The End of Textiles Quotas: A case study of the impact on Bangladesh

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Objective

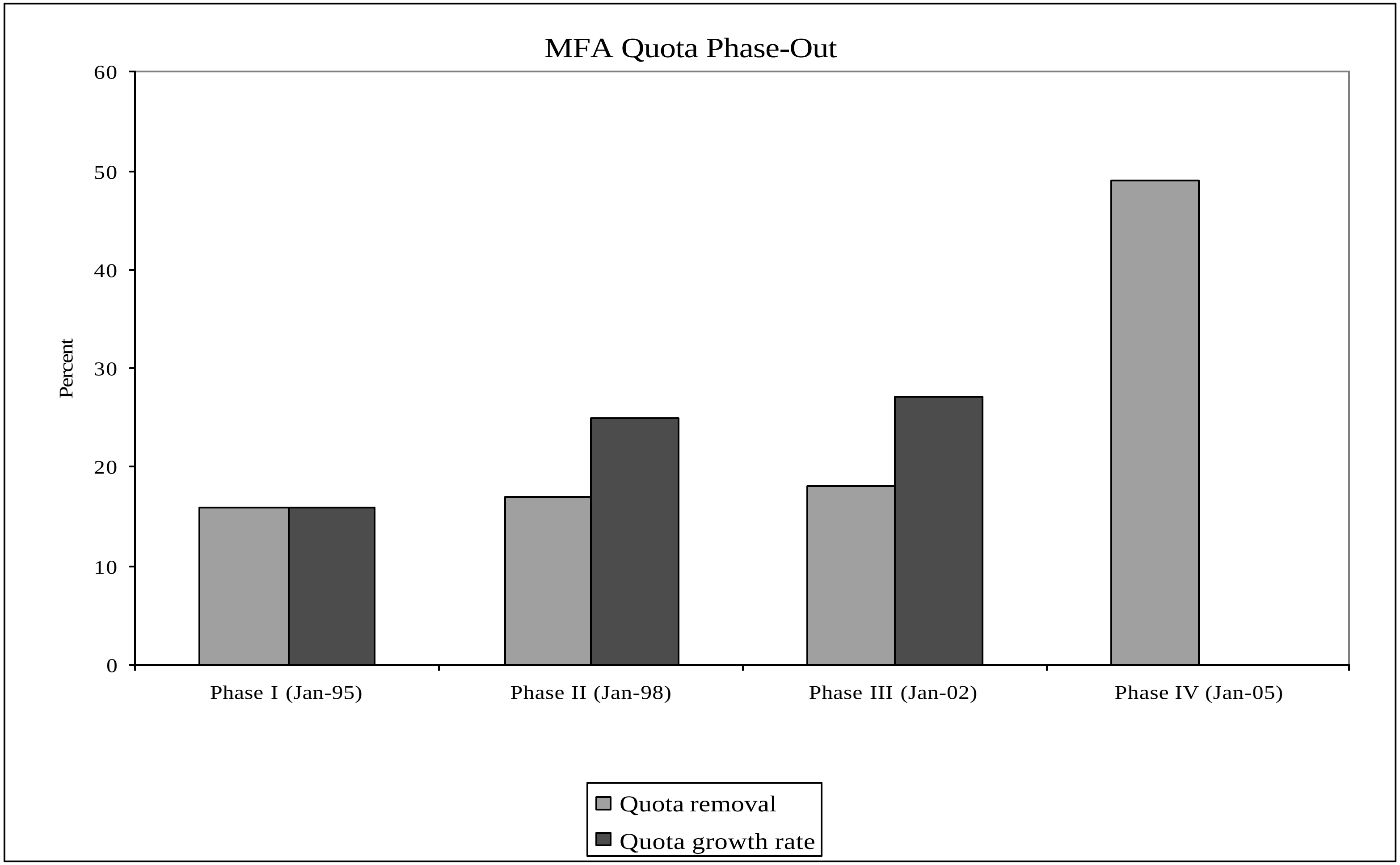
- To analyze Bangladesh’s vulnerabilities to the final stage of textiles quota elimination, focusing on the impact on employment, exports, and GDP growth

Outline

- Background for Bangladesh's RMG sector
- Analyzing past performance and competitiveness
- Domestic supply constraints
- Estimating the impact
- Conclusion

