Consortium for Development Policy Research

The Textiles and Garments Sector: Moving Up the Value Chain

This policy brief is based on the paper "The Textiles and Garments Sector: Moving Up the Value Chain" by Dr. Naved Hamid (International Growth Centre), Dr. Ijaz Nabi (International Growth Centre), and Rafia Zafar (Lahore School of Economics)

The Textile and Garments (T&G) industry has the potential to play an important role in expanding Pakistan's exports. The sector currently accounts for 48 percent of Pakistan's total exports, 30 percent of value-added in large-scale manufacturing, and 40 percent of industrial employment (Table 1).

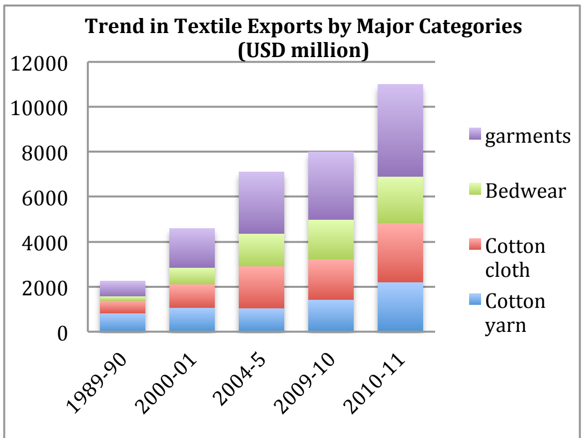
Table 1: Economic importance of the T&G sector

T&G sector's share of…	Percentage share in 2011/12
National exports	48
Large-scale manufacturing	30
Industrial employment	40
GDP	4
Market share capitalization	5

Source: Adapted from the State Bank of Pakistan (n.d.); Pakistan, Ministry of Finance (2013); All Pakistan Textile Mills Association (2014).

Within Textiles, the Garments industry is a significant and growing component. The value of Garments exports nearly quadrupled from US$ 1.02 billion in 1990 to US$ 3.72 billion in 2011-12 (Table 2).

Table 2: Trend in Textile Exports by Major Categories



Since Pakistan was recently granted GSP-plus status by the European Union (EU), a large market for T&G exports has opened up to Pakistan. Rising labor costs in China and the increasing technological sophistication of its manufactured exports are likely to reduce the Chinese share (about 40 percent in 2012) of the world garments market. Combined with the incomes rise in the large, fast-growing economies of China and India, Pakistani exports particularly garments, have an opportunity to meet this incumbent demand.

However, for the sector to realize its potential, policies that shape the incentive structure facing the industry need to be realigned.

T&G Exports: Structure and Trends

Since the beginning, Pakistan has followed a cotton textiles-led industrialization strategy. The textiles chain in Pakistan consists of activities that include cotton ginning, spinning, weaving, finished fabrics, textile made-ups (particularly towels and household linen), and garments (woven and knitted apparel). However, the industry's historical pattern of development and the resulting dominance of the spinning industry in textile policymaking as well as the presence of a highly protected synthetic fiber industry have become major constraints to the growth of the value-added components of the T&G sector since the 1990s.

Moreover, Pakistan has failed to benefit from the opening up of T&G trade in 2005, largely a result of government policies and the ensuing structure of Pakistan's T&G sector. As Table 3 shows, Pakistan's T&G exports are primarily either low or intermediate value-added products, which, in 2012, accounted for 69 percent of T&G exports compared to 32 percent of world T&G exports.

International Growth Centre

This policy brief is based on work done by International Growth Centre (IGC). The IGC is funded by UK Department for International Development (DFID).

FUNDED BY UKaid

Table 3: Structure of Pakistan and world T&G exports

		Share of Pakistan's T&G exports (%)		Share of world's T&G exports (%)	
Product	**HS code**	**2005**	**2012**	**2005**	**2012**
Low value-added					
Cotton yarn	5204-07	12.6	18.9	2.4	2.7
Intermediate value-added					
Cotton fabric	5208-12	21.5	21.9	6.8	5.4
MMF yarn and fabric	54	2.5	0.3	9.3	8.3
Knitted fabric	60	0.7	0.3	5.1	5.5
Textile made-ups	63	31.8	27.6	8.5	9.9
High value-added					
Knitted apparel	61	17.1	16.8	31.2	36.0
Woven apparel	62	13.8	14.2	36.7	32.3

Source: Authors' calculations are based on data from the United Nations Commodity Trade Statistics database.

