0.39</td>
</tr>
<tr>
<td>Thailand</td>
<td>1.61%</td>
<td>52</td>
<td>1</td>
<td>3</td>
<td>46</td>
<td>0.55</td>
<td>0.91</td>
</tr>
<tr>
<td>Philippines</td>
<td>11.86%</td>
<td>94</td>
<td>-5</td>
<td>113</td>
<td>118</td>
<td>0.49</td>
<td>0.76</td>
</tr>
<tr>
<td>Cambodia</td>
<td>27.22%</td>
<td>97</td>
<td>-1</td>
<td>159</td>
<td>124</td>
<td>0.25</td>
<td>N/A</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1.47%</td>
<td>N/A</td>
<td>0</td>
<td>71</td>
<td>98</td>
<td>-0.9</td>
<td>0.48</td>
</tr>
<tr>
<td>Malaysia</td>
<td>6.49%</td>
<td>N/A</td>
<td>0</td>
<td>137</td>
<td>38</td>
<td>0.51</td>
<td>1.41</td>
</tr>
<tr>
<td>Mongolia</td>
<td>-13.2%</td>
<td>N/A</td>
<td>-4</td>
<td>34</td>
<td>61</td>
<td>0.95</td>
<td>N/A</td>
</tr>
<tr>
<td>Nepal</td>
<td>-9.5%</td>
<td>408</td>
<td>-10</td>
<td>127</td>
<td>150</td>
<td>1.63</td>
<td>N/A</td>
</tr>
</tbody>
</table>

See Endnotes for references and other details.

**Geography**

Some retailers and brands look to countries that are in close proximity in order to ensure quick turnaround times. According to the Vice President of Global Conduct from a leading brand, “Mexico is not a low cost solution anymore, what makes it appealing is that it is very close, so location is important, speed to market, also the capabilities that exist in the Mexican suppliers…”[16] In this case, turnaround is especially important for products that change every season, and fashion products that require close proximity to the importing country.

However, though geography may be important, a large percentage of the sourcing decision making goes unexplained if we focus only on geography. If we go back to Figure 1, we see that only two of the nine countries that make up the U.S. market share in garments are from Central America; seven of the nine countries are in Asia. If geography was a very important factor, we would certainly see Mexico leading in U.S. market share. In addition, according to Birnbaum, geographic location has little to do with dead times and ensuring quick turnaround. The main delays in getting products to market are in the area of design and cutting and cutting the fabric. Improvements in these areas have more to do with the efficiency of the firms, not necessarily close proximity to the exporting country.[17]

**Niche markets**

Some countries were able to develop a niche or specialized market for a particular type of product while the MFA quotas were in place. Because of the established reputation and reliability of these products, some retailers have continued to import certain items from these countries, even though the country overall may be less competitive on other measures in the new global trading system.

An example of a developed niche market in the knitwear industry is the industry in Bangladesh. Faiz says of Bangladesh: “The knitwear industry has done particularly well, and there has been a shift from producing woven garment to manufacturing knitwear.”[18] However, because Bangladesh is known for reliable production mainly in the knitwear industries, retailers are very clear that they would not go to Bangladesh for more sophisticated items. According to the Director of Compliance at a major retailer, Bangladesh produces items cheaply and at the right quality level, but, “if we had a complicated style and nice fabric we wouldn’t want to take a chance in Bangladesh because they lack the experience and expertise [to do a good job].”[19]

Although retailers may continue to rely on countries that have demonstrated years of capability in producing particular products, this reliance on a niche product can be constraining for the country, as well as reduce incentives for the country to diversify into other more potentially lucrative areas or to improve competitiveness overall.
Factory Relationships

By far the most important factor in making post-quota sourcing decisions seems to be the relationship buyers have with particular factories in a wide variety of countries. According to David Birnbaum, consultant and international specialist on the garment sector, the strategy post-MFA is factory based, not country based [author’s emphasis]. Much of the evidence points to the fact that firms that are larger and more efficient are the ones that will remain in business in the quota-free era.