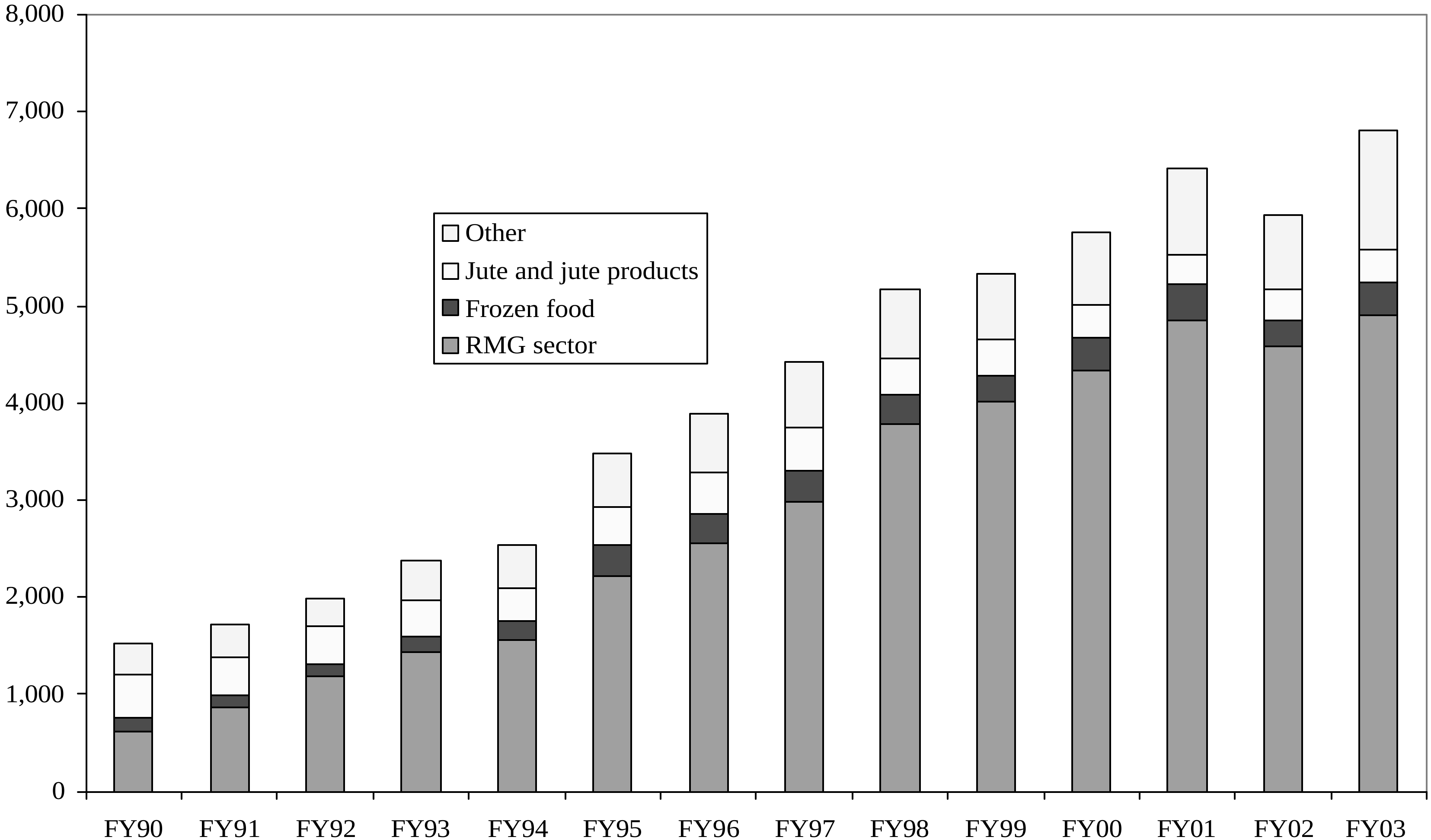
The Background

“Going off the cliff”



After very strong performance during most of the 1990s (about 16 percent per year), the growth rate of RMG exports has slowed down significantly since 1998

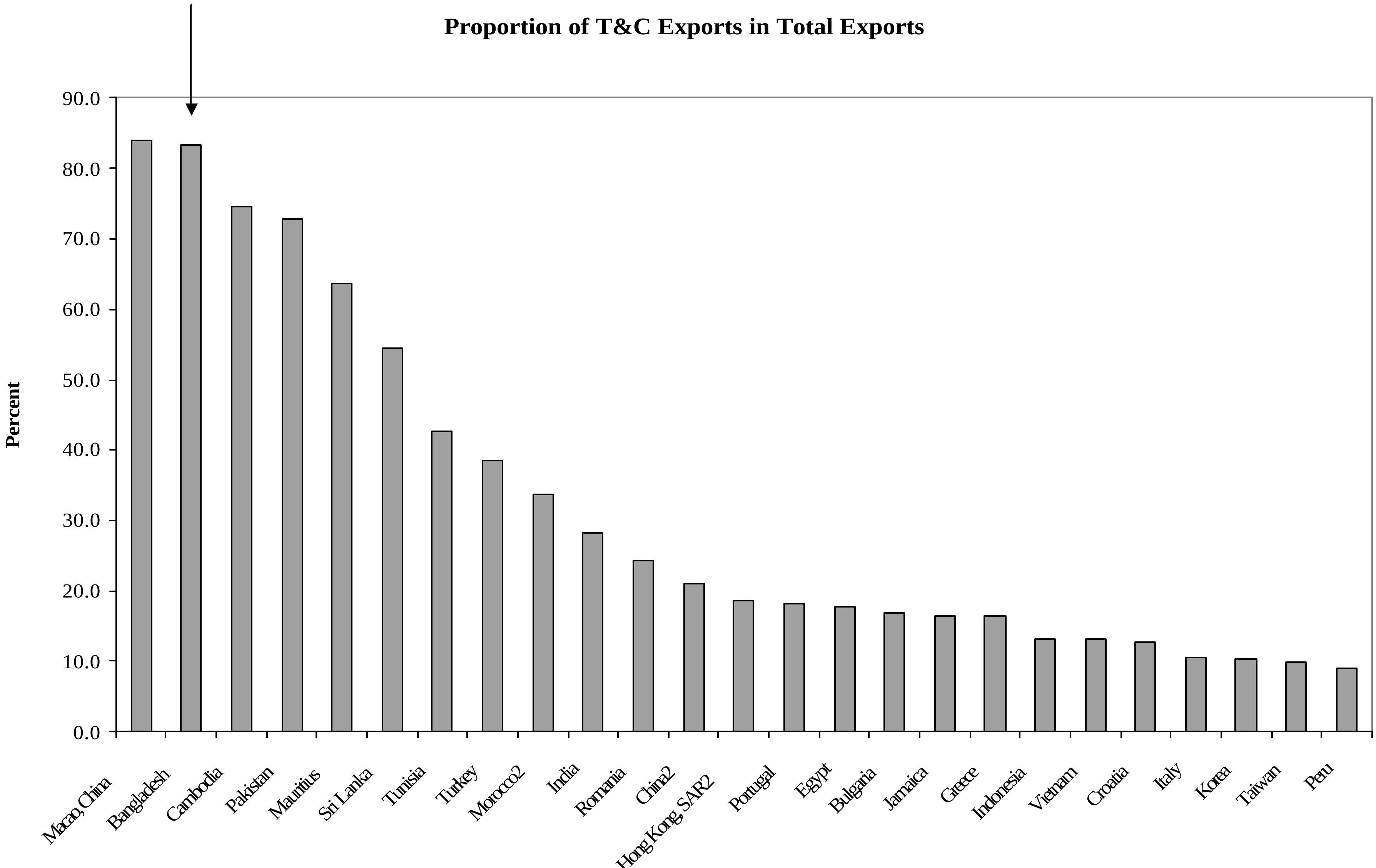
Bangladesh Exports (in millions of U.S. dollars)



The role of the RMG sector in the Bangladeshi economy is very important

- 77 percent of exports and 20 percent of imports
- directly employs 1.8 million people (40 percent of manufacturing employment), of whom 80 percent are women
- contributes to incomes of about 10-15 million people
- *Note: In terms of contribution to GDP, the direct contribution of the sector is relatively limited, at about 2.4 percent.*

