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The Garments and Textiles Industry: Global Trends and Prospects for South Asia

About the project

Funded by: International Growth Center (IGC)

Key Counterpart: Pakistan Business Council

Impact: The findings of this study fed directly into the deliberations by the subcommittee on competitiveness, led by Dr. Naved Hamid (IGC Resident Country Director), under Prime Minister's Economic Advisory Council (EAC). This work has also significantly deepened engagement with the private sector. The findings were presented to the Pakistan Business Council and incorporated into a set of PBC sponsored sector studies to inform their advocacy efforts.

This policy brief is based on an ongoing study "Sectoral Productivity and Competitiveness" by Shahid Yusuf (Growth Dialogue, George Washington University) and Ijaz Nabi (IGC and CDPR). It has been compiled by Zara Salman (CDPR).

In brief

- China remains the largest producer and exporter of textiles and garments by a wide margin followed by the European Union (EU), Bangladesh and Vietnam.
- China's declining exports of garments creates opportunities for other leading producers of garments especially the ones already tightly integrated into global value chains (GVCs).
- Pakistan and Bangladesh in particular, will need to diversify into garments using manmade fabrics that has higher unit value and can generate larger export earnings.

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The textile and garments industry has a global presence. Around 160 countries are engaged in the production of garments, textiles or often both. These products comprise six percent of the global trade. Pakistan's textile and garments industry accounts for 8.5% of its GDP and 60% of its exports.

China remains the largest producer and exporter of textiles and garments by a wide margin followed by the European Union (EU), Bangladesh and Vietnam. But these products have a diminishing share in China's total exports. This has been paralleled by a drop in the country's share of the global garments trade as China's labor costs have risen well above those of South and Southeast Asian countries. China's wage levels are now more than twice that in Vietnam. Despite this drop, China still meets more than one third of the global demand for textiles—34.5% in 2017 as against 37% in 2015 (Figure 1).

Looking ahead, China's share is likely to continue heading downwards as buyers from Europe and the United States have begun reducing their dependence on Chinese producers in the interest of diversification and in response to increasing trade tensions between China and some western countries. US based apparel companies are sourcing their products from vendors scattered across twenty or more countries. Moreover, the trend favors a consolidation of sources and vendors so as to minimize the costs of highly fragmented value chains¹.

China's declining exports of garments creates opportunities for other leading producers of garments especially the ones already tightly integrated into global value chains (GVCs) and could potentially fill the gaps left

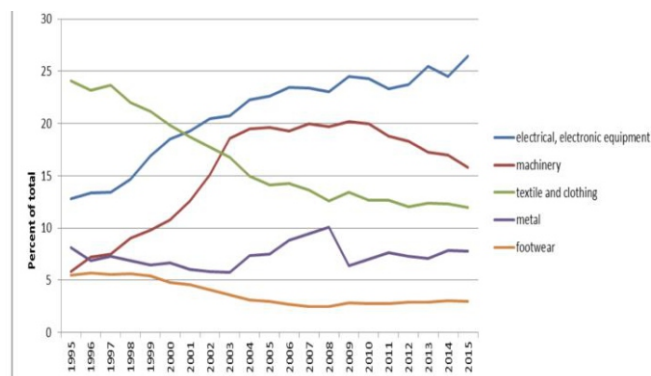
By Chinese manufacturers. Six countries are in the running: Bangladesh, India, Vietnam, Pakistan, Cambodia and Whether they will be able to displace Chinese firms and also increase their total export earnings will depend on a number of factors. The rest of this note examines the three factors likely affecting the fortunes of South and Southeast Asian exporters.

1. Growth of global trade could slacken during the medium term

Growth of world merchandise trade slowed sharply following the Financial Crisis of 2008-2009. Even though there was a recovery in 2017-2018 with trade growing annually by 4.4%, the outlook for the medium term—for a variety of cyclical and structural reason—remains less

promising. There is a risk that trade imbalances could lead to a fracturing of the multilateral trading system and increased protectionism.

Figure 1: Shares of China's principal export: 1995-2015



Source:WTO²

The slowing of growth also dampened trade in textiles and garments through 2016 to record lows. A modest rebound in 2017-2018 provided some relief to exporters, but the medium-term outlook remains uncertain because of an easing of economic momentum in the EU, the US and also in China. As these are the biggest textile importers accounting for 25%, 9% and 7% of global imports of textiles respectively, once their economic growth slackens, trade in textiles is likely to follow suit.

