Pakistan's Readymade Garments Sector: Challenges and Opportunities

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About the project

Funded by: Pakistan Business Council (PBC)

Key Counterpart: Pakistan Business Council (PBC)

Impact

The Pakistan Business Council used the findings of this report to lobby the government for policy reform. This work was also presented at a conference in State Bank in Karachi. The report was also presented at a roundtable conference with CDPR, PBC, and key players of the garments sector.

This report was prepared by Hasaan Khawar (CDPR), Nadia Mukhtar (LUMS), Maheen Javaid (LUMS), and Dr. Umair Javed (LUMS). The senior advisor on this project was Dr. Ijaz Nabi (IGC and CDPR).

In brief

- The focus of this study is the ready-made garments sector and evaluates the prospects for this sector going forward, especially in light of China Pakistan Economic Corridor (CPEC).
- This study leverages existing secondary research for its analysis, duly complemented and updated through fresh interviews of firms and sector associations, as well as an in-depth analysis of primary data on the textile sector.
- The study finds that despite considerable constraints on the manufacturing economy, Garment firms have continued to outperform other industrial sectors. China's transition away from low-value added garments production provides a window of opportunity for Pakistan to obtain a segment of China's $170 billion export share.
- However, it will require a redoubling of policy effort on the recommendations provided in this study, along with greater initiative and appetite on part of the private sector.

The Pakistan Business Council
FOSTERING ECONOMIC GROWTH

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Pakistan Business Council (PBC) and
The Consortium for Development Policy Research (CDPR)

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FOSTERING ECONOMIC GROWTH
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Foreword

This Study titled, ***"Pakistan's Readymade Garments Sector: Challenges and Opportunities"*** has been commissioned by the Pakistan Business Council **(PBC)** as part of its 'Make-in-Pakistan initiative."

The PBC's "Make-in-Pakistan" initiative which banks on Pakistan's domestic market of 207 million+ consumers aims to create "Jobs in manufacturing & Services", "value added exports and import substitution", leading to "higher taxes from a broader tax base'.

The Pakistan Business Council (PBC) is a business policy advocacy platform, established in 2005 by 14 of Pakistan's (now 78) largest private-sector businesses and conglomerates, including multinationals. It is a professionally-run organization headed by a full-time Chief Executive Officer.

The PBC is a not-for-profit entity, registered under Section 42 of the Companies Ordinance 1984. Though it is not required under the law to do so, the PBC follows to the greatest extent possible, the Code of Corporate Governance as applicable to listed companies.

The PBC is a pan-industry advocacy group. It is not a trade body nor does it advocate for any specific business sector or industry. Rather, its key advocacy thrust is on easing barriers to allow Pakistani businesses to compete in regional and global markets. The PBC conducts research, publishes position papers and policy notes and holds conferences and seminars to facilitate the flow of relevant information to all stakeholders in order to help create an informed view on the major issues faced by Pakistan.

The PBC works closely with the relevant government departments, ministries, regulators and institutions, as well as other stakeholders including professional bodies, to develop consensus on major issues which impact the conduct of business in and from Pakistan. The PBC has submitted position papers and recommendations to the government on legislation and other government policies affecting businesses. It also serves on various taskforces and committees of the Government of Pakistan as well as those of the State Bank, SECP and other regulators with the objective to provide policy assistance on new initiatives and reforms.

The PBC's Founding Objectives:

The major objectives of the PBC as stated in its founding documents are:

- To provide for the formation and exchange of views on any question connected with the conduct of business in and from Pakistan.

- To conduct, organize, set up, administer and manage campaigns, surveys, focus groups, workshops, seminars and field works for carrying out research and raising awareness in regard to matters affecting businesses in Pakistan.

- To acquire, collect, compile, analyze, publish and provide statistics, data analysis and other information relating to businesses of any kind, nature or description and on opportunities for such businesses within and outside Pakistan.

- To promote and facilitate the integration of businesses in Pakistan into the World economy and to encourage in the development and growth of Pakistani multinationals.

- To interact with governments in the economic development of Pakistan and to facilitate, foster and further the economic, social and human resource development of Pakistan.

The PBC is a Section 42 not-for-profit Company Limited by Guarantee. Its working is overseen by a Board of Directors. More information on the PBC, its members, and its workings, can be found on its website: www.pbc.org.pk

Ehsan Malik
CEO, Pakistan Business Council

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PM

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SIEMENS

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SOORTY

HUTCHISON PORTS
PAKISTAN

Standard
Chartered

SPEL
Synthetic Products
Enterprises Limited

TAPAL

TCS
WE MOVE YOU

telenor

Tetra Pak
PROTECTS
WHAT'S GOOD

TPL Trakker

Tufail

UBL
where you come first

Unilever

Acronyms

APTMA	All Pakistan Textile Mills Association
ASEAN	Association of Southeast Asian Nations
AVE	Ad valorem equivalent
BGMEA	Bangladesh Garment Manufacturers and Exporters Association
BIFT	Bangladesh Institute of Fashion and Technology
BKEMA	Bangladesh Knitwear Manufacturers and Exporters Association
BMR	Balancing Modernizing and Replacement
BTB	Back-to-Back
CCCT	China Chamber of Commerce for Import and Export of Textile and Apparel
CMT	Cut-Make-Trim
CPEC	China-Pakistan Economic Corridor
CPO	Chief Purchasing Officers
CSR	Corporate Social Responsibility
DLTL	Drawback of Local Taxes and Levies
DTRE	Duty and Tax Remission for Exports
EBA	Everything but Arms
EPZ	Export Processing Zones
EU	European Union
EWS	Early Warning System
FBR	Federal Bureau of Revenue
FDI	Foreign Direct Investment
FOB	Free on Board/ Freight on Board
FTA	Free Trade Agreement
FY	Financial Year
GCC	Gulf Cooperation Council
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GIDC	Gas Infrastructure Development Charge
GIPC	Garment Industry Productivity Centre
GoP	Government of Pakistan
GSP	Generalised Scheme of Preferences
GTF	Garment, Textiles and Footwear
HS	Harmonized System
ICT	Information and Communication Technologies

IGC	International Growth Centre
IOCO	Input Output Co-efficient Organisation
ISP	Industry Support Package
ITC	International Trade Centre
JAAF	Joint Apparel Associations Forum
JV	Joint Venture
KKH	Karakoram Highway
kW	Kilo Watt
L/C	Line of Credit
LPI	Logistics Performance Index
LTP	Long-Term Plan
LTFF	Long Term Finance Facility
MFA	Multi-fiber Arrangement
MFN	Most Favored Nation
MMBTU	One Million British Thermal Units
MMF	Man Made Fibre
MW	Mega Watts
NCSU	North Carolina State University
OBM	Original Brand Manufacturers
OBOR	One Belt One Raod
ODM	Original Design Manufacturers
OEM	Original Equipment Manufacturers
PM	Prime Minister
PRGMEA	Pakistan Readymade Garments Manufacturers and Exporters Association
PRGTTI	Pakistan Readymade Garments Technical Training Institute
PSDF	Punjab Skills Development Fund
PSF	Polyester Staple Fibre
PTA	Purified Terephthalic Acid
QAAP	Quaid-e-Azam Apparel Park
QIP	Qualified Investment Program
R&D	Research and Development
RLNG	Re Liquefied Natural Gas
RMG	Ready-made garments
SAFTA	South Asian Free Trade Area
SBP	State Bank of Pakistan
SEZ	Special Economic Zone
SME	Small and Medium Enterprise
TUF	Technology Up-gradation Fund
TURQUALITY	Turk Professional Qualifications Authority
UAE	United Arab Emirates
USA	United States of America
VAT	Value-Added Tax
WeBOC	Web Based One Customs
WRAP	Worldwide Responsible Accredited Production

Executive Summary

Introduction

The focus of this study is the ready-made garments sector, which is an important component of the range of textiles that Pakistan produces and exports. The study evaluates the following central question: Given that production in the garments segment is the most labour intensive, least energy- and capital-intensive and generates the greatest value addition out of all the products in the textiles value chain (viz., yarn, grey cloth, finished fabrics and garments) and thus should play to Pakistan's strength in resource endowment, what are the prospects for this sector going forward, especially in light of China Pakistan Economic Corridor (CPEC)?

An in-depth exploration of the garments sector, which this study provides, is critical in understanding the state of overall industrial performance and Small and Medium Enterprise (SME) firm capability, as well as international competitiveness of Pakistan's manufacturing sector. It will also help in the formulation of sector specific policies. This study builds on the detailed case-study based sector diagnostics carried out by Phase I and II (2013-2017) of the Readymade Garments Project, spearheaded by Dr. Ijaz Nabi and Dr. Naved Hamid, and supported by the London School of Economics' and Oxford University's International Growth Centre (IGC).

This study leverages existing secondary research for its analysis, duly complemented and updated through fresh interviews of firms and sector associations, as well as an in-depth analysis of primary data on the textile sector. It has been authored by researchers from the Consortium for Development Policy Research (CDPR) consisting of economists **Hasaan Khawar (CDPR), Nadia Mukhtar (LUMS),** and **Maheen Javaid (LUMS),** under the guidance of **Dr. Ijaz Nabi (IGC and CDPR) and Dr. Shahid Yusuf (IGC and George Washington University)**, in close partnership with the Pakistan Business Council (PBC). Given the centrality of PBC's constituent members to Pakistan's economic development, this report exemplifies the value of industry-academia linkages, with an aim to inform policy advocacy for the Garments sector specifically, and more broadly, for Pakistan's manufacturing economy.

Analysis and Findings

Textile industry contributes significantly to Pakistan's economy. In 2017, it contributed almost 8.5% to the country's GDP, accounted for one-fourth of industrial value-added and employed 40% of industrial labor force.

Within the textile value chain, garment sector enjoys a special place. Highest value is added at the stage

of garment manufacturing, making garments the main revenue earner amongst textile products. Garment sector's significance can also be assessed from the fact that it is the largest segment in terms of number of units and share in exports, compared with other textile segments. The garment sector provides employment to 2.38% of the labor force and constituted 23% of total Pakistan exports and 40% of total textile exports in 2007.

Garment exports have gained importance as a part of Pakistan's export basket over the years, increasing from 21% of textile exports in 2001 to 42% in 2016, the highest growth export products within textiles. Within garment sector, knitted Ready Made Garments (RMG) exports stood at $2.52 billion and woven RMG at $2.47 billion in 2017, representing 1.1 per cent of world exports in these categories, and ranking Pakistan as the 17th and 18th largest exporter of knitwear and woven garments in the world respectively.

In addition to its direct participation in the economy, garment sector acts as a driver of competitiveness for other sectors. Through backward linkages, an increase in production of garments spurs growth in downstream and allied industry. Additionally, there are positive spillovers within the sector as well, whereby compliant firms that are a part of global supply chains encourage local manufacturers to adhere to these compliances, as well.

UNDER-PERFORMANCE IN PAKISTAN'S GARMENT EXPORTS

Although garment sector's exports have increased over the years and it has been the best performing segment of textile value chain, the sector is grossly underperforming relative to its potential.

Pakistan's export base in garments is narrow, and is biased towards low value-added items that fetch lower prices in the international market. The top 6 products exported by Pakistan across knitwear and woven accounted for 52% of its garments exports in 2017, but only 20 per cent of total garment exports of the world. This implies that Pakistan is not participating in four-fifths of the world garment market. Moreover, compared to the garment export basket of the world, Pakistan's basket is still skewed towards low value-added items, such as cotton yarn and fabric and intermediate value items such as textile made-ups.

Similarly, Pakistan's garment exports are not well diversified in terms of destinations. In 2017, Pakistan exported half of its knitted and two-thirds of its woven exports to the EU. The United States is the largest individual partner country—accounting for roughly one-third and one-fifth of total knitwear and woven exports in 2017.

Although Pakistan's knitwear exports grew at 3% and woven exports increased at a rate of 7%, these growth rates seem unsatisfactory when compared with competitors. The fastest export growth in knitwear and woven garment exports respectively was depicted by Cambodia (9 and 17 per cent), Vietnam (11 and 8 per cent), and Bangladesh (7 and 6 per cent), which are Pakistan's regional competitors as well. This has resulted in widening export gap and relative world export shares between Pakistan and its competitors.

These issues are coupled by the low competitiveness of Pakistan's exports. While Pakistan is focused on dynamic markets, Pakistan's garment sector is not exporting products that have a growing demand, neither has Pakistan been able to adapt to changes in world demand. In terms of sectoral competitiveness, which is the leading factor increasing relative world market shares for Bangladesh, Cambodia and Vietnam, Pakistan's performance, although decent, is still inadequate. Pakistan ranks 42nd out of 172 countries on competitiveness of the garment sector, which is much lower than its competitors.

Pakistan has also been unable to leverage GSP Plus scheme to its advantage in full. Although acquiring GSP Plus has improved Pakistan's margin of preference in readymade garments vis-à-vis China, India, Thailand, Vietnam and Indonesia, Bangladesh and Cambodia still enjoy higher preferential margins than Pakistan under Everything But Arms (EBA) scheme. Since Pakistan acquired GSP Plus in 2013, garments exports to EU have increased by 10%, which is less than 0.5% increase in the share of Pakistan's garments in EU imports. Compare

this with Bangladesh, Cambodia and Vietnam, whose share increased by almost 6, 2, and 1.1 percentage points over the same time period. This reflects that Pakistan has directly lost out on potential exports that the EU has imported from its competitors instead.

IMPEDIMENTS TO ACHIEVING EXPORT COMPETITIVENESS

Pakistan's underperformance in exports can be attributed to a number of factors, divided into supply side, demand side and investment climate constraints.

Supply Side Constraints

Firms in garment manufacturing are currently suffering due to shortcomings in each stage of the textile value chain. The quality of cotton seed is poor, and during ginning moisture is added when the lint is pressed into bales, and cotton of different variety and grade is mixed together and sold as seed cotton for next season, which directly affects the quality of fabric to be used in garment. At the spinning stage, production of yarn qualities, especially on fine count end, is very limited. Also, due to weak backward link of the knit sector, there is a difficulty in sourcing knitted fabric, which constrains growth of knitwear. In dyeing and finishing stages, the local dyes and chemicals used are sub-par and safety standards are largely ignored.

Most garment manufacturers operate at low levels of efficiency and productivity. This is because firms lag in terms of knowledge about modern production techniques as well as organizational knowledge such as factory floor and inventory management. Technology adoption rates are low as investment in technology is risky and has longer payback times. Furthermore obtaining loans from banks during the learning periods is difficult. Due to this are unable to upgrade, and are stuck in a low-technology equilibrium where fierce price competition within the local market erodes profit margins and makes technology adoption even less likely.

Pakistan's garment industry faces high cost of production, compared to peers. Due to shortage of domestic cotton in 2016, garment manufacturers had to use imported cotton, which was costly. High duties are also levied on the cotton textile chain, i.e. 15 per cent in 2017, which increases input cost.

International demand for man-made fiber has been on the rise since late 1990s; however, Pakistan's underlying capacity to produce man-made fiber is not well-developed and there are only three manufacturers of polyester staple fiber (PSF). Although government increased tariffs to protect local industry, it has not developed. Making PSF artificially expensive through protectionist policies to support its production in Pakistan translates into poor quality synthetic fibre and higher costs of production, eroding competitiveness in international market.

Energy costs in the garment sector are high, and supply is unreliable. Per unit industrial electricity tariff is 14 cents per unit in Pakistan, compared to 10 cents in India and 2 cents in China. Industry has also complained that rates are frequently adjusted, and new tariffs are usually backdated, so that utility bills rise sharply. This affects liquidity and hence procurement, planning and production in all departments. Similarly, gas prices per mmBtu in Pakistan are more than 3 times that in Bangladesh. Unreliable electricity supply due to unscheduled power cuts causes disruptions in production flows and creates uncertainty in meeting delivery times. Larger firms are able to install backup sources of power supply, such as generators, however this is more difficult for smaller firms.

Labor cost in Pakistan is higher and labor productivity lower than competitors. Minimum wage in Pakistan is twice the monthly wage in Bangladesh ($121 versus $68), and Pakistan faces tough competition from lower wage countries, such as Bangladesh, Cambodia and Myanmar. Labour productivity is low due to absence of skilled workers in the design, planning and production stage of garments manufacturing, and unavailability of competent mid-level management. This may be attributed to low levels of education, irrelevant formal

vocational training programs, poor technical training capacity, and absence of coordination between industry and training service providers.

Government attempts to house the textiles value chain in industrial parks or economic zones have largely been unsuccessful, due to un-strategic location where labor is unavailable and costs are high (for example, in case of Faisalabad Garment City) or slow pace of development (as in Karachi Garment City). Hence, firms have been unable to realize economies of agglomeration. Endogenous spillovers of knowledge and ideas, as well as cost advantages due to scale and scope, are also precluded due to a fragmented supply chain arising from disparate geographical (North/South) garments clusters.

Access to credit is another issue for garment manufacturers. Smaller firms are unable to obtain loans from commercial banks, as they are unable to fulfill collateral requirements. Schemes such as export financing to ease credit constraints distort all commercial credit towards the finance scheme as such loans have a government guarantee. This reduces the funds available for non-participating exporters or indirect exporters, which may be vendors for exporting manufacturers. Also, such export finance schemes do not favor exporters taking risks and diversifying their products or exporting markets.

Demand-Side Constraints

On the demand side, the remarkable rise of Asia as the garment factory of the world—producing two out of every three garments in world markets by 2017 — has presented a challenge for Pakistan. The growing global garments market has attracted fierce competition from low-wage competitors as they seek to aggressively expand their world export shares in garments categories that are labor-intensive, relatively low-technology and consumers of moderate energy. Unfortunately, most of Pakistan's garment exports fall in this category, which is why Pakistan has been unable to increase its world export shares in readymade garments over the last ten years, notwithstanding its comparative advantage in this segment and an average yearly export growth rate of 5 per cent over 2013-17.

Due to higher production costs in Pakistan, global demand has shifted towards more competitive countries, with Pakistan able to secure only residual demand. Since these orders are smaller, it becomes difficult for firms to attain the scale necessary for cost effective production and modernisation of technology. Firms can circumvent this problem if they can raise values to graduate out of this over-saturated and competitive segment of world trade, allowing it to set higher prices, improve profit margins, and re-invest in upgrading their production technologies; however, this would only happen if the firm currently was growing, i.e. if it had high demand. In effect, low demand is begetting low demand in the absence of funds to invest in value addition. This traps firms in a low price-low value equilibrium.

Only a few big players in the sector have diversified their exports but they still face entry barriers. They have moved into higher value-added products by designing new product samples themselves and getting them approved from the lead firms for production. However, they still have not been able to market their products under their own brand name, as they are unable to surpass entry barriers in R&D and innovation.

Investment Climate Impediments

Pakistan ranks poorly on the Global Competitiveness Index, which is largely attributable to its low levels of human capital and labour market inefficiency. In terms of doing business, Pakistan performs particularly poorly on pillars of paying taxes, registering property, and trading across borders— ranking well behind Vietnam (79 places), China (69 places), and India (47 places). More crucially, investors in RMG complain about harassment by government officials who target revenue collection, rather than promote economic activity and exports.

Pakistan faces unfavorable tariffs in garment exports in the international market, which restricts market

access. Pakistan faces zero duties only in the EU, and compares unfavorably with Bangladesh and Cambodia in all markets. Bangladesh and Cambodia enjoy duty-free access with the EU, Canada, Japan, Australia, and even China (0.9 per cent tariff for Bangladesh). Vietnam and India enjoy duty-free free access in the ASEAN market.

Pakistan's currency in the recent past was overvalued with respect to the dollar, making exports less competitive in global markets. Exports become even more expensive relative to China, India, Vietnam, and Sri Lanka, as their currencies devalued much more than Pakistan. Government has clearly not realized that that exports pay for imports, not vice versa!

Trading across borders also remains time-consuming and expensive in Pakistan on account of poor regulatory frameworks for governing trade facilitation and managing trade-related infrastructure and administration. Customs procedures are cumbersome and delays are common.

CPEC – OPPORTUNITIES & CONCERNS

China Pakistan Economic Corridor (CPEC) provides an unprecedented opportunity for Pakistan to further expand its garment exports to the world in the coming years. Under the industrial cooperation pillar of CPEC, Pakistan can take advantage of China's retraction from the global market due to eroding cost competitiveness. This erosion can be attributed to surging labor costs in China, which was thrice the cost in Vietnam and Pakistan, twice that of India and six times that of Bangladesh. Through strategic positioning, Pakistan can leverage China's exit by expanding market share and exports.

Furthermore, CPEC is expected to drive improvement in Pakistan's garment sector through relieving infrastructure constraints. By ensuring improved energy supply, better internal connectivity and improved logistics, CPEC is likely to result in shorter factory to market lead times, enhanced global connectivity improving access to new international markets from Gulf to Europe, improved productivity and competitiveness and increased growth in the sector due to benefits of agglomeration in the SEZs.

However, expanded Chinese access to Pakistan's markets via CPEC is also perceived as a threat to local industry. Currently, the textile industry is concerned about serious competition from large-scale garment industry in Xinjiang.

Pakistan is not an important garment import partner of China – ranked eighteen among China's garment suppliers. In terms of Pak-China garment trade, Pakistan's garment exports to China have grown over the years from $0.26 million in 2003 to 42 million in 2017, increasing both Pakistan's share in China's imports and China's share in Pakistan's garment exports. Nonetheless, Pakistan's overall garment exports to China were nominal, i.e. less than 1% of Pakistan's total garments exports. Similarly, Pakistan's garment imports from China also constituted a nominal share i.e. 0.16% of Pakistan's total imports in 2017. Imports from China also include basic technology, such as overlocking and automatic sewing machines.

But China's trade pattern in RMG sector is shifting. As per the 13th five-year plan of Chinese Government for 2016 to 2020 period, China is strategically moving towards more value-added technology intensive products, to allow product differentiation from its low-cost competitors. Industries in China are investing in technology upgrading, rather than in economies of scale, as they have already exhausted the gains from the latter. Automation and advanced robotics are also being adopted in production processes, as a replacement for high-cost scarce labour.[1] For example, a Chinese T-shirt manufacturing company, Tianyuan Garments Co., is opening a factory where machine vision-based sewing robots will be used to produce apparel for Adidas.[2]

1 Young (2016, February 29)

2 Bhattacharya (2018, June 5)

Due to rising costs and consequently eroding competitiveness, China is gradually moving away from RMG exports. Since the early 2000s, firms in China have increasingly confronted difficulty in maintaining low production costs. With an appreciation of China's currency, inflation, higher cost of raw materials and shortages of water and electricity led by increasing industrialization, China faced a surge in the cost of production. Moreover, increasing labor costs, shortages of labor as workers shifted away from low paying to high paying jobs and labor protection laws and activism also directly or indirectly contributed to escalating input costs, due to which export-oriented firms have particularly suffered.[3] In 2016 alone, raw materials prices in China went up 7.8 percent, labor costs rose 6.8 percent, and rents increased by 9.7 percent, on average.[4] Soaring cost of production have resulted in protracted tightening of profit margins, and erosion of competitiveness. This has led to industrial restructuring and relocation, whereby Chinese manufacturers and global value chains are moving to economically viable countries with cheap labor in large numbers. Since 2015, Chinese manufacturers have proactively been building, acquiring or partnering with production facilities in countries such as Vietnam, Myanmar and Cambodia, while entering into strategic partnerships in Indonesia and Bangladesh.[5] Even brands such as Nike and Adidas, which are world's leading footwear and clothing companies, and Japanese clothing chains such as Uniqlo have shifted their operations to Southeast Asian countries.[6]

Pakistan can capitalize on China's shifting trade pattern in RMG sector. China is a growing importer of knitted and woven garments. In fact, it is the fastest growing importer of garments in the world.[7] At the same time, Pakistan's share of knitted and woven garment exports to China is very small, although growing. CPEC, through improved connectivity, can help Pakistan tap into China's expanding garment demand by further increasing garment exports to China. Moreover, China's garment export share in the global market has been declining. China's share in world garment exports nearly doubled from 18.3 percent to 37 percent between 2005 and 2010, however from 2010 to 2017 it decreased from 35 percent to 33 percent. This is in part a consequence of high labor cost in China, which has compromised its competitiveness in the international market. As China withdraws from the international market, it will leave a vacuum of US$ 145 billion (plus more as China becomes a net importer of garments) worth of world market wide open. This is a window of opportunity that Pakistan can potentially seize under the CPEC.

Pak-China FTA however, has not proved to be as beneficial for Pakistan as for China. Pakistan has been able to utilize only 39 out of 272 garment tariff lines, i.e. 14 per cent of the concessions on garments offered by China. In fact, over 15 per cent of the garment products given preferential tariffs in the FTA by China were not even imported by China from the world in 2017. More critically, China has provided ASEAN countries with duty free access in Chinese markets, whereas Pakistan faces tariffs in the range of 7 to 9 per cent. On the other hand, local industry in Pakistan has been harmed by Pakistan's tariff concessions in FTA allowed China to export cheap clothing to Pakistan, especially when domestic industry was suffering due to energy crisis. As a result, the profitability and/or underutilization capacity of the local industry was hurt. There is a need to renegotiate better access with China, especially for garment products that are common in Pakistan's exports and China's imports, which include knitted/crocheted t-shirts, shirts and vests.

RECOMMENDATIONS

There is need to have cohesion and clarity in government's vision, and a strong state capacity to identify, target, administer and manage policy interventions that do not distort incentives or prices, and instead of hand-holding, are able to provide the push that garment sector needs to takeoff.

3 Zhu & Pickles (2014)
4 Tang (2017, August 4)
5 Young (2016, February 29).
6 Nikkei Asian Review (2018, March 31)
7 ITC Trade Maps

Pakistan can use CPEC to leapfrog and climb the technology ladder in RMG sector. This could happen through joint ventures with Chinese companies that utilize Chinese expertise in RMG and Pakistan's low cost labour; outward investment by Pakistanis in China to acquire intellectual and technology resources (similar to what China itself did in the auto sector); technology partnerships with Pakistani firms in which Chinese firms provide the gaps required to access the foreign markets that China has traditional access to but is now moving out of due to rising labour costs; focusing on becoming suppliers of labour-intensive inputs to Chinese RMG firms (i.e. export to Chinese firms and through this become part of Chinese or global value chains) and enhancing exports to Chinese consumer markets. For Chinese industry that locates here, incentives to hire local labour and engage local firms in their value chains can catalyze this process.

But Pakistan needs a few success stories to catalyze this shift. If a few large Chinese garment exporters successfully set up manufacturing facilities in SEZs in Pakistan, it will change the perception of Chinese businesses about Pakistan. Consequently, other garment manufacturers, presently relocating to Southeast Asian countries such as Vietnam, Cambodia, Myanmar, etc., will consider Pakistan as a viable option as well. Once this process initiates, it will result in spillovers to other parts of the textiles sector, leading to growth in Chinese investment, especially in areas which have substantial demand, such as synthetic fibres, or where Pakistan is already a major player, such as denim garments and home textiles.[8] For Chinese industry that locates here, incentives should be offered that encourage them to hire local labour and engage local firms in their value chains.

To be able to avail this opportunity, however, Pakistan needs to stay competitive in terms of production costs and availability of labor and energy.[9] The degree of ease of importing inputs, such as man-made fibers and exporting garments also needs to be enhanced. Improved efficiency along the value chain, such as integration between textile and apparel, and improvement in social and environmental compliance by introducing better human resource practices will also help attract manufacturers.[10]

Pakistan needs appropriate and targeted industrial policy measures to support garment sector. Since Pakistan's industry comprises a large share of SMEs, it can follow India's example, where government is pitching its SME garments sector globally as a flexible way for big clients to cost-effectively produce small, customizable lots. Similarly, medium sized firms could take advantage of improvement in ICT to hold stocks in Pakistan for clients to lower their inventory costs. This requires providing support to SMEs so that they may offset their scale disadvantage through access to a reliable supply of inputs and competitive credit. Government should provide assistance in acquiring internationally recognized quality and safety certifications to increase SMEs export-readiness.

In order to improve value added exports, Pakistan must focus on law and order stability, increasing labour productivity, reducing production costs and increasing productivity. Most countries in the region have achieved this through a combination of investment in better machines, worker skills along with IT and logistics. Pakistan garments industry needs to take the lead in providing demand-based training, not just at the entry level, but also for upgrading skills of existing workers. With many firms highlighting the significant absence of skilled middle management, the government could create a common training center for middle managers, while more technical skills could be offered on factory premises, on an appropriate cost-sharing basis. Additionally, security is a big concern as businesses lose 3-4 production days every 4 months on account of domestic political turbulence. Business associations recommend that a dedicated industrial police force is developed to ensure that business-related law and order issues are dealt efficiently.