“At the end of the day, factories will play a major role...Doesn’t matter where the factory is located, but what skills the factory can provide...Location doesn’t matter, it is the skill set, the strategies that matter...you can no longer ask which country will do well...”[20]

“A lot of the planning is happening at the vendor and factory level, retailers are the ones that actually just follow the vendor (the ones who own and operate the factories)...Buyers make decisions based on the expertise of the vendor (owner, joint venture, trading company), they know how to make garments, they know where to make the product properly according to price points...A lot of these decisions are made by the vendor, not the buyer... the vendor is the expert in how to do this stuff...”[21]

“Really when it comes down to making a decision of where to place your production, ultimately it is the factory and the management of the factory that gives you the confidence to say that this company or factory can manage our production and manage our different requirements and deliver the right product at the right price at the right time at the right conditions...”[22]

“Long term trusted and reliable supply chain partners that successfully and efficiently produce and deliver merchandise were consistently cited as the key factor to future sourcing decisions...It is worth noting that many buyers are poised to place increased reliance on their vendors and suppliers. For many, establishing these strategic partnerships and strong relationships with suppliers was more important than country selection. As one respondent stated, ‘vendor trumps country,’ meaning it was less important where the product was manufactured, but more important whom they used to produce it.” (Business for Social Responsibility 2004)

If sourcing decisions were based solely on the factors that Andriamananjara (2005) and others deem as important post 2005, then countries like Bangladesh, Cambodia, and Pakistan would have drastically lost market share. Instead, these countries, after China and India, have not only retained their share of the U.S. market, but in many cases, they have increased their share. Based on the evidence, prior factory relationships (that were established during MFA) will continue to be important after the expiration of the quotas, even though these factories may be located in countries that rank low on other domestic factors. Many successful factories may be efficient, in spite of inefficient domestic policies that exist in the countries where these factories are located.

The Garment Sector in Bangladesh

The RMG industry occupies a very significant position in the economy of Bangladesh. It accounts for about 5% of the gross domestic product (GDP) and 25% of gross value addition in the manufacturing sector of the country. It is a major source of employment and absorbs about a third of the industrial workforce. Currently, the sector employs approximately 2.2 million workers, of whom almost 80% are females. It is also the most significant item of export, comprising 75% of total exports, and source of foreign exchange earning, with a contribution of more than three times that of foreign aid.

From a modest start in the 1970s, the ready-made garment industry grew phenomenally over the period of MFA during the last two decades and a half. The number of garment factories increased from 50 in 1983 to around 4,000 in 2004. Around 2,800 of these factories are located in and around Dhaka city, while most of the remaining are in the port city of Chittagong. About 65% of the factories produce woven garments, 20% are engaged in knitting, while the remaining 15% are involved in sweater production. Over the years, RMG exports have increased dramatically, from a meagre $68 thousand in 1978 to $4.5 billion in 2002 to $5.7 billion in 2004. More than half of the exports (57%) went to the countries of the European Union (EU) and 20% to the USA. During the 1990s alone, garment exports grew at a rate of 15%.[23]

Case Study of Bangladesh

Predictions

Prior to the MFA phase-out, many studies and industry analysts predicted that Bangladesh’s garment industry would be hit extremely hard (Abernathy 2002, SOMO 2004, Mlachila and Yang 2004)[24]:

“Although Bangladesh’s wages are low compared with most of its competitors, the productivity of its labor force is also low and stagnant. Coupled with inadequate infrastructure and policy-induced weaknesses, Bangladeshi exporters will likely find it difficult to compete in the short to medium term even if appropriate policy responses can be put in place rapidly” (Mlachila and Yang 2004).

“I thought Bangladesh would do pretty poorly, but was I wrong!” (Birnbaum interview)[25]

In an interview with Faiz,[26] he describes how there was concern within the country as well, “In early 2004, there was concern in the private sector about the possible negative impact of quota withdrawal on the RMG industry in Bangladesh but there was no panic. The Bangladesh
Garment Manufacturers and Exporters Association (BGMEA) in some of its publications in April-May 2004 pointed out that the industry would face stiff competition from China after MFA phase-out. In order to mitigate the effects, BGMEA emphasized the following:

— “Reducing lead times to no more than 60 days. Some market segments may even standardize at lead times of less than a week.
— Raising price competitiveness, mainly through reduction in costs at different points in the value chain.
— Offering quality products, in styles and material that the apparel buying market demands.
— Providing comfort to buyers in terms of social and environmental compliance and ethical sourcing.”

Bangladesh Continues to Do Well after Expiration of the Quotas

For the most part, many of these fears seem to be unfounded; Bangladesh’s garment and textile imports to the United States continue to be very strong. In the post-MFA period, Bangladesh has actually been able to increase its exports. In 2005 (January-December), it exported $6.9 billion worth of RMG products compared to $6.2 billion in 2004 (January-December), thereby registering a growth of almost 11%. This was mainly due to the knitwear industry, exports of which increased by about 27% during the same period, while that of woven garments slightly decreased.