In the case of international buyers, large Pakistani garment manufacturers have particularly faced much stricter scrutiny and have had to meet higher standards of compliance to retain or attract large buyers as customers. This has had wider implications since the Garments industry is labor-intensive and probably the largest employer in the manufacturing sector.

Constraints to the Growth of the Garments Sector

Product Range, Price Range, and Government Policy

One of the major constraints for Pakistan's garment exports is that they have a relatively narrow base, with a few products accounting for the bulk of exports. The top six products the industry exports account for over 78 percent of the country's garment exports but only 41 percent of the world trade in garments. Pakistan's exports are also concentrated around the lower end of the price range for the products it exports. For four out of the five most traded products, Pakistan's average export price is 47 to 58 percent of the world average export price (Table 4).

The government's poor industrial policy, through which they have protected existing T&G firms, is an important reason for the narrow product range and low export unit value of Pakistan's garment exports. This includes putting up tariff and non-tariff barriers on MMF yarn and various kinds of fabrics. Thus, garment exporters generally limit themselves to products that do not require imported yarn, fabric, or special trimmings and accessories, which reduces the value added to garments and consequently, their price range. Furthermore, given that MMF now comprises 65 percent of total fiber consumption in the world, this implies that Pakistani garment exporters are excluded from a substantial proportion of the market.[1]

Table 4: Average unit value of Pakistan's top five garment exports, 2012[3]

Product[2]	Pakistan exports (m$)	Average unit price (US$)		Pakistan average /world average (%)
		World	Pakistan	
6103	294	6.36	5.41	85.1
6105	543	7.91	3.99	50.4
6109	291	4.01	2.32	57.9
6203	921	13.62	6.38	46.8
6204	591	12.73	6.70	52.6

Source: Authors' calculations based on data from the United Nations Commodity Trade Statistics database.

[1] Hussain, S. T., Malik, K. Z., Khan, U., Faheem, A., Nabi, I., & Hamid, N. (2013). *A comparative analysis of the garments sector of Pakistan*. Lahore: International Growth Center, Pakistan.

[2] These are standard codes taken from the United Nations Commodity Trade Statistics database

[3] The combined export value of these five items was US$ 2,640 million, i.e., 71 percent of Pakistan's garment exports.

Energy Shortages

Another important factor affecting Garment exports is the growing energy shortages that Pakistan has faced since 2007. In 2012, most of the industry suffered power outages of 8 to 12 hours a day[4] while the supply of natural gas was suspended for several months in the winter. Many large firms have installed generators at a substantial cost to meet their basic power needs, but most small firms have not been able to afford this. Thus, the energy crisis has raised the cost of production for garment manufacturers in Pakistan, making them less competitive. The crisis has also increased uncertainty in production planning by creating the possibility of delays at different stages of the production cycle, over which the firm has little control. In the long-term, this will not only hinder the growth of export volume, but also impact the product price range, as the importance of timeliness increases when firms move up the price range.

Security and Country Risk Perception

Security concerns also create a constraint for Pakistani exporters, as it affects the price range within which exporters can compete. Due to the security situation, employees of international buyers almost never visit Pakistan and since the importance of such interaction increases as firms move up the price range for a product, this makes it very difficult for Pakistani exporters to target the medium-to-upper end of the garments market in any product.

Poor security, political uncertainty, and the law and order situation also means that international buyers have a high country risk perception of Pakistan. As a result, potential and incalculable delays in production and shipment results in excluding firms in Pakistan from among their list of 'reliable suppliers'. The implications of this for Pakistani exporters include smaller orders, items that are less time-sensitive and thus at the lower end of the price range, and a price discount relative to their competitors in other countries.