8 Hamid & Nabi (2013)

9 Hamid & Nabi (2013)

10 Lopez-Acevedo and Robertson (2016)

In this area Pakistan can learn from Vietnam, Bangladesh and Sri Lanka. The ILO-funded Better Work program in Vietnam had significant impacts on firm profit margins, with revenue-to-cost ratios rising by 25 per cent in four years. Bangladesh undertook private sector-assisted skills development by lead buyers and industry associations especially in foreign owned firms, which were then emulated by local firms to provide on-the-job trainings. Another successful example in Bangladesh is BGMEA Institute of Fashion and Technology (BIFT) where with government providing land and building, BIFT machinery, material, food and board, donor-funded foreign instructors, and guaranteed employment from garment associations, BIFT had 100 per cent placement records, moving from donor- to self-financing in a span of a few years. In Sri Lanka, through collaboration between government-garments sector association (Joint Apparel Associations Forum), a training manual (Competence and Beyond) was created to streamline training courses to industry need. In collaboration with foreign technical and institutions, current and future skills gaps were identified by creating national "certifications for product and process upgrading" and extension diplomas offered to impart those skills.

To improve the cost effectiveness of Pakistan's garments in the international market, government must remove extra taxes on utilities to ensure a uniform power tariff rate that is not significantly higher than regional competitors. Another strategy is for government to promote energy efficiency through investment incentives or tax credits. Moreover, to support firms in re-structuring their existing energy system, support could also be earmarked under the Technology Upgrading Fund 2016-2019. Tax breaks can also be offered for restructuring industrial activity to lower production costs.

For technology up-gradation, schemes such as the Technology Upgradation Fund included in both Textile Policies have not been effective, as they do not reduce the risks associated with technology adoption. In India and Bangladesh, to allay risks about technology, not only are imports of textile machinery allowed at reduced rates but so are the raw materials and parts needed to manufacture these machines domestically. In India, the government co-funds research contracted by the garments sector in India, while Vietnam provides grants for sustainable production, new materials, as well as innovation. Turkey provides tax exemptions on salaries of R&D personnel and on revenues associated with R&D in Technology Development Zones. China has the most comprehensive schemes, ranging from technology development funds, short-term capital provision to grants and income tax rebates of up to 50 per cent for select qualifying R&D expenses.

To address issues of economic upgrading, Pakistan may consider establishing central bonded warehouse facilities. These can be used to store duty-free imported raw materials such as man-made fibres, yarn and fabric, accessories, dyes and chemicals, along with RMG and textile machinery and spare parts as per forecasted demand. Exporters can then purchase these inputs from the warehouse duty-free according to their export orders. This would reduce lead times to markets by ensuring a readily available and competitively priced supply of inputs. The model was successfully tested in Bangladesh where they helped in product diversification and timely exports by significantly shortening the order cycle times of firms to sample, prototype and roll-out orders as all inputs were already available in the warehouse facility. Additionally, it lowered the inventory management risk of individual manufacturers (drop in demand would not affect firms as they did not need to maintain large inventory stocks), as well as the input price volatility manufacturers faced in import markets due to global downturns, shortages, or exchange rate fluctuations. Enabling environment will come from scale, which requires import liberalisation for raw materials. It is recognized that there will be leakages of bonded imports to local markets and also losses in terms of foregone import tariffs, but these would be offset by the employment, output, export and taxes paid through higher activity in the garments sector.

Other proposed measures may include incentives for quality certifications, branding and marketing to ease firms' transition into original design and brand manufacturing. To incentivize firms to upgrade their inputs, matching grants schemes or challenge funds can also be used. Turkey's TURQUALITY program allowed the garments sector to upgrade to the original design and brand stages through branding incentives and support to the manufacturers, particularly fashion designers, ranging from reduction in cost of brand

registrations, marketing and PR activities, opening up stores and warehouses to paying the rental costs at fairs and decoration costs of franchise stores.

In order to improve access to credit, government may consider introducing back-to-back L/Cs. Through such L/Cs firms can use lead firm export orders in foreign banks (master L/Cs) to open L/Cs with domestic banks. This credit is used to import intermediate inputs without having to pay directly, as the payments and interest are deducted from export proceeds once they are realized. In addition to helping larger firms, this will also release working capital for smaller and medium-sized exporters so that they can respond to opportunities in world markets. Other measures for credit support may include credit assistance through corporate loan guarantees and export credit insurance used in China, export project performance security and investment credit guarantees as implemented in Vietnam, or offering export credit, low interest rates and smallest L/C commission for export credit, as done in Bangladesh.

To resolve the problem of delays in refunds under drawback schemes, firms should be paid interest on pending refunds that have exceeded the permissible time limit (as in Singapore and UK) or to allow firms to adjust delayed refunds against other (current) tax liabilities. The latter would mean instead of government making any payments, it would be offsetting them. Trade policy support should also be given in the form of exemptions, rather than refunds.

Pakistan may also consider enhancing role of industry associations. Industry associations have been given considerable power in Bangladesh. For instance, the textile mills association determines which members can use bonded warehouse facilities and how to determine training curricula. Industry Associations for garments in Bangladesh have also been given the authority to issue customs certificates by the government—this has made it easier for firms to import raw materials and technology. Overall, associations need to be given a bigger role in vetting of government policies and in defining sustainable targets

Pakistan may also negotiate for removal of synthetic knitted fibers (and other key RMG inputs in which India is a global supplier) from India's Negative List for Pakistan. India is a large producer of synthetic fiber and fabric and is one the countries that Pakistan is allowed to source from according to GSP Plus rules, it would be beneficial for Pakistan to import synthetic fiber and fabric from India. For this, in the short-term, Pakistan must negotiate for removal of synthetic knitted fibers (and other key RMG inputs in which India is a global supplier) from India's Negative List for Pakistan.

In the meanwhile, government should consider reducing customs duty on import of PSF. A duty of 7% is imposed on import of PSF, the most commonly used man-made fibre. Similarly, exporters are paying 11 percent customs duty, as well as 5 percent regulatory duty, on the import of filament yarn. To bring about a change in the fibre mix which can lead to increased exports and diversification, it is important to reduce duty on polyester fibre and filaments.

To leverage CPEC, policymakers in Pakistan need to adopt a proactive approach so that garment sector can play to its strengths and derive support from China in weaker areas, instead of waiting for China to dictate the terms of this critical economic relationship. In order to ensure that local industry does not suffer, there is a need to respond to local industry's reservations. The policy measures should both target specific areas to encourage collaboration with Chinese industry as well as general investment climate constraints.

There is a need to make custom procedures more business friendly by improving their efficiency and effectiveness. Procedures need to be simplified, presence of officials in 24/7 customs clearance service monitored and glitches in WeBOC worked out and clearing agents trained to handle the system. Additionally, IOCO Lahore should be provided adequate manpower and jurisdiction so that approvals for import under DTRE can be expedited.

Conclusion

Pakistan was a leader among industrializing countries in the 1960s but unlike the East Asian economies, it failed to take advantage of the window of opportunity created by globalization that gathered momentum in the 70s and beyond. However, extricating the economy from this trap is possible given the potential opportunities that exist for a dynamic sector like Readymade Garments.

Despite considerable constraints on the manufacturing economy, Garment firms have continued to outperform other industrial sectors. China's transition away from low-value added garments production provides a window of opportunity for Pakistan to obtain a segment of China's $170 billion export share. This is entirely achievable, but will require a redoubling of policy effort on the recommendations provided in this study, along with greater initiative and appetite on part of the private sector. With these in place, there is no doubt that the Garments sector can help Pakistan achieve sustainable economic growth, a reduction in the trade deficit, and improvements in overall societal welfare through stable and well-paying employment.

CHAPTER 1

Economic Significance

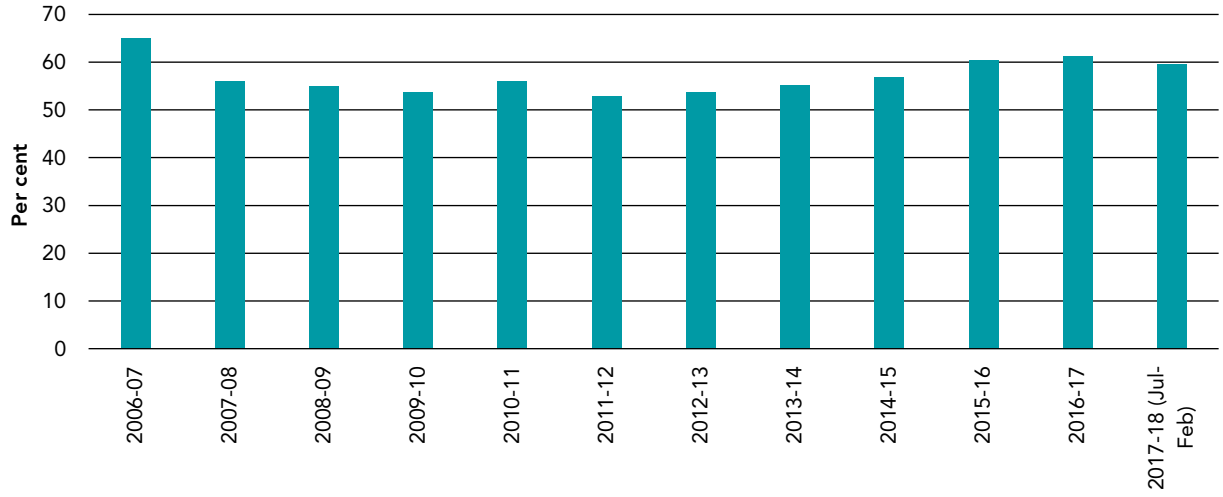
Pakistan is the 4th largest producer of cotton in the world and accounted for nearly 7% of world's cotton output in 2017.[11] Capitalizing on its large cotton production, Pakistan has developed and promoted its textile sector. Textile industry is the largest and one of the oldest industrial sectors in Pakistan. It contributed almost 8.5 per cent to the country's GDP, accounted for one-fourth of industrial value-added and employed 40 per centof industrial labor force in 2017 (Table 1-1).[12] Despite this, textile has consistently remained the single most important export sector of Pakistan, as Figure 1-1 illustrates.

TABLE 1-1 Contribution of textiles to Pakistan's Economy

Variable	Contribution of textiles to National Economy (%)
Share in GDP	8.50
Employment (share of industrial labor force)	40
Share in national exports	60
Share in FDI	0.56
Share in industrial value addition	25
Share in large scale manufacturing	21

Source: Pakistan Economic Survey 2017-18, ISBOB Punjab 2017, State Bank of Pakistan

FIGURE 1-1 Pakistan's Textile Exports as % of Total Exports



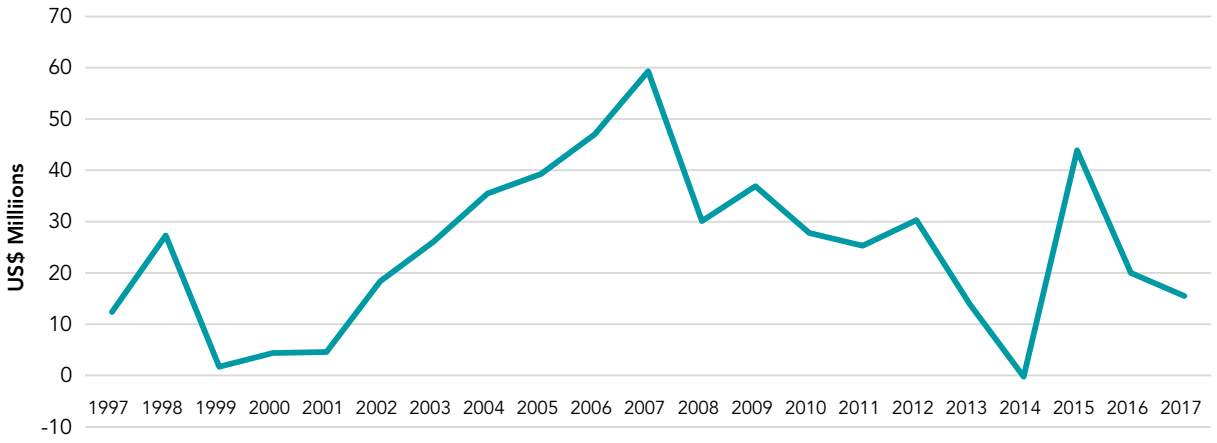
Source: Ministry of Finance (Government of Pakistan), various editions of the Pakistan Economic Surveys

11 US Department of Agriculture Foreign Agricultural Service; JCR-VIS (2016); Pakistan Economic Survey 2017-18

12 Pakistan Economic Survey 2017-18, ISBOB Punjab 2017, State Bank of Pakistan

Foreign Direct Investment (FDI), however, has not played an important role in textile sector, unlike the automotive and food sectors, which have historically received significant amounts of FDI.

FIGURE 1-4 FDI Trend for textiles (Net inflows)

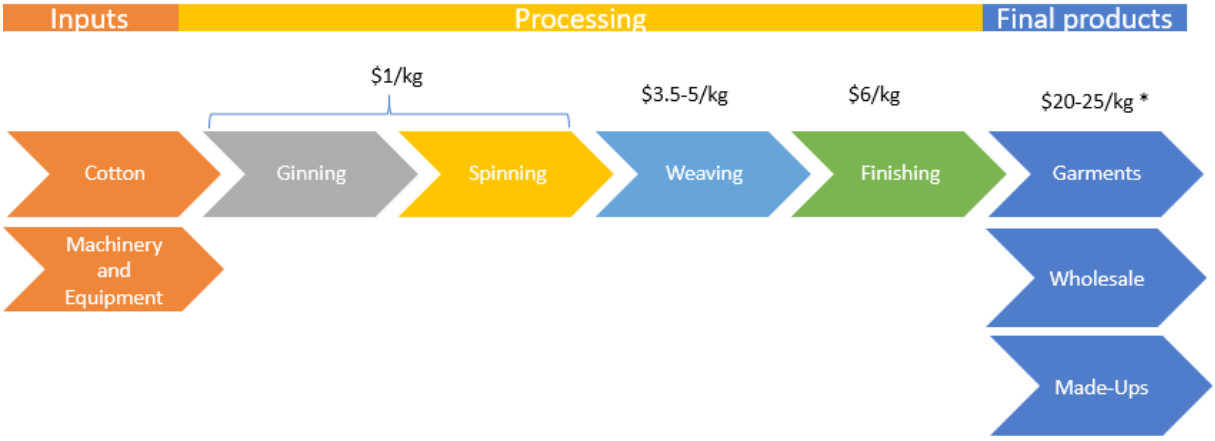


Source: State Bank of Pakistan

1.1 Textile value chain

Textile value chain comprises of the following segments: ginning, spinning, weaving, finished fabrics, garments (woven and knitwear), home textiles (particularly bed linen and towels) and synthetic fiber.[13] Figure 1-2 shows the position of garments in the textiles value chain and the increase in economic value as we move along the value chain of cotton. It is evident that garment manufacturing has the highest value addition, i.e. about $20-25/ kg of fabric. Figure 1-3 also shows that garments are the main revenue earner among textile products, as their price in the international market has nearly tripled in the last 16 years.

FIGURE 1-2 Structure of the Cotton Value Chain and Value Addition of Each Stage in 2013

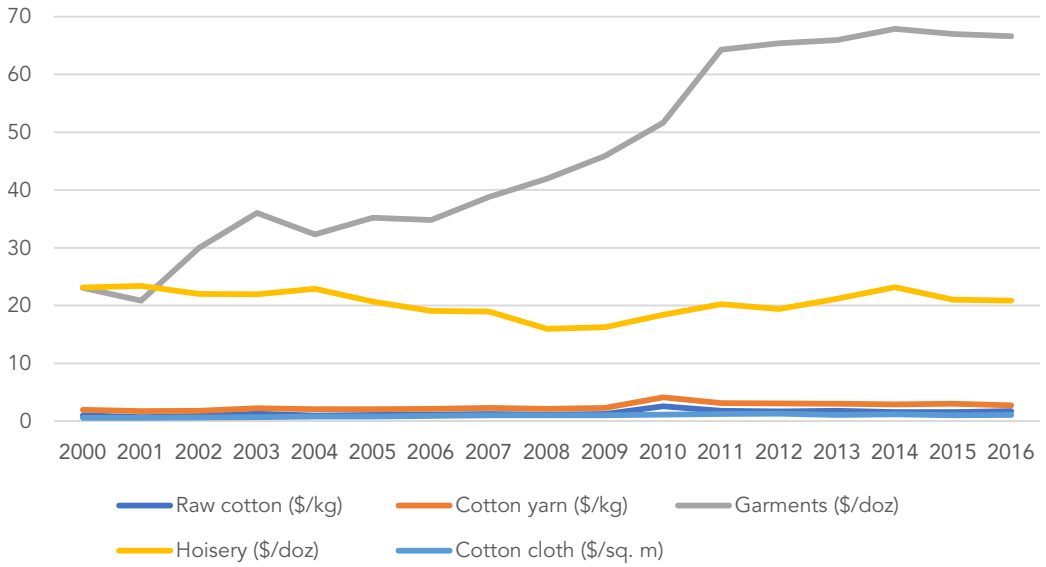


* Per kg of fabric (allowing for 5 percent in wasted fabric and an additional 10 percent of the garment's value for the cost of trimmings and accessories)

Source: Hamid, Nabi and Zafar (2013)

13 Nabi & Hamid (2013)

FIGURE 1-3 Category-wise Price of Pakistan's Textile Exports



Source: APTMA

1.2 Zooming in on garments

Table 1-2 also shows that garments sector is a significant component of this value chain in Pakistan – largest in terms of number of units and share in exports.

TABLE 1-2 The Importance of Garments in the Textile Value Chain in 2017

	Number of units	Size	Production	Exports (US$ Billion)
Ginning	1,260		20 million bales	0.36
Spinning	517*	13.414 million spindles 199,000 rotors		1.26
Weaving	124 large 425 small	170 integrated 28,500 shuttle less 400,000 power looms	1 billion sq meters cloth	2.64
Finishing	10 large 625 small		4.8 billion sq meter cloth	
Garments (Woven)	50 large 2,500 small		670 million pieces	2.32
Knitwear	2,500		350 million pieces	2.36
Towels	400	10,000 Towel Looms	53 million pieces	0.78
Synthetic fabric			636,000 tons per annum	0.67

Source: Pakistan Readymade Garments Manufacturers & Exporters Association; APTMA. Figures for 2016-17 taken from Pakistan Economic Survey 2017-18 and TDAP.

Despite the significant role of garments in the textile value chain in terms of value addition and the widespread availability of local raw-material for garment manufacture, the sector has not been able to move up the value chain as rapidly as Pakistan's potential would suggest. Processes at the bottom of the value chain spectrum, especially spinning sector, have experienced higher growth than garments, owing to more favorable policy incentives and easier to meet input requirements in terms of labor skills and management capabilities.[14]

14 Nabi, Hamid and Zaffar (2013)

Investment in the textile sector has also been heavily biased towards spinning sector. According to Pakistan Readymade Garments Manufacturers and Exporters Association (PRGMEA), in the 10-year period 1999-2009, an estimated US$7.5 billion were invested in textiles. Of this, nearly 80 percent was in spinning, weaving and finishing activities. Garments and made ups constituted only about 12 per cent of total textile investment or nearly US$ 900 million.[15] Due to these factors, and lack of FDI, progress of garments sector in Pakistan has been at a slower pace than similar sectors of other countries, such as Bangladesh and Turkey.[16]

1.3 Economic significance of garments sub-sector

On the whole, the garment sector contributes significantly to Pakistan's economy. As per the last Labour Force Survey (2014-15), garment manufacturing provided employment to 2.38 per cent of the labor force and also constituted 23 per cent of total Pakistan exports in 2017.[17] FDI, however, has not played an important role in the sector (see Table 1-3).

TABLE 1-3 Economic importance of garments

Variable	Value (%)
Share in labor force	2.38
Share in national exports	23.00
Share in textile exports	40.00
Share of foreign-owned firms	2.00

Source: ITC Trade Maps; TDAP, Lopez-Acevedo and Robertson (2016)

1.3.1 Exports

World clothing exports have increased almost six-fold from 1990 to 2017, to reach $454.2 billion, representing about 1.6 per cent of the world merchandise exports in 2017.[18] China leads in garments exports, representing nearly a third of all exports in 2017, followed by Bangladesh, Vietnam, Italy, and Germany and India. Pakistan is ranked the 17th largest exporter of garments in the world in 2017 (Table 1-4).

TABLE 1-4 Top exporters of apparel (HS 61&62), 2017

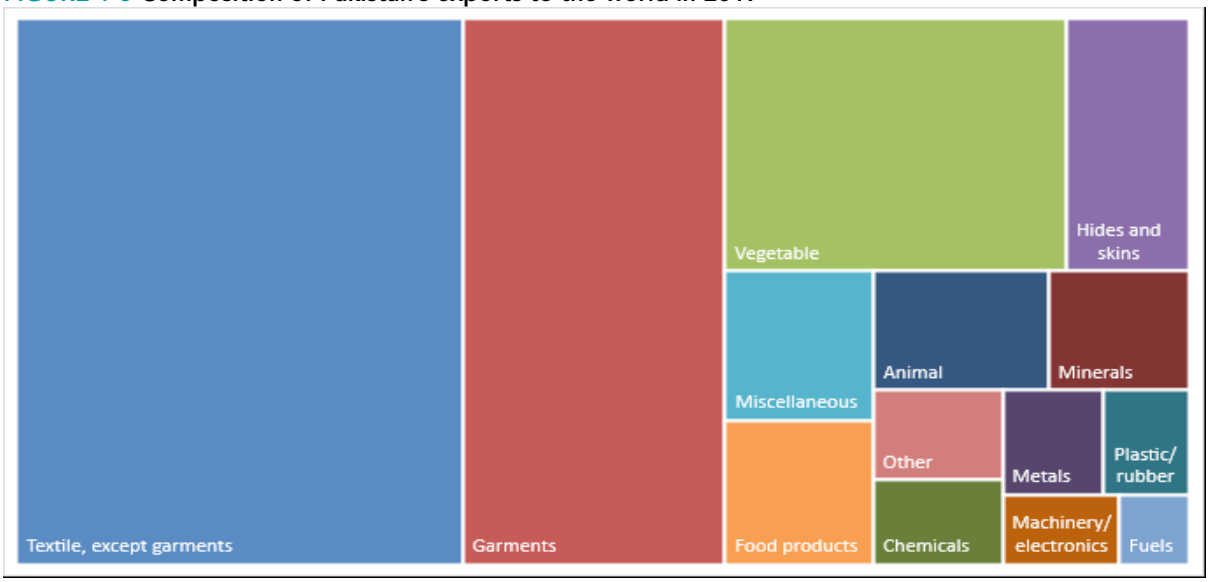
Country	Exports 2017 ($bn)	% share of world exports	Rank
China	145.6	32.06	1
Bangladesh	34.8	7.66	2
Viet Nam	27	5.94	3
Italy	21.3	4.69	4
Germany	20.8	4.58	5
India	17.3	3.81	6
Turkey	14.8	3.26	7
Spain	13.8	3.04	8
Hong Kong, China	13.7	3.02	9
Cambodia	11.3	2.49	10
Pakistan	5	1.10	17
World	454.2		

Source: Data sourced from ITC TradeMap

15 Hamid & Nabi (2013)
16 Hamid & Nabi (2013)
17 ITC TradeMap (2017)
18 UN Comtrade; this includes woven and knitted/crocheted cloth (HS Chapter 61 and 62).

Garments constituted a major chunk, i.e. 23% of Pakistan's exports in 2017 (Figure 1-5) and accounted for 20% of Pakistan's textile exports. After textile made-ups and cotton—which represented 34 per cent of total Pakistan exports in 2017— knitted and woven readymade garments were the 3rd and 4th ranked exports of Pakistan in 2017. Knit RMG exports stood at $2.52 billion and woven RMG at $2.47 billion in 2017, representing 1.1 per cent of world exports of HS61 and HS62, and ranking Pakistan as the 17th and 18th largest exporter of knitwear and woven garments in the world respectively.

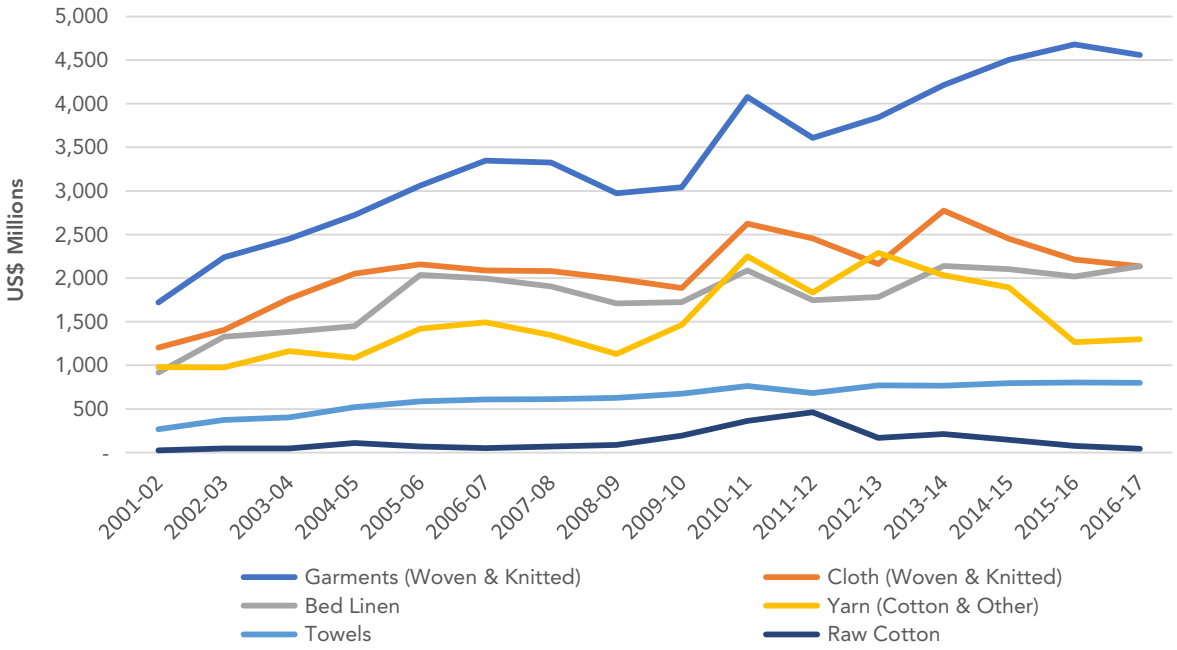
FIGURE 1-5 Composition of Pakistan's exports to the world in 2017



Source: Based on data from UN Comtrade

In addition, garment exports have become more important in the export basket of Pakistan over the years and have outperformed other components of the textile value chain, especially in the last 5-6 years (Figure 1-6).

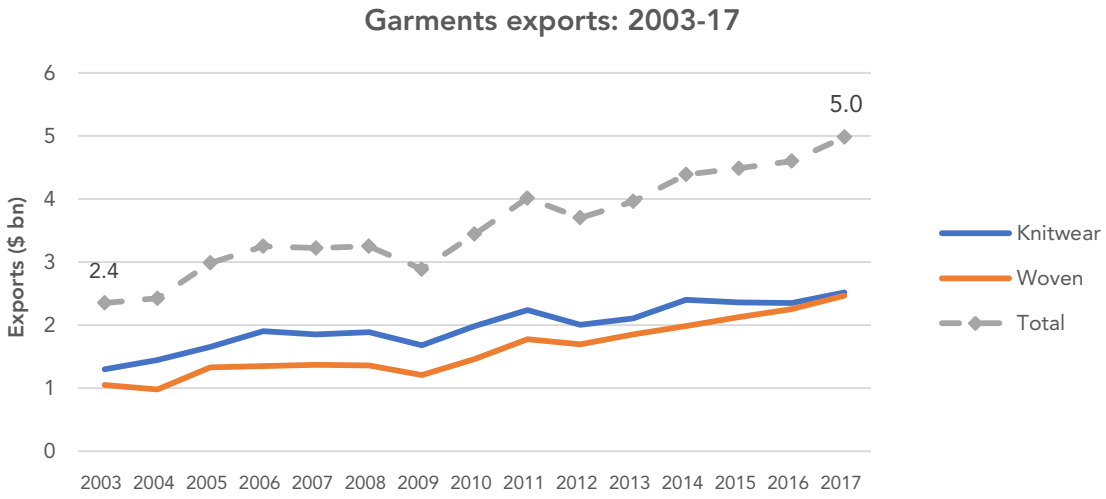
FIGURE 1-6 Pakistan's Textile Exports by Major Categories



Source: Pakistan Readymade Garments Manufacturers & Exporters Association and Trade Development Authority of Pakistan

In terms of growth, garment exports have roughly doubled over the last 15 years from $2.4 billion to $5 billion, growing at 5 per cent per annum over the last 5 years (Figure 1-7). Both knitwear and woven exports showed positive trends, with Pakistan's exports of each growing faster than respective world exports. Pakistan's knitwear exports increased at 4.6 per cent per annum in the last 5 years, compared to a contraction of 0.5 per cent per annum in world knitwear exports. Similarly, in the last 5 years woven RMG exports of Pakistan grew at an average of 7.4 per cent while world woven exports rose at 2.3 per cent per annum (Figure 1-8).