According to some estimates, 400 new factories have been registered and 65,000 new workers recruited after the ending of MFA. Even if these factories are not all effectively operational, this growth in investment and employment is real.

Costs continue to be the key to Bangladesh’s success: “Costing we get from Bangladesh is so low compared to other countries, that’s the main reason they’ve done so well…Bangladesh is successful because it is cheap primarily, not because they have an infrastructure to support factories…the majority of the fabric coming from China or Taiwan…they haven’t built that infrastructure…they do have export processing zones where they have stable electricity, better roads, they assist you with getting workers, do have better labor conditions in those zones…a worker in an export processing zone gets paid more than a worker outside the zone…”

Thus, the abolition of quotas, contrary to earlier predictions, has not yet adversely affected the Bangladeshi garment industry, largely due to the restrictions that still apply to China. Today, Bangladesh continues to be one of the leading exporters to the US and EU markets, and the knitwear industry has done particularly well since there has been a shift from producing woven garments to manufacturing knitwear. However, according to Faiz, the full impact of quota abolition will probably not be felt before 2008, when restrictions on China are scheduled to end.

Limited Domestic Reforms Undertaken in Bangladesh

In spite of what seems to be a positive outlook for the garment industry in Bangladesh, the country has actually achieved limited reforms that would improve its business environment, corruption, and political stability. Industry analyst Birnbaum declares Bangladesh to be the most corrupt country. “Those investors who are able to be successful, know how to work within the corrupt system by paying workers slightly more than the minimum wage ($25/ month) and avoiding strikes whenever possible.”

According to Faiz, the government has made public pronouncements to help the RMG industry increase its competitiveness by improving infrastructure and the business environment. However, things have moved very slowly and in some cases, like the power supply, the situation has gone from bad to worse. Some of the problems are too big to overcome in the short-term, like lack of adequate electricity and congestion in the Chittagong port. The slow pace of reforms has more to do with the overall state of governance in the country. The two owners’ organizations - the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA) - are active in advocating their interests and have regular consultations with the government and other stakeholders. However, despite their economic and political clout, they have of late lost much of their credibility in the eyes of the civil society due to their inability and unwillingness to deliver on their promise to raise the minimum wage to the satisfaction of the workers. Labor unrest has increased in recent times.

Emphasis on External Factors

According to the Director of Compliance at a major retailer, though Bangladesh has hurdles, port issues, and corruption, they still ship merchandise and they are doing more this year than last year and more than the year before. What has made the country so successful in this industry?

The two factors (other than low cost) that have made Bangladesh successful are: [1] its niche in the knitwear market and [2] the efficiency of certain foreign owned factories in Bangladesh that continue to maintain strong relationships with key retailers. Most retailers agree that other countries in Asia like China, Korea, Taiwan, and the Philippines are capable of much more sophisticated work and Bangladesh’s work is quite
basic. However, the country has been able to capitalize on this particular area, and continues to maintain significant market share. In addition, many of the factories in Bangladesh with owners from Korea and Hong Kong have been able to maintain highly efficient and first rate factories, producing quality goods at a cheap price. [32]

**What is the Future of this Strategy?**

What is the future of Bangladesh’s strategy that focuses on low wages, strengths in basic knitwear, a few efficient factories, high corruption and domestic inefficiencies, and limited political capacity to take on any significant reforms? According to Birnbaum, this is not a very viable strategy: “In Bangladesh, it is mainly cutting and sewing garments… I don’t know how that formula is going to play out going forward… Sri Lanka [on the other hand] is quality operation… it is a better place to go… they have the customers, people go to Sri Lanka because you have quality management, a decent factory, delivering a good product, people can do difficult work…” [36] There is hesitation to work in Bangladesh among certain companies, in spite of the efficient factories that are located there, “You can have a really good factory in Bangladesh, but it’s hindered by the unstable political situation and lack of infrastructure and very low level of labor standards and enforcement…” [37]

However, according to the Director of Compliance at a major retailer, who also agrees that Sri Lanka is much better than Bangladesh in the areas of labor standards, wages, better infrastructure, fabric mills, needlework, and quality merchandise, a company like his will always have a need for simple knitwear that Bangladesh produces: “In reality, we will be in a similar situation 10 years from now [importing from Bangladesh].” [38]

In Bangladesh, there tends to be much optimism, “I think both the private sector and government officials are, on the whole, optimistic about the future. This is partly due to the fact that predictions of gloom did not come true and the sector, especially knitwear, has been doing quite well in the post-MFA period. However, this is not to say that they are not aware of the shortcomings and challenges facing the industry, one of which is the deteriorating and volatile owner-labor situation.” [39]

In the long term, “…low costs will keep the industry alive as will industry efforts, however using price as the only means to add value may not be enough if vertical integration and other sourcing criteria are not developed… need for infrastructure improvements…” (Business for Social Responsibility 2004)

**Policy Implications and Conclusions**

“Some countries are doing huge business and will continue to do huge business… question is how can they grow or make sure it doesn’t shrink fundamentally overnight?” [40]

Under the quota regime, low wage countries like Bangladesh were successful, and even now they appear to be; however, as the importance of “new” criteria begins to permeate the marketplace, these countries will need to make the necessary policy changes to continue to be competitive. (Faiz 2006).