Thus, countries in South Asia such as Pakistan, that have tied their industrial fortunes to the garments and textiles industry may have to struggle in the face of strong competition to grow their exports and move up the value chain into products that Chinese firms are increasingly shifting into.

2. Market conditions are changing

The garment industry is undergoing a transformation and the spread of digital technologies will only accelerate the process. A key change has been an increasing focus on lean retailing with chains striving to optimize their inventories to avoid both burdening the balance sheet and having to dispose of unsold items at steep discounts.

Increased computing power, access to a larger volume of data from multiple sources, better data analytics, and the use of AI is making it easier to forecast demand. Survival of retailers depends upon the speed of response to often volatile consumer preferences.

Retailers are continuously fine-tuning their orders in anticipation of demand; hence purchase of

¹ Leading American brands source approximately a third of apparel and textiles from China, a third from Vietnam and the balance from other countries.

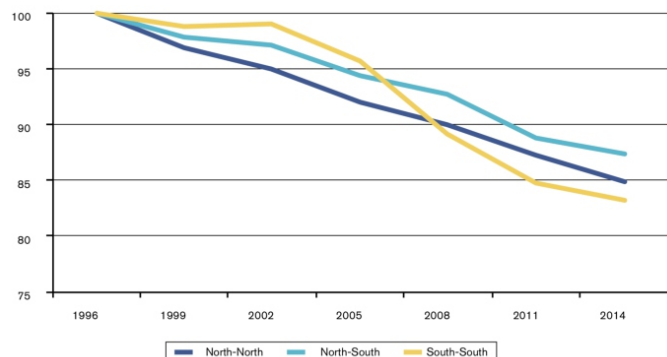
² https://www.wto.org/english/res_e/publications_e/world_trade_Report18_e.pdf

products in smaller lots and compressed ordering cycles are becoming the norm. With lead times being adjusted downwards, there is greater pressure on suppliers who need to be able to react more speedily and to turn a profit on smaller volumes. Moreover, inventory costs are being pushed down the supply chain, with suppliers, (some of which are SMEs) shouldering the costs of holding a variety of materials in order to fulfill an order.

Online shopping has lent additional impetus to fast fashion and this along with advances in technology, has implications for the supply chain. A company such as Zara ships some products from Asia by air and then also sends finished products back to Asia by air.

Thus, Asian manufacturers of garments and textiles need to factor in a slower growth of the global market and the likelihood that there might be a telescoping of value chains with the production of certain items being re-shored to western countries. Moreover, Asian countries may have to focus on (less profitable) intra-regional and South-South trade that has been expanding- due to falling transport, information and transaction costs-more rapidly than global trade. (Figure 2)³

Figure 2. Declining overall trade costs 1996-2014



Source:WTO⁴

3. Technological change is accelerating

Although the production of textiles is relatively capital intensive and highly mechanized, that of garments remains one of the least digitized and

automated among the principal manufacturing subsectors. It is an activity that is moving into the crosshairs of digital technology.

This will have major implications for investment in fixed assets, in technical skills including managerial ones, in intangible assets particularly R&D⁵ that enable a firm to assimilate and maximize returns from new technologies, and also investment in the capabilities of the workforce. Advances are coming thick and fast in the material that goes into the making of garments and a wide of technical textiles used by the auto, medical, hygiene, transport, construction, and other industries.⁶

South Asian producers, Pakistan and Bangladesh in particular, that have specialized in cotton garments (up to 75% of exports vs. world average of 46%),⁷ will need to diversify into garments using manmade fabrics and catering to the market for athletic and outdoor apparel that has higher unit value and can generate larger export earnings. Over the medium term, companies in South Asia must come to terms with the progressive automation of garment making and the use of AI. This will not happen overnight.

Already, automation is on the march starting with standardized items that are produced in high volume such as T-shirts and sweaters. Companies like Levi-Strauss are using lasers to give its jeans the worn look in 90 seconds displacing a labor and chemical intensive process that could take 20 minutes. Firms in Bangladesh are also using laser hole burning machines.