FIGURE 1-7 RMG exports over time: Break-up (HS 61 & HS 62)

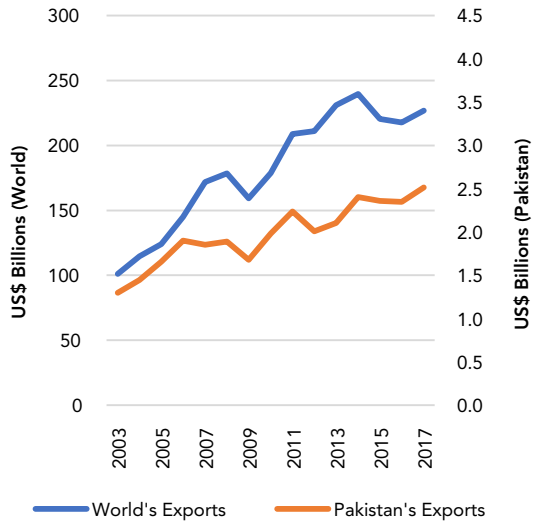


Source: Data sourced from ITC TradeMap

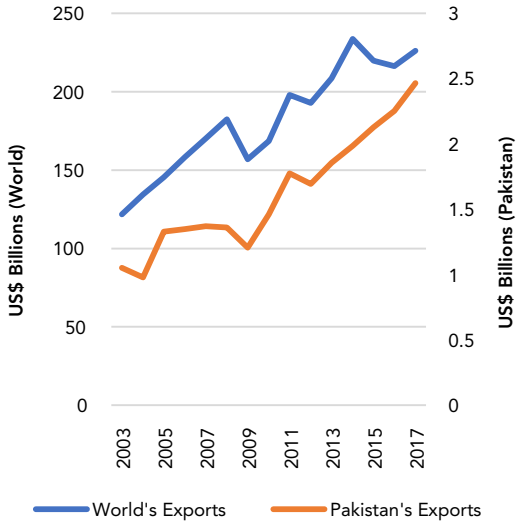
Figure 1-8 shows that until 2013, knitted garments growth in Pakistan was lower than world growth, but that has changed since then. For woven garments, export growth rates are about the same till 2013, but while world exports have fallen, Pakistan has continued the same trend.

FIGURE 1-8 Pakistan and World Garment Exports

i) Pakistan and World Knitted Garment Exports



ii) Pakistan and World Woven Garment (HS 62) Exports



Source: Trade Map – Trade statistics for international business development

In addition, garment manufacturing process has the highest return on investment in terms of exports. Garment manufacturing is the least capital and energy intensive among textile activities, with energy cost amounting to only 2-3 per cent of the total cost of production. It is estimated that an investment of US$1 million in spinning and weaving results in a lower value of US$0.27 million worth of exports, compared with US$3.2 million in exported garments.[19] Therefore, increasing garment exports can help resolve the balance of payments crisis in Pakistan.

Pakistan's top garment exports are of cotton-based menswear, mostly shirts, trousers, shorts and ensembles, as well as knitted non-cotton T-shirts, cardigans, jerseys or pullovers (Table 1-5). Taken together, these top 10 exported products of the RMG sector represented 14.2 per cent of Pakistan's total exports in 2017, indicating the high contribution of this sector to Pakistan's foreign reserves.

TABLE 1-5 Top 10 export products of Pakistan in 2017.

HS code	Product label	Exports ($mn)
620322	M/B woven ensembles of cotton	1291.7
620342	M/B woven trousers and shorts of cotton	410.4
610590	M/B textile material knit shirts (non-cotton/non-MMF)	310.7
610910	Knit T-shirts, singlets and other vests of cotton	197.8
620462	W/G woven trousers and shorts of cotton	197.1
611090	Knit jerseys, pullovers, cardigans, waistcoats etc. of textile materials	195.8
610349	M/B knit trousers, shorts, overalls of textile material	175.7
610510	M/B knit cotton shirts	168.3
620349	M/B trousers and shorts of textile materials	113.5
620339	M/B jackets and blazers of textile materials	69.5
Total	**Top 10 exports of RMG in 2017**	**3.1 billion**

Source: Data sourced from ITC TradeMap

As shown above, the garments sector is a major contributor to the national economy. Together with the direct and indirect contributions the sector makes to the economy through higher and better jobs, demand and investment, as well as sustainable production techniques, the sector is a key driver of growth and economic development in the country.

1.4 Driver of competitiveness for other sectors

Backward linkages exist when growth in an industry leads to growth of its downstream industries, such as input suppliers. Pakistan's backward linkage multiplier in the textile sector was 7.76 in 2007, which shows that a single unit injection in the textile sector yields 7.76 units of income in the economy through growth in downstream sectors.[20] This increase is because the change in demand activates other sectors to provide greater inputs. In the absence of linkages data in the clothing sector for Pakistan, data for Bangladesh can be used to demonstrate Pakistan's linkage effects as the situation of garments sector of the two countries is similar.[21] Clothing sector in Bangladesh, as well as in China and India, have a high backward linkage multiplier, meaning that it receives a large number of inputs from other industries: the "pull power" of the clothing sector is high. For example, Bangladesh's total backward linkage multiplier with respect to just the cloth sub-sector was 1.93

19 Sánchez-Triana et al. (2014)

20 2006 is the most recent year for which data on linkages in textile sector is available for Pakistan. 7.76 is the total multiplier, which is given as the sum of production multiplier (3.18), commodity multiplier (2.55), factor/gdp multiplier (1.22) and household multipliers (0.82) for textile sector. MPRA (2010).

21 IGC (2017)

and 1.84 for woven and knitted cloth, respectively in 2012. A one-unit change in demand for garments results in almost twice the production of woven and knitted cloth.[22]

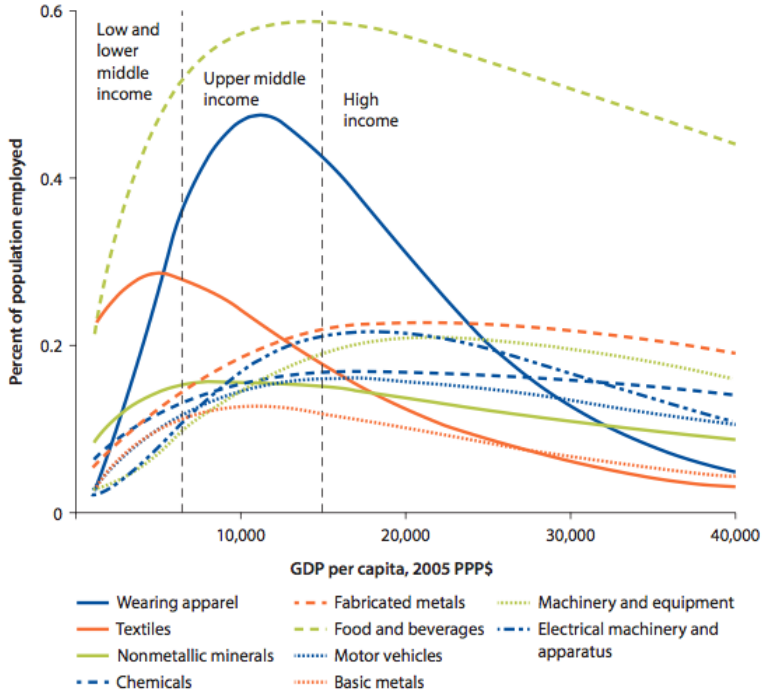
Other than positive spillovers to other sectors, garment firms that are a part of the global supply chain have positive externalities within the sector as well. According to a study conducted by International Growth Centre (IGC), most of the firms which are a part of global supply chain follow international worker safety and environment standards. For instance, most medium and large factories are WRAP (Worldwide Responsible Accredited Production) certified, which is a certification for social compliance. These firms act as trend-setters, for other manufacturers, who are not subject to such standards, to emulate.[23]

1.5 A driver of jobs

In addition to its role as a key contributor in exports, garments sector is a major employer in the manufacturing sector. It requires relatively low capital investment and several of its activities, such as cutting and sewing, are labour intensive.[24] Ready-made garment sector employed 2.38 per cent of the manufacturing labor force in the Pakistan in 2016.[25]

According to empirical evidence, garments industry is one of the largest employers for countries categorized as low-income, lower-middle income (like Pakistan) and middle-income, employing up to 0.5 per centof the population from 1963 to 2007 (see Figure 1- 9). Other, more sophisticated industries such as chemicals, automobiles and fabricated metals stand lower in importance as an employer, and only overtake garments after a country has attained high income status.[26]

FIGURE 1-9 Apparel Sector as an Important Employer for Developing Countries (1963-2007)

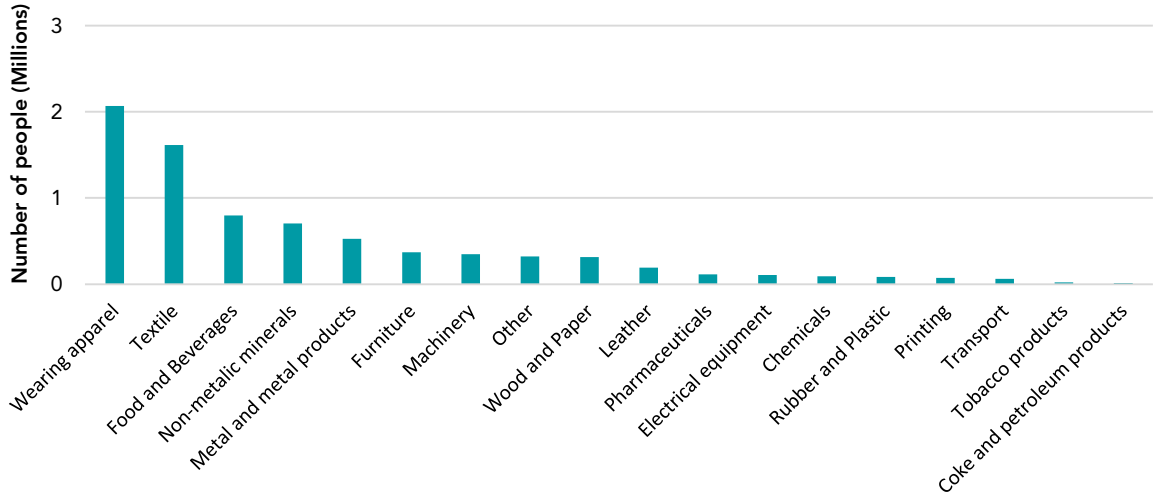


Source: Lopez-Acevedo et al., 2016, p. 20

22 Hamid & Nabi (2013)
23 Hamid & Nabi (2013)
24 Nabi et al. (2013)
25 TDAP (2016)
26 Lopez-Acevdeo & Robertson (2016)

In Pakistan, the garment sector employs the largest number of people in manufacturing as well as within the textile value chain. According to garment manufacturers interviewed in an IGC study in 2013, while 50,000 kg of cotton fiber created 400 jobs in the spinning, weaving and finishing stages, it led to 1600 jobs in garment manufacturing.[27] According to the last Labor Force Survey of 2014-15, apparel is the largest employer in the manufacturing sector, employing over 2 million individuals (Figure 1-10).

FIGURE 1-10 Employment in Major Industries in Pakistan 2014-15



Source: Labour Force Survey 2014-15

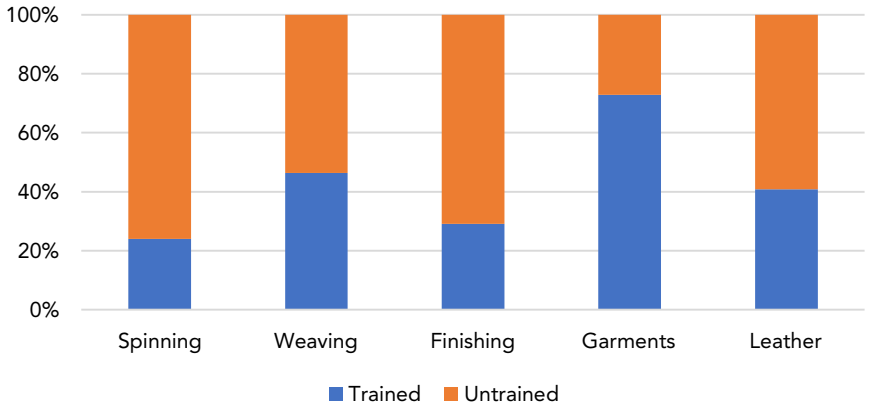
More importantly, these numbers can rise significantly in response to an increase in the output of the garments industry. According to the World Bank, 1 per cent growth in garment production is associated with 0.3 to 0.4 per cent increase in employment for both men and women.[28] This employment multiplier shows that the garments industry has tremendous potential for job creation in Pakistan.

1.6 Better jobs

In addition to being labour intensive, garment industry mostly employs skilled workers. According to the Labour Force Survey 2014-15, the wearing apparel industry has the highest ratio of trained labour among all manufacturing industries, i.e. 73 per cent. Figure 1-11 compares the proportion of trained labour in different activities of textile value chain and leather. Most of the labour in the garment industry receives training as helpers on their jobs, but a notable number also get formal training provided by the garment firms. Most of the large garment units provide stitching training to their workers.[29] In the absence of training programs on supervisory skills, trained stitchers get an opportunity for promotion to positions of supervisors and quality control workers.[30]

27 Nabi and Hamid (2013)
28 Lopez-Acevedo & Robertson (2016)
29 Hamid & Nabi (2013)
30 Hamid & Nabi (2013)

FIGURE 1-11 Ratio of Skilled and Unskilled Labor Force 2014-15



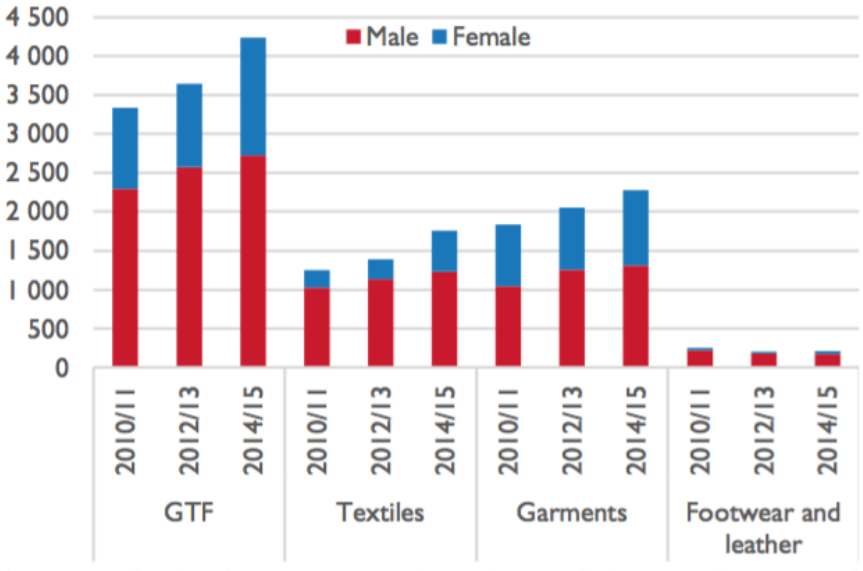
Source: Labour Force Survey 2014-15

Skilled workers in garment industries have higher incomes than unskilled workers. According to a study conducted by IGC, wages of skilled workers are two-thirds higher than that of unskilled workers. Thus, the garment industry provides jobs that are able to pull individuals out of poverty and transform the lives of their next generation.[31]

1.7 Garments and Gender parity

Garments industry is one of the most female intensive industries in Pakistan. Figure 1-12 shows that garment manufacturing firms (in the formal sector) employ a higher share of female workers as compared to textile and footwear and leather industry. More specifically, compared to the primary textile sector (ginning, spinning, and weaving), garment enterprises have a more favourable male-to-female workers ratio, across different sized firms, i.e. small, medium and large-scale firms (Table 1-6).

FIGURE 1-12 Employment in Garments, Textiles, Footwear and Leather by Sex: 2010-2015



Note: GTF refers to Garment, Textile and Footwear. The data captures formal workers only.
Source: Huynh, 2017

31 Hamid & Nabi (2013)

It can also be seen that the share of female employees is the highest in medium-scale garment enterprises, followed by small and large-scale firms (Table 1-6). For instance, in the formal sector, there are 4 males for every female in medium scale firms, compared with 27 males for each female in large-scale firms. Given that the share of female workers has risen over the years in the garments industry, the ratios are likely to decrease over the years, reflecting higher gender inclusiveness.[32]

However,there is substantial evidence to suggest that the gender pay gap is very high in the garments sector, that women are more likely to be concentrated in no-growth jobs as compared to men, and that they are more likely to face non-compliance issues. None of these findings borrow justification from actual advantages (human capital, skill, ability) of men relative to women. Rather, when female worker characteristics are adjusted, the gender pay gap widens further, indicating outright gender discrimination. Within South Asia, this is particularly true of India and Pakistan. This is in contrast to Bangladesh, where women workers tend to earn more than men.[33] Addressing these issues could not only lower the disproportionate burden of poverty on women for those who do work, but also improve female labour force participation, an objective in itself.

TABLE 1-6 Male/ female Employment Ratio in Pakistan

Industry/size	Small	Medium	Large
Textile	6.0	7.5	29.7
Garment	4.9	3.8	27.0
Others	4.2	6.5	27.2

Source: Lopez-Acevedo et al., 2016, p. 125

Resolving issues of gender discrimination is likely to induce an increase in wages by expanding demand for labour in the garment industry. According to empirical results, female labour supply in South Asia is quite elastic: in Pakistan, a 1 per cent rise in expected wages increases the probability of female labour force participation by 16.3 per cent.[34] Moreover, low-skilled female workers are more responsive to expected wages than high-skilled female workers, with 1 per cent rise in expected wages associated with 24 per cent rise in low-skilled and 12 per cent rise in high-skilled female labour force participation.[35] Therefore, in the presence of surplus labour an increase in demand in the garments sector can significantly contribute towards improving gender parity in labour force.

1.8 Cluster development in the garments sector

The major industrial clusters of Pakistan's garments industry are located in the South (Karachi) and North (Lahore, Sialkot and Faisalabad). Each of these clusters specializes in specific products; Lahore mainly produces denim products while Faisalabad is concentrated in hosiery items (Knitwear). Sialkot is more diversified, exporting sports and technical wear garments in both knitted and woven categories.[36] However, the value chain from fabric manufacturing to dyeing and accessories manufacturing is still fragmented.[37] Creating a well-integrated value chain would help firms to benefit from economies of scale and scope, greater demand for primary textile sector and allied industries, knowledge spillovers, and agglomeration economies that could arise due to a readily available pool of skilled labour and raw materials, as well as production know-how. At the same time, this would create avenues for labour-intensive growth in new areas where economic activity is lower.

32 IGC (2017)
33 Saxena & Salze-Lozac'h (2010)
34 Lopez-Acevedo & Robertson (2016)
35 Lopez-Acevedo & Robertson. (2016)
36 PSDF (2015)
37 IGC (2017)

Recognizing the benefits from apparel clusters, the Quaid-e-Azam Apparel Park (QAAP) being established in Sheikhupura, Punjab where proposed special fiscal incentives and infrastructure facilities could spur domestic and foreign investment in the garments sector. Incentives proposed in QAAP include cheaper land, exemption from custom duties on import of capital goods, tax holidays, availability of affordable skilled labor as well as government subsidies for training labour. In terms of infrastructure, the industrial park is to have reliable energy and water supply, a labour colony, improved connectivity to main markets, airports, and railway stations, along with a state-of-the-art waste water management system.[38] This will lower the cost of production and enhance ease of business to foster investment. Investment could take the form of new firms or relocation and expansion of existing garment manufacturers and accessories suppliers. Foreign investment would also be more likely in a dedicated apparel zone, especially through joint ventures.

38 PIEDMC. QAAP. Retrieved from http://pie.com.pk/quaid-e-azam-apparel-park/. Accessed on 29th September 2018

CHAPTER 2

Pakistan's Garment Exports

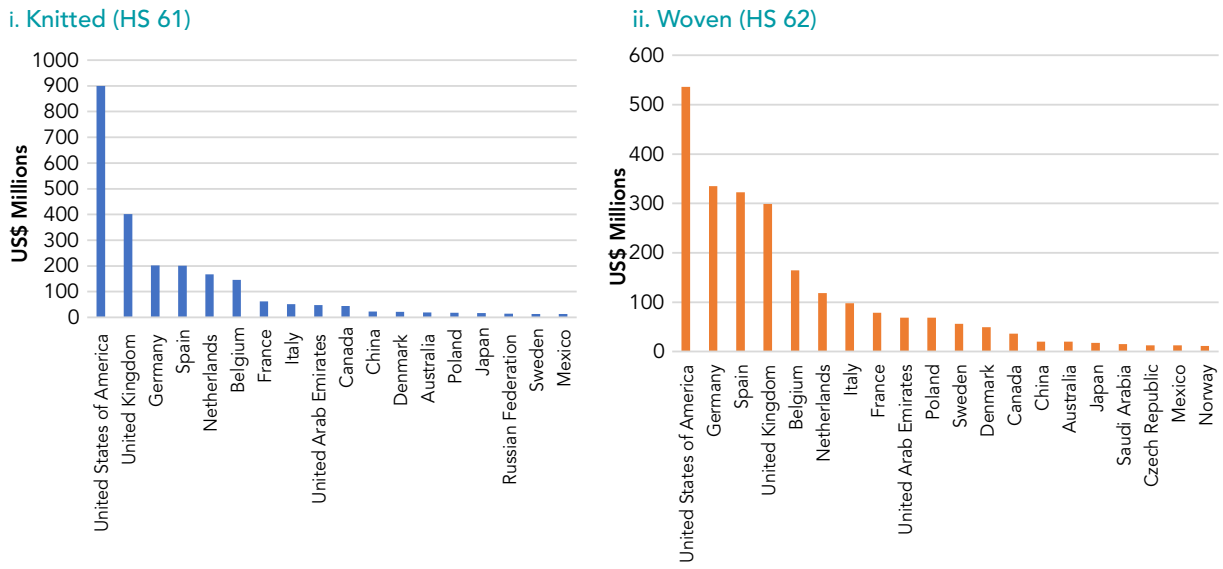
Despite the importance of garments sector in Pakistan's economy, the sector has not been able to attain its potential in terms of the underlying capacity of Pakistan's textile sector.

2.1 Lack of product and market diversification

Pakistan's export basket over the last 15 years has not changed much from an initial dependence on knitted cotton-based garments exported under MFA quotas.[39] There is lack of diversity in both products and markets. Pakistan's exporting base is narrow, with reliance on a few categories—the top 6 products exported by Pakistan across knit and woven accounted for 52 per cent of its garments exports in 2017, but only 20 per cent of total garment exports of the world.

Of Pakistan's garment exports, over 95 per cent are destined for high-income countries, such as United States and countries of the European Union. Pakistan's top export market is the EU for both, woven and knitted RMG, followed by the USA and UAE (Figure 2-1). In 2017, Pakistan exported half of its knitted and two-thirds of its woven exports to the EU[40]. The United States is the largest individual partner country in both categories—accounting for roughly one-third and one-fifth of total knitwear and woven exports in 2017.

FIGURE 2-1 Pakistan's Top 20 Export Destinations for Garments (HS 61& 62), 2017



Source: Data sourced from UN Comtrade

39 Lopez-Acevedo, G. and Robertson, R. (2012). Sewing Success? Employment, Wages, and Poverty following the End of the Multi-Fibre Arrangement. *Directions in Development-Poverty*. Washington, DC: World Bank. Retrieved from https://openknowledge.worldbank.org/handle/10986/13137

40 The EU is taken to include the United Kingdom as well.

2.2 A Bias Towards Low Value Addition

Table 2-1 shows that there is a bias towards low value-added products in Pakistan's textile exports. From 2005 to 2012, low-value added exports increased, with a decrease in intermediate value-added products, and a no change in the share of apparel. However, from 2012 to 2017, there has been a decrease in the share of textile exports at the lower end of the value chain, and export of apparel has gone up from 31 to 40 per cent. It is noteworthy that in comparison with the textile export basket of the world in 2017, Pakistan's basket is still skewed towards low value-added products.

TABLE 2-1 Structure of Pakistan and world's textile and garment exports

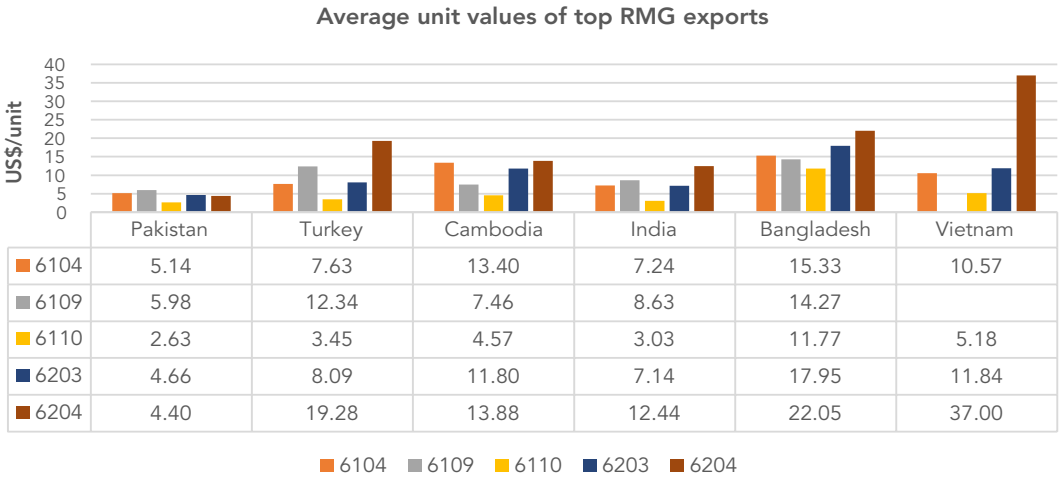
Product		Share in Pakistan's T&G exports			
Low value-added	HS Codes	2005	2012	2017	Share in world's T&G exports in 2017
Cotton Yarn	5204-07	12.6	18.9	10.1	2.3
Intermediate value-added					
Cotton fabric	5208-12	21.5	21.9	17.2	4.2
MMF yarn and fabric	54	2.5	0.3	0.2	7.3
Knitted fabric	60	0.7	0.3	0.2	5.4
Textile made-ups	63	31.8	27.6	32.0	9.8
High value-added					
Knitted apparel	61	17.1	16.8	20.3	35.3
Woven apparel	62	13.8	14.2	19.9	35.7

Source: Data sourced from ITC Trade Maps

2.3 Lower Value Exports

Export unit values (value of exports divided by quantity) are presented below for the top 5 HS 4-digit export categories of Pakistan. Although unit values are not landed prices, they are indicative. Pakistan RMG unit values are generally among the lowest for all products relative to a group of benchmark countries. Importers could take this as a signal of Pakistan's supply cost advantage or of lower product quality. As the 4-digit HS level aggregation contains both low-value and high-value added products, this could also be due to an export mix dominated by low-end products such as T-shirts or vests. Poor marketing in partner countries, low original design capabilities, and an absence of branding are other possibilities. Although it is difficult to pinpoint, it is likely to be a combination of all four reasons.