This study has demonstrated that unlike what many of the pundits predicted, many of the smaller garment exporting countries in Asia have not completely fallen off the map. However, the reason for their continued success is less to do with certain changes in domestic policies that were expected, but more to do with particular external factors that seemed to have continued even after the expiration of the quotas. My research shows that in particular, prior relationships with specific factories (anywhere in the world) that continue to be efficient (in the eyes of certain buyers) are what continue to make them successful. So a country like Bangladesh may continue to have inefficiencies at the national level, but a few of the larger efficient factories will continue to do business, attracting buyers. However, even if this is the case, countries cannot remain complacent because the competition is too fierce and the stakes are too high.

Policy recommendations going forward must fall under two main areas: First, since factories are so important, factory level inefficiencies need to be addressed and improved. This is in the areas of labor and health conditions, employment laws and productive equipment. More than wages, productivity needs to be addressed. According to a survey by Spinanger and Verma in 2001, lower wages, if not associated with reasonable productivity, are not a very important factor of overall success.

The second is that ultimately, crucial domestic reforms cannot be ignored. Thus, perhaps it is the successful factories within each country that need to push for positive reforms that will improve the business environment in their country in order to attract future business. Factories, even the ones that are successful, need to be concerned that buyers may start reducing their business if certain domestic policies or the environment truly hinders business operations. Factories need to work with the government and ultimately the buyers, to come to a consensus of what “competitive”, “efficient” and “productive” mean and how they can be translated to

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<th>Table 4: Labor Costs in the Apparel Industry - Selected Countries</th>
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<td><strong>Country</strong></td>
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Source: Sri Lanka Garment Buying Office Association; 2005
actionable changes. For example, Spinanger and Verma (2003) find that transport infrastructure is even more important in investing decisions as the final stage of quota integration was drawing closer.

Ultimately, the factories are located in the countries themselves, so, as the Vice President of Global Conduct at a major brand says, “It is a combination of things...if you think about the capability and cost of the product and the factory, those are the things that really drive our sourcing decisions, however the capabilities and costs are affected by the country location [author’s emphasis]...certain countries have different types of labor infrastructure and enforcement of laws, that impact our decisions as well...” [42]

According to Salze-Lozac’h (2006), “The risk is that the growth in exports being experienced by countries like Bangladesh, India, and Pakistan, even after the end of the MFA, may give some exporters, governments, and even some trade unions, the illusion that they are competitive enough. However, at a time of uncertainty and fierce international competition, no country can afford to avoid or postpone necessary discussions and actions to improve productivity and competitiveness. The window for action is limited in time and should be seen as an opportunity to open the discussion on the important factors that influence the choice of buyers in sourcing for garment products in a new quota-free world trade.”

For better or for worse, extensive garment industries have been established in these countries. Now that competition has been introduced, the goal is to ensure that dramatic job losses do not take place and improvements in working conditions are made in the jobs that are available. Ultimately, it is the hope that this sector can bring many of these countries out of their impoverished situations.