Bangladesh depends heavily on the exports of textiles and clothing



Analyzing Competitiveness

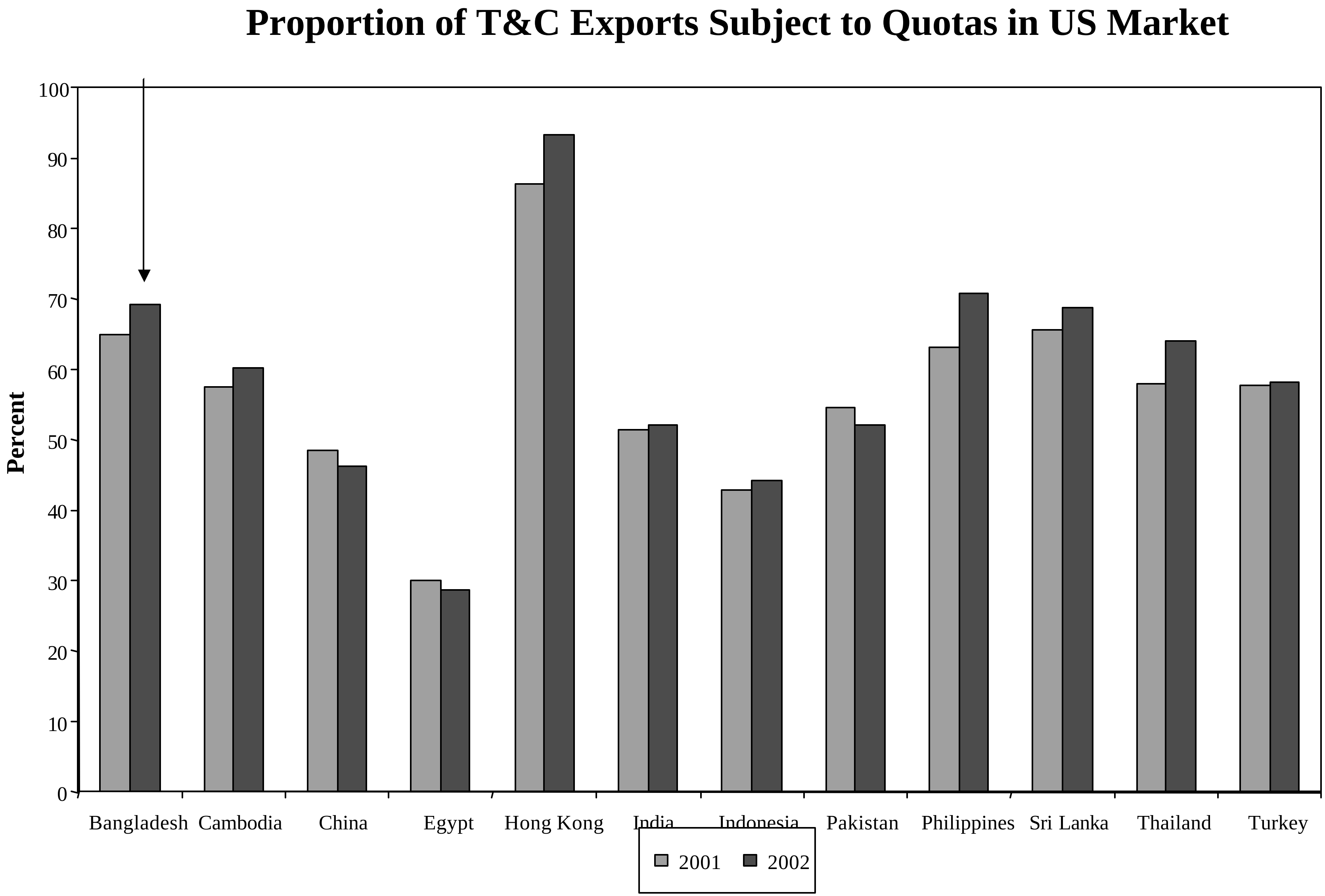
Facts about Bangladeshi T&C exports

Four restricted markets: US, EU, Canada and Norway:

- Quota and tariff restrictions remain in the US
- Quota- and duty-free access in the EU under EBA
- Quota- and duty-free access in Canada
- Quota- and duty-free access in Norway for all LDCs.

➔Considerable preferences in the restricted markets other than the US.