FIGURE 2-2 Average unit values of Pakistan's top 5 RMG exports (2017)



	Pakistan	Turkey	Cambodia	India	Bangladesh	Vietnam
6104	5.14	7.63	13.40	7.24	15.33	10.57
6109	5.98	12.34	7.46	8.63	14.27	
6110	2.63	3.45	4.57	3.03	11.77	5.18
6203	4.66	8.09	11.80	7.14	17.95	11.84
6204	4.40	19.28	13.88	12.44	22.05	37.00

Source: Data sourced from ITC TradeMap. Accessed on August 2018

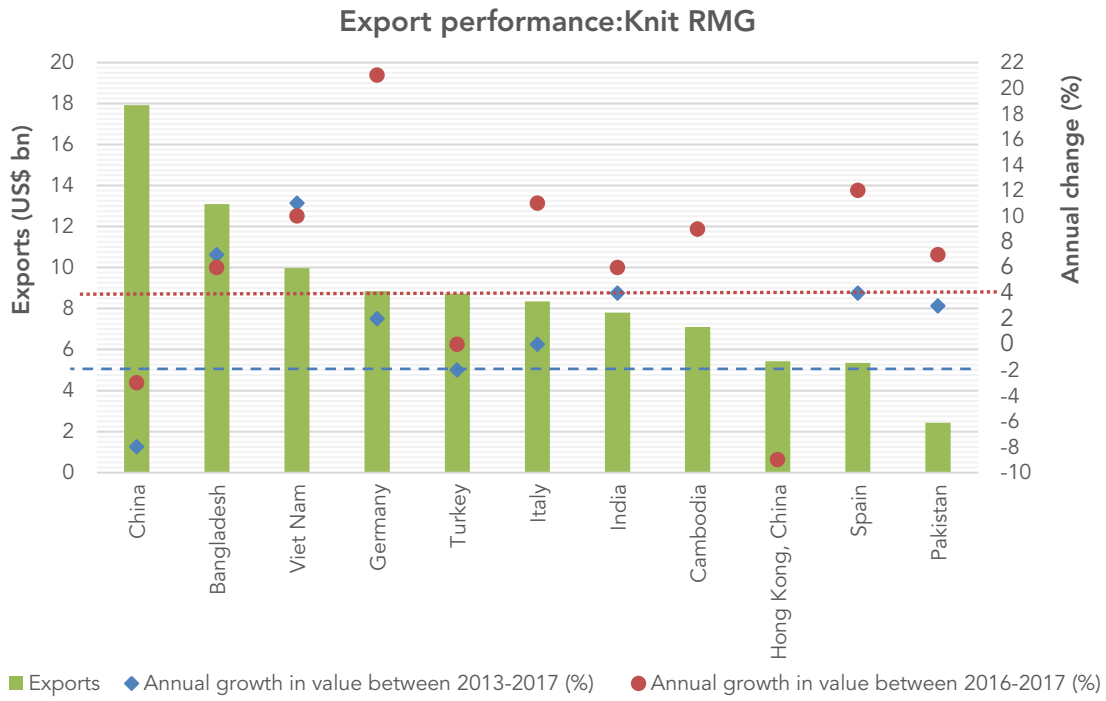
Detailed analysis at the HS 6-digit level of export unit values and Pakistan rankings in destination markets (Annexure I) reveals that Pakistan is not the top export partner even in markets where it has the lowest unit value. This seems to suggest that Pakistan's competitors in the same HS 6-digit bracket have added value to their product such that they are able to command both higher prices and higher demand.

2.4 Slow Export Growth Vis-à-vis Competitors

As mentioned, while Pakistan's exports grew faster than world exports of knitwear and woven at 3 and 7 per cent respectively per year over the last five years, this growth paled in comparison to the growth rates of the top 5 garment exporting countries of 2017 (Figure 2-3 and Figure 2-4). The fastest export growth in knitwear and woven garment exports respectively was depicted by Cambodia (9 and 17 per cent)[41], Vietnam (11 and 8 per cent), and Bangladesh (7 and 6 per cent), which are Pakistan's regional competitors as well.

At the HS 2-digit level, China is still the world leader in 2017 with combined RMG exports of $145.6 billion, despite the 8 per cent per annum decline in China's knitwear exports over 2013-17. The EU with its manufacturing experience in textiles value chain is represented quite strongly in the top 10 exporters of both categories, especially in woven garments exports—with Germany, Italy, Spain, and France featuring annual growth rates at or above 4 per cent (the world average over 2016-17 depicted by the orange dotted line in Figure 2-3 and Figure 2-4). Hong Kong, China represented 3.1 and 2.9 per cent of knitted and woven RMG world exports in 2017, respectively, of which the majority were re-exports originating from the Chinese mainland.[42]

FIGURE 2-3 Top ten exporters of knit RMG, 2017

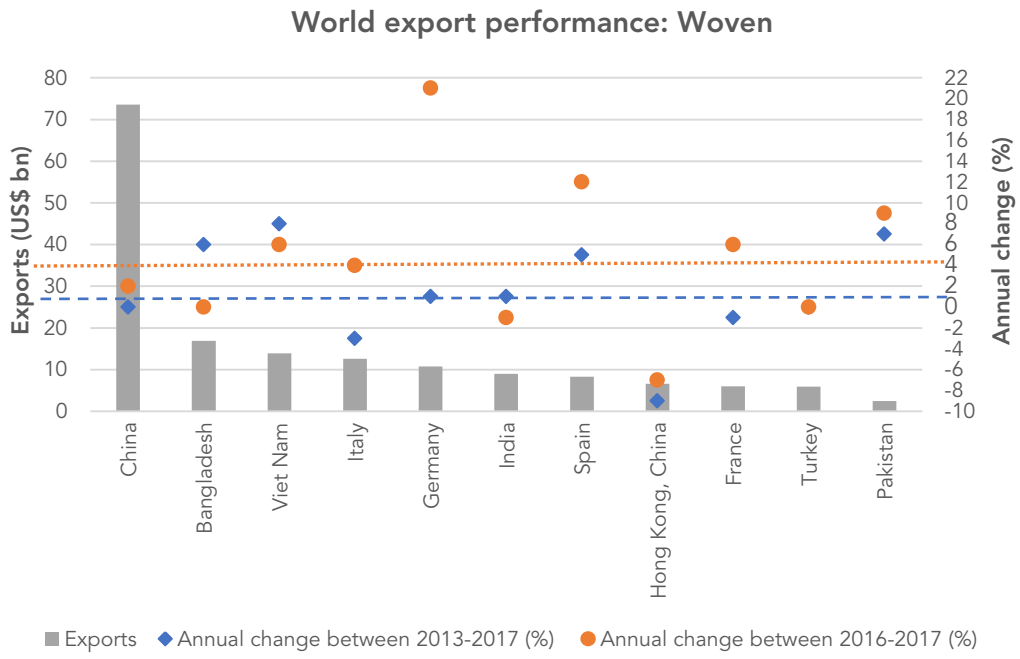


Note: Blue dashed line represents average annual growth in value of world exports over 2013-17, i.e. -2 per cent
Orange dotted line shows average annual growth in value of world exports over 2016-17, i.e. 4 per cent
Source: ITC TradeMap as of August 2018

41 Cambodia does not feature in the top 10 exporters of woven garments (ranked 14th in 2017), due to greater specialization in knitwear (export rank in 2017 was 8th). Nevertheless, it has grown at a remarkable pace since 2013, with higher woven garments exports than Pakistan (1.5 per cent world share in 2017). Myanmar is another Asian country where woven garments exports have grown rapidly, i.e. by 17 per cent per annum over the last five years, with a world export share of 0.8 per cent in 2017

42 Hong Kong Trade Development Council Research Center. Clothing industry in 2018. Retrieved from http://hong-kong-economy-research.hktdc.com/business-news/article/Hong-Kong-Industry-Profiles/Clothing-Industry-in-Hong-Kong/hkip/en/1/1X000000/1X003DCL.htm. Accessed on 26th September 2018

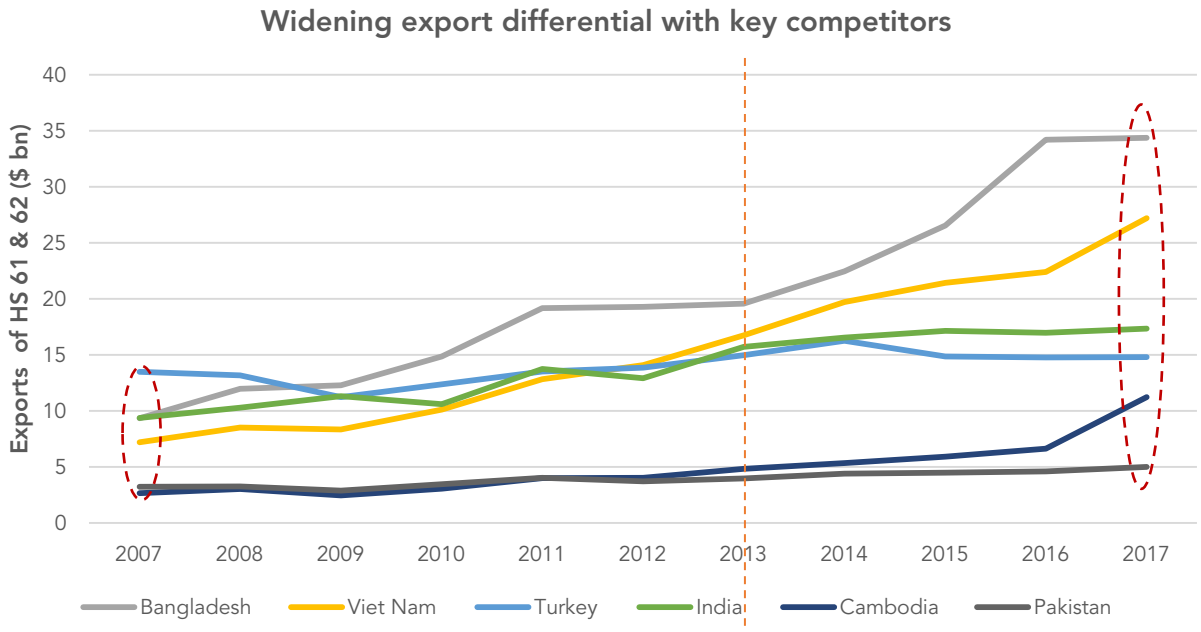
FIGURE 2-4 Top ten exporters of woven RMG, 2017



Note: Blue dashed line represents average annual growth in value of world exports over 2013-17, i.e. 1 per cent
Orange dotted line shows average annual growth in value of world exports over 2016-17, i.e. 4 per cent
Source: ITC TradeMap as of August 2018

This had two effects—firstly, it widened the export gap between Pakistan and its competitors (Figure 2-5). Excluding exports from China, the ratio of total exports (HS 61 and 62) for the top global and regional exporter (Bangladesh) and Pakistan has risen from 3 to 7 from 2007 to 2017, particularly owing to the increasing gap after 2013. In fact, the difference between the exports of Pakistan and all regional competitors except Turkey has increased over the years (Figure 2-5).

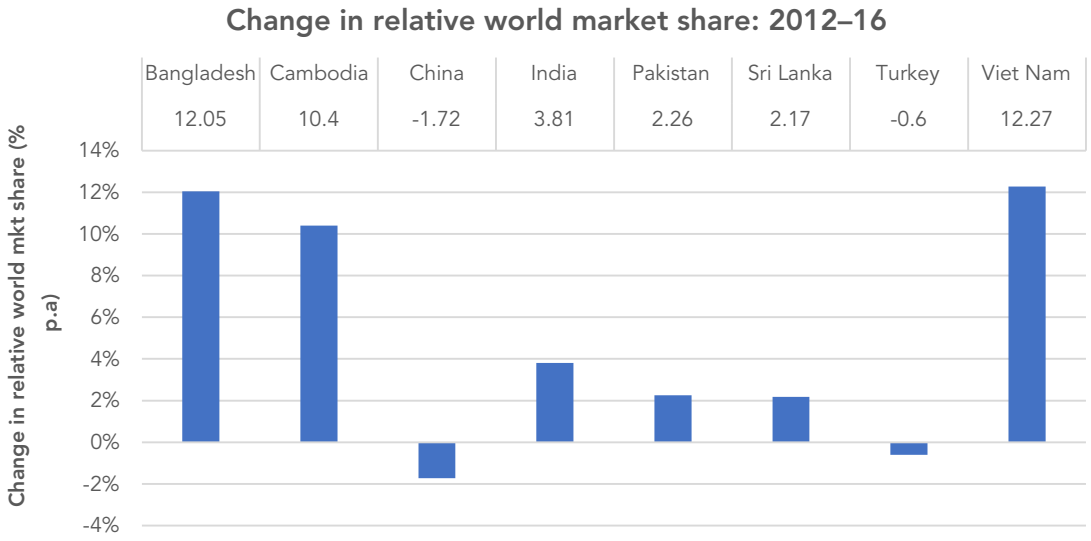
FIGURE 2-5 Widening export differential with key competitors



Source: Data accessed from ITC Trade Maps in August 2018

Another variable that indicates that Pakistan's readymade garments have not been able to keep pace with its key competitors—which are mostly regional—is its relative share in world exports, which did not rise commensurate with its competitors. As may be seen clearly from Figure 2-6, Pakistan's relative world market share[43] increased at 2 per cent over 2012 to 2016. In sharp contrast, Vietnam and Bangladesh have grown phenomenally in terms of relative world market shares, by 12 per cent per annum over 2012-16. India has also outperformed Pakistan—its world market share increased by almost 4 per cent per annum over 2012-16.

FIGURE 2-6 Changes in relative world market shares (% per annum) 2012-16



Note: This is the change in export shares for country n, weighted by the share of country n's import markets in world imports

2.5 Low export competitiveness

The change in world market shares relative to partner imports is a good indicator of how competitive a country's exports are over time. Increases in relative world market shares can be attributed to four possible drivers

i. actual competitiveness of that sector[44]
ii. adaptation to changes in international demand[45]
iii. Correct initial specialization on the most dynamic product within the sector[46]
iv. Correct initial focus on the most dynamic target markets[47]

In Pakistan, while garment sector has not been able to export products that have a growing demand or adapt to changes in world demand (as showcased by negative product specialisation and adaptation effects), competitiveness and focusing on the most dynamic importers have been the leading drivers of increase in relative world market shares over 2012-16 (Figure 2-7).

43 International Trade Competitiveness' index of relative change in world market share is defined as the change in the exporting country's share in destination markets' imports times the initial share of partner countries' imports in world trade. For example, this is the change in Pakistan's export share for clothing over 2012-16 multiplied by how much its partners are actually importing in terms of overall world imports of clothing. It takes into account how much clothing partner countries are importing from all countries (as a fraction of world imports), i.e. their relative significance or actual representation in world imports.

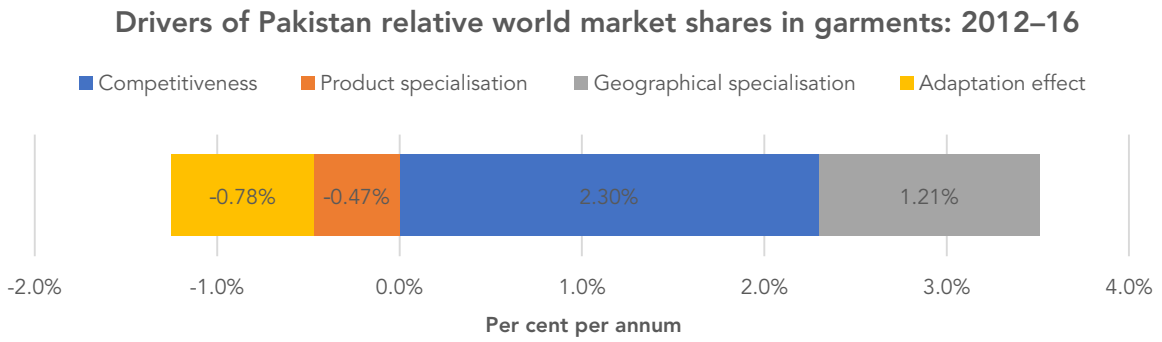
44 Competitiveness effect is calculated as the change in the exporting country's share in destination markets' imports times the initial share of partner countries' imports in world trade

45 Initial market share of the exporting country in partner countries times the change in the share of partner countries in world trade.

46 Initial product specialization is the change in the share of elementary markets in world trade times the difference between the initial share of the exporting country in elementary markets and the initial market share of the exporting country in destination markets

47 Adaptation effect is the change in the share of the elementary markets in world trade times the change in the exporting country's market share in these elementary markets

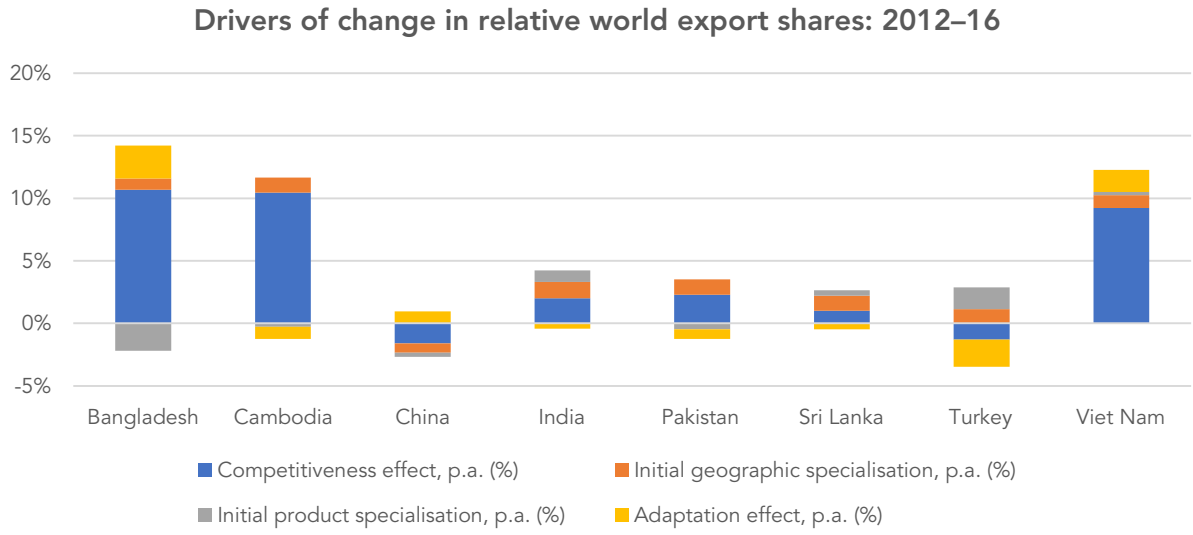
FIGURE 2-7 Drivers of Pakistan relative world market shares in garments: 2012-16



Source: Data sourced from Trade Competitiveness Map

However, juxtaposed with competitors, Pakistan's performance in competitiveness is unsatisfactory (Figure 2-8 and Figure 2-9). Pakistan's sector competitiveness has increased by 2.3 per cent per annum over 2012-16, but worryingly, its competitors are much better ranked than Pakistan (42nd out of 172 countries). Competitiveness is the key source of superior world export performance for the top-growing RMG exporters of Bangladesh (15th), Cambodia (16th) and Vietnam (19th), with relative world export shares rising most due to competitiveness, by 10.7, 10.5 and 9.2 per cent per annum respectively (Figure 2-9). This is problematic because these 3 countries export to the same markets as Pakistan, i.e. the EU and the United States, and are consequently directly competing with Pakistan.

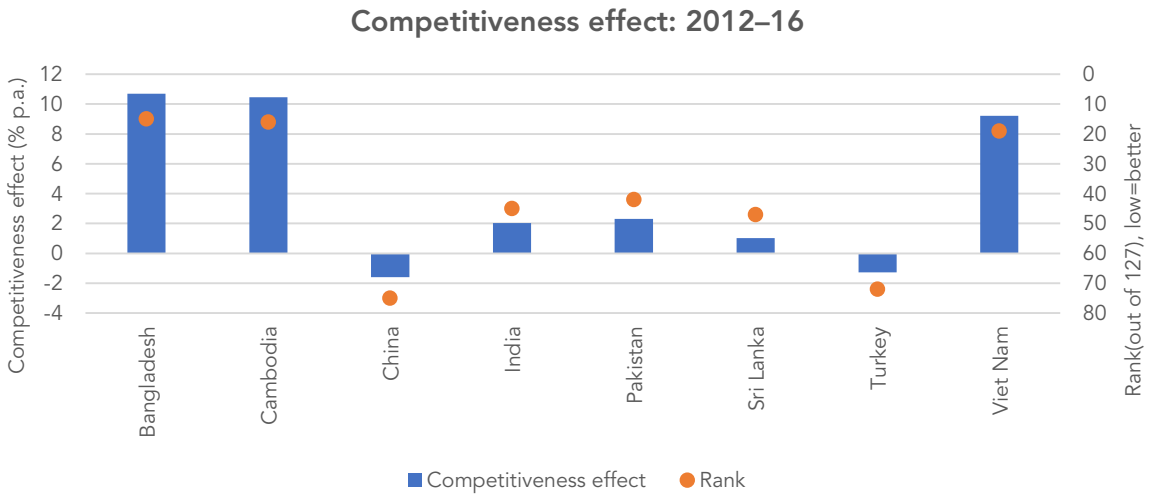
FIGURE 2-8 Comparing drivers of change in relative world export shares (2012-16)



Source: Data sourced from Trade Competitiveness Map

China's low competitiveness over 2012-16 is noteworthy. With China focusing more on technical textiles than garments, their huge market share is available to Pakistan or any other country that takes the appropriate measures today. By prospering utilizing its economic partnership with China under CPEC, Pakistan could look to enter into Chinese value chains as China has done with Vietnam and Cambodia. This could help China retain their established markets but outsource labour intensive processes to Pakistan. There is a scope for complementarities, but this would depend on making Pakistan more attractive than Vietnam or Cambodia.

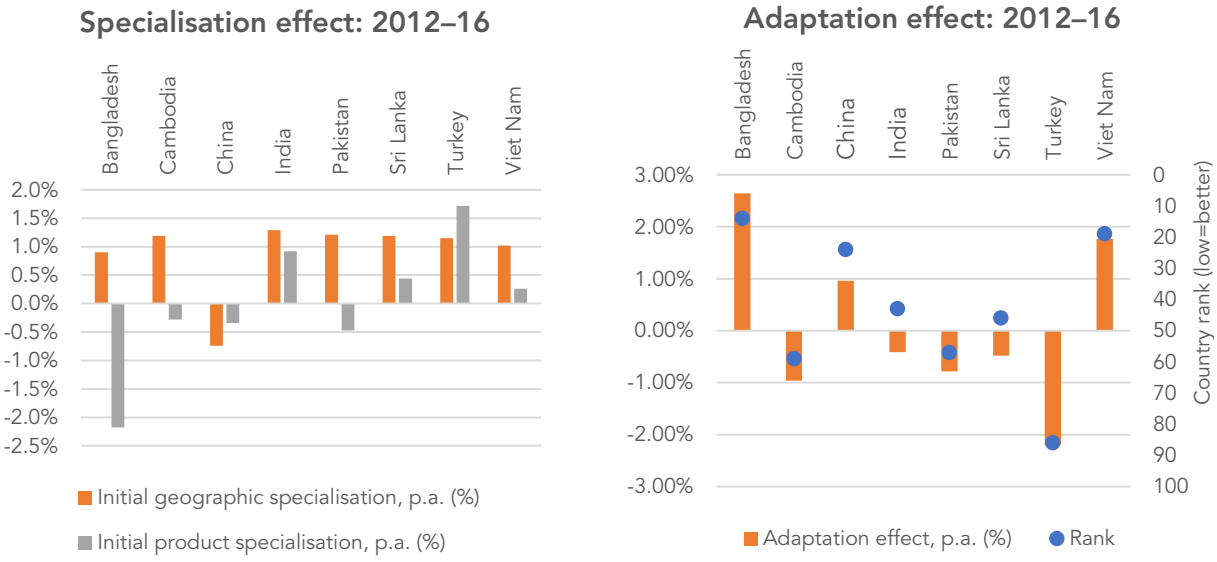
FIGURE 2-9 Change in relative world export shares due to competitiveness (2012-16)



Source: Data sourced from Trade Competitiveness Map

In terms of geographical specialisation Pakistan increased its relative world market share by 1.2 per cent per annum due to initial specialisation of Pakistan's exporters on dynamic markets. This is largely in line with the reference country group (Figure 2-10, left panel).In contrast, Pakistan has not benefitted from initial sectoral specialisation on dynamic (growing demand) products, as the demand for Pakistan's exported products is declining and these products are over-represented in Pakistan's clothing exports to its partners. It appears that Bangladesh and Cambodia also focused on less dynamic products over 2012-16.

FIGURE 2-10 Change in relative world export shares due to specialization and adaptation to global demand (2012-16)



Source: Data sourced from Trade Competitiveness Map as of August 2018.

Critically, Pakistan's relative market share has worsened due to the low adaptability of garment manufacturers to respond to changes in world demand. It ranks 57th out of 172 countries, whereas Bangladesh and Vietnam

place 14th and 19th respectively (Figure 2-10, right panel). This shows that Pakistan's exports of clothing move in the opposite direction to world demand, rising in clothing products that exhibit declining world import demand and vice versa. This contrasts with Bangladesh; its clothing sector exports have moved in tandem with world demand. Together with sector competitiveness, this is perhaps the key reason for Bangladesh's overall superior trade performance: its exports are driven by world demand, reflecting a domestic supply that can quickly respond to variations in world market. Roughly 22 per cent of the increase in Bangladesh's relative world market share over 2012-16 can be attributed to its ability to adapt to world demand. As its world export shares indicate, the sector has suffered by picking up products with declining world demand.

2.6 GSP Plus

The most recent example of a half-availed opportunity is that of GSP Plus with the EU. A comparison of Pakistan's export performance relative to regional competitors in the European Union (EU 28)—the largest export market of Pakistan and the world's largest importer of readymade garments— provides a sobering check on the hopes pinned by Pakistan on preferential market access.

Pakistan applied for duty-free access to the EU market under the GSP Plus scheme in 2013, successfully acquiring it in 2014. Pakistan, along with Sri Lanka and the Philippines from Asia, are part of the EU's 10-year GSP Plus arrangement. One of three EU market schemes for developing countries, this offers duty-free access for a group of products to low-income and "vulnerable" developing countries until 2023. While Pakistan cannot "graduate" out of this scheme, its status is contingent on sustainable development and good governance measured by conformance and performance in ratifying 27 conventions.[48]

Acquiring GSP Plus has improved Pakistan's margin of preference in readymade garments vis-à-vis China and India (which faced average export-weighted tariffs of 11.5 and 9 per cent respectively, over 2011 to 2016). Similarly, in the EU market Pakistan enjoys a preference margin of 12 per cent with Thailand and 9.6 per cent with Vietnam and Indonesia, all tough competitors in the EU garments market.

On the other hand, Pakistan does not enjoy preferential margins over Cambodia and Bangladesh, two of the most dynamic RMG exporters of the last 10 years. Both these countries benefit from the more generous EU Everything but Arms (EBA) scheme, which does not expire, entails no capping restrictions (exports to the EU can grow without bound) and has more beneficial Rules of Origins (in order to qualify for 0 per cent duty, EBA countries are not restricted to sourcing inputs from regional groupings).[49] The latter effectively puts Pakistan at a distinct disadvantage, despite similar duty-free access as Bangladesh and Cambodia. Their less rigid rules of origin allow them to import raw materials from the cheapest partner, while Pakistan is limited to sourcing inputs from its own sub-regional grouping.

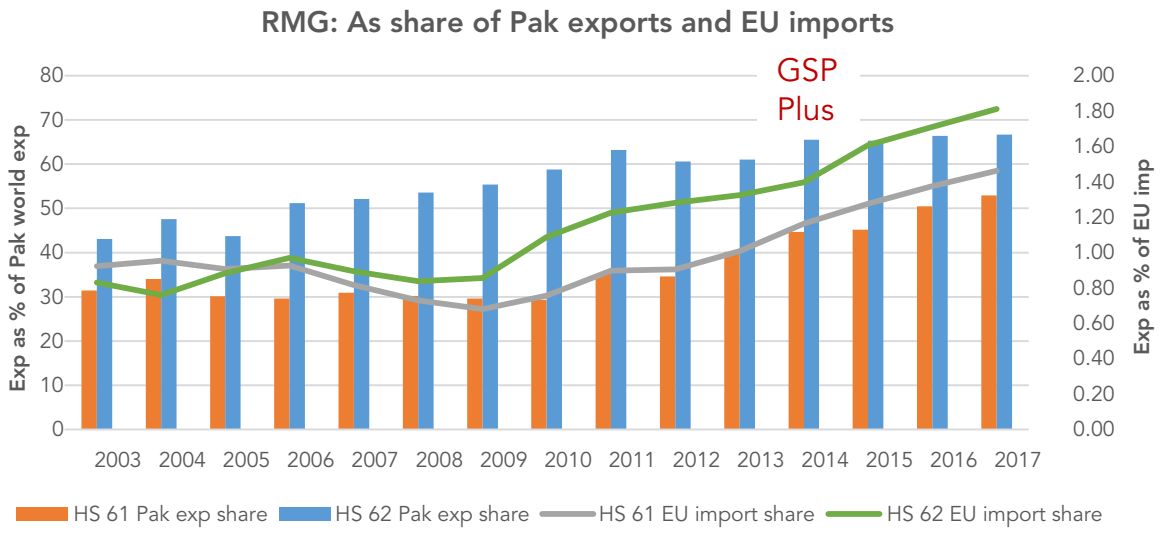
Failure to increase

It has now been five years since Pakistan attained GSP Plus status, the half-way mark of the 10-year arrangement. In 2017, Pakistan exported $3 billion out of its total RMG exports of $5 billion (60 per cent) to the European Union, a 10% increase from 2013 (Figure 2-11). However, as a share of EU imports from the world, the share has risen insignificantly, from about 1.2 to 1.6 per cent across both categories, i.e. less than half a percentage point increase.

