

7 Broad Conclusions and Policy Implications

7.1 Broad conclusions

The textiles and clothing sector is a leading sector in terms of trade and employment in all major south Asian countries. It constitutes more than 40 per cent of total regional exports and provides employment to more than 10 million people in most of the countries. The steady rise in T&C exports from south Asia was arrested by the global economic crisis of 2008 and the sector's exports declined by 18 per cent, reducing its share of global exports from 7.7 per cent in 2007 to 6 per cent in 2009. There are growing competitive pressures on the sector in the region as a result not only of reduced global demand, but also the erosion of preferences caused by free trade agreements, the withdrawal of GSP+ schemes and other policy-related developments. This makes it important to improve the cost competitiveness of the sector so that all countries in the region are able to respond positively to the existing and forthcoming global challenges. One way to increase regional competitiveness is through the formation of regional production supply chains, whereby each country exports the products in which it is competitive and imports inputs from the countries within the region which have a cost advantage.

In this context, the main aim of this study is to identify the potential production supply chains that can be formed within the region so as to improve the cost competitiveness of the region as a whole. This may enable south Asia to increase its share in global T&C exports and benefit each of the countries in the region in terms of enhanced exports, output and employment. The study finds that there is a high potential for intra-industry trade in textiles and clothing in south Asia. Using the average for the period 2005–2007, the Grubel-Lloyd index for south Asia with respect to world trade in T&C is estimated to

be 27.3 per cent, while that with south Asia is estimated to be 16.6 per cent. This indicates that in the T&C sector, south Asia's intra-industry trade with the world is much higher than that with the region.

What is interesting is that within south Asia, there exists both demand for and supply of T&C sector inputs within the region, as different countries specialise in different segments of the sector. Bangladesh and Sri Lanka have higher shares of clothing in their exports, while Pakistan has a higher share of textiles. India, on the other hand, produces and exports across the value chain. In order to identify the potential supply chains, the methodology adopted is based on a simple logic, which is to identify those inputs used in the T&C sector which a country imports globally but not from south Asia, although there exists a south Asian country which globally exports these inputs. For such inputs, which may be products that fall within or outside the T&C sector, both demand and supply exists in the region.

Using the input–output database constructed by UNCTAD (through its India Project Office) for the T&C sector (which identifies the inputs of each of the HS 6-digit codes), the analysis is undertaken at HS 6-digit level for chapters 50–63. For each of the four countries, the final product for global exports is identified. The criterion used is existing exports with a total value of over US\$100,000 (using average exports for 2005–2007). For the identified final products for exports, the stage I inputs are identified that are globally imported by the country (more than US\$100,000). Two south Asian countries which globally export this input with a value of over US\$100,000 are identified. Using the same criterion, the study identifies the primary inputs to stage I inputs and identifies the potential exporters and importers of these inputs, forming a potential supply chain.

The number of stages of identified potential 3-stage supply chains in which a country may participate are 1,032 for India; 795 for Pakistan; 418 for Sri Lanka; and 245 for Bangladesh. These 3-stage potential supply chains are formed for the global

export of identified final output. Thirty-seven unique T&C tariff lines are identified as final product for export in the potential supply chain for India; 29 for Pakistan; 15 for Bangladesh; and 8 for Sri Lanka. It should be noted that the potential final output need not necessarily comprise clothing, but can also be raw materials such as fabrics or yarn. The largest number of unique stage I inputs which can be imported from within the region is that for Sri Lanka (34), closely followed by Pakistan (27), India (25) and Bangladesh (19). The number of unique primary inputs used in stage I inputs that can be imported is greatest for Pakistan (103), followed by Bangladesh (47), India (19) and Sri Lanka (2). These inputs comprise both T&C and non-textiles inputs such as chemicals. The study also identifies 2-stage supply chains where information on primary inputs used in stage I inputs is unavailable.