Bangladesh depends very much on restricted markets (95%) and restricted products

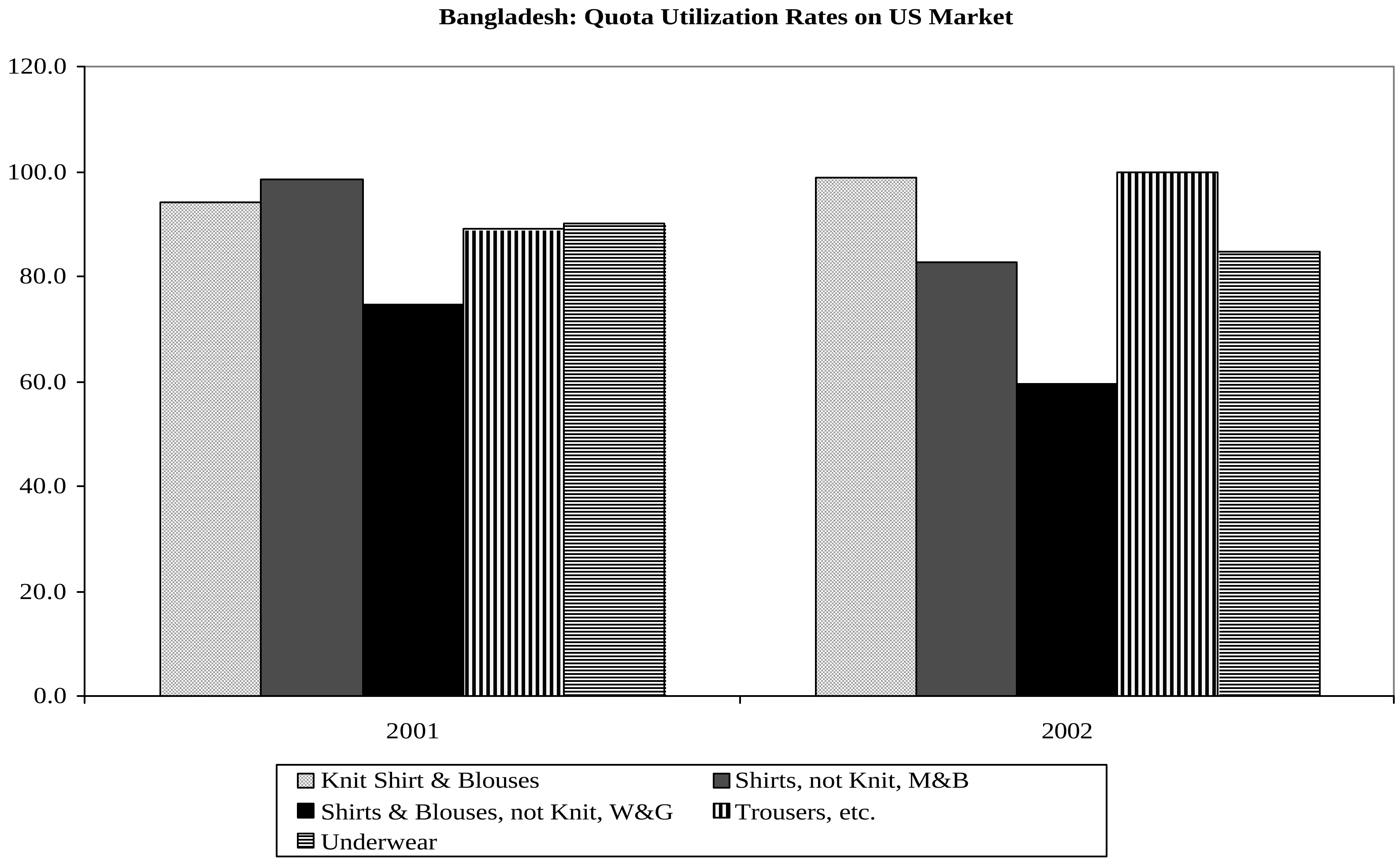


This means the stake is high

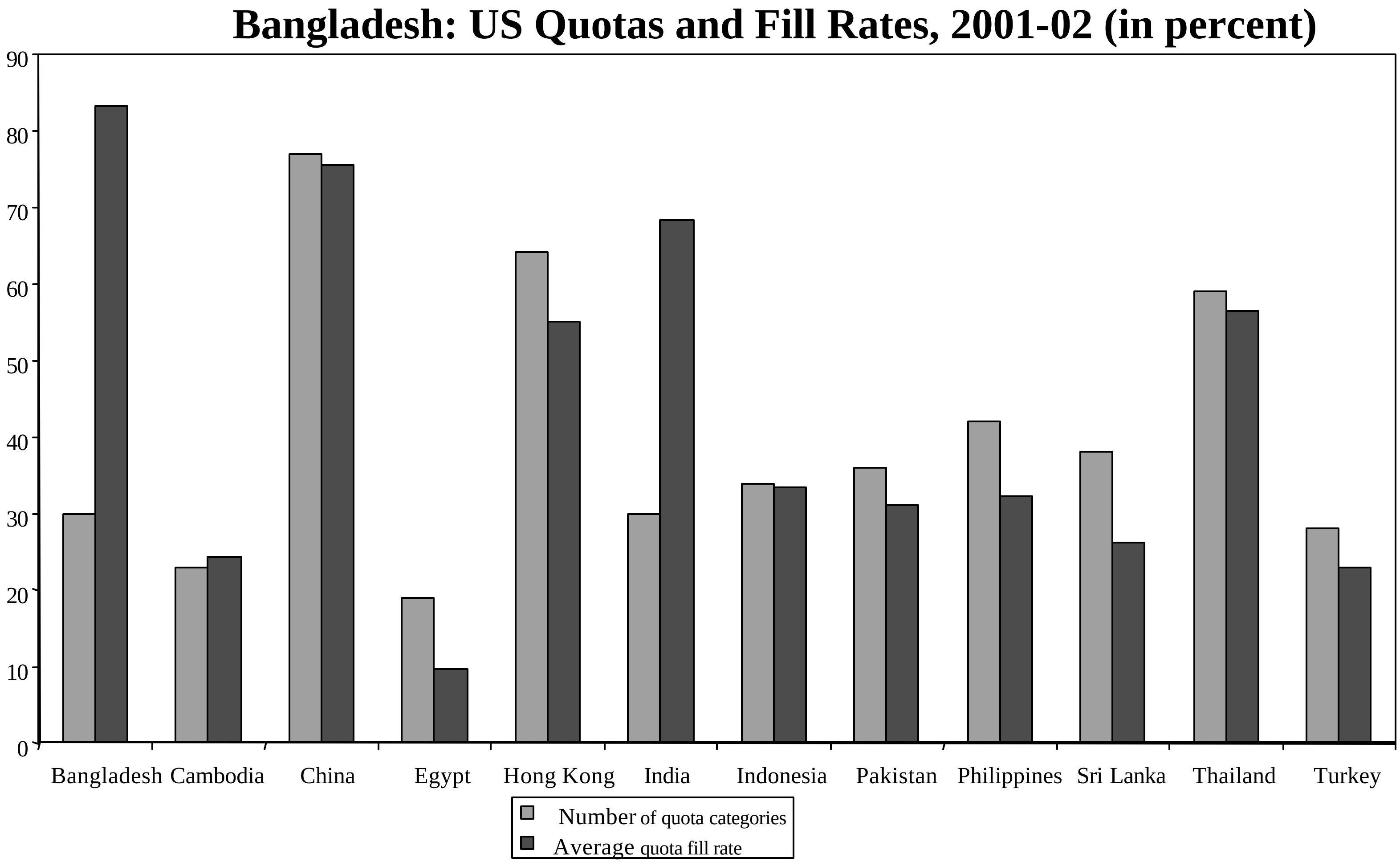
- Fewer benefits from higher prices in the unrestricted markets after 2004
- Large gains in the restricted market if competitive, or
- Large losses if not competitive

➔So is Bangladesh competitive? Because the T&C market is so distorted, past growth does not tell much

Bangladesh's quota utilization rates in the US are generally high and this suggests that quotas are binding



Bangladesh's quota utilization rates compare favorably with its main competitors



Implications of high quota utilization

- High quota utilization does not necessarily mean that Bangladesh is more restricted than its competitors
- Need to look at indicators of quota restrictiveness
- In a well-functioning market, quota prices measures the restrictiveness of quotas.