48 Since 2016, assessment of progress on protecting labour and environment, curbing drug trafficking and corruption, and upholding basic human rights is to be conducted every two years. Pakistan passed its first assessment in 2018.

49 European Commission. Rules of Origin: GSP. Available at http://trade.ec.europa.eu/tradehelp/rules-origin-generalised-scheme-preferences. Retrieved on 29th July 2018

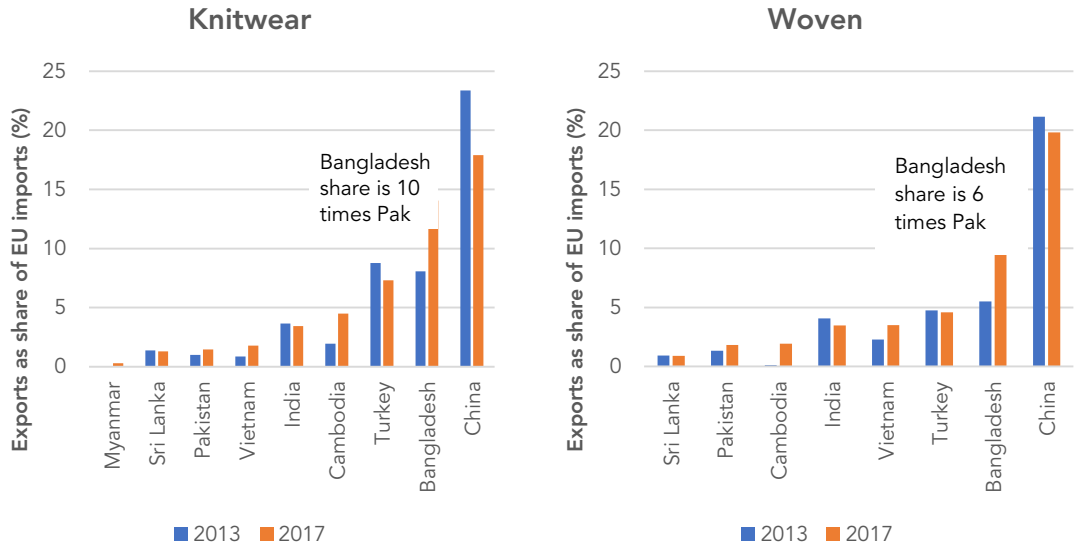
FIGURE 2-11 RMG exports of Pakistan (2013-17)



Source: Data from ITC TradeMap, as of August 2018

Pakistan's share of EU imports increased by roughly 0.5 percentage points in both categories of knitted and woven garments over 2013-2017. Over the same time, the market share of Bangladesh, Cambodia and Vietnam increased by roughly 6, 2, and 1.1 percentage points. Some of this rise may be attributable to more favourable rules of Origin, but are unlikely to account for the total differential with Pakistan. Of all regional competitors in 2017, Pakistan had the lowest share in EU imports after Sri Lanka. Vietnam and Cambodia were ranked 4th in woven and knitwear markets, respectively.[50] This indicates that Pakistan has directly lost out on potential exports that the EU has imported from its competitors instead. It is noteworthy that Bangladesh's share is 10 and 6 times that of Pakistan in knitwear and woven garment exports, respectively (Figure 2-12).

FIGURE 2-12 EU import shares for readymade garments over 2013-17: A comparison



Source: Data sourced from ITC TradeMap

50 In addition to competition from China, Bangladesh, Vietnam and Cambodia, exports sourced from within the EU have also increased from $82 million to $94 million over 2013-17 (by 14 per cent). This indicates that intra-EU trade has increased, with Italy accounting for 47 per cent of clothing produced in the EU. Source: European Commission (2017). Midterm evaluation of the EU's GSP Final Interim Report 21 September 2017

As Table 2-2 indicates, Pakistan faces tough competition in its leading exports to the EU market.

TABLE 2-2 Leading exports of Pakistan, 2017: A comparison

HS code	Top exporter (share of EU imports in %)	Pakistan import share of EU (%)	Rank in EU
620322	China (13.6)	6.2	5
620342	Bangladesh (24.7)	10.5	2
620462	Bangladesh (20.5)	6.4	4
'610590	Spain (24.6)	16.1	2
'610349	China (16.1)	6	5
'611090	China (26)	1.2	17

Source: Data sourced from ITC TradeMap, own calculations

As the failure to fully benefit from the GSP Plus shows, preferential market access is only one consideration for export growth.

CHAPTER 3

Impediments to achieving export competitiveness

3.1 Supply-side constraints

Supply side constraints affect the quantity, quality and competitiveness of garment products. As discussed below, these pertain to issues in domestic value chain, costs of production, labor productivity, cluster development and access to credit.

Unreliable domestic supply chain

Shortcomings in each stage of the garment value chain subsequently affect the quality of garments. Starting with the bottom, due to poor quality of both cotton seeds and their storage, garment industry is concentrated in short-staple cotton-based garment products. At the ginning stage, cotton lint storage is inadequate, moisture is added when the lint is pressed into bales, and cotton of different variety and grade is mixed together and sold as seed cotton for next season by unscrupulous ginners.[51]

With two-thirds of total yarn produced used domestically, the quality of yarn produced is a key determinant of the garments value chain. The spinning sector has historically been very strong in rotor and ring spinning of cotton into coarse count yarn. Production of yarn qualities, especially on fine count end, is very limited. Of the total yarn produced in 2016-17, 47 per cent was of coarse count, 23.7 per cent was medium count, and only 5.4 per cent of fine and super count.

The primary textiles sector has not made the progression to knitting and weaving fabric needed by the garments sector. This is partly due to the entrenched government support to the cotton yarn spinning sector along with the relatively lower entry barriers of investment in spinning as compared to weaving. The situation is relatively worse for knitted fabric. The knitted sector took off during the 1980s due to high demand for knitted cotton shirts in the US market through MFA quotas and was largely based on smaller firms with dyeing and bleaching capacities.[52] Although the knit sector was backed by a strong spinning sector, the backward link with fabric was never fully developed. As a result, firms are currently facing more difficulty in sourcing knitted fabric, reducing the supply elasticity of Pakistan's knitwear segment. This explains the lower per annum export growth rates (3 per cent per annum) for this sector over 2013-17 in comparison to the woven sector (7 per cent per annum).

51 Hussain et al. (2009). SWOT analysis of Pakistan textile supply chain. Retrieved from https://www.researchgate.net/publication/228447616_SWOT_Analysis_of_Pakistan_Textile_Supply_Chain

52 Beyond GSP Plus

The woven fabric sector also faces multiple issues on account of the non-mill (power loom) segment which dominates the weaving sector (80-90 per cent).[53] Problems in sourcing superior yarn, arranging and paying for reliable energy (the power loom sector is energy-intensive) and access to credit arise due to its informal nature. Lower productivity due to old technology and inefficient production techniques, and the influx of cheap Chinese imported fabric has also adversely affected the weaving sector. Collectively, investment in textile machinery (spinning and weaving) has fallen steeply by 44 per cent since 2005-06 peak investment of $1 billion, to less than $0.56 billion in 2016-17.[54]

Moving from yarn or fabric to garments manufacturing is even more demanding, not just due to higher investment requirements as compared to spinning and weaving, but also due to the raw materials, managerial competence, technical expertise and organizational know-how required.[55] The manufacturing of dyes and chemicals used in the dyeing and finishing stages is also sub-par and safety standards are largely ignored. Poor colour range and consistency means that garment producers must re-dye fabrics or trimmings which can take up to two weeks, adding to production times and costs.[56] Most garment manufacturers interviewed prefer to import higher quality and safety-compliant dyes, which are subject to testing within the factory or are sent to Hong Kong for testing abroad as Pakistan laboratory certification is not accepted internationally.

Technology adoption: A market failure

As widely documented, Pakistan does not face issues of capacity, as most sectors in the textile value chain have excess capacity. For instance, the garment industry operates at less than 70 per cent of its capacity.[57] Rather, the issue is one of capability, i.e. being unable to adequately utilise existing capacity in the best manner. Factory floor studies have documented that even where capacity was being optimally utilised, it was not operating at maximum efficiency. Overall productivity in garment factories is low, as Pakistani firms lag in terms of knowledge about modern production techniques as well as organizational knowledge such as factory floor and inventory management.[58]

Technology adoption is the main constraint in the garments sector, with firms unable to acquire and learn about technology. The problem arises due to a market failure as technology is not an off-the-shelf product that can be absorbed without cost. Investment in technology is therefore less likely due to the risks associated with technology adoption. Relative to investment in machinery, these risks arise due to payback times that are unknown, as learning about the technology takes place. The market failure in technology adoption for firms is one of financing—which banks are unwilling to provide during the learning period. This makes borrowing costly for firms, as banks try to shift the associated risks to firms using higher interest rates and ask for better quality collateral. On the other hand, firm ability to self-fund will depend on appetite for risk as well as liquidity.[59]

Technology largely determines firm capability to produce more using given inputs as well as respond to opportunities for product and market diversification. However, there is a lengthy period of learning-by-doing involved which can sometimes be unsuccessful. Larger firms are early adopters of technology, after which information spillovers facilitate learning about the technology. This leads to a second round of technology adoption by smaller firms.

53 PACRA (2011). *The textile sector: A sector study*. PACRA. http://www.pacra.com.pk/pages/research/web_sector_study/textile/Textile_Mar_11.pdf

54 Spinning sector needs measures to arrest declining yarn exports. *Editorial*. Pakistan Textile Journal. February 2018. Retrieved from http://ptj.com.pk/Web-2018/02-2018/Editorial.html

55 Hussain et al. (2013)

56 Texmin.nic.in/sites/efault/files/IIFT

57 Nabi and Hamid (2017). IGC Study

58 McCartney, M. (2014). *The Political Economy of Industrial Policy: A Comparative Study of the Textiles Industry in Pakistan*

59 McCartney, M. (2014). *The Political Economy of Industrial Policy: A Comparative Study of the Textiles Industry in Pakistan*

The resulting S-shaped technology learning/adoption curve has led to multiple equilibria in the garments industry, good and bad. While some large and more enterprising medium-sized firms have been able to adopt technology and cater to any world market,[60] others are still stuck in a low-technology equilibrium, where fierce price competition within the local market erodes profit margins and makes technology adoption even less likely. Competition has increased among small and medium sized local firms as orders continue to shrink — especially in knitwear—with Pakistan losing out to Bangladesh post-2005 and Vietnam post-2007.[61] As each firm tries to underprice others to get orders, investing in technology is unlikely. A coordinated push will be necessary to ensure that smaller and medium sized firms improve technology together to move the industry to a better equilibrium, as no individual firm will find it profitable to adopt new technology without others also adopting at the same time. This is because they do not have the requisite volumes that could allow them to meet bank collateral requirements. To solve this coordination failure, access to finance and some means of quasi-insurance will be key.

A comparison of existing technology at each stage of production is given below. It shows that Pakistan has the lowest technology after Bangladesh, while Sri Lanka has much higher technology, particularly at the pre-production and preparatory stages.

TABLE 3-1 Comparing technology across RMG producers, 2017

Stage of production	China	Sri Lanka	India	Bangladesh	Pakistan	Vietnam
Pre-Production (Order planning and maintenance)	Mid to advanced			Base to mid		
Production Preparatory (Cutting)	Mid to advanced			Base to mid		Mid
Production (Sewing)	Mid		Base to mid			Mid
Post-Production (Finishing & Packaging)		Base	Mid	Base to mid		
Manufacturing efficiency, method, wage & time keeping	Mid			Base		Mid

Source: Ministry of Textiles, India. (2018)

Higher costs of production versus peers

Without adding margins and port transport costs, a standard cotton polo shirt in 2016 cost $3.46 in Bangladesh and $3.93 in China, spanning the whole value chain from cotton to garment. Costs in cut-make-trim firms are much lower, as in Vietnam, where fabric costs are excluded and a polo shirt costs $0.39.[62] According to the garments industry, while a similar shirt in Pakistan cost $3.20 in 2014, it can now cost up to $4, despite cotton being cheaper in Pakistan than in regional competitors. As discussed below, the reasons behind increasing production cost relative to its peers are rising energy and cotton prices since 2015 and 2016, respectively, along with rising minimum wages, lower labour productivity and limited potential for availing economies of agglomeration, scale and scope.

Cotton and trimmings

Although Pakistan is relatively self-sufficient in cotton-based textiles, its imports of cotton have recently risen owing to volatility in cotton crops (poor crop in 2016 followed by crop substitution in 2017).[63] To protect the spinning sector, duties on the cotton textile chain (Table 32) are high (15 per cent) in 2017 and input costs have risen accordingly.

60 IGC (2013) Garments as a driver of economic growth: Insight from case studies. IGC Working Paper F-37036-PAK-1

61 Anh, N., Duc, L., and Chieu, T. (2016). The Evolution of Vietnamese industry: Learning to compete. Working Paper No. 19 Africa Growth Initiative at Brookings. Retrieved from https://www.brookings.edu/wp-content/uploads/2016/07/L2C_WP19_Nguyen-Luu-and-Trinh-1.pdf

62 Kathuria, S. and Malouche, M. (2016). Thematic Analysis: Export Constraints and Potential in Selected Sectors Toward New Sources of Competitiveness in Bangladesh. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0647-6

63 PACRA (2017). Textiles sector: An overview

TABLE 3-2 Duty structure on cotton

	Raw cotton	Cotton yarn	Greige/processed fabric
Customs duty	4	5	5
Sales tax	5	10	10
Total	9	15	15

Source: PACRA (2017). Textiles sector: An overview

Some relief has been provided through duty drawbacks on local taxes and levies offered under the PM Exporter Package 2017-18 (that has been extended till 2021, see below). While the rebate rate is highest for garments at 7 per cent (see Table 33), claims are pending with the FBR since January 2017.

TABLE 3-3 Duty drawback on local taxes and levies (2017-2021)

	Rebate (%)
Yarn	4
Greige fabric	4
Processed fabric	5
Made-ups	6
Garments	7

Source: PACRA (2017). Textiles sector: An overview

Firms add value by concentrating on trimmings (buttons, zips, and labels), accessories and embroidery. While adding value through zips, pockets, and embroidery, many exporters selling to world markets through big brands are required to source trimmings and accessories from designated sellers in other countries. Production costs rise significantly when sourcing pockets, zips, and threads from 18-20 input suppliers per production line, or as many as 60 suppliers for multi-product firms.[64] Although the final price of the garment rises accordingly, the overall effect on the firm's profit margin depends on tariffs and local duties on imports.

Man-made fibres and fabric

Pakistan's production and exports of garments made from synthetic materials has remained low, although globally, this segment has grown rapidly since 1998, and now accounts for 65 per cent of fibre demanded in the textile sector. Pakistan's underlying capacity in the man-made fibre sector is not well-developed— there are only 3 manufacturers of polyester staple fibre (PSF), the most commonly used man-made fibre (MMF) in Pakistan. Similarly, blended yarn used for synthetic material is not produced locally (only 25 per cent spinning machines use MMF to make blended yarn).[65] It must therefore rely on imports to meet the excess demand. While the government has sought to protect this sector through high tariff walls, the domestic industry has been unable to achieve the government objective of substituting the imports of MMF. This is largely due to the local unavailability of the chemicals required for production of the core raw material (PTA) used to make synthetic fibres, imports of which are subject to tariffs.

Government protection had a significant impact on the garments industry's capacity to produce garments made from man-made fibres. Historically, Pakistan raised its tariffs on MMF in 1998-99 at a time when global demand for synthetics began to rise. This was done to protect the domestic industry, as MMF fibres accounted for 22 per cent of total domestic fibre consumption. The tariffs put in place from 1998 to 2003 set Pakistan on a very different path than it would have taken had high tariffs (Table 34) of 25 per cent not been levied at this

64 IGC (2013) Garments as a driver of economic growth: Insight from case studies. IGC Working Paper F-37036-PAK-1

65 Memon, N. (2018) Pakistani cotton yarn exports continue its decline. Dadabhoy Institute of Higher Education. Pakistan Textile Journal. February 2018

critical juncture. Eventually, tariffs were lowered. In 2018, tariff on man-made staple fibres is 7 per cent for PSF, but 0 per cent for viscose, acrylic, and nylon (as these cannot be produced domestically).[66]

TABLE 3-4 Tariffs on man-made staple fibres over time High tariff escalation (2017)

Year	Fibre tariff (%)		
1998	25		
2003	20		
2006	6.5		
2017	7		
Polyester Staple Fibre (2017)		**Yarn**	**Processed fabric**
7		11	16

Source: Data from SBP. (2017-18). State of Pakistan's economy, 3rd Quarterly Report 2017-18

Tariffs are moderate at the lowest (to optimize tariff collection) and peak at the highest end (to encourage domestic value addition by spinning MMF into yarn and converting into cloth). This tariff escalation has two effects. Firstly, RMG manufacturers import more MMF fibre rather than fabric, unlike emerging competitors of Vietnam and Cambodia. This not only makes Pakistan RMG products uncompetitive in world markets today, but more importantly, precludes them from importing fabric and adding value to sell to more lucrative and dynamic markets tomorrow. That would require Pakistan to produce according to a 50:50 cotton to synthetic fibre mix in order to stay relevant and competitive, whereas it is currently at an 80:20 mix.[67] Secondly, the MMF sector itself has suffered through under-invoicing of imports and smuggling from China, the world's largest producer of synthetic material.

Making PSF artificially expensive through protectionist policies to support its production in Pakistan translates into poor quality synthetic fibre and higher costs of production, ultimately rendering Pakistan globally uncompetitive. Moreover, even with protection, it is not possible for RMG sector to meet its synthetic fibre demand domestically, as there are only 3 local producers of polyester fibre and filaments. As the synthetic RMG market grows, Pakistan loses out on a lucrative portion of RMG exports, which on account of value-addition, quality of fabric and performance, and wider range of uses, command higher prices. Meanwhile, Pakistan's competitors have simply imported synthetic fibre, yarn or material from the cheapest supplier in the South Asian region, added value and exported garments for sale at higher unit prices.[68]

In a positive development, the government has sought to support garment manufacturers to aid them in achieving product diversity and value-addition. As per the Textile Policy 2014-19, to help Pakistan achieve a cotton to synthetic mix more in line with high global demand for synthetics, duty drawback can be availed on imported MMF. In addition, to encourage use of domestic MMF, manufacturing exporters can deem it as imported and also claim drawback on that. However, this is a costly strategy when 80 per cent of world production of polyester staple fibre takes place in South and Southeast Asia (China, India, Taiwan etc.).[69]

Collectively, these imported inputs raise the import dependency of textile exports of Pakistan compared to China and India (Figure 3-1). This is measured as the share of textile imports relative to exports. With their strong indigenous textile value chain of both natural and man-made fibres (China) and India are much less

66 SBP (2018). *Special Section 2: Synthetic Textiles is Key to Sustaining Export Growth Momentum. State of Pakistan's Economy–Third Quarterly Report 2017-18.*

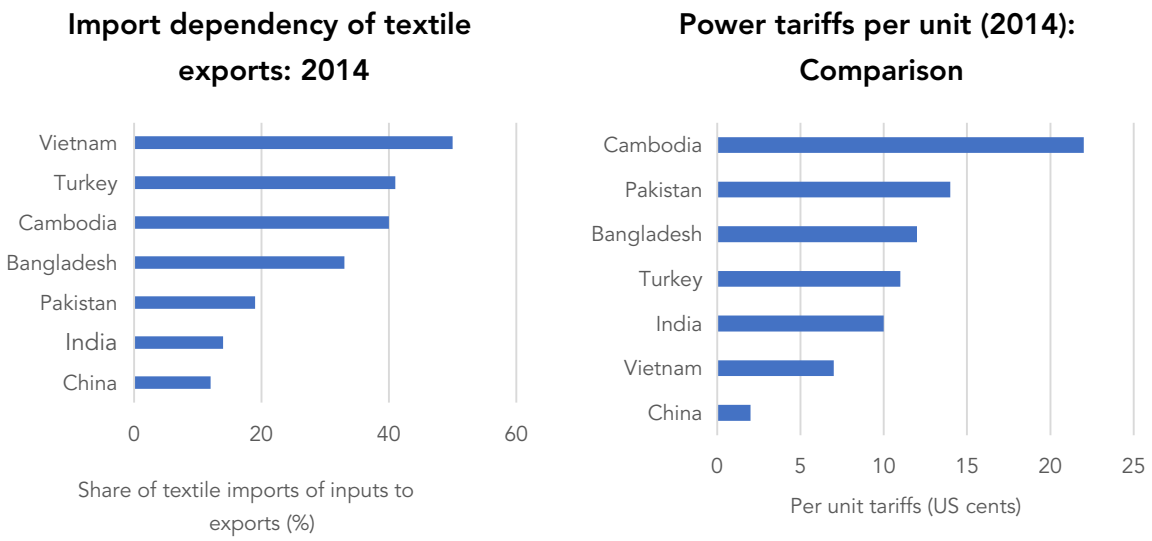
67 Hamid, N. and Nabi, N. (2017).

68 SBP (2018). *Special Section 2: Synthetic Textiles is Key to Sustaining Export Growth Momentum. State of Pakistan's Economy–Third Quarterly Report 2017-18.*

69 Memon, N. (2018) Pakistani cotton yarn exports continue its decline. Dadabhoy Institute of Higher Education. Pakistan Textile Journal. February 2018

dependent on imported textile inputs. This reduces the cost of sourcing, which for Pakistan is subject to exogenous variation arising from exchange rate volatility, supply of foreign reserves, rules of origin, and extent of market access in countries it sources these inputs from. Although Bangladesh, Vietnam and Cambodia have an even higher import dependency than Pakistan,[70] their governments have had a much clearer and committed stance on export-led industrial policy. As a result, these government have put in place policies to give access to the cheapest and best quality inputs from other countries (see chapter 6). Moreover, their governments have been successful in securing favorable access to partner countries through trade agreements with the EU and Asian countries under the EBA and ASEAN, respectively. Pakistan has not been able to do the same with either India (under SAFTA) or FTA (China), the leading exporters of man-made fibres (ranked 1st and 3rd in 2017, respectively).

FIGURE 3-1 Imported inputs and energy costs comparison (2014)



Source: Ministry of Textiles, India. http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

Energy

Although the electricity situation has improved tremendously, on account of prioritized provision of electricity to the textile and clothing sector,[71] continuous energy supply is not yet the norm in Pakistan. Bigger firms rely on captive power generation, an expensive option that is not available to smaller and medium-sized firms. With the garment value chain fragmented across firms of various sizes, this causes disruptions in production flows, creating uncertainty in meeting delivery times. Unreliability in meeting order specifications relegates producers to making more basic entry-point type garments with simple (and hence more reliable) supply chains, trapping firms in low price-low-value downward price spirals.[72] Even with plants operated on own energy, departments must take turns in sharing the energy across firms—causing delays in processing orders across major production lines such as dyeing, printing, cutting, and sewing. Moreover, energy fluctuations make it impossible to operate expensive computer-aided machines for design and manufacturing without captive power generation, as they are extremely sensitive. This limits growth prospects for medium sized and smaller firms considerably.

The current energy mix in the textile and clothing sector is gas, electricity (public) or private electricity

70 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

71 CDPR. (2016) CPEC study

72 CDPR. (2016) CPEC study

generation. Gas is a significant input cost in yarn production, which accounts for almost 40-50 per cent of the inputs in knitwear manufacturing. While industry says that gas costs have almost doubled since 2005 (from Rs.6 to Rs. 11 per unit), this is nevertheless cheaper than diesel-operated generators (Rs. 26/kW hour). Moreover, there is significant regional variation in gas tariffs within Pakistan. In Punjab, where 70 per cent of industry is located, manufacturers pay Rs.1100/mmBtu, where as in Sindh the tariff is Rs. 600/mmBtu.[73]

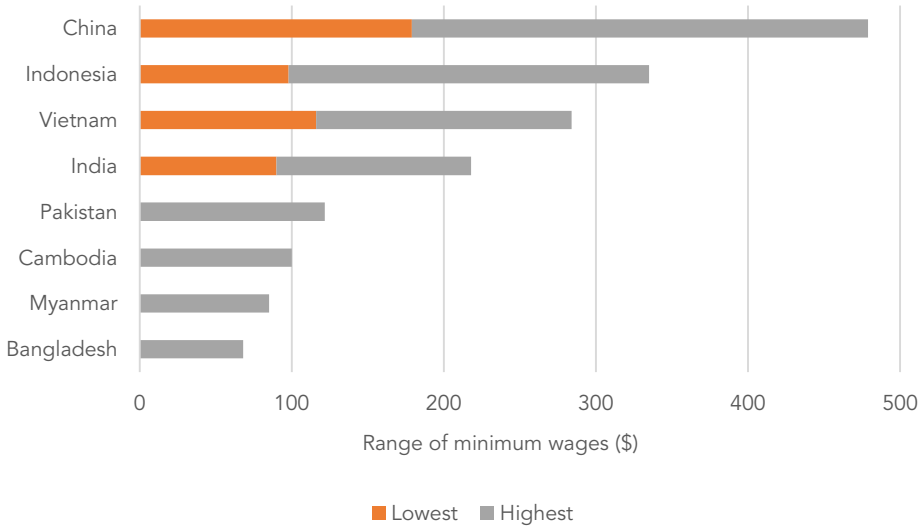
Gas prices in Pakistan are higher than in comparator countries. According to industry sources, the per mmBtu cost are as follows: $3 in Bangladesh, $4.5 in India, $6 in Vietnam and $10 in Pakistan. Electricity supply is intermittent in Bangladesh and Pakistan and alternative energy sources cost much more. As shown in Figure 3-1, per unit tariff costs are highest in Cambodia, Pakistan's per unit industrial tariff is 14 cents per unit, compared to India and China (10 cents and 2 cents, respectively).[74]

Wages

Except for China, Turkey— and increasingly India—the other countries in this group rely on labour cost advantages to secure import orders from developed country firms. This is largely due to the labour-intensive production technologies in the garments sector. Labour costs determine the nature of business relationships that buyer companies create with suppliers such as Pakistan and Bangladesh in buyer-driven global productions networks. Suppliers have two broad options. They can either avail low cost production or alternatively, offset high costs against other gains driven by product and process specialization, operational performance, technological superiority and market proximity.

Pakistan currently falls in the former category and is facing tough competition from lower wage countries, such as Cambodia and increasingly Myanmar (with garments exports rising from $0.34 billion in 2010 to $2.5 billion in 2017). As shown by Figure 3-2, Pakistan's monthly wages are twice the monthly wage in Bangladesh ($121 versus $68).

FIGURE 3-2 Comparing monthly wages in the RMG sector, 2017



Source: Lee, K. (2017). Production in Bangladesh: Recent development and opportunities

73 Discussion with industry, 18th September 2018. Faisalabad

74 Pakistan Agriculture Research. Various issues of *Textile News*. Retrieved from https://par.com.pk/news/category/textile

Labor Productivity

Pakistan currently ranks 5th from the bottom (125th out of 130 countries) in the Human Capital Index 2017.[75] This a result of poor performance in terms of deployment of human capital (jobs) and development (level and quality of education and skills).[76] Skills premia in the RMG sector are quite high, since good quality workers are hard to acquire, and poaching (attracting workers by offering marginal increases in wages) means that the overall factory floor productivity is low. This is due to constant churning of labor (hiring and firing), frequent use of piece-rate/contractual workers to cater to bigger orders, and non-compliance with minimum wages. This lowers the overall labour productivity of firms.

Labour productivity in Pakistan is low due to absence of skilled workers in the design, planning and production stage of garments manufacturing. Although most of the labour in the sector is trained, according to a study by Punjab Skills Development Fund (PSDF), the industry views the current workers as having "average skills". Hamid and Nabi (2013) find that most large firms carry out in-house training of most of their workers; nonetheless, the training rates stand low in the sector.[77] Most of the high quality industry-demand driven Training Service Providers such as Pakistan Readymade Garments Technical Training Institute (PRGTTI) are concentrated in Lahore and operating at capacity, whereas government training and vocational institutes face a mismatch between the skills demand and supply. There is poor coordination between industry and government training service providers.[78] Research on garments sector skills by PSDF points out that only 32 per cent of garment firms have a formal system in place to train their workforce, "from which they are able to tap into only 4.4 percent of the existing workforce".[79]

Moreover, besides top-tier export-oriented garment manufacturers, compliance with labor standards remains an issue in the garment sector. Workers, particularly informal (but in many cases formal workers as well), do not enjoy protection of labor welfare laws, including minimum wage legislation, and work in poor conditions. Informal workers are also precluded from social security benefits, job security, pension or other benefits associated with formal employment.[80] Similarly, legal limits of working hours are often violated, and workers work over-time to increase their earnings as they are commonly paid on piece-rate basis. About 63 per cent of men report having worked over 48 hours in a week.[81] This has adverse impact on labor health, lowers productivity and increases risk of accidents.