**Endnotes**

1. For a full discussion of predictions, see USITC, chapter 2 [Return to Text]
2. Andriamananjara 2004 [Return to Text]
3. Interview with David Birnbaum, November 28, 2006 [Return to Text]
4. (TABLE 2, Note 1) See Andriamananjara 2004 for more details [Return to Text]
5. (TABLE 2, Note 2) Distinction in Mlachila and Yang: the table shows a partial listing [Return to Text]
6. (TABLE 2, Note 3) See Abernathy 2004, pgs. 3, 8 for a discussion of regional trade agreements [Return to Text]
7. Interview with the author, November 10, 2006 [Return to Text]
8. Interview with the author, December 20, 2006. [Return to Text]
9. (TABLE 3, Note 1) Source: U.S. Department of Commerce, Office of Textiles and Apparel (otexa.ita.doc.gov/msrpoint.htm) [Return to Text]
10. (TABLE 3, Note 2) devdata.worldbank.org/wdi2006/contents/Tables5.htm [Return to Text]
11. (TABLE 3, Note 3) www.doingbusiness.org. Economies are ranked on their ease of doing business, from 1 to 175, with first place being the best. A high ranking on the “ease of doing business” index means the regulatory environment is conducive to the operation of business. This index averages the country’s percentile rankings on 10 topics, made up of a variety of indicators, giving equal weight to each topic. [Return to Text]
12. (TABLE 3, Note 4) Ibid. “Dealing with licenses” tracks the procedures, time, and costs to build a warehouse, including obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections. [Return to Text]
13. (TABLE 3, Note 5) Ibid. “Employing workers” measures the flexibility of labor regulations. It examines the difficulty of hiring a new worker, rigidity of rules on expanding or contracting working hours, the non-salary costs of hiring a worker, and the difficulties and costs involved in dismissing a redundant worker. [Return to Text]
14. (TABLE 3, Note 6) www.worldbank.org/wbi/governance/pubs/ govmatters2001.htm. This index is one of six indices developed to measure governance. The authors draw 194 different measures from 17 different sources of subjective governance data constructed by 15 different organizations. These sources include international organizations, political and business risk rating agencies, think tanks, and non-governmental organizations. The Political Stability index measures perceptions of the likelihood that the government in power will be destabilized or overthrown by possibly unconstitutional and/or violent means, including terrorism. This index captures the idea that the quality of governance in a country is compromised by the likelihood of wrenching changes in government, which not only has a direct effect on the continuity of policies, but also at a deeper level undermines the ability of all citizens to peacefully select and replace those in power. The component indicators are aggregated using an unobserved components model that expresses the observed data in each cluster as a linear function of the unobserved common component of governance, plus a disturbance term capturing perception errors and/or sampling variation in each indicator. The choice of units for governance ensures that the estimates of governance have a mean of zero, a standard deviation of one, and range from around -2.5 to around 2.5. Higher or positive values indicate greater political stability. [Return to Text]
15. (TABLE 3, Note 7) Abernathy 2004 [Return to Text]
16. Interview with the author, December 20, 2006 [Return to Text]
17. Interview with the author, November 28, 2006 [Return to Text]
18. Interview with the author, November 10, 2006 [Return to Text]
19. Interview with the author, December 6, 2006 [Return to Text]
20. Interview with David Birnbaum, November 28, 2006. [Return to Text]
21. Interview with the Director of Compliance at a major retailer, December 6, 2006 [Return to Text]
22. Interview with the Vice President of Global Conduct from a leading brand, December 20, 2006 [Return to Text]
23. Faiz 2006 [Return to Text]
24. See Mlachila and Yang (2004) for a list of studies that estimate the negative impact of the quota removal on Bangladeshi exports, p. 26. [Return to Text]
25. November 28, 2006 [Return to Text]
26. Interview with the author, November 10, 2006 [Return to Text]
27. BGMEA: GSP, EBA and Rules of Origin of the European Union: An analysis of changes required so that Bangladesh may avail intended market access benefit, Dhaka, May 11, 2004, p. 3. [Return to Text]
28. Interview with the Naushad Faiz, November 10, 2006 [Return to Text]
29. Ibid. [Return to Text]
30. Interview with the Director of Compliance at a major retailer, December 6, 2006 [Return to Text]
31. Interview with the Naushad Faiz, November 10, 2006 [Return to Text]
32. Interview with the author, November 28, 2006 [Return to Text]
33. Interview with the Director of Compliance at a major retailer, December 6, 2006 [Return to Text]
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36. Ibid. [Return to Text]
37. Interview with the Vice President of Global Conduct from a leading brand, December 20, 2006 [Return to Text]
38. Interview with the author, December 6, 2006 [Return to Text]
39. Interview with the Naushad Faiz, November 10, 2006 [Return to Text]
40. Interview with the Director of Compliance at a major retailer, December 6, 2006 [Return to Text]
41. (FIGURE 5) Export data from WTO: “International Trade Statistics 2005” (Figures for India and Nepal are from 2003, as no data for 2004 was given); 2001 employment estimates from South Asia Multidisciplinary Advisory Team (SAAT), International Labour Organization “Garment Industry in South Asia, Rags or Riches? Competitiveness, productivity and job quality in the post-MFA environment,” Edited by Gopal Joshi, New Delhi, 2002. [Return to Text]
42. Interview with the Vice President of Global Conduct from a leading brand, December 20, 2006 [Return to Text]

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