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The textile industry

The looming revolution

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ImagineChina

China, the world's workshop, is poised to become its tailor. What will happen to textile industries elsewhere, especially in South Asia?

THE shirt on your back probably had an exotic life before it reached you. Say you bought it in America and the label said it was “Made in Sri Lanka”. It may well have been made from Chinese fabric, woven from Chinese yarn, spun from Chinese cotton or man-made fibre. Why, you may wonder, was your shirt not actually cut and sewn in China? We know they have scissors and sewing machines there and millions of nimble-fingered operators. After all, many of the other shirts on the shop hangers were indeed made in China.

The question is being asked with increasing urgency in China, too, as well as in Sri Lanka, Bangladesh, Nepal, Cambodia, El Salvador, Honduras and more than 40 other countries with thriving clothing industries based on exports. They are bracing for the scheduled elimination, at the end of this year, of quotas that have governed their exports to the world's two biggest markets: America and the European Union. The quotas have restrained some countries' exports, but in others have created an export industry that might not otherwise have existed.

China is definitely in the first category—its sales in America and Europe will surely grow once quotas are lifted. The questions are: by how much? And what will be done to impede their growth? The American government is under pressure from its own manufacturers to stem a potential flood of Chinese imports. Mechanisms to do this, so-called “safeguards”, were built into the agreement that America signed with China in November 1999 as part of China's accession to the World Trade Organisation (WTO).

A big trade row seems inevitable. American manufacturers want their government to maintain 15 of the 91 quotas that expire at the end of the year—including those for trousers, shirts, sheets and underwear. They also want to keep limits on imports of three products—bras, dressing gowns and knitted fabrics—for which quotas were lifted in 2002 and the “safeguards” subsequently invoked.

The deadline for a government decision on whether to accept the first of these petitions (cotton trousers) fell on November 1st, the eve of the presidential election. The manufacturers had milked as hard as they could the political implications of their bid for protection, saying that China will “destroy” the American textile industry. Trade unions also weighed in, saying that 350,000 jobs have been lost in America's textile sector in the past three years, and that, if nothing is done, many of the remaining 695,000 will likewise soon be on a fast boat to southern China. Sure enough, the petition was granted. America is now looking into whether it will impose safeguards on five other categories of clothing, and will decide by next February. If imposed, these new quotas will limit China's export growth to 7.5% in each category.

China has responded robustly, arguing the “safeguards” were designed to correct actual import surges, not threats yet to materialise. American textile importers and buyers accuse their compatriot manufacturers of trying to achieve through government intervention what they have failed to manage through investment, planning and improving productivity: becoming internationally competitive.

It is not just the rich world's garment-makers that are alarmed. Trade associations from more than 50 countries have signed the “Istanbul declaration”, asking the WTO to keep the quotas for a further three years. They include groups from poor and middle-income places such as Bangladesh, Sri Lanka, Indonesia, Morocco, Tunisia and Turkey.

The declaration argues that circumstances have changed dramatically since the phasing out of quotas was agreed. It claims that the admission of China to the WTO at the beginning of 2002 was not contemplated at the time. (In fact, China had tried hard to become a WTO founder member in 1995.) More to the point, it accuses China of keeping its currency at an artificially low level, and of other dirty tricks such as “state subsidies and the proliferation of non-performing loans and rebate schemes”. Of course, if they are right, this applies to almost all Chinese exports, not just textiles.

The signatories to “Istanbul” fear the end of quotas will mean the loss of important inflows of foreign exchange, the closure of some businesses and the loss of as many as 30m jobs to China's allegedly encroaching global monopoly. The worry is that, having no natural comparative advantage beyond abundant cheap labour, they will lose market share to countries with vertically-integrated supply chains—ie, those that produce their own fibre, yarn, fabric and clothes.