Labour productivity has also stagnated due to the lack of experienced/trained mid-level managers, who act as the crucial link between workers and management to create effective, efficient and productive systems or processes to achieve firm targets.[82] This is borne out by evidence that low labour productivity not only lowers output, but also leads to overstaffing—having to hire more workers to produce the same output. A study previously found that garment factories in Pakistan took 1.7 times longer to make a product, efficiency gains could reduce costs by 45 per cent, and overstaffing was as high as 57 per cent.[83]

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75 This index measures the capability of a country to add value to the world economy through their knowledge and skills, by measuring country-level capacity, deployment, development and know-how.

76 WEF (2018). Global Human Capital Report 2017. Retrieved from http://reports.weforum.org/global-human-capital-report-2017/dataexplorer/?doing_wp_cron=1538204262.6081919670104980468750#economy=PAK

77 Hamid & Nabi (2013)

78 Hamid, N. and Nabi, I. (2017). Implementing policies for competitive garments manufacturing. F-37211-PAK-1

79 Hamid & Nabi (2017), p. 26.

80 ILO (2016)

81 ILO (2017)

82 Technopak (2018). Study on the garment sector of India to understand their requirements for capacity building. Sponsored by the Ministry of Textiles India

83 McCartney, M. (2014). *The Political Economy of Industrial Policy: A Comparative Study of the Textiles Industry in Pakistan*

Cluster development

Small and medium sized firms feature heavily in the garment sector due to the fragmented nature of production and the low start-up capital required to specialize in a particular process. Most firms are not vertically integrated, i.e. majority of firms do not possess complete production and processing capabilities from cotton to garment. However, due to geographical distance between the two main clusters in the North (Lahore, Faisalabad, Sheikhupura, Sialkot and Faisalabad) for knitwear and the South (Karachi) for woven, there is little coordination between the two clusters.

Attempts to foster industry linkages have not been very fruitful, and government attempts to house the textiles value chain in industrial parks or economic zones have largely failed. Trade Policy 2003 proposed development of 3 garment cities in Lahore, Karachi and Faisalabad. Lahore and Faisalabad garment cities have been established and rented out to value added manufacturing units, however, industry suggests that such plants are very costly to run due to inadequate availability of skilled labour, which must be transported daily from within a 50-km radius in the case of the Faisalabad Garment City.[84] Development of Karachi Garment City has been sluggish due to obstacles such as litigation, non-supply of gas, water and electricity, and lack of funds.[85] On the other hand, the Pakistan Textile City that was planned for Karachi in 2003 has now come to an end.[86]

As a result, firms have been unable to realize the economic benefits that result from co-location of similar firms, or economies of agglomeration. This has skewed the process of spatial transformation of Pakistan to urban centers, where left unchecked, the negative externalities (congestion, pollution, scarcity rents from pressure on resources) exceeded the benefits from sharing of ideas and knowledge, lower transportation costs of goods, services and people, common pool of resources and labour, as well as greater demand for goods.[87]

Access to credit

Access to finance is a stumbling block for garment firms, especially small- and medium-sized firms. Most SMEs use own limited funds for business expansion, whereas commercial loans are hard to get due to high collateral requirements. Larger firms have more working capital, but often it is tied up in export refunds.

Pakistan has historically relied on subsidizing the cost of borrowing. Such export finance schemes have certain drawbacks. The most important for the government is that it needs to raise revenues (mostly from tax) or cut expenditures to reduce the fiscal deficit that results from providing subsidised credit. There are also high ex-ante administrative screening costs and non-negligible ex-post monitoring costs for the involved institutions (such as the State Bank and government agencies) in addition to the high transaction costs for firms that must undergo considerable scrutiny and documentation. Moreover, export financing distorts all commercial credit towards the finance scheme as such loans have a government guarantee. This reduces the funds available for non-participating exporters or indirect exporters. The latter are domestic vendors for exporting firms, which do not generally qualify for exporter schemes (either finance or local duty rebates). The most significant disadvantage, however, of relying on such export finance schemes is that it does not favour exporters taking risks and diversifying their products or exporting markets. This implicit bias results from the risk associated with providing cheap credit for export, and banks are less likely to lend to exporters without a reasonable export track record. This lack of finance discourages firms from product and market diversification, preventing them from expanding into new, possibly higher value-added products. Collectively, this means that the majority of firms in the sector remain stuck in low value-added traditional goods, which hampers the export competitiveness of the sector.

84 Stakeholder intrview with Masood Textiles (2017).

85 Ministry of Textile Industry (2015)

86 GoP, Textile Industry Division (2017). Retrieved from http://www.textile.gov.pk/. Accessed on September 29th, 2018

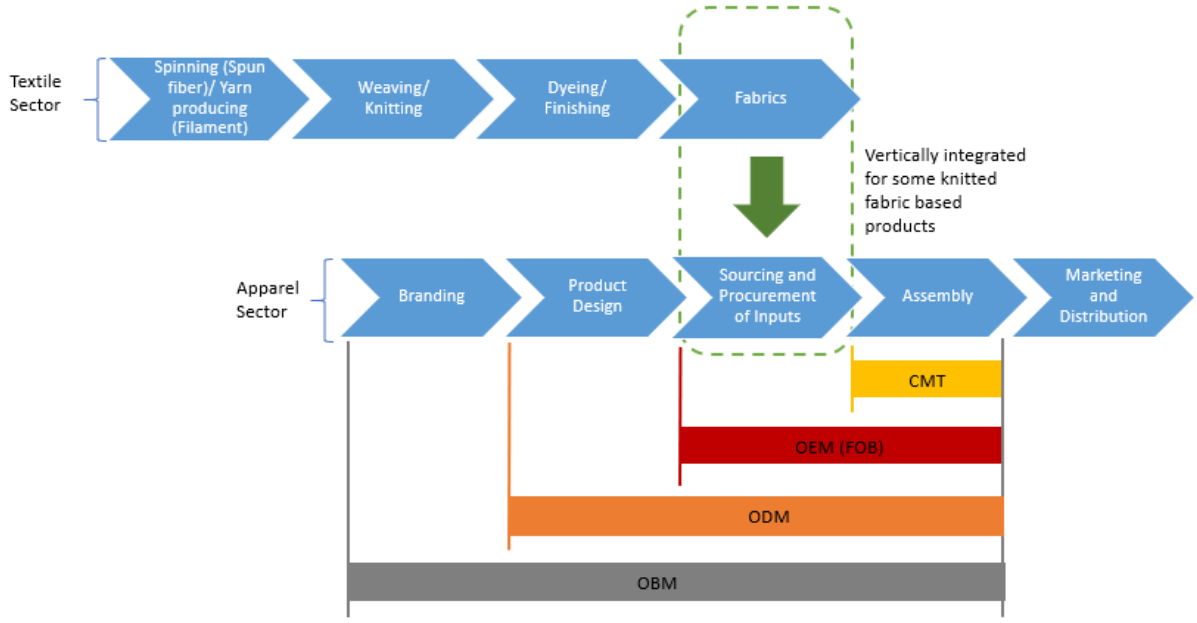
87 Sanchez-Triana et al. (2014). Revitalizing industrial growth in Pakistan. Chapter 2: The importance of manufacturing. World Bank: Washington, DC,

3.2 Demand-side constraints

Global trade in RMG has been based on North-South buyer-driven networks for the last 30 years. Global buyers determine what is to be produced, where, by whom, and at what price. The regional sourcing hubs for Asia are South Korea, India and Hong Kong for knitwear, denim and woven garments, respectively. The network comprises input suppliers, intermediaries, producers, exporters, and marketers, with buyers/marketers largely based in developed countries such as EU, USA and Japan. On the other hand, the suppliers of inputs, intermediate textile inputs, and manufacturer-cum-exporters are concentrated in the developing countries, mostly in Asia, Egypt and Morocco along with some countries in Latin America (Mexico and Colombia).[88]

These garments manufacturers add differing levels of value to products at each stage. Value is created along the production chain through production (low) all the way to design and marketing (high). Garment producers can be classified on the basis of their value addition as either cut-make-trim (CMT), original equipment manufacturers (OEMs)/full package suppliers, original design manufacturers (ODMs), or original brand manufacturers (OBMs). Each stage represents a rung higher on the garments value chain and shows that supplier firm capabilities can range from simple assembly of inputs given by lead/buyer firms (CMT) to producing lead firm designs through own sourcing (full-package suppliers) all the way to producing and selling own designs to lead firms (ODM). The last stage is producing own designs and selling in world markets under own brand names (OBM) (Figure 3-3).

FIGURE 3-3 Production and distribution flow in textile and apparel chain



Source: Lopez-Acevedo, G. and Robertson, R. (2012)

The majority of firms in the Pakistani garments sector began as second-tier CMT suppliers to a few established OEMs that went on to become OEMs themselves. CMT stage has the lowest entry barriers due to labour intensive nature of production, low energy requirements, and little start-up capital required. The next step is for the firm itself to arrange inputs (local or imported) as per the lead firm design, to meet quality and standard

88 Lopez-Acevedo, G. and Robertson, R. (2012). Sewing Success? Employment, Wages, and Poverty following the End of the Multi-Fibre Arrangement. *Directions in Development-Poverty*. Washington, DC: World Bank. Retrieved from https://openknowledge.worldbank.org/handle/10986/13137

specifications, to finish and lastly to package the garment to deliver goods on time. Most firms in Pakistan are at this stage of the value chain and outsource the CMT functions to second-tier assemblers. This stage has low levels of value-addition, a notch above simple assembly, which sell cheaply in the global market.

Therein lies the dilemma faced by the average firm in the garments sector. Current growth prospects are bleak for low-value added exports, as instead of being a strategic primary supplier, Pakistan is a backup supplier within a typical product category, and is only able to get smaller orders in residual demand (the demand left over for Pakistan after subtracting the export supply of other cost-competitive countries). This makes it difficult for firms to attain the scale necessary for cost effective production and modernisation of technology. The ideal response by firms would be to raise values to graduate out of this over-saturated and extremely competitive segment of world trade, allowing it to set higher prices, improve profit margins, and re-invest in upgrading their production technologies. With better technology would come higher demand, as new markets and products could be targeted. But this would only happen if the firm was currently growing, i.e. if it had high demand—a classic chicken-and-egg type problem. In effect, low demand is begetting low demand in the absence of funds to invest in value addition. This traps firms in a low price-low value equilibrium.

While a few firms have diversified their exports by moving into higher value-added products by designing new product samples themselves and getting them approved from the lead firms for production, these represented the top 2 per cent of their industry. Even Pakistan ODMs that design and develop their own products have not been able to market these products under their own brand name, as there are high entry barriers in R&D and innovation. Marketing is also difficult without setting up international offices—of the few OBMs that exist in Pakistan, most produce for the domestic market.[89] In contrast, Bangladesh has quite a few ODMs, China has some OBMs, while Vietnam and Cambodia are largely at the CMT and OEM stage.[90]

3.3 Overall impediments to trading and doing business

In addition to the specific demand and supply impediments pervading the garments sector, there are economy-wide behind and across border constraints that are responsible for the sector's underperformance.

Global competitiveness and ease of doing business

Many empirical studies have documented the positive impact of factors such as macroeconomic stability, strong institutions, human capital and maturity of financial markets on economic growth.[91] These and other parameters are captured by the 12 pillars of the Global Competitiveness Index, which describes competitiveness as the set of institutions, policies and factors that determine the productivity of a country.[92] After almost 10 years, Pakistan has managed to rank outside the bottom 20 countries of the world—its global position has improved by 7 places from 122nd to 115th place (out of 137 countries) over last year (Figure 3-4).

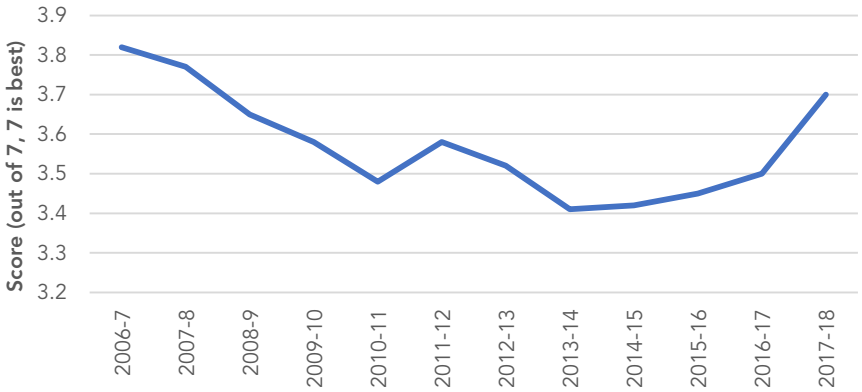
89 Hussain et al. (2013)

90 Lopez-Acevedo, G. and Robertson, R. (2012). Sewing Success? Employment, Wages, and Poverty following the End of the Multi-Fibre Arrangement. *Directions in Development-Poverty*. Washington, DC: World Bank. Retrieved from https://openknowledge.worldbank.org/handle/10986/13137

91 See for stability (Fischer 1991; Easterly and Kraay, 2000), strong institutions (Acemoglu, Johnson, and Robinson, 2001; Dollar and Kraay, 2003), human capital (Romer, 1990; Barro, 2001) and maturity of financial markets (Pagano, 1993)

92 This index takes into account 12 pillars ranging from macroeconomic stability and labour market efficiency to human capital, financial market development and technological readiness.

FIGURE 3-4 Global Competitiveness Index: 2006-17

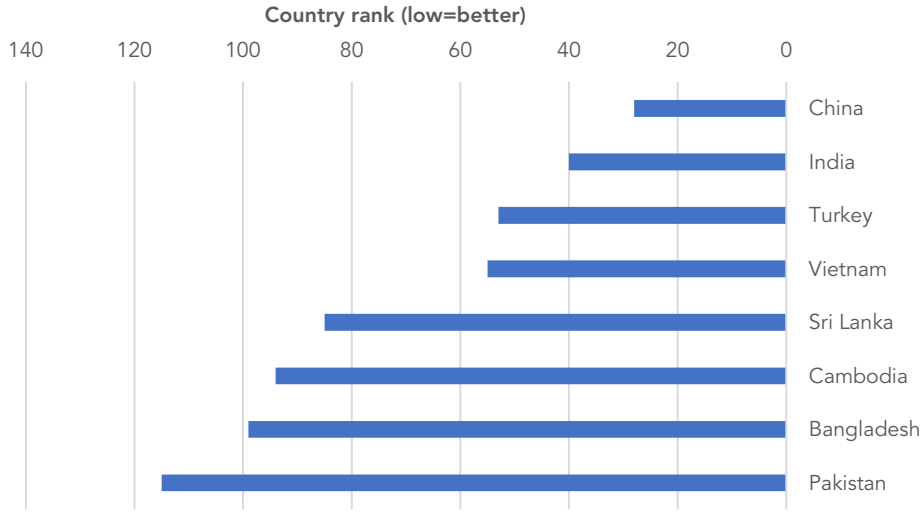


Source: World Economic Forum (2018). Global Competitiveness Index.

Pakistan's overall low ranking is largely attributable to its low levels of human capital and labour market inefficiency—it ranks 8th and 7th from the bottom out of 137 countries, respectively, casting significant doubt on Pakistan's ability to adapt to, and benefit from, changes in world demand for readymade garments. While the time trend shows that competitiveness has picked up since 2013-14 –mostly due to better macroeconomic conditions, better financial markets, and increased business sophistication—surveyed businesses state that corruption, (top constraint for last three years), taxes, government instability and inefficient bureaucracy have eroded their capacity to effectively compete globally.[93]

In addition, Pakistan is the least competitive among countries in the reference group, with China, India, Turkey, and Vietnam taking the lead (Figure 3-5). The margin of underperformance is very large, as can be seen by country rankings, with Pakistan especially laggard in overall technological readiness.[94]

FIGURE 3-5 Comparison of global competitiveness: 2018



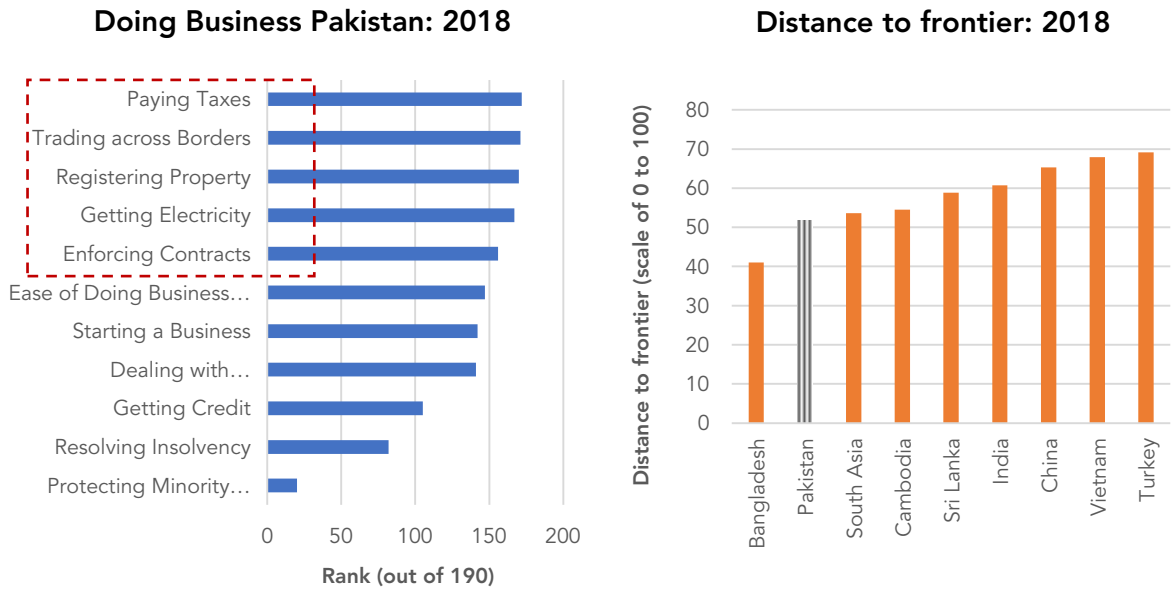
Source: World Economic Forum (2018). Global Competitiveness Index.

93 World Economic Forum (2018). The Global Competitiveness Index 2017-2018 edition: Pakistan. Retrieved from http://www3.weforum.org/docs/GCR2017-2018/03CountryProfiles/Standalone2-pagerprofiles/WEF_GCI_2017_2018_Profile_Pakistan.pdf

94 World Economic Forum (2018). Appendix B Global Competitiveness Index 2017–2018 Rankings. Retrieved from http://www3.weforum.org/docs/GCR2017-2018/04Backmatter/TheGlobalCompetitivenessReport2017%E2%80%932018AppendixB.pdf

In terms of doing business, in 2018, Pakistan ranks 147 out of 190 countries, slipping 3 places from 2017. Distance to the frontier (how well Pakistan has done with respect to the best performing country) reveals that doing business in Pakistan is about twice as hard as in the top ranked country of 2018. Pakistan is the second from the bottom across the chosen comparator group, placing better than only Bangladesh. Figure 3-6 (right panel) shows that Pakistan performs particularly poorly on paying taxes, registering property, and trading across borders— ranking well behind Vietnam (79 places), China (69 places), and India (47 places).

FIGURE 3-6 Doing business in Pakistan and distance to frontier



Source: World Bank (2018). Doing Business: Pakistan. Lower rank is better.

Market access: Unfavourable Tariffs

External trading costs arising from tariffs are presented in Table 35. It shows the import duties levied on apparel exports in the main export destinations of Pakistan to compare market access. Bangladesh is the biggest beneficiary of duty-free access in general, with the EU, Canada, Japan, Australia, and even China (0.9 per cent tariff), followed by Cambodia. Vietnam and India enjoy duty-free free access in the ASEAN market, while Pakistan faces zero duties in the EU market only.

TABLE 3-5 Market access in key apparel markets (2017): Comparison of tariffs applied at the HS 2-digit level

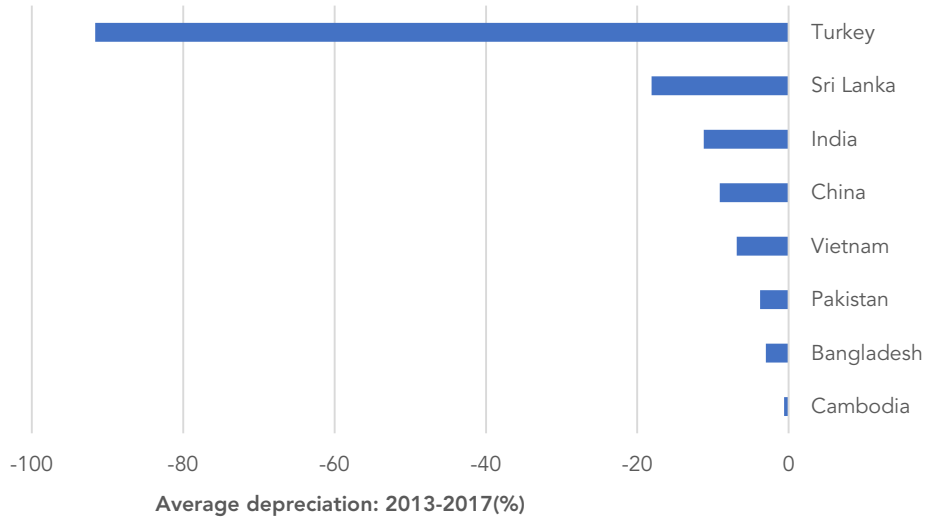
Exporter / Market	EU	United States	UAE	China	Canada	Japan	Australia
Bangladesh	0	14 (HS 61) 10.4 (HS 62)	5	0.9	0	0	0
Cambodia	0	As above	As above	0	0	0	0
Pakistan	0	As above	As above	6.7 (HS 61) 9.5 (HS 62)	17.5 (HS 61) 16.7 (HS 62)	9.7 (HS 61) 8.9 (HS 62)	4.8
Turkey	0	As above	As above	15.2 (HS 61) 16.2 (HS 62)	17.5 (HS 61) 16.7 (HS 62)	9.7 (HS 61) 8.9 (HS 62)	4.8
Sri Lanka	9.4 (HS 61) 9.2 (HS 62)	As above	As above	11.5 (HS 61) 12.8 (HS 62)	17.4 (HS 61) 16.4 (HS 62)	9.7 (HS 61) 8.9 (HS 62)	4.8
Vietnam	As above	As above	As above	0	17.5 (HS 61) 16.7 (HS 62)	0	1 (HS 61) 1.9 (HS 62)
India	As above	As above	As above	11.5 (HS 61) 12.8 (HS 62)	17.5 (HS 61) 16.7 (HS 62)	0	4.8
China	11.8 (HS 61) 11.5 (HS 62)	As above	As above	-	17.5 (HS 61) 16.7 (HS 62)	9.7 (HS 61) 8.9 (HS 62)	0 (HS 61) 0.9 (HS 62)

Source: ITC TradeMap

Unfavourable Exchange Rate

External factors such as comparative exchange rates of Pakistan's RMG competitors must also be considered. Wages and export prices are affected by relative exchange rate movements. It has been acknowledged that Pakistan's currency in the recent past was overvalued with respect to the dollar, making exports less competitive in global markets.[95] Exports become even more expensive relative to China, India, Vietnam, and Sri Lanka given how much their currency has depreciated over 2013-17 (Figure 3-7) below. The current depreciation of the currency against the dollar of about 20 per cent has resulted in an improvement in export earnings year-on-year compared to July 2017.

FIGURE 3-7 Pakistan rupee versus key apparel competitors



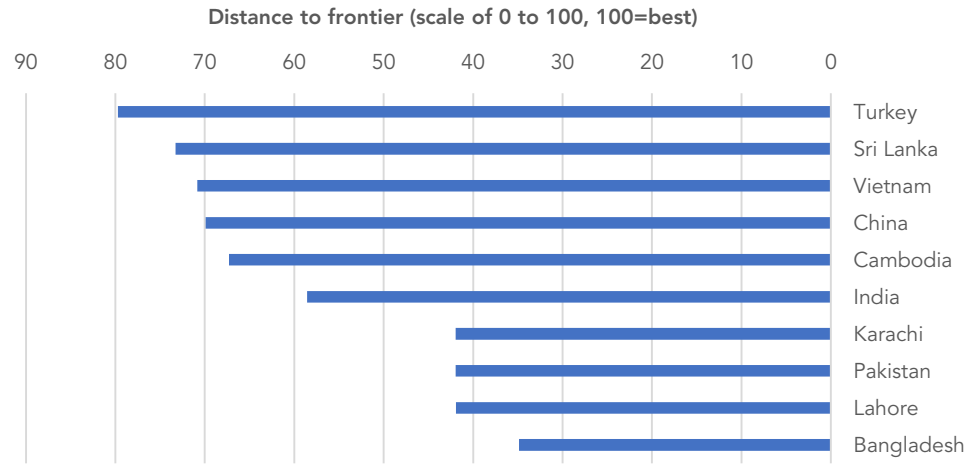
Source: World Bank database. Data on India taken from Federal Reserve US website https://www.federalreserve.gov/releases/h10/hist/dat00_in.htm

95 SBP (2015). *Annual Report 2015: Special section 2: What has caused stagnation in Pakistan's exports?* Retrieved from http://www.sbp.org.pk/reports/annual/arFY15/Special-Section3.pdf

Export Costs and Time

The indicator on trading across borders is useful to compare across countries, as it gives a rough indication of the cost and time it takes a typical firm to export and import a standardized cargo of goods. The indicators used are documentary compliance, border compliance and domestic transport.[96] Turkey, Vietnam, Cambodia and China do particularly well, but Pakistan's performance in 2018 was half that of the best performing economy (Figure 3-8).[97]

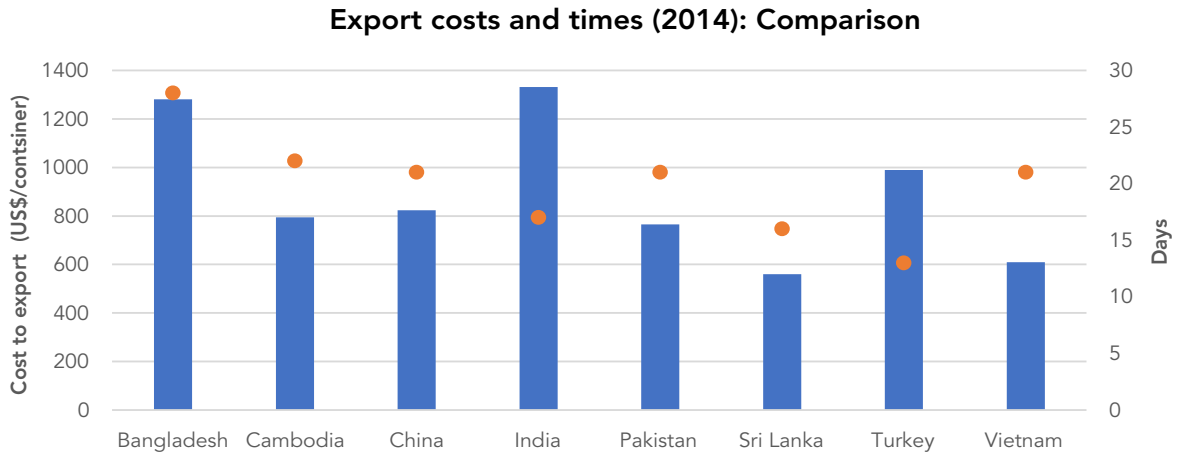
FIGURE 3-8 Trading across borders: Distance to frontier (2018)



Note: Distance to frontier measures country performance relative to best performer
Source: World Bank (2018). Doing Business: Pakistan

Shipping export costs for the latest available year (2014) indicate that for Pakistan it costs $765/container to ship out an export order that reaches its destination in 21 days. On the other hand, it costs more ($1281/container) and takes a week longer in Bangladesh (Figure 3-9). However, it is about $165/container cheaper to export from Sri Lanka and Vietnam, indicating room for improvement.[98]

FIGURE 3-9 Export costs (2014): A comparison



*Source:*World Bank (2014). https://data.worldbank.org/indicator/IC.EXP.COST.CD?locations=PK

96 World Bank (2018). Doing Business: Pakistan. Retrieved from: http://www.doingbusiness.org/data/exploreeconomies/pakistan

97 Note that Bangladesh performs even worse than Pakistan on this parameter. This is worrisome because it suggests that Bangladesh could increase its exports further if it could reduce its transhipment and shipment times.