The existing trade flows in the identified 3-stage and 2-stage supply chains indicate that countries in south Asia have an import demand for inputs relevant for establishing supply chains in the T&C sector, but that this demand is met mainly from sources outside the region although the region has the supply capacity for exports. When one estimates the percentage share of a country's global imports of the identified inputs and compares it with the region's exports of these inputs, it is seen that Bangladesh's global imports of these identified inputs comprise only around 18 per cent of the region's exports of the inputs. For Sri Lanka the figure is around 9 per cent and for Pakistan around 7.5 per cent. This indicates that sufficient supply capacity exists within the region to meet the demand for the identified inputs. However, India's global imports of the identified inputs is around 350 per cent of the region's exports, showing that India's demand for the identified inputs is much greater than the region's export capacity.

A possible constraint to the formation of the potential supply chains that have been identified is the availability of lower-cost inputs from other global suppliers. To take this into account, the export unit values of each of the major south Asian countries, together with those of the major global

suppliers of the product, is reported. The study shows that for many of the products identified as inputs in the potential supply chain, countries within the region have lower export unit values than the major global suppliers. In spite of the existence of a lower-cost exporter in the region, in all the countries under review global imports of many of the identified inputs are higher than imports from within the region.

Many of the identified inputs in the potential supply chains are identified as products in countries' SAFTA sensitive lists, with tariffs of over 5 per cent. This indicates that at national level each country has policy tools to form the identified supply chains and lower its import unit values from the region as compared to the world. SAFTA has a very important role in making the potential supply chain work. The lowering of tariffs and removal of the identified products of imports from a country's sensitive list under SAFTA can help not only to improve the cost competitiveness of a country's imports, but also to make its exports more globally competitive.

For 12 of the 13 inputs from the T&C sector that are globally imported by Bangladesh, the export unit value of at least one regional supplier is lower than that of the top exporter. For India, out of 38 potential inputs of imports from within the region, all tariff lines have import tariffs of more than 5 per cent and 12 tariff lines are on India's sensitive list under SAFTA. In Pakistan, in 43 of 117 potential inputs of imports from within the region, the export unit value of at least one regional supplier is lower than that of the top exporter. All tariff lines have import tariffs of 5 per cent or more and 17 tariff lines are on Pakistan's sensitive list under SAFTA. For Sri Lanka, out of 36 potential inputs of imports from within the region, in 35 products, the export unit value of at least one regional supplier is lower than that of the export unit value of the top exporter. However, none of the tariff lines have import tariffs of more than 5 per cent and none of the tariff lines are on Sri Lanka's sensitive list under SAFTA.

7.2 Issues to consider and policy implications

The above analysis brings to the forefront an important conclusion: despite the existence of strong potential for the formation of regional supply chains in the T&C sector in south Asia, market forces on their own have not been successful in developing these supply chains. Intra-regional trade remains very low and complementarities in the region have been ignored in favour of competition, which has denied south Asian countries the opportunity to lower the production costs of their global exports.

Regional supply chains, if put in place, offer not only a reduction in production costs, but also the advantages of economies of scale and lowering lead times for global deliveries. However, the formation of supply chains gives rise to an important concern: they could undermine countries' efforts to develop their own domestic backward linkage industries. In order to address this concern, the methodology for this study has been devised in such a way as to rule out such a possibility. A basic consideration in the analysis is whether the countries are already importing from the rest of the world and, if so, whether regional sourcing can replace those supplies. Therefore if, for example, a country is sourcing all its import requirements from its internal backward linkage industries, there is no scope for developing regional supply chains. In other words, since global imports already exist, there is no reason to believe that regional imports will hurt domestic industries.

It is also important to point out that the analysis only considers regional imports for use in the export-oriented sector and not for domestic consumption. As a result, regional supply chains – at least in the way they have been presented in the study – do not pose a threat to domestic industry.

Following from the above, it is worth mentioning that the sensitive list under SAFTA may not be a constraint on regional supply chains. In most cases, the export-oriented sectors procure their raw materials from the cheapest possible global sources. Even when the relevant domestic import competing

sectors operate under the shield of tariffs and other support measures, exporters are allowed duty free import of raw materials or to make use of such facilities as duty drawback and bonded warehouses to protect their competitiveness by importing inputs from globally efficient suppliers. From this perspective, the sensitive lists maintained by the countries of the region should not be a problem in allowing their exporters to source raw materials from the region. This is an issue that deserves the attention of policy-makers and businesses.

