Briefing note

Comparative country study of the development of textile and garment sectors

Lessons for Tanzania

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Key messages

- During the early stages of industrialisation, countries generally enter the textile and apparel sector through garment manufacturing. Export orientation is the driver of growth and it is typically catalysed by FDI in early stages.
- Countries have had mixed success in moving beyond garment manufacturing, which is often dependent on the types of foreign investors present.
- Preferential market access helps attract investment in export-oriented production. However, on its own, it does not lead to backward linkages or promote locally owned manufacturing. Incentives need to be set by the public sector to encourage investors to diversify, upgrade, source locally and invest for the long run.
- Governments have supported sector development through proactive industrial policy, targeted sector promotion, investor-friendly policies and regulations, financing innovation and supporting infrastructure, including export processing zones.

Recommendations

- Improve the business environment, along with investment attraction and aftercare.
- Target investors who are willing to make long-term investment commitments, help build local capabilities and develop backward linkages.
- Actively support backward linkages into yarn, fabric and other intermediate inputs, as they may not simply follow from growth in garment exports.
- Speed up progress in developing industrial parks and special economic zones.
- Promote trust and mutually beneficial dialogue between the government and the private sector.

Introduction

This briefing note summarises the findings of a recent paper gathering empirical evidence on growth trajectories in the textile and apparel sector from six case studies (Balchin and Calabrese, 2019). These countries (Bangladesh, Cambodia, Ethiopia, India, Lesotho and Madagascar) have had varying degrees of success in developing their textile and garment sectors. Here, we extract relevant lessons from different approaches for developing a vibrant, vertically integrated, textile and apparel sector with strong local capability and ownership.

Key questions for each country context included:

- At which stage in the value chain did the country start? Most start in garmenting; were there exceptions? Did the country get 'stuck' in one stage? Why or why not?
- Did the development of integrated value chains occur organically or by design?
- What was the role of the public sector? Were there specific efforts to stimulate backward linkages (e.g. from garmenting backwards into textile manufacturing)?
- What conditions facilitated value chain development and enabled the country to respond to opportunities at different stages of the cotton-to-clothing value chain?
- What was the country's approach to foreign direct investment (FDI)? Did foreign investors help build local capabilities or invest in backward linkages via domestic sourcing of inputs (e.g. fabric)? Why or why not?
- What policy measures were taken to promote local ownership? How successful was this?

This briefing note intends to start the discussion on the key lessons and implications for Tanzania, to steer the next stages of research and investigation.

Insights and highlights from six country case studies

Bangladesh: strong domestic ownership and pockets of backward linkages

Bangladesh is among the largest textile and garment exporting countries in the world. The industry was kick-started by a partnership between a local entrepreneur and South Korean conglomerate Daewoo, to form Desh Garments Ltd in 1977. The presence of a foreign company was fundamental to Desh's learning about production processes. It provided advanced technologies, built capacity and facilitated further training and the transfer of skills. It also helped Desh to develop networks of suppliers and customers.

The rules of origin of the Everything But Arms (EBA) scheme were a major factor in Bangladesh's success. Daewoo selected the country because of its preferential access under EBA, which at the time required two-stage transformation, thus necessitating substantial in-country value addition (Ahmed, 2012). Another factor was the role played by the second-generation Bangladeshi firms that entered the sector following the first wave of foreign investment, as a large cohort of Bangladeshi managers left Desh to start their own operations. Domestically owned textile and apparel manufacturers now represent the vast majority of the sector, exercising huge political clout through the Bangladesh Garment Manufacturers and Exporters Association.

The Government of Bangladesh played an active role in removing restrictions on foreign investment, which allowed firms like Daewoo to enter the market. Government policies also supported upgrading and backward linkages through a back-to-back letter-of-credit facility. This enabled raw material imports. It also assisted with the following:

- targeted support to export processing zone (EPZ) firms for upgrading
- allowances for duty-free imports of capital machinery
- raw materials and intermediate products used in export-oriented industries
- financial support (including subsidised credit to invest in technology and machinery)
- the provision of bonded warehouse facilities (Moazzem and Sehrin, 2016).