Estimated export tax equivalent for clothing 2002/03 (World Bank Estimates)

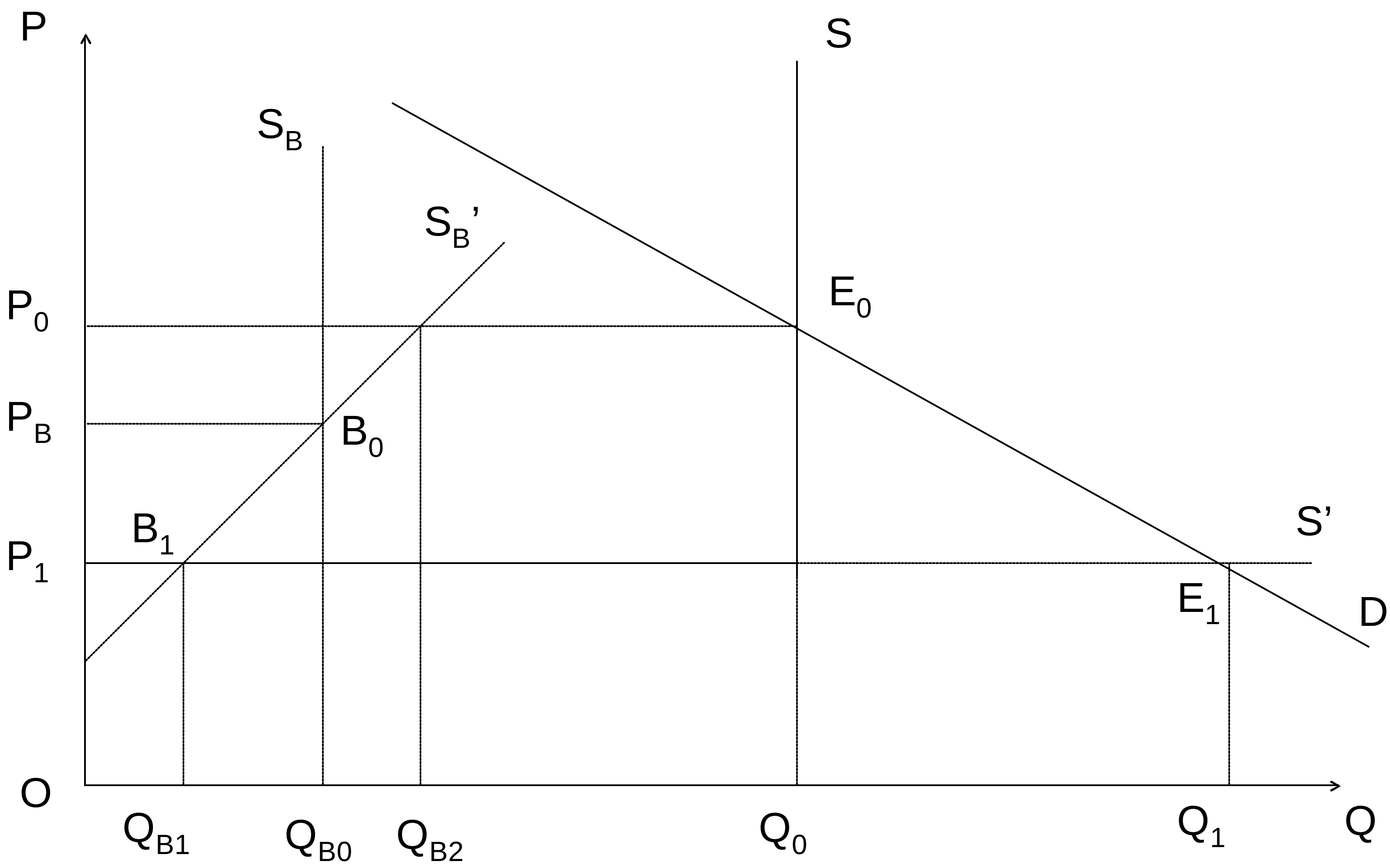
(percent of f.o.b. prices net of quota rents)

	USA	EU
Bangladesh	24 (7.6)	0
India	20	20
Pakistan	10	9
China	36	54

Growth rates of Base US Quotas, 2004 (percent per year)

Bangladesh	**12.9**
China	2.0
India	10.6
Pakistan	12.0
Indonesia	9.8
Sri Lanka	9.7
Thailand	9.6
Vietnam	6.0
Average	**8.5**