98 World Bank (2014). https://data.worldbank.org/indicator/IC.EXP.COST.CD?locations=PK

Within Pakistan, Karachi was the best city to trade across borders in Pakistan in 2010 (latest year for which subnational Doing Business data is available), although overall, the cost of doing business was lowest in Faisalabad. Lahore was the worst city in terms of number of trade-related procedures, times, and costs in 2010 (Table 3-6).

TABLE 3-6 Time and cost of trading, by city (2010)

Variable	Faisalabad	Karachi	Lahore
Time to export (days)	22	22	23
Cost to export (US$/container)	639.1	611.0	791.2
Time to import (days)	20	18	20
Cost to import (US$/container)	738.6	680.0	1088.4

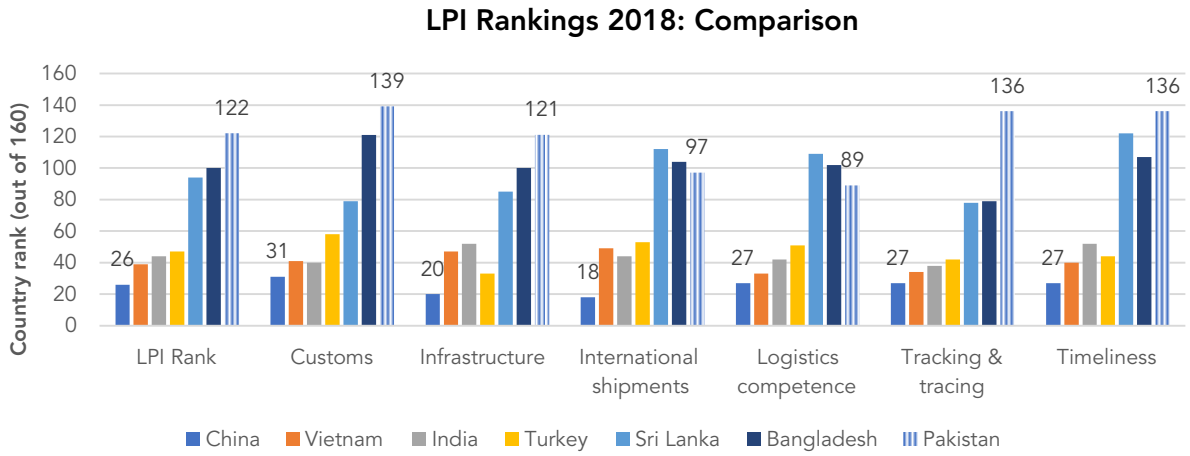
Source: World Bank (2010). Subnational Doing Business Costs, 2010. Retrieved from http://www.doingbusiness.org/data/exploreeconomies/pakistan/sub/

While Karachi was ranked best, it still took an average of 10.5 documents to trade (table A-1 in Annexure 2) in 2010, and the effect of reforms introduced since 2011 (table A-2 in Annexure 2), have had a slower impact on lowering trade costs.

Trade infrastructure and logistics

Pakistan's overall ranking in Logistics Performance Index (LPI)[99] is 122 out of 160 countries in 2018, slipping 54 places since 2016. Not only is Pakistan's LPI score (2.42/5) below the regional South Asia (2.51/5) and lower-middle income country (2.57/5) averages, but Pakistan is consistently the worst performer on all but two (shipping and logistics competence) of the six dimensions of the LPI when compared against its top competitors in RMG exports (Figure 3-10).

FIGURE 3-10 Logistics Performance Index (2018)



Note: A lower country rank is better
Source: World Bank (2018). Logistics Performance Indicator.

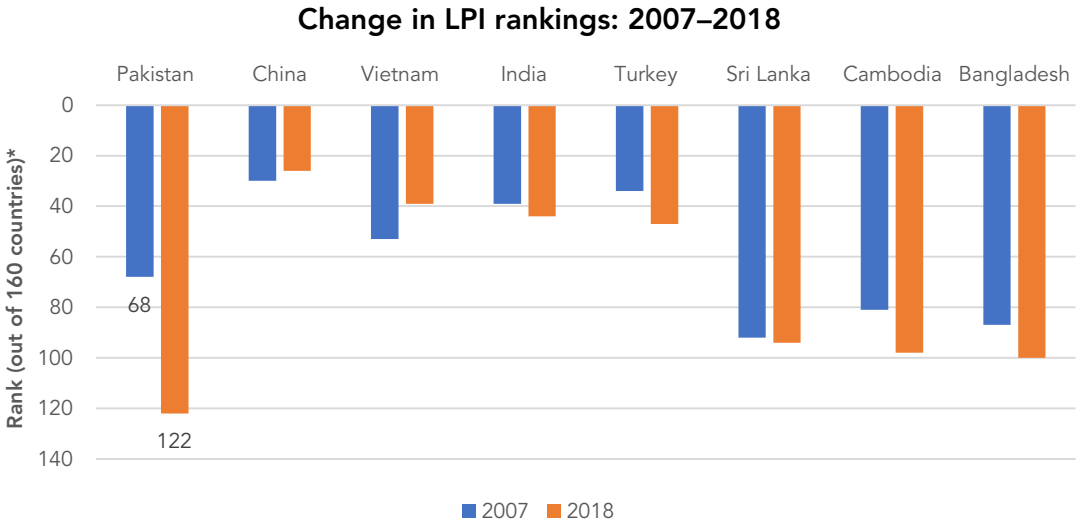
Pakistan performs particularly poorly on customs, ranking 131 places behind China. Pakistan's garments industry is very dissatisfied with customs clearance due to multiple contact with government agencies (and

99 LPI is a cross-country comparative ranking across 6 broad dimensions of trade logistics, which include: i) Efficiency of the clearance process; ii) Quality of trade and transport related infrastructure (including information technology); iii) Ease of arranging competitively priced shipments; iv) Competence and quality of logistics services (e.g., transport operators, customs brokers); v) Ability to track and trace consignments; vi) Timeliness of shipments in reaching destination within the scheduled or expected delivery time.

hence, high transaction costs and corruption) as well as careless handling and subsequent damage to cargo. Even though 24/7 services are now available at ports, officials are often absent. According to Pakistan Doing Business Report, the government has recently tried to improve its online customs clearance procedure Web Based One Customs (WeBOC) by allowing traders to fill relevant forms online as well as introducing e-payment option to FBR for trade taxes,[100] however there have been reports of frequent shutdowns which hinder import and export activities.[101]

Custom officials enjoy considerable power in showing *ad hoc* discretion in terms of checking consignments and export documents. Collectively, this increases incentives for illegal trade. As a result, garments firms trading through legal channels cannot compete with firms that use smuggled inputs—costs of compliance are simply too high, and delays result in loss of export orders. Moreover, delays of 3-4 days in custom clearance of imports are common; these are costly and also make it difficult for firms to meet deadlines. There is evidence indicating that firms are reluctant to diversify to products that may require them to import new materials or fabrics different from the ones they usually use, due to time-consuming custom procedures.[102] IOCO was set up in Lahore to expedite approvals required to import fabric and yarn under DTRE; however, since Lahore office has to refer to Karachi office for approvals this failed to improve lead-times.[103]

FIGURE 3-11 Change in LPI rankings (2007-2018)



Note: * There were 150 countries in 2007. A lower rank is better
Source: World Bank (2018). Logistics Performance Indicator. Data retrieved from https://lpi.worldbank.org/international

Even with Bangladesh, the second worst performer (mostly due to customs, infrastructure and international shipments) Pakistan significantly underperforms in consignment tracking and timeliness (Figure 3-11). Moreover, Pakistan's performance has worsened considerably over the last ten years, while China and Vietnam have surged ahead (see Figure 3-12). As the gap between Pakistan and its RMG competitors widens, the industry faces tough decisions in terms of improving attractiveness and inserting itself into regional and extra-regional value chains.[104]

100 Pakistan Doing Business Report. Retrieved from http://pakistandoingbusiness.com/reforms-completed-june-2018/
101 Zalmay, K. (2017, April 23). Customs WEBOC system on the verge of collapse. Daily Times. Retrieved from https://dailytimes.com.pk/15597/customs-weboc-system-on-the-verge-of-collapse/
102 IGC (2013) Garments as a driver of economic growth: Insight from case studies. IGC Working Paper F-37036-PAK-1
103 IGC (2013) Garments as a driver of economic growth: Insight from case studies. IGC Working Paper F-37036-PAK-1
104 World Bank. (2018). LPI. Data retrieved from https://lpi.worldbank.org/international).

Taxes

Multiple taxes including sales tax, income tax, corporate tax, turnover tax, super tax as well as custom duties, regulatory duties, cesses (and surcharge on utilities) raise the cost of doing business further. Pakistan has one of the poorest ratings in Asia according to the Paying Taxes Report of 2017, both in terms of time taken for tax compliance (312 hours) and number of procedures (47). Pakistan compares poorly to the Asia-Pacific region (23.5 taxes) and Bangladesh (33 taxes). Overall, Pakistan ranks 156th out of 189 countries in terms of paying taxes, including post-filing index, while Bangladesh ranks 151st.[105]

These higher transaction costs increase undocumented economic activity. The informal sector of the garments industry is one of the largest in the country due to the fragmentable nature of production and the low entry barriers at each stage of the garments supply chain. Not only does this result in tax evasion, but also non-compliance with safety, labour and quality standards. This lowers the productivity of the garments sector through low quality and uncompliant vending activities. With large firms able to vertically integrate to offset these uncertainties in raw material supply, smaller and medium-sized firms cannot. This prevents them from achieving export-readiness.

105 PwC (2017). Paying Taxes 2017. Appendix 2: Economy sub-indicators results by region. Available at http://www.pwc.com/gx/en/paying-taxes/pdf/pwc-paying-taxes-2017-appendix2.pdf

CHAPTER 4

Previous Policy Measures Adopted in Pakistan

This section describes the policies pertaining to the readymade garments sector and discusses the shortcomings and the industry perception of the policy environment.

4.1 Textile Policy (2009-14 and 2014-19)

Box 1: Historical context of policies in textile sector

Historically, textile trade was conducted under the Short-Term and Long-Term Arrangement of the 1960s, the Multi-Fiber Arrangement (MFA) of 1974 to 1994, and the 10-year WTO Agreement on Textiles and Clothing (ATC) that lapsed in 2004.

In Pakistan, since after the partition policy support for the sector has been grounded in import substitution industrialization at each stage, i.e. replacing imports with domestic production through various trade, tax, and financing measures. In the 1960s this manifested itself in incentives to import machinery, whereas in the 1970s there was a push towards importing technology to make textile machinery (mostly for spinning, less for weaving) domestically. Pakistan had yet to reap the benefits from its previous policy stance when the US quotas for garments allocated to Pakistan under the MFA ushered in a new industrial philosophy of export-led industrialization in the 1980s.

Export-led industrialization became attractive due to increased global demand for textiles as well as the MFA quotas that guaranteed Pakistan a certain quantity of exports to developed country markets. The prohibitive import tariffs on textile machinery were lowered to allow manufacturers to compete globally on price, and Pakistan was able to take advantage of both the MFA quotas and rise in world demand. With price the chosen parameter of competition, however, Pakistan's exports were automatically restricted to cloth and basic knitted garments, while exports of higher value-added products such as fashion and luxury textiles along with high-value added apparel (ladies wear) hinged on MFA quota access. Pakistan did not have any comparative advantage in such products, as became evident after the ATC ended in 2005.[1]

Its policy of offering cheap credit to manufacturing exporters as part of a larger Textile Vision 2005 (1999-2000) could not encourage economic upgrading. In 2005, a research and development (R&D) cash subsidy of 6 per cent was also given to apparel exporters, a scheme now widely recognized to be misused, even by

Box 1: Historical context of policies in textile sector *(continued)*

industry. The $500 million spent under the Textile Vision 2005 failed to improve productivity in the sector by 2008, with the textile (spinning) sector appropriating the major share of funding for equipment and technology upgradation. Moreover, the financing facilities offered by the government were rendered useless by the macroeconomic instability (high interest rates increasing to a maximum of 35 per cent, increased cotton prices, and overall inflation)—with most financing facilities merely covering the increasing production costs, instead of their intended purpose of value-addition. As a result, these policies failed to increase Pakistan's share in garments trade after 2005, and importers no longer bound to source within quota found more co mpetitive trade partners such as China, Bangladesh, India and Vietnam. On average, since 2005, Pakistan has lost share in high value-added exports, and as a result has been forced to compete in the most price-competitive low value-added segments of world exports.[2]

[1] *Hussain et al. (2013). A comparative analysis of the garments sector of Pakistan. F-37038-PAK-1*
[2] *Ibid.*

The Ministry of Textiles (formed in 2004) is tasked with overall responsibility of sustainable development of the textile and clothing sector, which also includes releasing 5-yearly Textile Policy, which explains the contours of public support for the textile and garments sector at large, and the role that its attached departments must play to achieve the same.[106]

The first National Textile Policy of 2009-14 (Rs.188 million) set an ambitious target of $25 billion textile exports by the end of 2014, a target that is yet to be achieved in 2018. It included the creation of a Textile Investment Support Fund, Technology Upgradation Fund (TUF), drawback of local taxes and levies (DLTL) for two years that could be extended, refund of 6 per cent R&D on prior claims, and reliable gas and power supply. This policy was considered largely ineffective by industry due to lack of implementation, with percentage of government funds released against pledged amounts extremely low at 25 per cent halfway through the policy timeframe and weekly gas supply of only 4-5 days in 2012.[107]

A new Textile Policy 2014-19 (Rs.64 billion) was introduced in 2013, with an ambitious strategy. It aimed to improve textile exports, jobs, investment in machinery, value addition and fibre and product mix. Table 41 shows the key goals and proposed schemes of the textile policy.

106 PACRA (2011). The textile sector: A sector study. PACRA. http://www.pacra.com.pk/pages/research/web_sector_study/textile/Textile_Mar_11.pdf

107 Amin, T. (2012). Non-implementation of textile policy (2009-14): Exports suffer nearly $5 billion loss. The Business Recorder. May 9th, 2012. Retrieved from http://fp.brecorder.com/2012/05/201205091187077/

TABLE 4-1 Goals and proposed schemes of Textile Policy 2014-19

Key goals to be achieved till 2019 • Double textile exports from $13 billion to $26 billion per annum • Add $5 billion investment in machinery and technology to the sector • Create 3 million new jobs • Improve fibres mix in favor of non-cotton i.e. 14% to 30%. • Improve product mix especially in the garment sector from 28% to 45% • Two-fold increase in value-addition from $1billion per million bales to $2 billion per million bales	
Scheme	**Details**
Drawback of Local Taxes and Levies (DLTL)	Increased duty drawback rate for garment exporters from 3% to 4% of FOB value of enhanced exports (the highest compared to made-ups and processed fabrics), based on annual export growth of over 10 per cent
Sales tax regime	An expeditious refund system and a fast track channel for manufacturers-cum-exporters, whereby FBR would dispose of all their pending sales tax refund claims within 3 months.
Easy finance	• Value-added sector provided Long Term Financing Facility (LTFF) for up-gradation of technology from State Bank of Pakistan at 9% for 3-10 years duration. • Mark up rate for Export Refinance Scheme of State Bank of Pakistan reduced from 9.4% to 7.5% from 1st of July 2014.
Vocational training	Vocational training program by PSDP to provide training to labor for value-added activities, such as garments and made-ups.
Technology Upgradation Fund Support	Extension in technology upgradation fund till 2019, aimed at improving overall technological configuration of the sector, remove critical imbalances in the value chain and achieve compliance with international standards.
Tariff on machinery imports	Duty-free imports of machinery for textile sector, extended for another 2 years.

Source: GoP. (2014) Textile Policy 2014-19

Interventions to streamline tariff structure, diversify products to include new value-added products such as children wear, lingerie, beachwear, etc, develop and facilitate SMEs via development of business portal, assist firms in improving productivity and meeting compliance, develop SMEs, facilitate associations in energy audits and provide market information and import/export data were also proposed in the policy. To implement these policies, actionable Strategic Master Plans would be made per sector.

Industry views the 2nd Textile Policy (to date) as having largely been unable to catalyze value-addition in the sector as it envisaged, and while financing was availed (especially by the spinning sector), benefits of this investment have not been felt by garments manufacturers. Pakistan's credit schemes concentrate on export refinancing, which is costly for the government—the SBP has to refinance the loan (at the same or higher interest rate) that commercial banks extend to firms for trade purposes. They are also distortionary, as banks prefer refinanced loans over normal credit. Moreover, schemes such as the Technology Upgradation Fund included in both Textile Policies have been somewhat effective as they do not completely reduce the risks associated with technology adoption, beyond partial cost-sharing with the government. Allaying risks requires imports of spare parts to be made duty-free or at reduced tariffs (as in India and Bangladesh). Not only does this increase the absorption of new technology as technicians use raw materials and parts for maintenance and repair, but it also helps the local heavy machinery industry learn about new technology and manufacturing those same machines domestically. This indirect technology learning is very important, especially as no adequate R&D support was included in the policy.

As a result, further policy support was extended to exporters in January 2017 when it was felt by the government that export-led growth missed the mark, as the top candidate to achieve export-led growth is generally considered to be the textile and apparel sector. Two general incentives schemes have been initiated to help exporters since 2017, the PM Exporter Package (2017-18) and an extension of the same in 2018 for three years.

4.2 The PM Incentive Package for Exporters 2017-18

This was introduced in January 2017 as a Rs. 180 billion 1.5-year scheme to incentivise exporters and address the declining trend in overall exports since 2014. It heavily targeted the textile sector, especially the value-added segments of garments and made-ups.

The Package proposed expedition of prior refunds as per deadlines (the most recent deadline is phased refunds over 12 months starting from 1st July 2018), to address the main concern of the sector, that of pending refunds with the Federal Board of Revenue (FBR).[108] However, despite this the goal of the repayment of pending claims still remains elusive, and as of August 2018, government has repaid only Rs.25-30 billion of Rs. 200 billion outstanding.[109]

In the meanwhile, to ease liquidity, Drawback on Local Taxes and Levies (DLTL) cash subsidies were the main policy tool of this Package, which were now offered at a higher drawback rate, i.e. 7% of FOB value for garment manufacturers, half of which was available without condition from January to June 2017, while the remaining drawback was contingent on showing growth exceeding 10 percent during FY 2017-18, relative to 2016-17. However, textile sector exporters have demanded re-evaluation of the performance-based eligibility conditions of the duty-drawback scheme. While year-on-year export growth for June 2017 compared with June 2016 shows an increase of 8.5 per cent in textiles sector, exporters argue that securing and meeting orders takes roughly 1.5 years.

The package also approved an RLNG pipeline to ease gas shortages critical to the dyeing stage of knitwear production. Also, to encourage investment in the sector, interest rates were "locked" at current low levels (7.5 per cent) for the duration of existing loans. The export refinance facility was kept at 3 per cent for 2017-18. Short-term measures pertaining to reduced import and sales taxes (for five zero-rated export sectors, including textiles) were also included. Nevertheless, not only were tariffs not lowered on the most common import (polyester filament yarn), but it also faced an additional regulatory duty of 5 per cent.[110]

Nonetheless, the industry welcomed the package due to its timeliness and perceived it to be successful as per initial feedback from firms—profits rose by 10 per cent on average across all firms in FY 2017-18 and exports rose in the overall textile sector through greater liquidity on account of duty drawbacks as well as a 20 per cent devaluation since March 2018, the effect of which was half passed on to global consumers and half internalized.[111]

4.3 Federal Budgets (2016-2018)

Due to the significance of the textiles and clothing sector, broader policy support is required in a number of areas. Similar to Pakistan, low skills is also an issue in Bangladesh, which is why it has been unable to surpass Vietnam and China in sourcing decisions thus far. In fact, Vietnam and China are at par in the Human Capital Index of 2017, which measures capacity, deployment, development and know-how. Bangladesh is currently ranked 111th out of 130 countries.[112] In comparison to similar factories in China, Bangladesh workers produce 5-8 polo fewer shirts per person day, which, in conjunction with high worker turnover, substantially lowers the cost advantage Bangladesh has. Nevertheless, as other firms consider moving to Bangladesh in the next 5 years according to the

108 Staff Report. (2018). Textile sector rejects budget 2018-19. Daily Times. Published on April 29th 2018. Retrieved from https://dailytimes.com.pk/233875/textile-sector-rejects-budget-2018-19/

109 Hussain, A. (2018). Textiles flourish despite the odds. Profit by Pakistan Today. Published July 16, 2018. Retrieved from https://profit.pakistantoday.com.pk/2018/07/16/pakistan-textiles-flourish-despite-the-odds/

110 Hussain, B. (2018). Despite getting incentives, textile exporters still struggle. The Express Tribune. Published April 25, 2018. Retrieved from https://tribune.com.pk/story/1693976/2-despite-getting-incentives-textile-exporters-still-struggle/

111 Hussain, A. (2018). Textiles flourish despite the odds. Profit by Pakistan Today. Published July 16, 2018. Retrieved from https://profit.pakistantoday.com.pk/2018/07/16/pakistan-textiles-flourish-despite-the-odds/

112 World Economic Forum. Human Capital Index, 2017. Retrieved from https://weforum.ent.box.com/s/dari4dktg4jt2g9xo2o5pksjpatvawdb

"China plus Vietnam plus Many" model due to rising labour costs in China (especially the eastern provinces) and Vietnam,[113] wages could rise. RMG exports to Japan have jumped after revised Rules of Origin under the GSP scheme it offers Bangladesh, and its biggest retailers (e.g. Uniqlo) are now keen to source from there.[114] As more countries invest in Bangladesh, its unit export values may rise, which could translate into higher wages.[115] However, Pakistan can only benefit if it addresses its weak human capital—it is currently 5th from the bottom in the Human Capital Index 2017. e Federal Budget. The Federal Budget 2016-17 included[116]

i. Duty-free import of textile machinery
ii. Long Term Finance Facility (LTTF) to continue at a mark-up rate of 5 per cent for textile (spinning and ginning included) and 6 per cent for exporters
iii. Arranging uninterrupted supply of electricity and gas
iv. Technology Up-gradation Fund (TUF) Scheme 2016-19 for the textile sector
v. No sales tax on packaging material as textiles is one of five zero-rated export sectors

Industry were largely dissatisfied with this budget and claimed that it did not have the financial scope to implement the National Textile Policy of 2014-19. Moreover, industry's main concerns related to liquidity issues and rising electricity and gas tariffs, which were still unaddressed. Hence, ahead of the Federal Budgets of 2017-18 and 2018-19, industry met with relevant government counterparts to and put forward demands that would curb their production costs and improve input supply.[117] (see Box 2 on *Industry Demands*).

Box 2: Industry demands ahead of Budgets 2017-18 and 2018-19[2]

i. Provide gas to the system at regionally competitive rate of Rs. 400 per mmBtu
ii. Remove levy of Gas Infrastructure Development Charge (GIDC)
iii. Provide electricity at the rate of Rs. 7 per kilowatt hour as opposed to Rs. 11.3 Kwh in 2017
iv. Remove Rs. 3.5 per kWh surcharge on electricity
v. Release export refunds pertaining to sales tax, export rebates, incentive schemes, which amounted to over Rs. 200 billion as of July 2018
vi. Pay the remainder of the Rs. 180 billion promised in the PM Incentive Package for Exporters, according to which the government had to pay Rs 10 billion per month
vii. Extend the duty drawback scheme for 5 years, and increase the rate of drawback by 1 per cent annually, capping it at 12 per cent for garments
viii. Provide long-term financing facility (LTFF) to indirect exports as well
ix. Lower turn-over tax on exports from 1 to 0.25 per cent
x. Ensure zero-rating not just of packaging materials, but also spare parts and fuel
xi. Reduce or remove import duties on synthetic yarn and polyester staple fibre (PSF)
xii. Abolish Export Development Surcharge and suspend collection till such time that the unused Export Development Fund is spent—the Textile Policy is partly funded through EDF, and while textiles

113 Lu, S. (2018). The state of sourcing from Vietnam: An update. Retrieved from https://shenglufashion.com/2017/08/10/outlook-of-sourcing-from-vietnam-updated-august-2017/

114 Kathuria, S. and Malouche, M., eds. (2016). Strengthening Competitiveness in Bangladesh—Thematic Assessment. A diagnostic trade integration study. World Bank Group: Washington, D.C. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0898-2

115 Kathuria, S. and Malouche, M. (2016). Thematic Analysis: Export Constraints and Potential in Selected Sectors Toward New Sources of Competitiveness in Bangladesh. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0647-6

116 TexTalks. (2017). Budget 2017-18 and the textile sector. Retrieved from http://textalks.com/budget-2017-18-textile-sector/

117 Hussain, B. (2018). Despite getting incentives, textile exporters still struggle. The Express Tribune. Published April 25, 2018. Retrieved from https://tribune.com.pk/story/1693976/2-despite-getting-incentives-textile-exporters-still-struggle/

Box 2: Industry demands ahead of Budgets 2017-18 and 2018-19[2] *(continued)*

contribute significantly, the EDF is not spent on textiles.

xiii. Introduce a different and lower tariff rate of electricity and gas for the five zero-rated export sectors

xiv. Manufacturers-cum-Exporters – Stitching Units should be allowed to import yarn under Duty and Tax Remission for Exports (DTRE) and DTRE rules need to be revisited to make them export friendly.

Sources
[1]TexTalks. (2017). Budget 2017-18 and the textile sector. Published October 31st, 2017. Retrieved from http://textalks.com/budget-2017-18-textile-sector/
[2]Hussain, A. (2018). Textiles flourish despite the odds. Profit by Pakistan Today. Published July 16, 2018. Retrieved from https://profit.pakistantoday.com.pk/2018/07/16/pakistan-textiles-flourish-despite-the-odds/

Budget 2017-18 proposed a few schemes for the garments sector, which included allowing cotton hedge trading for domestic cotton, establishment of Brand Development fund for textile sector, approval for construction of 1000-APTMA-funded stitching units, introduction of online textile business/trade portal and availability of tax credits for Balancing Modernizing and Replacement (BMR) on new investment or setting up of new business.[118] However, Budget 2017-18 did not implement the proposals put forward by the industry, therefore industry's concerns still remained.

The industry was also largely unsatisfied with Budget 2018-19 as due to election year 2018, the budget had very little concrete support for the RMG sector. A new timeline of 1st July 2018 was given to the manufacturers to clear withheld refunds in phases in next 12 months, however, industry had reservations about it being met since the sitting government would no longer be in power by the deadline.[119] Moreover, exporters complained that no specific incentives directed towards the exporting sector were announced. Moreover, industry concerns that electricity tariffs are high and not only are rates adjusted, but that new tariffs are usually backdated, which causes utility bills rise sharply, affects liquidity and hence procurement, planning and production in all departments, were largely ignored.

Most measures of Budget 2018-19 related to tax. On a positive note, long-standing demand of lowering corporate income tax was included to reduce it from 30 to 25 per cent between 2018-2023, through phased reductions and phased elimination of super tax by 2021 was also proposed. The income tax rate of individuals/sole proprietors was also reduced to a maximum of 15 per cent; however, this increased discrepancy between the income tax liability of sole proprietors and corporations. Unregistered users of domestic raw material would have to pay a further tax of 3 per cent on purchase of all input supplies. Some measures for imports were also a part of the budget, including an increase in sales tax on import of finished textile goods and removal of customs duty for raw-materials used for PTA manufacture.[120]

Generally, manufacturers in the industry seem be pessimistic about the impact of budgets on the sector, as they think the incentives are not implemented in true spirit, and so fail to achieve the desired results.[121]

4.4 Extension of the PM Exporter Package 2018-21

The Federal Budgets of 2017 and 2018 did not provide the resources required to implement the PM Exporter Package. With Rs.180 billion over 18 months roughly amounting to Rs. 10 billion in payments per month, on

118 TexTalks. (2017). Budget 2017-18 and the textile sector. Retrieved from http://textalks.com/budget-2017-18-textile-sector/

119 Daily Times. (2018). Textile sector rejects budget 2018-19. Daily Times. Published April 29th, 2018. Retrieved from https://dailytimes.com.pk/233875/textile-sector-rejects-budget-2018-19/

120 Adil, Y. (2018). Budget 2018-19: Highlights and comments. Retrieved from https://www2.deloitte.com/content/dam/Deloitte/pk/Documents/tax/Budget%20Highlights%20&%20Comments%202018-19-deloittepk-noexp.pdf

121 Shah, S. (2018). Textile sector concerned over concession-less budget. The News. Published April 28th, 2018. Retrieved from https://www.thenews.com.pk/print/309884-textile-sector-concerned-over-concession-less-budget

average, only 5 per cent was actually provided each month.[122] Government liabilities under the scheme (Rs. 17 billion as of June 2018) are also accumulating mostly due to DLTL for the textile sector (see Table 42). During Jan-June 2017 as per the cash subsidies available under the DLTL scheme, Rs. 26 billion have been paid against claims of Rs. 34 billion. In total, Rs. 32 billion (17 per cent of allocated amount) have been released by the government under this Package over 18 months. Moreover, as exports rise, these claims could rise to Rs. 60 million.[123]

TABLE 4-2 Pending government liabilities as of August 2018

Scheme	Pending (Rs bn)
Sales tax refund	30
Custom rebate	10
Income tax credit	15
Tech Upgrading Fund (2009-14)	20
Mark-up support scheme	10
Drawback on Local Taxes and Levies of Federal Budget	3
Drawback on Local Taxes and Levies of PM Incentive Package	21

Source: Data sourced from Profit Today (2018)

To further ease cash flows, the PM Exporter Package has been extended from 2018 to 2021 covering garments, home textiles, and processed fabrics, and excluding raw materials such as yarn and grey fabric. It will provide direct support of Rs.51 billion (mostly cash subsidies of Rs. 41 billion for DLTL), with indirect support of Rs. 14 billion, which is composed of implicit benefits from zero-rating of packaging material and duty reductions on imports of 255 input tariff lines. Electricity tariffs have been reduced through extension of the PM's Industry Support Package (ISP) of 2016-17 for another three months, i.e. Rs.3/kilowatt hour subsidy is available until August 31st, 2018. [124] All major policies of the previous Package have been extended, such as DLTL along with duty-free imports of non-polyester fibres and textile machinery.