Over time, the strongest backward linkages have emerged in the domestic manufacture of knitwear fabric, which has reduced lead times for garments and improved overall competitiveness. Woven textiles remain largely imported.

Cambodia: CMT growth, but upgrading remains elusive

While Cambodia is a latecomer in the global garment industry, its production and exports have grown rapidly. The quota system was instrumental in kick-starting activity in garments, as foreign firms used Cambodia as a platform for garment production. In conjunction with the International Labour Organization's Better Factories programme, which promoted Cambodia as an ethical sourcing destination, this helped build the country's profile as a garment producer (Sibbel and Borrmann, 2007).

An open investment regime was another important factor in Cambodia's success, providing generous incentives for export-oriented firms and national treatment to foreign investors. Cambodia's welcoming environment for FDI facilitated large amounts of foreign investment. However, over time, the lack of proactive government policy to facilitate domestic investment, either in garments or in the upstream sectors, has preserved the dominance of foreign investors and not encouraged value addition within the country.

The Cambodian garment industry is currently focused on cut, make and trim (CMT) production and there is very limited integration along the value chain. Cambodia does not produce cotton or textiles, and imports are sourced abroad by foreign companies. Thus, domestic value addition is limited. Moreover, most decisions related to production are made outside of Cambodia. Encouraging more domestic value addition will mean moving from CMT towards a free-on-board (FOB) system that would enable relocation of some processes and decision-making – such as the development of styles as well as fabric and accessory purchasing decisions – to Cambodia.

Ethiopia: strong government leadership, but a mixed start to domestic links

The rapid growth of export-oriented garment manufacturing in Ethiopia owes much to a favourable mix of proactive, state-led industrial policy. This focuses on an ambitious industrial park programme, strong incentives for investment and effective investment promotion led at senior levels of central government. It also relies on significant FDI inflows.

While the government operates a two-pronged policy of import substitution and explicit export promotion, priority in attracting FDI is accorded to higher value-added, export-oriented investment. Some foreign manufacturers, mostly Turkish and Asian firms, have invested in production bases in Ethiopia to supply major international brands and retailers. This has facilitated rapid growth in Ethiopia's export-oriented garment production capacity: apparel exports expanded from less than $250,000 in 2000 to $63 million in 2016.

There are several vertically integrated textile companies and some international firms have established vertically integrated garment factories in Ethiopia. This is a distinguishing feature from most garment-exporting countries in sub-Saharan Africa (Staritz et al., 2016).

Ownership in the sector is also more diversified than in other garment exporting countries in sub-Saharan Africa and includes different types of locally owned firms operating in both the textile and garment segments. The presence of locally owned firms is partly due to Ethiopia's history of garment manufacturing, which not only saw support for the development of indigenous expertise (Yost and Shields, 2017), but also explicit government provisions to include domestic entrepreneurs from the outset.

Despite this, backward linkages and local subcontracting remain limited and overall domestic industrial capabilities have yet to catch up with the sector's growth. A long history of textile production for traditional wear has supported some backward integration from garments to textiles, but Ethiopia still imports significant volumes of yarns and fabrics, and its reliance on foreign inputs for the garment sector has resulted in a rapidly expanding trade deficit. Use of domestically grown cotton in the production of modern textiles is also constrained by low quality and volume.

The government is attempting to address this by offering performance-based incentives – including working capital, access to foreign currency and cost sharing for skills development – in industrial parks, to encourage backward

linkages to domestic suppliers. However, skills development and domestic management capacity remain significant concerns in terms of Ethiopia's ability to take advantage of the influx of FDI, as these capacities constrain opportunities for supplying foreign firms.

India: large internal market begets vibrant domestic ownership

The textile and garment sector in India is rooted in a long history of cotton and textile production. The modern sector was developed through a combination of two measures. One was trade protection, which promoted the use of domestic inputs. The second was supportive government policy, which promoted production and encouraged exports. In recent times, the sector has opened up to the international market and foreign investment, while the government has maintained its support to ensure competitiveness.

The Indian garment sector has a history of producing cotton and textiles, and a domestic market of 1 billion consumers. The sector is well integrated along the value chain and there are high levels of domestic ownership. This differs from many of our case study countries, which that have populations of less than 100 million and rely on exports to achieve economies of scale. While FDI is increasingly present both in production and retail, these investments have not been catalytic in promoting the initial growth of the sector.