Impact of Quota Removal on Bangladesh



The similarity index

$$I^{AB} = \sum_{i=1}^{n} Min(S_i^A, S_i^B) \bullet 100$$

S_i^A = share of product *i* in country *A*'s exports to a market

S_i^B = share of product *i* in country *B*'s exports to the same market

n = number of products covered

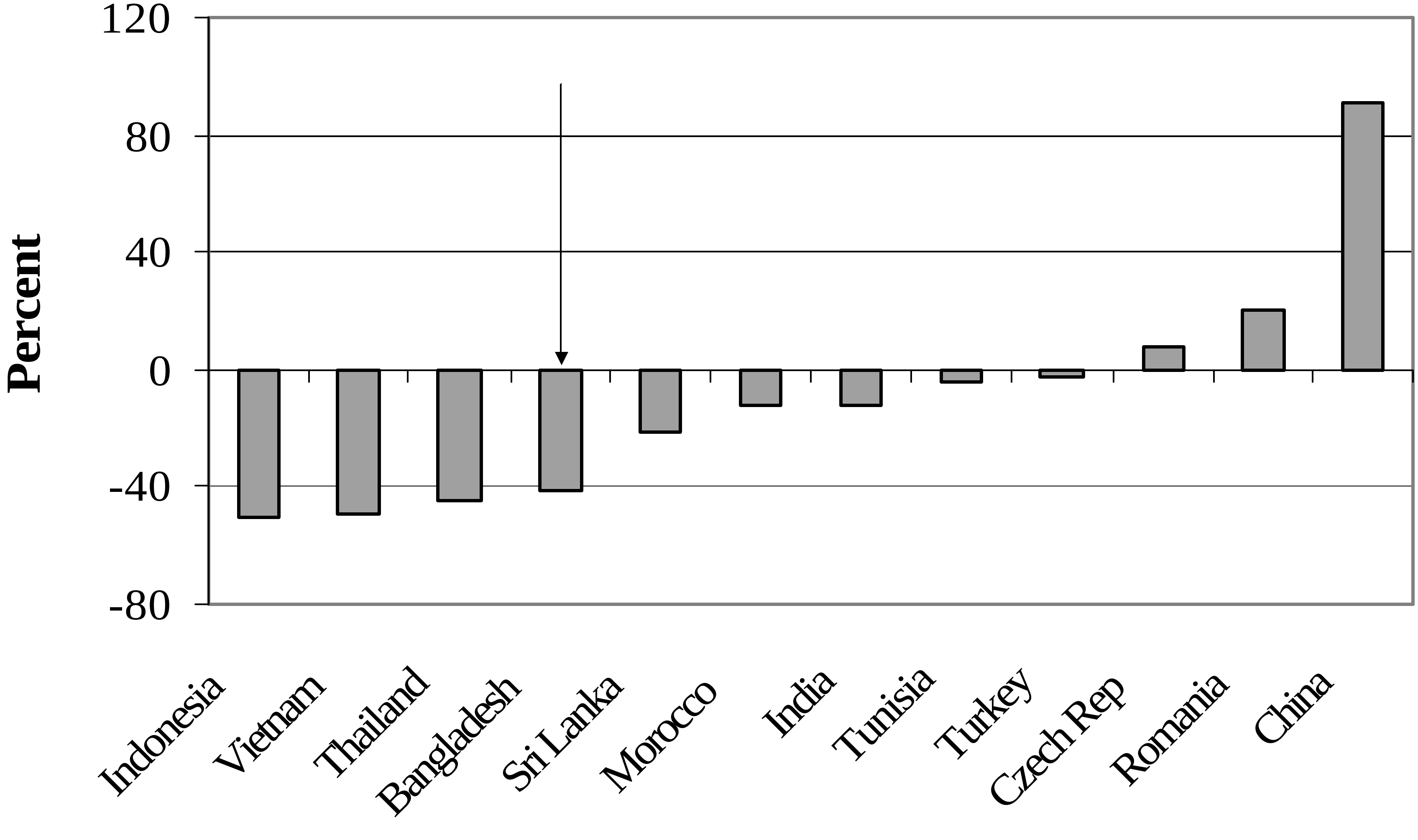
Product similarity between Bangladesh and its competitors

Competitor	USA	EU
China	71.5	22.0
India	57.1	39.1
Pakistan	34.8	67.6

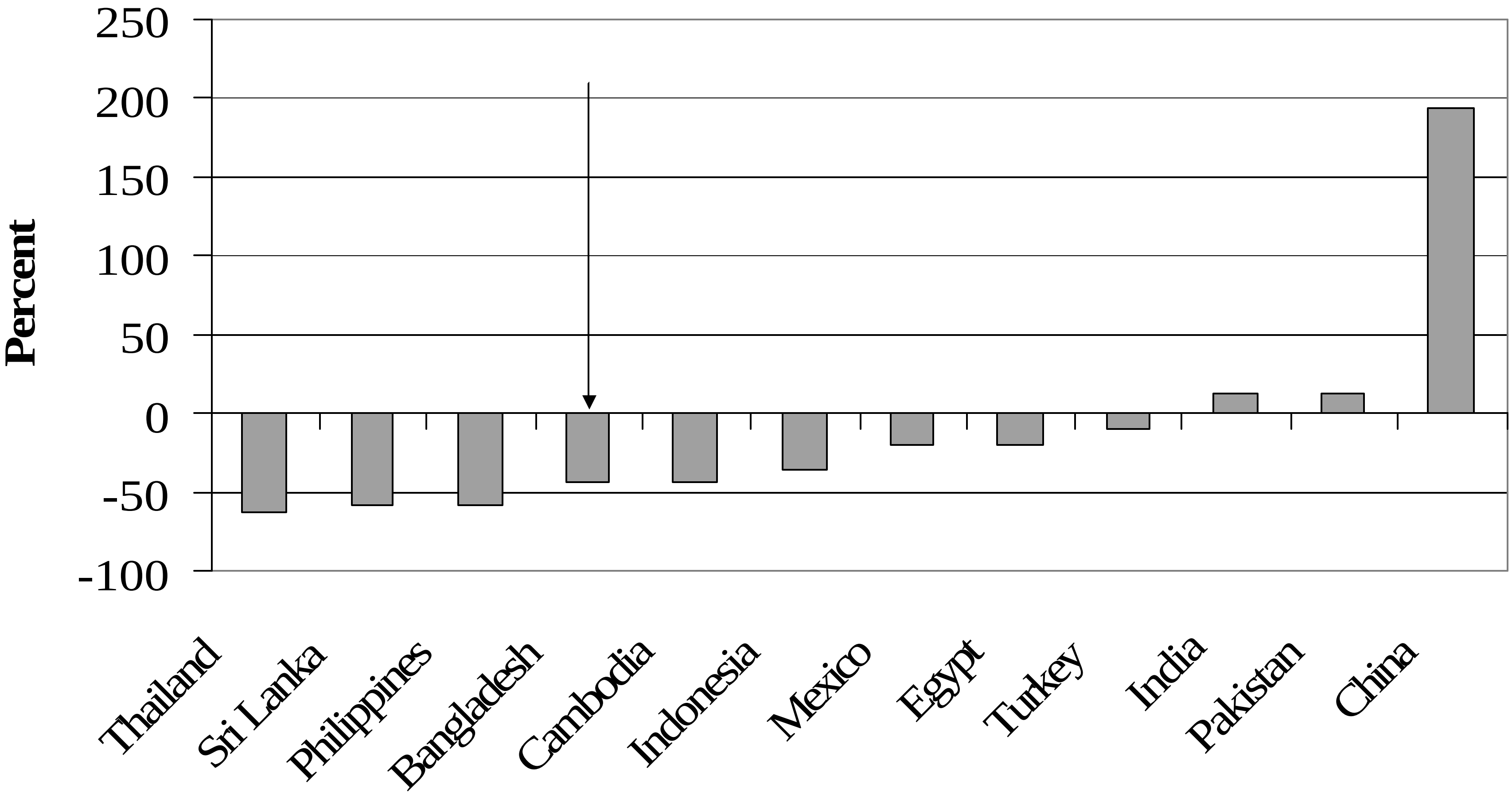
At the Product Level

- In the US market, for every Bangladesh product restricted by quota its Chinese counterpart is also restricted face higher quota prices and quota utilization; Nine out of top 10 exports coincide
- In the EU market, five quota categories cover 86 percent of Bangladeshi exports. These categories account for only 13 percent of Chinese exports and have very high quota prices.