Above all, that means China. But Chinese manufacturers are not the only ones expecting a bonanza. In India and Pakistan, too, many see a moment of great opportunity. For South Asia as a whole, the impact of the end of the quota regime is potentially enormous. In poor countries with small manufacturing bases and a vast rural majority, garmentmaking offers a labour-intensive way of lifting people out of poverty. Sudhir Dhingra, boss of Orient Craft, India's largest apparel exporter, which employs about 18,000 people, says that each machine he buys creates four jobs in his factories and another four outside. In a typical factory, he says, four-fifths of the workers will have started life as poor villagers. Few will have had more than an elementary education.

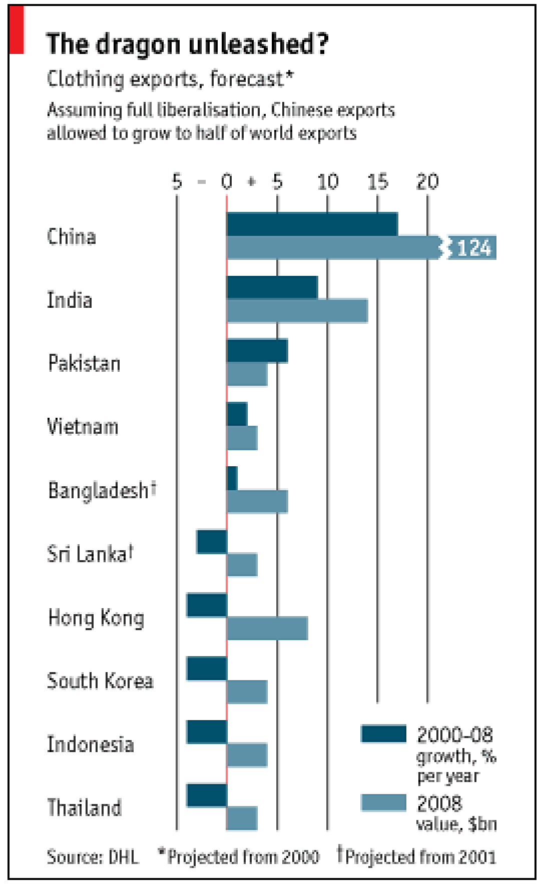
I wouldn't start from here

Clothing is one of the most basic of human needs, and its international trade one of the oldest. Along with food, it is also most subject to artificial distortions. The demise of the biggest such distortion, the quota regime, was agreed a decade ago. The Agreement on Textiles and Clothing

(ATC) came into force, along with the WTO itself, in 1995. It covered the staged elimination of quotas in America, Canada and the EU (as well as Norway, which removed its last quotas in 2001). It was intended as a bridge between the old Multi-Fibre Arrangement, which had covered textile trade since 1974, and the full integration of the trade into the multilateral system.

By 2002, imports to the ATC countries, not counting internal EU imports, accounted for 43.5% of a global textile and clothing trade estimated at $360 billion. Under the ATC, quotas were to be lifted in four stages. But nearly half—49% of import volume—was to be left to the last moment: January 1st 2005. In practice, America chose to “integrate” low value-added items and many that were covered by under-used quotas. As a result, some two-thirds of American textile imports, including 80% of clothing imports, or $61 billion, are subject to quotas until the end of this year. In a survey by Goldman Sachs, an investment bank, 71% of American and European manufacturers, wholesalers and retailers said they at present base more than 20% of their sourcing decisions on quotas. Hence the panic.

There is an historic irony that poor countries should be quaking at the prospect of textile-trade liberalisation. They have long demanded the dismantling of rich-country protection in an industry where they should have most to gain. Quotas that expanded before eventually vanishing were supposed to allow them to take advantage of their low-paid workforces. It seems a long time ago now, but in the early 1980s they witnessed the emergence of three Asian producers—Hong Kong, South Korea and Taiwan—as big exporters of cheap clothes. At their peak, these three accounted for nearly a third of world clothing exports. In 20 years, that share has fallen to 8%, as lower-cost countries have taken away their markets.