The Indian Government has played an influential role in the sector's development by actively promoting the use of domestic textiles for garment production and, at the same time, supporting exports through a series of targeted policies. Examples of this include establishing separate export promotion councils for textiles and apparel, and using duty drawback programmes to promote exports (Tewari, 2006).

Lesotho: growth in garment sophistication, but limits to further linkages

The development of Lesotho's garment industry is a much-publicised example of how preferential trade and FDI can interact to kick-start industrialisation around export-oriented garment production. The sector's rapid growth, particularly since 2000, has been driven in large part by preferential access for exports to key markets alongside an influx of FDI from Taiwanese and South African firms.

The Government of Lesotho has also played a proactive role in attracting investors. These efforts have included making improvements to transport infrastructure and introducing customs and logistics systems. The government has also provided early-stage special FDI incentives and industrial zones, as well as serviced factory shells (Shakya, 2011).

But Lesotho's experience demonstrates both the power and limitations of trade preferences and the varied implications that foreign investment can have for the development of backward linkages and the localisation of manufacturing. Although, Lesotho has been producing garments for over 40 years, the sector remains highly reliant on the African Growth and Opportunity Act (AGOA). Very little progress has been made in developing locally owned garment factories and indigenisation of the sector continues to be a major challenge. Most manufacturing is confined to CMT activities and there has been little backward linkage, vertical integration or enhancements in domestic value addition.

However, the contrasting impacts of Taiwanese and South African investment offer insights into the role foreign investment can play in supporting a domestic sector. South African firms in Lesotho operate a different production model and are generally more locally embedded in a regional production network that is tied to nearby South Africa. South African firms have focused on a regional value chain involving Lesotho to capitalise on lower labour costs and duty-free access to Southern African Customs Union markets (Kao, 2016). They produce smaller-run, higher-fashion products to supply South African retailers. This is in contrast to the long runs of basic or semi-basic items produced by Taiwanese firms for the US market under AGOA (Morris and Reed, 2009; Morris and Staritz, 2016). The emphasis on more complicated products with higher fashion content has contributed to some domestic upgrading, albeit within garment manufacturing.

The potential for further growth of the sector is capped by Lesotho's small population and (landlocked) geographic location. The sector is too small to justify significant expansion into other

value chain segments such as inputs (e.g. trim and buttons). Lesotho's close proximity to South Africa has made it difficult to retain entrepreneurial talent in the country, due to the ease of migration to South Africa, thus constraining the emergence of a local business class.

Madagascar: a tale of two investment models shows linkages are possible

A 'single factory EPZ' model, providing a range of incentives to EPZ firms regardless of their location, has helped to make Madagascar's textile and garment sector more outwardly oriented. Combined with preferential access to major export markets, low labour costs and relatively high productivity, FDI from Asian, European diaspora and Mauritian regional investors has also been a key driver of growth in Madagascar's now highly export-oriented garment industry (Andersson, 2009; Fukunishi and Ramiarison, 2012).

While the industry in Madagascar owes much of its recent success to the availability of trade preferences and export orientation, its experience also highlights the vulnerabilities that can arise when a sector is built around preferential market access that attracts relatively footloose investors. The loss of Madagascar's AGOA eligibility in 2010 following a political crisis resulted in the exit of most Asian-owned firms focused on production for the US market.

However, more locally embedded diaspora investors and regionally embedded Mauritian-owned firms did not leave over the loss of AGOA; instead, they shifted market channels and altered their product mix. Companies changed their production to shorter-run, smaller-batch, higher-quality and more complex products to supply regional markets (especially South Africa) and Europe. This resulted in positive impacts on process, quality, skills and product upgrading, illustrating how different investors can adapt in contrasting ways to external developments.