There may be some apprehension about compromising the export sector's competitiveness by using raw materials and primary inputs manufactured in the region. Another related concern is whether the regional supply chains could lead to trade diversions, triggering welfare costs. However, as pointed out above, south Asian countries already export many of these items to the world market and compete well with other major global suppliers; in light of this, the concern about undermining the competitiveness of the export sector may not be justified in a range of product lines. On the other hand, it is important to note that the study does not advocate trade policy induced measures (such as tariff concessions for regional partners) to promote regional trade or supply chains. The south Asian T&C industry is overwhelming globally market-oriented and exporters must have access to raw material supplies at world prices. Therefore, any suggestion of discriminatory tariffs on input supplies by source is not considered, thereby eliminating the possibility of trade diversion. Nevertheless, it does not rule out the scope of policy interventions by south Asian countries, as they can be more ambitious in integrating their T&C industries across the region. This, however, has not been considered by the current study.

There are other factors associated with competitiveness where regional supply chains can exert beneficial effects. Unlike in traditional trade theories, there is now robust evidence that transport costs reduce tradable volumes. In ideal circumstances, supplies procured within the region will involve lower transport costs, thus improving individual south Asian

countries' competitiveness. With regard to the exports of textiles and apparels, most south Asian countries suffer from high lead times (i.e. the time from the receipt of an export order to its delivery at the importer's designated port). Regional sourcing of raw materials, particularly for apparels, can greatly help mitigate this problem.

The distribution of regional export gains may also attract the attention of some observers. As some countries within the region have a larger supply capacity than others, concerns may be raised about unequal distribution of gains from regional supply chains. This argument is misconceived. According to the methodology adopted, countries import intermediate inputs in order to increase their exports. If countries could not experience increased export earnings, regional imports would not rise. In addition, one should not focus only on the distribution of regional exports; what is more important is the growth of overall exports to global markets.

However, one important caveat about the supply chain assessment must be acknowledged. Despite the use of highly disaggregated data, it has not been possible to take into account quality variations across various suppliers. There is no denying that the quality of inputs will determine a supplier's ability to cater for a particular market. In the case of apparels, in particular, many importers provide strict specifications for the inputs to be used and their preferred sources. This can somewhat reduce the scope for regional sourcing. Nevertheless, the study has provided detailed and disaggregated product level information on where potential for developing regional supply chains exists. Based on this, industry stakeholders can more precisely assess any likely effects of product heterogeneity on regional sourcing and exports.

It goes without saying that much of the existing scope for exploiting supply chains largely depends on the progress made on overall co-operative efforts among the south Asian nations. The existence of bilateral political differences has affected the advancement of regional economic co-operation. It has been found that when it comes to regional partners, south Asian

countries are more restrictive than in their trade regimes with the rest of the world. Together with tariff barriers, a plethora of non-tariff measures seriously constrain intra-regional trade and investment flows. Due to lack of political will, the region also suffers from relatively poor trade facilitation and high transaction costs associated with cross-border exchange. All this will naturally have serious implications for the promotion of regional supply chains.

Nevertheless, the study identifies inputs in which the countries in the region are exporting globally or have the potential to export, but they may not be the least-cost supplier in the region. There is a need to develop the potential of these products within countries in order to increase their supply capacity and competitiveness. Apart from high tariffs and inclusion of products in countries' sensitive lists, other reasons for the lack of supply chains in this sector in the region could be the existence of non-tariff barriers. Stakeholder consultations are needed to identify specific non-tariff barriers that designed in a manner such a way that they impede imports from within the region, which lowers the possibility of the formation of supply chains. The importance of trade facilitation for improving the competence and competitiveness of the region in forming supply chains and emerging as a more cost competitive supplier needs urgent attention.

To conclude, the study brings out the potential of south Asia to emerge as a globally more competitive supplier of textiles and clothing through identified potential supply chains that can be formed within the region. However, there is a need for policy intervention in terms of a detailed examination of the sensitive lists of each country under SAFTA; a re-examination of tariffs for the identified products under SAFTA; the removal of non-tariff barriers; and emphasis on trade facilitation.