Garments for growth

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Outline

• Importance of the RMG sector and export competitiveness vis-à-vis regional comparators
• Main challenges undermining RMG sector
  • Supply-side
  • Demand side & investment climate
• Identifying opportunities for the RMG sector
  • CPEC and the China-Pak FTA Phase II
  • Potential obstacles
• Way forward
RMG sector: Importance and diagnostics
In 2018, garments contributed to

- **23%** of national exports
- **40%** of textile exports
- **2.6%** Of labour force
- **4 times** More value addition at manufacturing stage than previous stages in value chain

Even this conservative estimate means 1.7 million employed in garments alone.

- Roughly speaking, 50,000 kg of cotton fibre ➔ 400 jobs in spinning, weaving & finishing
- 1600 jobs if utilized in garments

So not only is the employment multiplier large, but jobs require less capital and lower investment

* A very conservative estimate, based on industrial employment growth between LFS 2014-15 and 2017-18
...and its significance is growing

Source: Pakistan Readymade Garments Manufacturers & Exporters Association and Trade Development Authority of Pakistan
HS 61 (Knitwear) and HS 62 (Woven) apparel are the 3\textsuperscript{rd} and 4\textsuperscript{th} top export of Pakistan.

<table>
<thead>
<tr>
<th>Exports 2018 (USD bn)</th>
<th>HS 61</th>
<th>HS 62</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-2018 (%) p.a.</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Share in world exports (%)</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Ranking world exports</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>Top export</td>
<td>Shirts of textile materials</td>
<td>Ensembles of cotton</td>
</tr>
<tr>
<td>Share world export (%)</td>
<td>43.6</td>
<td>88.4</td>
</tr>
</tbody>
</table>

<table>
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<tr>
<th>Top 5 destinations of Pak exports (%)</th>
<th>Share in Pakistan's exported value between 2014-2018 (%)</th>
<th>Growth in export value between 2014-2018 (% p.a.)</th>
<th>Average tariff faced by Pak (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>36.3</td>
<td>-2</td>
<td>14.3</td>
</tr>
<tr>
<td>UK</td>
<td>15.4</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>7.7</td>
<td>15</td>
<td>0</td>
</tr>
<tr>
<td>Spain</td>
<td>7.7</td>
<td>12</td>
<td>0</td>
</tr>
<tr>
<td>Germany</td>
<td>7.6</td>
<td>13</td>
<td>0</td>
</tr>
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<tr>
<td>USA</td>
<td>23.1</td>
<td>6</td>
<td>10.7</td>
</tr>
<tr>
<td>UK</td>
<td>12.7</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Spain</td>
<td>11.9</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Germany</td>
<td>10.7</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6.9</td>
<td>6</td>
<td>0</td>
</tr>
</tbody>
</table>

China is the 12\textsuperscript{th} and 14\textsuperscript{th} largest destination for HS 61 and HS 62 respectively (1.1% and 0.8% export share of Pak). Pak currently faces average tariffs of 4.5% and 6.6% in China.
Despite recent growth, Pakistan’s world export ranking remains low

<table>
<thead>
<tr>
<th>Country</th>
<th>Exports 2018 ($bn)</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>145</td>
<td>1</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>39</td>
<td>2</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>28.2</td>
<td>3</td>
</tr>
<tr>
<td>Italy</td>
<td>23.2</td>
<td>4</td>
</tr>
<tr>
<td>Germany</td>
<td>23</td>
<td>5</td>
</tr>
<tr>
<td>India</td>
<td>15.7</td>
<td>6</td>
</tr>
<tr>
<td>Turkey</td>
<td>15.3</td>
<td>7</td>
</tr>
<tr>
<td>Spain</td>
<td>14.4</td>
<td>8</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>13.1</td>
<td>9</td>
</tr>
<tr>
<td>Cambodia</td>
<td>12.9</td>
<td>10</td>
</tr>
<tr>
<td>Pakistan</td>
<td>5.4</td>
<td>17</td>
</tr>
<tr>
<td>World</td>
<td>479</td>
<td></td>
</tr>
</tbody>
</table>

*Note: 2019 figures estimated from monthly trade statistics from SBP. Accessed Jan 2020

Source: Data accessed from ITC Trade Maps in Jan 2020
Moreover, Pakistan’s export gap widened regionally over 2007-17

..as Pak exported products with stagnant demand (2012-16)

Widening export differential with competitors

Over 2013-17, 2/3 of Pakistan’s top exported product lines moved opposite to world demand

Source: Data sourced from Trade Competitiveness Map
Global RMG growth (till 2020) has been forecast at 5-6% p.a. Yet Pakistan’s RMG sector faces many challenges.