In addition to a variation in the end markets targeted by inward investors, differences in those investors' global value chain relationships and levels of local embeddedness also influenced upgrading (Staritz and Morris, 2013). Since then, Asian investors in Madagascar have mostly sourced fabric through their global networks and focused on simple CMT operations for basic long-run production for the US market. In contrast, French diaspora and Mauritian investors have shown a higher propensity to upgrade processes and products, and also to diversify their export markets to supply smaller batches of differentiated products with higher unit values and more demanding processes and production capabilities (Kaplinsky and Wamae, 2010). Alongside the case of Lesotho, this shows an emerging trend of diaspora or African investors being more likely to embed themselves in the country for the long term, with knock-on effects on upgrading and domestic capabilities.

Conclusions and policy implications

Openness (both to trade and foreign investment) and export orientation are important drivers of growth across the cotton-to-clothing value chain, particularly for countries that lack the size of India's domestic market. An open investment regime, along with EPZs and/or industrial parks, often combined with early-stage incentives, can be effective tools for attracting and channelling domestic and foreign investment into production. This has been especially relevant in the development of garment production in Ethiopia, Lesotho and Madagascar.

In most of the countries analysed in our report, the development of the sector began with garment production or assembly, with subsequent phases of growth closely linked to various waves of (predominantly foreign) investment in export-oriented garment production. India can be viewed as a clear exception. Bangladesh has managed to upgrade and move away from basic garment production and, to an extent, has moved backwards into textile manufacturing, but countries like Cambodia, Ethiopia and Lesotho remain stuck at producing basic, low value-added apparel products, albeit with notable exceptions based on the type of investment and the end markets served by exporters. This indicates that the process of building backward linkages out of garmenting is not automatic and can be heavily influenced by the overall business strategy and structure of the multi-national investors present.

If the business strategy of the investor is driven by temporary preferential market access, there are vulnerabilities that need to be mitigated.

Preferential market access is important in the initial stages of textile and garment sector development. However, once the sector is established, active steps need to be taken to promote upgrading and linkages.

In most settings, investments by Asian transnational firms with disembedded production units have been motivated by a desire to access rents from preferential market access. This has generally brought little backward integration or supply-chain upgrading. In contrast, regional investors with local production networks and diaspora investors have been more locally embedded (e.g. in Madagascar). They are less likely to leave when trade preferences end and more likely to invest in upgrading and linkages. In Bangladesh, inward investment has been used strategically through a joint-venture partnership to develop capabilities in textile and garment production that were not initially present.

Governments have a role to play in shaping these factors. This may involve proactive industrial policy (e.g. Ethiopia), active sector promotion (e.g. Lesotho), the provision of an investor-friendly regime (e.g. Cambodia) or government-financed innovation and infrastructure to support an expanding domestic private sector (e.g. Bangladesh), or a combination thereof. It may also involve measures to identify and target the 'type' of investor the country wishes to bring in – though based on our case studies, the presence of different investor types has appeared to happen more organically.

These insights suggest the long-term development of Tanzania's textile and garment sector could be supported by the following measures:

- Promote an export-oriented model, focusing on high-value markets.
- Make business-environment improvements, with better investment promotion, attraction and aftercare.
- Target the right types of investor, focusing on those willing to make long-term investment commitments, help build local capabilities and develop backward linkages.
- Actively support backward linkages into yarn, fabric and other intermediate inputs, as they may not simply follow from growth in garment exports. This can be more effective if backed by complementary support to help expand domestic firms further up the value chain.
- Speed up progress in developing industrial parks and SEZs.
- Improve coordination in relation to the implementation of policies designed to aid the development of the textile and garment sector.
- Promote trust and dialogue between the Tanzanian government and the domestic private sector.

Future research could focus on generating greater understanding of: (i) the types of foreign investor most likely to embed in Tanzania for the long term and invest in backward linkages, and how best to target them (e.g. through incentives and after-care); (ii) the specific improvements in the business environment likely to have the largest payoffs for the attractiveness of the textile and apparel sector; (iii) the best approaches to accelerate development of local capabilities and skills in textile and apparel manufacturing through the opportunities brought by FDI; (iv) the specific policies and incentives most likely to promote backwards linkages, particularly into textiles and accessories (vertical linkages); and (v) how firms can be incentivised or supported to move beyond CMT towards a FOB system that enables domestic relocation of processes and decision-making.

References

For a full list of references, please refer to the original paper:

Balchin, N. and Calabrese, L. (2019) *Comparative country study of the development of textile and garment sectors*. London: ODI

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