Quotas have worked, up to a point, in bringing business to poor countries. But they have had some perverse effects. Firstly, the manufacturing process has become ludicrously cosmopolitan—the Sri Lankan shirt described above had had a sheltered life. “The textile supply chain”, says Arvind Singhal, of KSA Technopak, a Delhi-based textile and retail consultancy, “looks like a Dali painting.” Fine Indian cotton might be turned into fabric in Italy, cut in America, sewn in Honduras and sold back to America.

Second, some countries that had no mechanised textile industries at all until a few years ago have become dependent on them. For example, as Cambodia emerged in the 1990s from three decades of isolation, horror, civil war and Vietnamese occupation, quotas brought foreign investment, especially from Hong Kong and Taiwan, in clothing factories. Their products now make up more than 70% of the country's merchandise exports. The proportions are even higher in Bangladesh and Macau. In Pakistan, Mauritius and Sri Lanka it is also above 50%.

The Indian hope trick

D.K. Nair, of the Indian Cotton Mills Federation (ICMF), an industry lobby, argues that American quotas turned China's textile industries into a Frankenstein's monster. As many Indians see it, China's quotas were set generously in the 1980s for political reasons. This explains the Chinese industry's hectic expansion. By contrast, India's growth was artificially stunted. The entire Sri Lankan and Bangladeshi garment industries were, he argues, “an offshoot of our quota problems”.

So Mr Nair sees the recent tear-jerking appeals on behalf of countries such as Bangladesh as hypocritical. By portraying China as the only beneficiary of the liberalisation, American industry is hoping to garner international backing for its protectionist impulses.

“Welcome”, read the digital display at the entrance to one of the huge exhibition halls in Delhi that made up the Indian Handicrafts and Gifts Fair in October, “to the next best”. It is a fitting, if presumably unintended, slogan for India's textile industry. The refrain repeated time and again by post-quota bulls is not that India is a world-beater. More an egg-beater: “nobody,” the bulls say, “wants to put all theirs in China's basket.”

Mr Dhingra is one such optimist, arguing that India is a “very good second option.” He is adding 30% to Orient Craft's capacity, opening three new factories this year and two in 2005. He candidly accepts that in many products, China offers buyers a “more attractive and cheaper option.” For example, he says, it is “now impossible to make money out of children's clothing.” China's prices—45 US cents an item—are simply unbeatable.

Many buyers, however, still need to hedge their bets. KSA Technopak's Mr Singhal agrees. China will not swamp the global market because prudent supply management demands diversification. Even if one ignores the political risks of dependence on China, recent disasters around the world have been diverse enough to reinforce the message: terrorist attacks, hurricanes, earthquakes, SARS—all can disrupt supply lines. Wal-Mart, the world's biggest retailer and buyer of about one-tenth, or $15 billion-worth, of China's annual exports to America, stresses its desire for a steady and geographically diverse supply of product.

India recommends itself as what Mr Singhal calls a “secondary base”. It is an English-speaking democracy. It is, after China and America, the world's third-largest cotton producer. Reliance, an Indian firm, is the world's biggest polyester maker. With 34m spindles, India is, next to China, the world's biggest yarn-spinner. It has huge clothing and carpet industries with centuries of history behind them. Wajahat Habibullah, the government's textiles secretary, points out that the wealth of the Mughal empire, which gave way to the British Raj, was founded on carpets and textiles.

A very fine yarn

The ICMF, the Indian manufacturers' lobby, has forecast that Indian textile exports can grow at 18% a year to reach $40 billion by 2010, making up more than a third of the country's merchandise exports, compared with a quarter at present. In the process, 5m jobs would be created, so that the industry, already India's second-biggest employer after agriculture, will have 40m workers.