Phase III Exports to the EU
(percentage change Jan.-Sept. 2003 vs. Jan.-Sept. 2001)

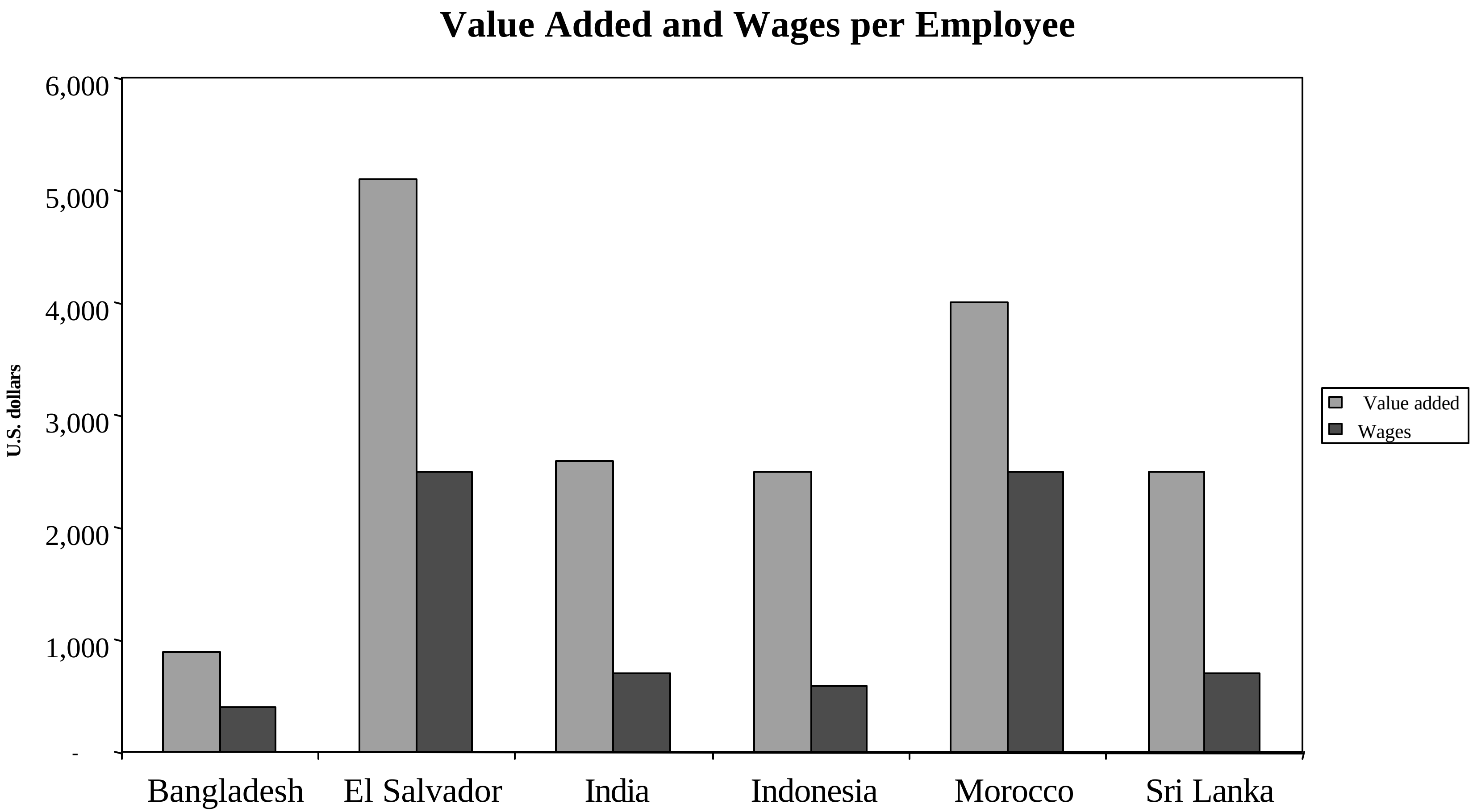


Phase III Exports to the US
(percentage change Jan.-Sept. 2003 vs. Jan.-Sept. 2001)



Supply Constraints

Bangladesh's biggest comparative advantage, preferential access, is likely to disappear and low wages won't do the trick



Bangladesh has considerable structural weaknesses

- Unreliable and insufficient electricity supply
- Unreliable, expensive (especially for overseas communications) telecommunication network
- Very slow ports:

  Lead times in Bangladesh are typically 120-150 days compared to 90-120 days in India

Policy-induced weaknesses

- Restrictions to FDI in RMG sector (➔virtually no FDI in the sector, except in EPZ.
- Requirement to have back-to-back LCs before imports are approved ➔lengthening of lead times
- Governance:
  – Bangladesh was ranked last in Transparency International's Corruption Perception Index (CPI) last during the past three years
- Other nuisances:
  – Prevention of use of land ports for textile imports
  – Requirement to use nationally registered shipping companies for 40 percent of exports

Estimating the Effects of Quota Removal

Model and Data

- Standard GTAP model
- Standard GTAP database V5
- Own estimates on export tax equivalents for Bangladesh
- Database updated to 2007 to capture medium-term impact (using *WEO* projections)

Assumptions

- *All* quotas are removed (except in one scenario in which China continues to face restrictions)
- No other policy changes
- No dynamic or non-price effects
- Labor and capital are fully mobile across sectors

Modeling strategy

- Given the uncertainty over key parameters and market conditions, a range of model closures and assumptions are tested:
  - Elasticity of substitution
  - Labor market conditions
  - Investment behavior
  - Post-ATC restrictions on China

Simulation Results – Fixed nominal wages (*percentage deviation from the baseline*)

	Central elasticity
GDP	-2.3
Employment	-4.5
Trade balance (% of GDP)	-1.2
Total exports	-14.2
Clothing	-17.7