Constraints: Supply- and demand-side
Impediments: Supply-side constraints

1. Unreliable domestic supply chain
2. Market failure in technology adoption
3. Higher production costs versus peers
4. Low labour productivity
5. Poor access to credit
6. Unable to benefit from clustering

Producers have to make more basic entry-point type garments
Firms trapped in low price-low-value downward spirals
Approx. $4* 
$3.93 
$3.46

* Without adding margins and port transport costs

• Asia new garment factory of the world—producing 2 out of every 3 garments in world markets as of 2017
• Challenge for Pakistan: fierce competition from low-wage competitors in labor-intensive, low-technology garments
• Difficult to attain scale necessary for cost effective production and modernisation of technology

• Investment in textile machinery (spinning and weaving) has fallen: 44% decline since 2005-06 peak investment of $1 billion (<$0.56 billion in 2016-17)

Without improving investment attractiveness, Pakistan cannot insert itself into regional and extra-regional value chains
A US$ 145+ billion worth world market wide is on offer due to the slow withdrawal of China from apparel

Opportunities to revive the RMG sector: CPEC AND Phase II of the CPFTA
Can CPEC revive the garments sector?

Textiles is one of the areas of focus in industrial cooperation in Long Term Plan (LTP)

CPEC comes at an opportune time for Pakistan garments sector and can help relieve some of the impediments identified

1. Alleviate energy shortages: 5320 MW of electricity have been added to grid by 2019
2. Technical cooperation for supply chain development, especially in PSF and MMF
3. China invested USD 2.7 billion in Xinjiang (2017) to use imported cotton from Pak
4. The SEZs and industrial parks under planning could provide “islands of excellence”

- Benefits hinge on improving garments sector attractiveness in Pakistan, to encourage export-driven FDI, and for Chinese firms to engage with local labour & firms and not just turn RMG sector into assemblers for China
Pak-China FTA Phase II (2020-2030)

• The RMG sector stands out as a clear winner: Pakistan now has better market access than its top 5 competitors in China for 52 RMG product lines (at the HS 6-digit level).

1. Pakistan now has duty-free access to China like its developing country competitors such as Bangladesh, Vietnam, Cambodia, Thailand or Indonesia.
2. Better access than developed country competitors like Italy, Japan, Portugal, USA or South Korea.
3. If RMG sector can diversify its product mix, it can capture additional Chinese demand of USD 1.23 billion: a LR opportunity as Pak currently does not export at all.

• CPFTA II offsets the tariff disadvantage of the ASEAN-China FTA in 2010 that adversely affected Pak’s RMG sector during CPFTA I (2007-12).
CPEC and CPFTA II could be the push

**What Pakistan offers**
- Relatively complete cotton supply chain and lower wages
- GSP Plus access to European markets
- Alternative to South China Sea suppliers amid US-China trade wars

**What China wants**
- Realising “Made in China 2025” vision
- JVs in production due to difficulty in operating fully owned firms without local partners
- Pak: import of synthetic and blended fabrics from China
- Pak: JVs in distribution
- China: JVs in production
- China: use Pak raw material and process garments in SEZs

**What they both get**
- Exporters estimate that RMG demand could rise by 15-20% for Pakistan in 5-8 years
  - Global buyers will source from Pakistan due to its equivalent/better market access in China due to both CPFTA II and CPEC compared to its competitors
- Exporters believe that to maximise its gains, China will also re-locate its fabric production to Pakistan.
Way forward: Looking beyond Chinese market access and CPEC

Information about new (esp. Chinese) markets, partners, distributors and standards

Trade Facilitation: Need FTAs with Turkey, Japan and South Korea to secure better export opportunities and import options

Domestic supply chain (especially synthetic) is weak: incentivise imports of blended/MMF fabric from cheapest supplier, improve DTRE mechanism

Non-tariff barriers: Create awareness, brand Pakistani products aggressively, mutual recognition of standards, help firms meet standards by connecting successful exporters
Conclusion

• RMG will pave way for economic development: many low-income countries that have/are transitioning to middle-income status have grown due to RMG sector

• Two new opportunities on offer: CPFTA Phase II and CPEC

• But market access does not guarantee export success

• Sector and GoP must resolve internal supply-side constraints, facilitate trade and provide information to connect B2B

• Policy objective must be facilitation of the sector to make RMG an attractive opportunity for all countries, not just China