The final frontier for the automation of garments is how to grasp and handle different fabrics each with its own drape, texture and non-linear static and dynamic characteristics. The grippers currently on offer cannot match the dexterity of a skilled human operator. However, new light weight grippers that can manipulate deformable items are being developed and it is only a matter of time before they begin serving the needs of the fast fashion industry in developed countries.⁸

³ "The increase in world trade during the last decade was largely driven by the rise of trade between developing countries (South-South). The significance of South-South trade flows for developing countries is evident when considering that in recent years, they represented more than half the trade of developing country regions (imports and exports). South-South trade share varies by region, from about 40 per cent in Latin America to almost 70 per cent in South Asia and East Asia. Although a certain proportion of South-South trade encompasses intraregional flows, an important part involves trade with China. Since 2005, China has become an increasingly important partner for all other developing country regions". UNCTAD (2017) https://unctad.org/en/PublicationsLibrary/ditctab2017d6_en.pdf

⁴ https://www.wto.org/english/res_e/publications_e/world_trade_Report18_e.pdf

⁵ <https://www.oecd.org/sti/inno/46349020.pdf>

⁶ Horrocks and Anand (2016) <https://www.sciencedirect.com/book/9781782424581/handbook-of-technical-textiles>; <https://www.textilemates.com/technical-textiles/>

⁷ Domestic demand in Pakistan is primarily for plain weave cloth with a high thread count. Indian and Sri Lankan firms are making the transition to higher value complex and differentiated items produced in smaller lots.

⁸ See Kondratas (2005)

http://www.fibtex.lodz.pl/52_20_84.pdf

Takeaways for Pakistan's textile and garments industry

A) The growth of world trade may slow, and this may also impact the textile/garment business. The future looks less rosy and a lot of uncertainty has been injected by the upsurge of protectionism in developed countries.

B) China is likely to maintain and possibly even increase its dominance of the textile market during the medium term. However, much depends on what happens to its garments industry. China has the resources to automate and to hold on to its share of the global market for garments. More likely, given trade tensions and rising labor costs, some of the lower value adding segments of this industry could be transferred abroad. If Pakistan can improve its business climate and the productivity of its workforce, it could be a beneficiary. The window is a narrow one. If Pakistan does not grasp the opportunity in the next few years, most Chinese Foreign Direct Investment (FDI) in garments will go to Vietnam, Cambodia, Bangladesh and Africa.

C) In order to sustain the growth of export earnings, Pakistan will have to move into higher value items (as India and Sri Lanka have done) and into garments that use manmade fibers. It will also have to target expanding markets in emerging economies and lessen its dependence on the markets of the EU and the US. One way of moving up the value chain is to incentivize FDI in more complex high value products.

D) Fast fashion, online purchasing, customization of products, small lot production, and lean retailing will spread from the advanced countries to emerging markets (they already

are making inroads in China) the major markets for Pakistan's current and future exports. Serving these markets will call for greater flexibility on the part of producers and emphasis on speed of delivery.

E) Labor displacing automation is unavoidable, but it needs to be selective and cost effective.⁹ Firms need to keep close tabs on cutting edge technologies and to weigh their merits. If they pass muster, it is important to invest and learn by doing. Technological laggards ultimately pay a high price in the form of lower productivity and diminished competitiveness. Firms need to be proactive and stay one step ahead of the competition. And the competition will only become fiercer.

F) Pakistan's textile industry does too little R&D. Most of the technology it acquires is embodied in equipment.¹⁰ This needs to change. Technology search and technology assimilation calls for its own research effort. This has to go hand in hand with workforce training, so as to make optimal use of new technologies as they are brought into use.

G) Over the longer run, Pakistan needs to reduce its dependence on the textile and garments industry. From a developmental standpoint, it is a dead end and this should be apparent from Pakistan's economic performance to date. It is never going to drive the economy. As automation makes deeper inroads, the industry will employ fewer workers and the nation will have to develop other activities that both generate sufficient employment and steadily increase the growth of total factor productivity. A tough challenge, but it is not too early to start thinking of how the structure of the economy will need to be reshaped.

⁹ See Deeghawathura (2018) <https://www.project-syndicate.org/commentary/global-south-disrupted-apparel-industry-by-heshika-deeghawathura-2018-06?barrier=accesspaylog>

¹⁰ Wadho and Chaudhry (2018) <https://www.sciencedirect.com/science/article/abs/pii/S004873331830088X>