Simulation Results

	Central elast.	Lower elast.	Higher elast.
GDP	-2.3	-1.3	-4.1
Employment	-4.5	-2.5	-7.7
Trade balance			
in % of GDP	-1.2	-0.7	-2.1
Total exports	-14.2	-6.8	-29.5
Clothing	-17.7	-8.3	-38.1

Simulation Results

	Fixed N. wages	Constant real wages	Constant employment
GDP	-2.3	-1.3	-0.3
Employment	-4.5	-2.1	0.0
Trade balance			
in % of GDP	-1.2	-0.4	0.3
Total exports	-14.2	-8.4	-3.0
Clothing	-17.7	-11.8	-6.2

Simulation Results

	Central elast.	Lower investment	China restricted
GDP	-2.3	-3.7	-1.7
Employment	-4.5	-7.6	-3.2
Trade balance			
in % of GDP	-1.2	-0.3	-0.9
Total exports	-14.2	-10.2	-10.1
Clothing	-17.7	-13.6	-12.7

Simulation Results

	Central elast.	Lower elast.	Higher elast.	Const. real wages	Const. empl.	Lower invest.	China restr’d
	(1)	(5)	(6)	(2)	(3)	(4)	(7)
GDP	-2.3	-1.3	-4.1	-1.3	-0.3	-3.7	-1.7
Employment	-4.5	-2.5	-7.7	-2.1	0.0	-7.6	-3.2
Trade balance							
In % of GDP	-1.2	-0.7	-2.1	-0.4	0.3	-0.3	-0.9
Total exports	-14.2	-6.8	-29.5	-8.4	-3.0	-10.2	-10.1
Clothing	-17.7	-8.3	-38.1	-11.8	-6.2	-13.6	-12.7

Conclusions

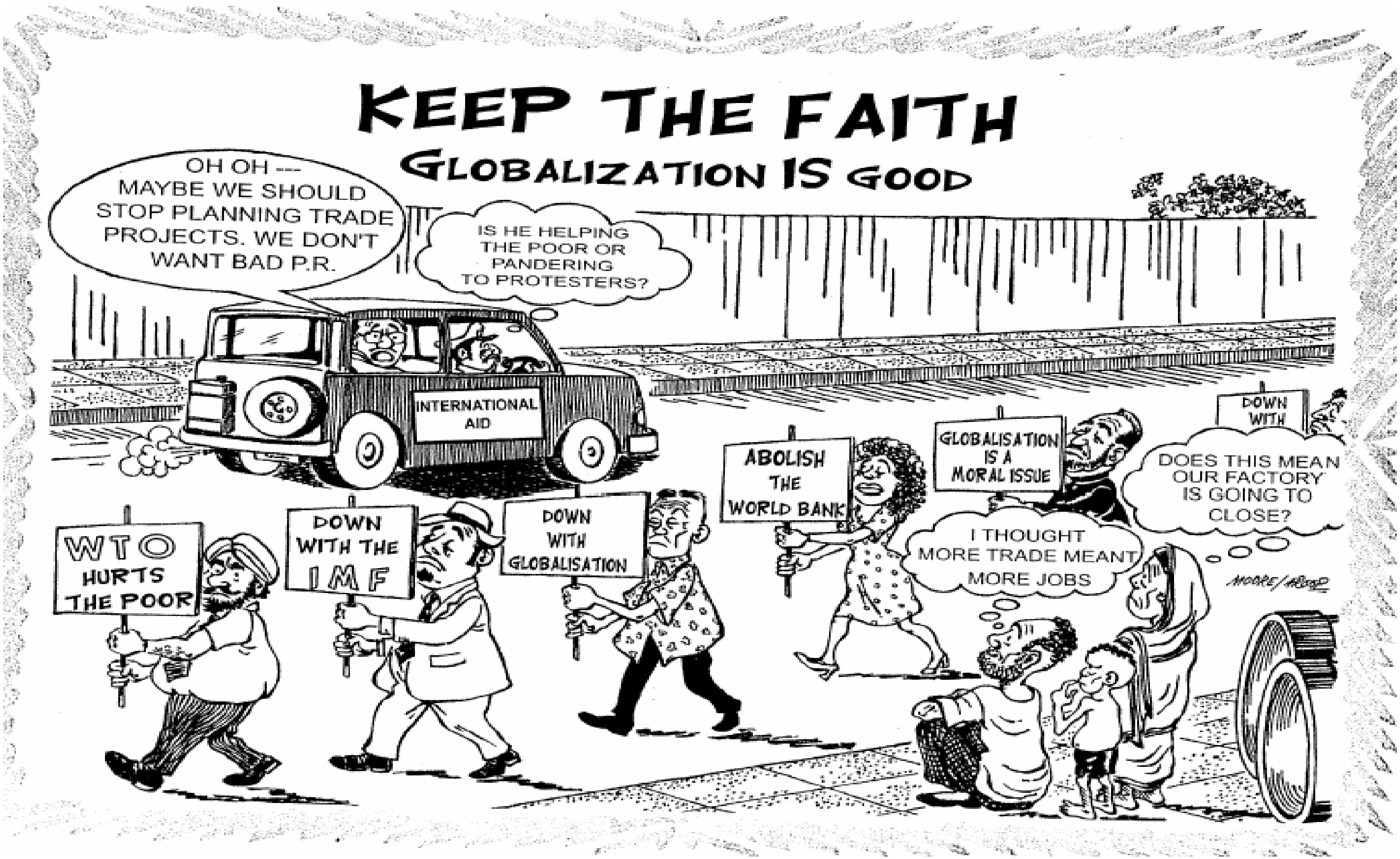
- Bangladesh is vulnerable to quota removal given its:
  - high dependence on RMG exports
  - high dependence on restricted markets
  - low labor productivity
  - structural rigidities and policy weaknesses
- Based on what has happened in Phase III quota integration and modeling results the outlook post 2004 is one of considerable risks

What to do?

A new IMF policy

Trade Integration Mechanism (TIM)

Don’t throw away the baby with the bath water...



Policy recommendations

- Abolish back-to-back letter of credit requirement
- Enhance trade facilitation
- Lift ban on FDI outside the EPZ
- Eliminate or reduce tariffs on yarn and fabrics
- Abolish the “cash incentive” program