Lack of Investment in Human Resources

In Pakistan, the lack of educated and skilled workers is an important constraint to industry in general. The low level of general education in the country translates into poor trainability of the workforce while the shortage of formal vocational training institutions results in a skills gap that firms must fill themselves. Of the large firms, over 60 percent complained of a shortage of stitchers and over 85 percent reported difficulties in finding middle managers[5]. Moreover, most firms felt that the poor quality of entry-level workers' schooling was an issue for training.

Realizing Potential for Growth: Firm Response

Despite these constraints, the Garment industry has taken steps to overcome them in order to expand production. These steps include:

- *Overcoming International Isolation:* Many firms are using information technology not only to improve their production planning and management, but also to overcome the constraint arising from buyers' unwillingness to travel to Pakistan because of security concerns. These technologies include an online 'order tracking form', online access to all the CCTV cameras on the premises, allowing the employers to monitor in real time the production area, cafeteria, etc., for compliance assurance. Other firms are working on meeting global standards for environment and social compliance.
- *Moving Up the Value Chain*: In order to move up the value chain, it is essential for a firm to have their own design capacity for product development where larger profit margins lie. Therefore, big firms have R&D offices operating locally and abroad. Another approach firms are taking to move up the price range is the targeting of niche markets such as heavy protective garments or uniforms for schools or football players. Some firms have developed the capacity to produce small orders

[4] While firms located on industrial estates received an uninterrupted power supply for eight hours a day, other firms in Punjab were subject to hour-long power outages every one or two hours throughout the day.

[5] Small and medium firms felt the shortage of stitchers far less than large firms, but as far as the shortage of middle managers was concerned, the proportion (75 percent) was almost as high.

of complex garments, such as heavily embroidered garments.[6]

Recent Initiatives by the Punjab Government

Due to the export potential of the Garment industry and its employment generating capacity, the Punjab Government has taken initiatives to facilitate them, through the recommendations of a working group comprising of garment manufacturers and policy makers.

Market Access

In the past, Pakistan had missed international schemes that would benefit exporters because of bureaucratic delays and lack of pursuance of application on the diplomatic front. This resulted in delays to avail the duty-free export status to the EU under the new GSP-plus scheme. Based on the recommendations of the working group, the Punjab Chief Minister personally guided the process to ensure reports were submitted in time and the necessary diplomatic effort made to secure sufficient support for approval by the European Parliament. As a result of these efforts, Pakistan's application for GSP-plus status was approved in December 2013.

Skills Development

Based on the demand for skilled labour, the Punjab Skills Development Fund (PSDF) launched the Skills for Garments scheme, designed to address skills shortages in the apparel industry, especially at the worker and middle management level. Under this scheme, the PSDF has started its first program for training over 9,000 individuals using a private provision, government-financed model.

Customs Facilitation

Considering the barrier created by the current import regime for the garment industry, the Punjab Government has facilitated meetings between representatives of garment manufacturers' and the Federal Board of Revenue to discuss the former's concerns and suggestions for simplifying the import regime. Consequently, the following recommendations have been implemented:

- A customs clearance facility for imports by the garments industry has been made available on a 24/7 basis.
- The Input Output Coefficient Organization (IOCO) office in Lahore has been fully staffed to provide quick approval for the import of materials by garment exporters under the Duty and Tax Remission for Exports (DTRE) scheme.[7]

Developing Garment Clusters

To address the issue of energy shortage, otherwise under the federal purview, the Punjab Government has set up a model garments cluster where existing firms can relocate or undertake expansion projects. The Quaid-e-Azam Apparel Park is being developed on over 1,500 acres of land near the Sheikhupura motorway interchange, 40 km from Lahore. It will have space for over 100 garment manufacturers and accessories suppliers, dedicated power plants for an uninterrupted power supply to the estate and common facilities such as effluent waste treatment plants, clean drinking water, and solid waste disposal.

[6] Nabi, I., & Hamid, N. (2013). *Garments as a driver of economic growth: Insights from Pakistan case studies*. Lahore: International Growth Center, Pakistan.

[7] Before a firm can import materials for use in the manufacture of garments for export under the DTRE scheme, it must obtain certification of the quantities to be imported from the IOCO. Previously, the IOCO office in Lahore served primarily as a drop-box and all applications were processed at the head office in Karachi. This often required making several trips to Karachi by someone from the firm and caused long delays in getting approval.