A WTO study backs the optimism. It expects India's share of the American market to increase from 4% to 15%, as against a jump from 16% to 50% for China. The losers would be Mexico, South America, the EU, Africa and the Middle East. But there are doubters. India's industry is still dominated by thousands of small family-owned firms. Many lack the marketing skill to take advantage of the new freedoms. Nor is the industry universally admired. In neighbouring Sri Lanka, some garmentmakers say that Chinese fabric suppliers are cheaper, faster and more reliable.

In March, a report by McKinsey, a consultancy, commissioned by DHL, a shipping and logistics firm, suggested that, in the absence of further reforms, the growth rate of India's textile exports would be no more than 8% a year. It reported a study comparing the number of men's shirts produced per hour and found that India's productivity was at 35% of American levels. China scores a much more impressive 55%. The overall productivity of India's textile industry was only 16% of America's.

Many reforms are promised by the Congress-led government that took power in May. On some—such as a sweeping tax reform—it is optimistic it can deliver. Others, however, especially labour-law reform, will be difficult for a party that relies for its parliamentary majority on the votes of communist parties. Kamal Nath, the commerce minister, says a manufacturer told him he had declined an order for 50,000 shirts because he could not risk taking on workers he could not let go. “We have to move from protection of employment to promotion of employment,” says Mr Nath, more in hope than expectation.

One other likely winner in the new regime is Pakistan. Its strengths are low labour costs, a raw-material base in both cotton and man-made fibres, and an estimated $4 billion in investment in the past four years. Because of its importance as an American ally, Pakistan has benefited from enlarged quotas in recent years. But in some market segments—such as bed linen and towels—it is seen as a good global competitor.

But what about the expected losers? Like athletes forced on to performance-enhancing substances who now struggle to compete on their own merits, they will suffer painful after-effects from quotas. In South Asia, Bangladesh, Nepal and Sri Lanka are all vulnerable. In Bangladesh, for example, the industry has grown from 400,000 people and 800 factories in 1990 to nearly 2m people and 4,000 factories now. Nine-tenths of the workers are women. Zaidi Sattar, an economist at the World Bank in Dhaka, estimates that 10m-12m people depend on the industry.

An IMF report published in June puts the potential loss to Bangladesh's exports from quota elimination at 25%. That, says Mr Sattar, is “on the pessimistic side”. But there are real worries. There is a debate about the garment industry's lack of “backward linkages”—its raw materials are all imported, putting a premium on labour costs, productivity and transport. Some want the government to help by subsidising the production of man-made fibres and fabrics. Upstream, textiles are a capital-intensive industry and capital is in short supply and expensive in Bangladesh, so taxpayer's money might be better spent on, say, roads.

Threads of life

You would have to be a very hard-hearted free-trader not to feel a pang for the threatened Bangladeshi garment worker. Like her counterparts in Sri Lanka and Nepal—and elsewhere—she already suffers from living in a country beset by political instability, and has to bear the additional burden of frequent cyclones and floods.

The effect of the quota eliminations may not, however, turn out to be as bad as some fear. The Goldman Sachs survey found that 86% of European buyers and all the American ones were already negotiating price cuts. Yet Bangladesh was second only to India among countries where buyers expected to increase procurement in 2005. It must be doing something right.

The survey also found that most buyers expect to buy from fewer countries than before. The trade is ever more dominated by a few giant retailers—such as Wal-Mart and J.C. Penney—whose purchasing decisions will help dictate the shape of the global industry. That is grim news for many of the less productive garment-manufacturing locations.

Yet Wal-Mart says that its global garment procurement in 2005 will be much the same as in 2004. There are a number of reasons to think that it may be some time before the full impact of the year-end cut-off is felt. First, countries have found their niches—Sri Lanka, for example, is strong in lingerie; it is one of Victoria's Secrets. Second, safeguards against surges of Chinese imports are likely to be invoked in both the EU and America for some products, leading to arguments at the WTO. That will extend the transition period. Change may not come as fast, or as brutally, as the pessimists fear. But remorselessly, the loose threads of the global textile industry are being tied up.