Overall, the Package aims to improve not just export competitiveness, but also capital and technology investment (both foreign and domestic) in the textile sector through a stable policy framework till 2021. The incremental increase in total exports due to the PM's Export Package for 2017-18 is expected to be $2.7 billion. As textile and clothing sector exports rose over this period, the gains accruing to the textile sector are likely to be quite high.[125]

122 Amin, T. (2015). Policy (2014-19): Ambitious textile goals unveiled. Business Recorder. Published Feb 10th, 2015. Retrieved from http://fp.brecorder.com/2015/02/2015021011499O2/

123 Monitoring Report. (2018). Government released Rs.32 billion under PM package to enhance exports. *Profit by Pakistan Today*. Published July 25, 2018. Retrieved from https://profit.pakistantoday.com.pk/2018/07/25/govt-released-rs32-billion-under-pm-export-package-to-enhance-exports/

124 Haider, M (2018). ECC approves Rs51 bn package to boost exports. The News. Published on May 31st 2018. Retrieved from https://www.thenews.com.pk/print/323546-ecc-approves-rs51-bn-package-to-boost-exports

125 Monitoring Report. (2018). Government released Rs.32 billion under PM package to enhance exports. *Profit by Pakistan Today*. Published July 25, 2018. Retrieved from https://profit.pakistantoday.com.pk/2018/07/25/govt-released-rs32-billion-under-pm-export-package-to-enhance-exports/

CHAPTER 5

CPEC – Opportunities and Concerns

China-Pakistan Economic Corridor (CPEC) is the flagship project of Chinese One Belt One Raod (OBOR) initiative, to deepen China's connectivity with the world. CPEC runs from western region of China to Gwadar port, located on Pakistan's southern coastline in Baluchistan. Along CPEC route, investments are being directed towards construction of road and railway networks, and improvement of marine and air transportation system. An array of projects, including establishment of special economic zones, an improved supply of electricity, oil and gas pipelines and an optical fiber cable project are also being undertaken as a part of bilateral cooperation between China and Pakistan under CPEC (Figure 5-1).

FIGURE 5-1 Main Projects of CPEC

Source: Information accessed from http://cpec.gov.pk/others

Currently, the total volume of the projects envisaged under the umbrella of CPEC stands at USD 62 billion, upgraded from initial USD 46 billion.[126] These projects have been structured as short, medium and long-term, extending over a period of 15 years, up to 2030. Five joint working groups have been formed under JCC to oversee their respective areas, which include long-term planning, energy, transportation infrastructure, industrial cooperation and Gwadar port. It is expected that network of roads developed under CPEC will usher in development and growth in Pakistan. From within the China, the Northwestern autonomous region of Xinjiang is especially expected to immediately benefit from this enhanced connectivity.[127]

5.1 Role of garments sector within CPEC: Initiatives

Textiles are one of the sectors of focus within industrial cooperation under CPEC. The Long-Term Plan (LTP) for CPEC highlights the significance of its textile and garments industry. The LTP emphasizes on promoting the quality and efficiency improvement of the textile and clothing industry, expanding the size of the textile industry, and increasing the supply of high value-added products. The LTP also covers promoting the Kashgar Economic and Technological Development Zone, and Caohu Industrial Park for encouraging export processing to establish a regional cooperation and development model.

5.2 Expected impact of CPEC on readymade garments

The potential impact of CPEC on the garments sector is expected to be significant, through planned investment in energy, logistics and connectivity, special economic zones and the creation of industrial parks.

Improved Energy Supply

Power projects undertaken in energy sector under CPEC can help Pakistan overcome energy crisis, which has been one of the leading constraints in the garment sector. In the last few years, electricity shortages have even led to closure of some garment firms in Lahore, Sialkot and Faisalabad.[128] Under CPEC, Chinese investors have invested up to US$ 33 billion in a portfolio of energy projects, which will produce around 11,000 MW of energy.[129] The increased supply of electricity can help meet the demand, and ensure continuous and reliable power supply to garment sector besides exerting downward pressure on cost of energy. This will lead to lower cost of production of garments, increased competitiveness and enhanced productivity, allowing firms to operate closer to their optimal scale. Moreover, it will also help retain garment businesses and attract FDI in the sector.

Better internal connectivity and logistics

The garments sector will also benefit from improved connectivity to ports and markets under the $11 billion planned investment in transportation, [130] of which $7 billion is for Early Harvest Projects to be completed by the end of 2018.[131] It is expected that transport and logistics costs will half because of CPEC. The benefits of upgrading the transport infrastructure of Pakistan is tremendous, as transport losses have risen from 3.5 per cent of GDP in 2012 to an estimated 4-6 per cent of GDP by 2017. Most costs arise from the fact that 96 per cent of passenger and freight is being carried by road as opposed to much cheaper rail, and the high prices

126 Kugelman (2018, March 1).
127 IGC (2014)
128 Study-I
129 Ministry of Planning, Development & Reform, CPEC (n.d.)
130 Niaz, M. (2016). Tale of two CPECs. 1st March, 2016. *Dawn*. https://www.dawn.com/news/1242804/tale-of-two-cpecs
131 Niaz, M. (2016). Tale of two CPECs. 1st March, 2016. *Dawn*. https://www.dawn.com/news/1242804/tale-of-two-cpecs

and frequent strikes of the unorganized trucking sector.[132] CPEC could change this, by improving road and rail connectivity, thereby increasing the feasibility of using co-modal transportation systems comprising rail and road. Evidence suggests that rail is cheaper than roads for carrying cargo over distance exceeding 500km and given the physical distances between exporters in Punjab and ports in Karachi, rail should be the primary mode of freight cargo. Using the global practice of multi-modal freight transport with an optimal mix of trucking and rail will help garment exporters reduce factory to market lead times. To that end, it is expected that once the three CPEC railway projects are completed by 2025, Pakistan railways could cater to 20 per cent of all freight cargo.[133]

Enhanced Connectivity Leading to New International Markets

Through improved connectivity, CPEC can allow Pakistan to cater to the garment needs of the countries from Gulf up to Europe.[134] In 2017, garments sourced from Pakistan accounted for only 1.7% of GCC's garment imports from the world.[135] Middle East is an attractive retail apparel market, with UAE ranking 2nd, Kuwait 4th and Saudi Arabia 6th in Retail Apparel Index 2013.[136] Hence, there is significant potential to increase garment exports to Gulf Cooperation Council (GCC). Similarly, given the GSP+ status, Pakistan can further enhance its exports to the European Union, facilitated by reduced travel times and cost due to CPEC.

Role of SEZs

The proposed special economic zones under CPEC can provide an impetus to the garment sector, as the local industry can benefit from the incentives offered. These include exemption from duties and taxes, concessional loans, land on installments and facility of one window operation. These SEZs will provide exporters with easy access to raw materials at world prices and a business-friendly custom procedures environment as well, which have currently been identified as an important challenge by garment exporters in Pakistan.[137]

Synergies with Xinjiang

China has recently invested $2.7 billion to develop its largest cotton textile production base in Xinjiang, the region of China connected to Pakistan via CPEC. The idea is to import raw-material from Pakistan to feed the industry. In this regard, multiple concessions have been proposed by the Chinese to ensure uninterrupted flow of raw-materials such as cotton and yarn from Pakistan to China which can be manufactured into finished goods at Xinjiang and sent back to Pakistan for international markets. Local firms in Pakistan recently had to rely on expensive cotton imports, due to the cotton crisis, and additional demand of cotton from Xinjiang would pull up prices and limit availability of cotton.[138]

The textile industry is also concerned about serious competition from large-scale garment industry in Xinjiang with economies of scale. In order to ensure that local industry does not suffer, there is a need to respond to local industry's reservations and reconsider any special incentives by Pakistan for textile products or even by the Chinese on relaxation of import duties on Pakistani commodities (for textile and garment sector) destined for Kashgar economic zone, to ensure that a concessionary regime is symbiotic and can promote value-addition in Pakistan, as well.[139]

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132 Kiani, K. (2017). Transport policy: need of the day. *Dawn*. 13th February, 2017. https://www.dawn.com/news/1314522

133 Wikipedia. CPEC. Available at https://en.wikipedia.org/wiki/China%E2%80%93Pakistan_Economic_Corridor#cite_note-140

134 Ministry of Planning, Development and Reform. (2018, March 9).

135 Calculation using ITC Trade Maps

136 A.T. Kearney Retail Apparel Index (2013) ranks the top 10 developing countries ranked in the A.T. Kearney Global Retail Development Index for their clothing retail industries.

137 Hamid & Nabi (2017)

138 IGC (2014)

139 IGC (2014)

Industry Relocation

The LTP duly stresses the need for capital and updated modern technology for the textile and garments industry. Moreover, Chinese businessmen have shown interest in relocating garment units to Pakistan and entering into joint ventures with local businesses. Pakistan should take objective steps to ensure these plans materialize, so that high value-added industry locates in Pakistan, and not only in China, and Pakistan can benefit from broadening industrial base and technology transfers.[140]

In short, the garment industry is one of the core sectors that are overlapping in the trade baskets of both countries. Pakistan should develop detailed blueprints of these priorities playing to domestic industry strengths and deriving support from China in weaker areas, instead of waiting for China to dictate the terms of this critical economic relationship. This can help Pakistan maximize the benefit from increased investment under CPEC, that surpasses the benefits of CPEC as a simple trade corridor.[141]

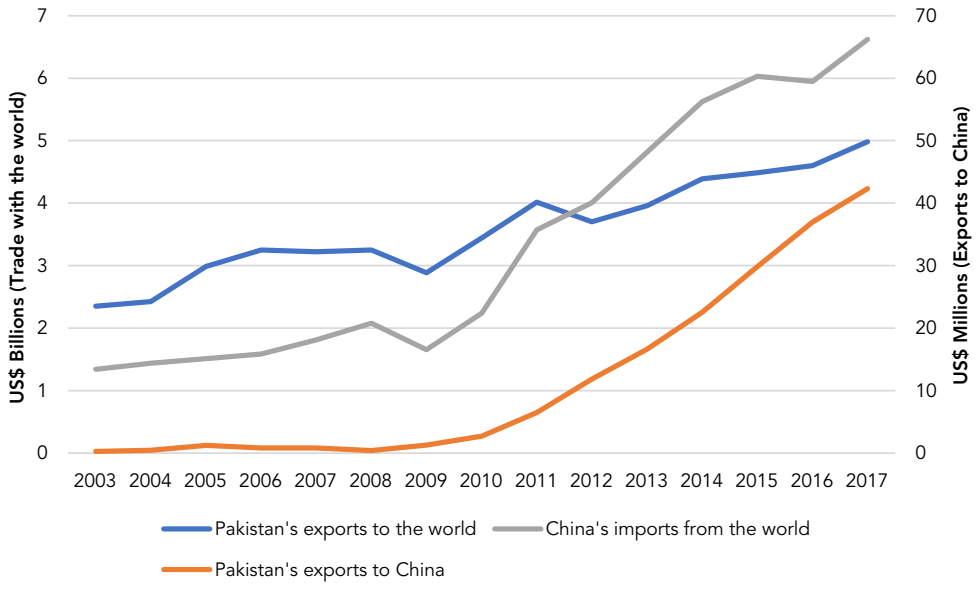
5.3 Garments trade with China

Currently Pakistan and China are engaged in garment trade, with ties improving over the years.

5.3.1 Pakistan's garment exports to China

The upward trend of Pakistan's garment exports to China in Figure 1 indicates that Pakistan's trade ties with China have strengthened over the years. As mentioned above, the surge in Pakistan's exports to China has been concurrent with the growth in Pakistan's garment exports to the world and China's garment imports from the world (Figure 5-2). Figure 5-2 shows that in the last 5 years, Pakistan's knitted/crocheted and woven garments exports to China have increased at a higher growth rate than Pakistan's exports to the world. This points to rising significance of China in Pakistan's garment exports. Moreover, growth rate of Pakistan's garment exports to China also outstrips China's garment import growth, hence Pakistan's importance as China's garment import partner has also increased over the years.

FIGURE 5-2 Trend of Pakistan and China's Garment Trade (HS 61+ HS62)



Source: ITC Trade Maps

140 IGC (2014)
141 IGC (2014)

TABLE 5-1 Growth rate (% per annum) from 2013-2017

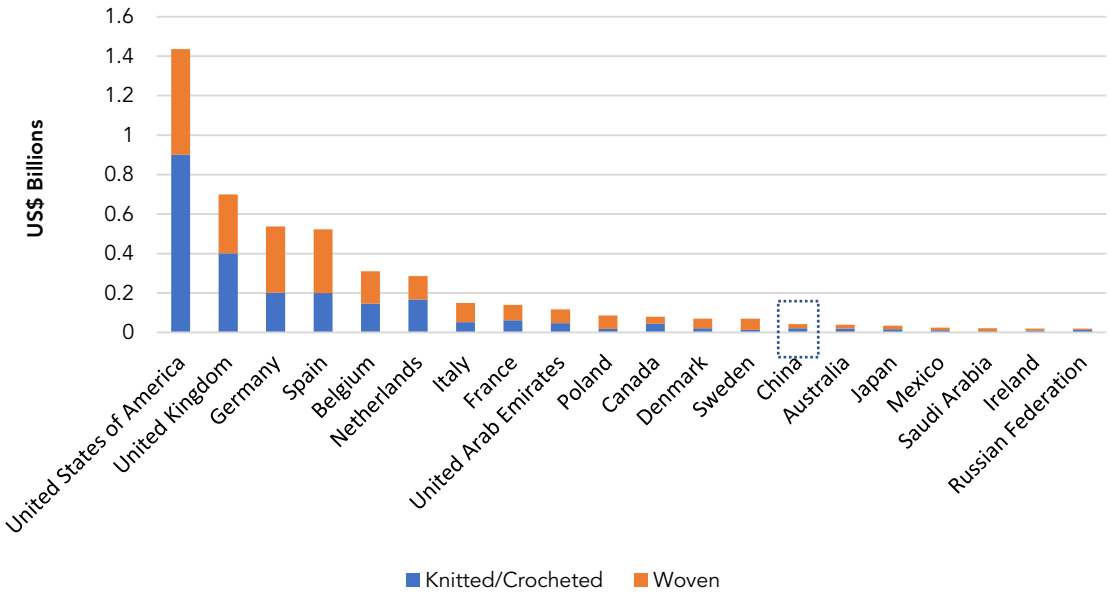
Category	Pakistan's exports to the world (%)	China's imports from the world (%)	Pakistan's exports to China (%)
Knitted/Crocheted garments (HS61)	3	12	31
Woven garments (HS62)	7	4	23

Source: ITC Trade Maps

Nonetheless, as shown in Figure 5-3, Pakistan's overall garment exports to China were nominal, i.e. US$ 42 million ($22 million knitted/crocheted and $20 million woven garments) in 2017, which made up less than 1% of Pakistan's total garments exports. Therefore, despite the growth in Pakistan's exports to China, China is still not a prominent destination for Pakistan's garment exports.

Similarly, Pakistan does not feature as an important garment import partner of China (Figure 5-4). As reported by China, Pakistan ranked eighteen among China's garment suppliers, supplying only $70 million worth of Chinese garment imports ($37 million knitted/crocheted and $33 million woven garments), which makes up 1.05% of China's total garment imports.

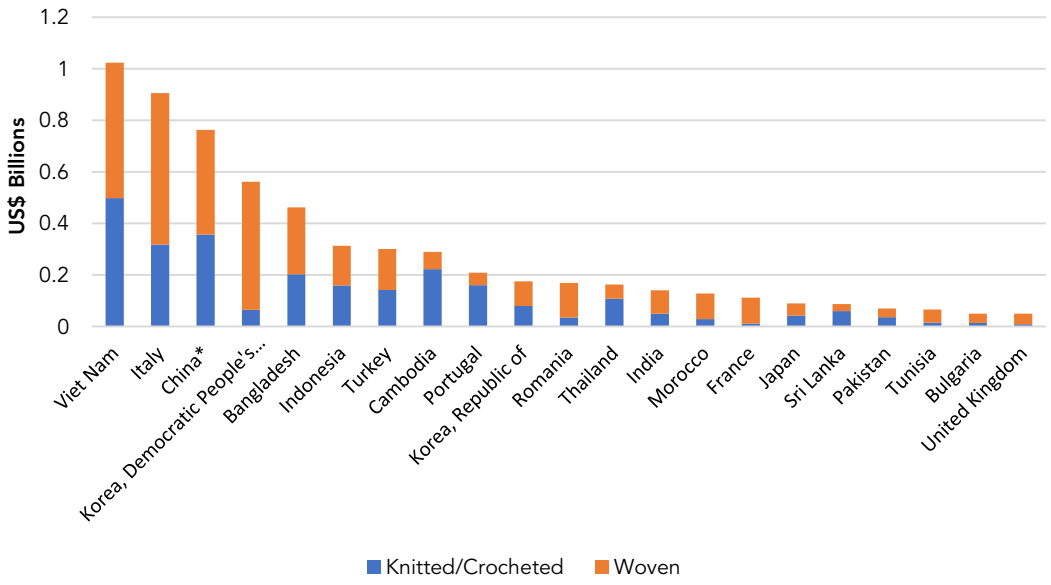
FIGURE 5-3 Pakistan's Top 20 Export Destinations for Knitted Garments (HS 61) and Woven Garments (HS 62), 2017



Source: ITC Trade Maps

As may be seen, Pakistan's exports to its top destination of the United States are much bigger compared to China, i.e. by a factor of about 45 and 24 times in HS 61 and HS 62 respectively.

FIGURE 5-4 Top 20 import partners of China's garments (woven and knitted/crocheted) in 2017



*Re-import by China
Source: ITC Trade Maps

Table 5-2 shows the main categories of Pakistan's garment exports to China in 2017. Nearly 58 per cent of Pakistan's exports to China are constituted by woven and knitted menswear suits, ensembles, trousers and shorts, followed by knitted T-shirts.

TABLE 5-2 Top Pakistan's Garment Exports to China in 2017

HS Code	Description	Value in 2017 (US$ Million)	Share in garment exports to China (%)
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts (not knitted or crocheted)	17.6	41.6
6103	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts (knitted/crocheted)	6.8	16.1
6109	T-shirts, singlets and other vests, knitted or crocheted	4.5	10.6
6110	Jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted (excluding wadded waistcoats)	3.4	8.1
6204	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts	2.5	6.0
6104	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts, knitted or crocheted	2.4	5.7
6105	Men's or boy's shirts, knitted or crocheted (excluding nightshirts, T-shirts, singlets and other vests)	1.4	3.2
6106	Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted	0.4	0.91

As discussed earlier, China is a growing importer of knitted and woven garments. In fact, it is the fastest growing importer of garments in the world.[142] At the same time, Pakistan's share of knitted and woven garment exports to China is very small, although growing. CPEC, through improved connectivity, can help Pakistan tap into China's expanding garments demand by increasing garments exports to China.

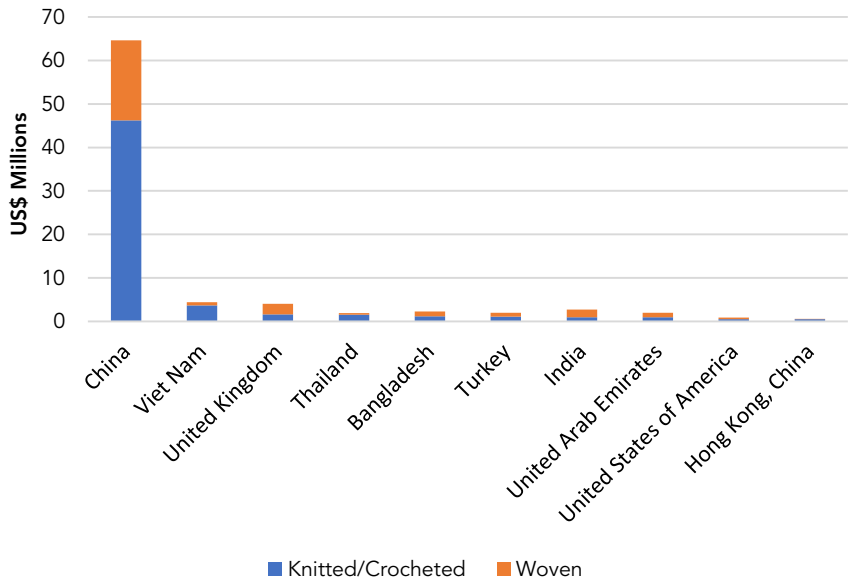
142 ITC TradeMaps

Moreover, China's garment export share in the global market has been declining. China's share in world garment exports nearly doubled from 18.3 percent to 37 percent between 2005 and 2010, however from 2010 to 2017 it decreased from 35 percent to 33 percent. This is in part a consequence of high labor cost in eastern provinces of China, which were the mainstay of garments production in the country. This has compromised its competitiveness in the international market. As a result, China has moved out of simple and high-volume garments, and into technical wear and fabric. Nevertheless, the completeness and scale of China's supply chain, high labour productivity, sheer range of product offerings, as well as world-class infrastructure make it unlikely that China will exit the garments market within the next 2-3 years (indeed, when asked about sourcing destinations, half of survey respondents planned to maintain or even increase sourcing from China in 2018-19).[143] However, given the increased focus of China on high-value added garments, low-wage exporters could see by 2025 a potential opening in the world market worth US$ 145 billion (plus more as China becomes a net importer of garments). This is a window of opportunity that Pakistan can potentially seize under the CPEC.

5.3.2 Pakistan's garment imports from China

Pakistan's garment imports constituted a nominal share, i.e. 0.16% of Pakistan's total imports in 2017. However, of these imports, 71 per cent were sourced from China (Figure 5-5), followed by Vietnam, UK, Thailand and Bangladesh.

FIGURE 5-5 Top 10 sourcing countries for Pakistan's garment imports 2017



Source: ITC Trade Maps

Pakistan imported a range of garments from China in 2017 (Table 5-3). These were mostly in the category of knitwear, especially baby garments and clothing accessories, followed by menswear shirts, trousers, ensembles and shorts.

143 Lu, Sheng. (2018). Apparel sourcing in 2018. Retrieved from https://shenglufashion.com/2018/01/09/apparel-sourcing-in-2018-results-from-the-just-style-state-of-sourcing-survey/

TABLE 5-3 Pakistan's Top 5 Garment Imports from China in 2017

HS Code	Description	Value in 2017 (US$ Million)	Share in Pakistan's garment imports from China in 2017
6111	Babies' garments and clothing accessories, knitted or crocheted (excluding hats)	11.4	17.7
6105	Men's or boys' shirts, knitted or crocheted (excluding nightshirts, T-shirts, singlets and other vests)	10.9	16.8
6103	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts	6.9	10.7
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts	6.1	9.4
6110	Jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted (excluding wadded waistcoats)	2.7	4.2

Source: ITC Trade Maps

Pakistan also imports textile and garments machinery from China. The automatic sewing machines used for industrial stitching are mainly imported from China and Germany. Overlocking machines used to trim and overlock edges of cloth, and specialized machines used for cutting, making button holes and stitching of buttons are also being imported from China.[144]

5.4 Role of the Pak-China Free Trade Agreement

The Pak-China FTA, signed in 2006, was an important step in the trade relationship of the two countries. Trade agreements in goods are generally followed by agreements on trade in services, especially commercial presence, trade-related services as well as movement of persons and flows of technology. This section explores the extent to which the Pak-China FTA allowed Pakistan to gain access to the significant garments market of China and how Pakistan can benefit from China's "Made in China 2025" initiative that seeks to increase China's world share in value-added manufacturing exports.

5.4.1 Enhancing garments trade—The Pak-China FTA: An unbalanced deal

While the FTA was a milestone in the trade relations of both countries, over the years, the FTA has proved to be more beneficial for China than for Pakistan. Among textiles, China has provided market access to Pakistan on cotton fabrics, bed linen and other home textiles and has reduced tariff by 50 per cent on knitwear and woven garments. Pakistan, on the other hand, has given market access to China mainly on machinery or raw-materials.[145]

Pakistan has increased its garment exports to China post-FTA, especially in the last few years. However, given Pakistan's garment exports to China, Pakistan has been able to utilize only 39 out of 272 garment tariff lines, i.e. 14 per cent of the concessions on garments offered by China. In fact, over 15 per cent of the garment products included in the FTA by China were not even imported by China from the world in 2017 —these include 3 of the 13 garment items granted complete elimination of tariff in the Pak-China FTA.

Table 5-4 shows the complementarities between Pakistan's top exports and China's top imports. As can be seen, none of the products are in category I, which entails zero tariffs, or category II, which offers payment of only 0-5% tariffs for 5 years. Roughly 4 of the top 6 complementary products are not given any concessions.

144 Memon (2016)

145 Ministry of Textile (2009)

TABLE 5-4 Complementarities between Pakistan's top exports and China's top imports

Product Code	Product Description	Pakistan's exports in 2017 (US$ 000)	Share in Pakistan's exports in 2017 (%)	China's imports in 2017 (US$ 000)	Share in China's imports in 2017 (%)	Pakistan's exports to China in 2017 (US$ 000)	Category in FTA
611595	Full-length or knee-length stockings, socks and other hosiery, incl. footwear	199886	4.0	79845	1.2	1539	Not in FTA
610910	T-shirts, singlets and other vests of cotton, knitted or crocheted	197757	4.0	429100	6.4	4421	Cat V
610510	Men's or boys' shirts of cotton, knitted or crocheted	168344	3.4	98399	1.5	1192	Cat V
610990	T-shirts, singlets and other vests of textile materials, knitted or crocheted (excluding cotton)	106416	2.1	223459	3.3	62	Cat III (61099010) Cat V (61099090)
620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts, of cotton	410423	8.2	350321	5.2	733	Cat III
620462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton	197075	4.0	214230	3.2	2086	Cat IV

Note: Cat I= No tariff, Cat II= 0-5% tariff for 5 years , Cat III= 50% on the margin of preference in five years, Cat IV=20% reduction on the margin of preference, Cat V= No concession
Source: Data accessed from ITC Trade Maps, Oct 2018

More critically, China has provided ASEAN countries with duty free access in Chinese markets, whereas Pakistan faces tariffs in the range of 7 to 9 per cent (Table 5-5), due to which Pakistan is unable to realize its full trade potential with China.

TABLE 5-5 Tariff imposed on garment imports from Pakistan and ASEAN countries in China

HS Code	Product Label	Tariff faced by Pakistan (%)	Tariff faced by ASEAN (%)
61	Articles of apparel and clothing accessories, knitted or crocheted	7	0
62	Articles of apparel and clothing accessories, not knitted or crocheted	9	0

Source: Pakistan Business Council, https://www.pbc.org.pk/wp-content/uploads/PBC-final-5.pdf

On the other hand, Pakistan's provisions to China under the FTA have harmed local garment industry. At the time the FTA was signed, textile and garment industries in Pakistan were adversely affected due to the energy crisis. As a result, Pakistan's tariff concessions in FTA allowed China to export cheap clothing to Pakistan. As a result, the profitability and/or underutilization capacity of the local industry was harmed.[146]

5.4.2 A transitioning China

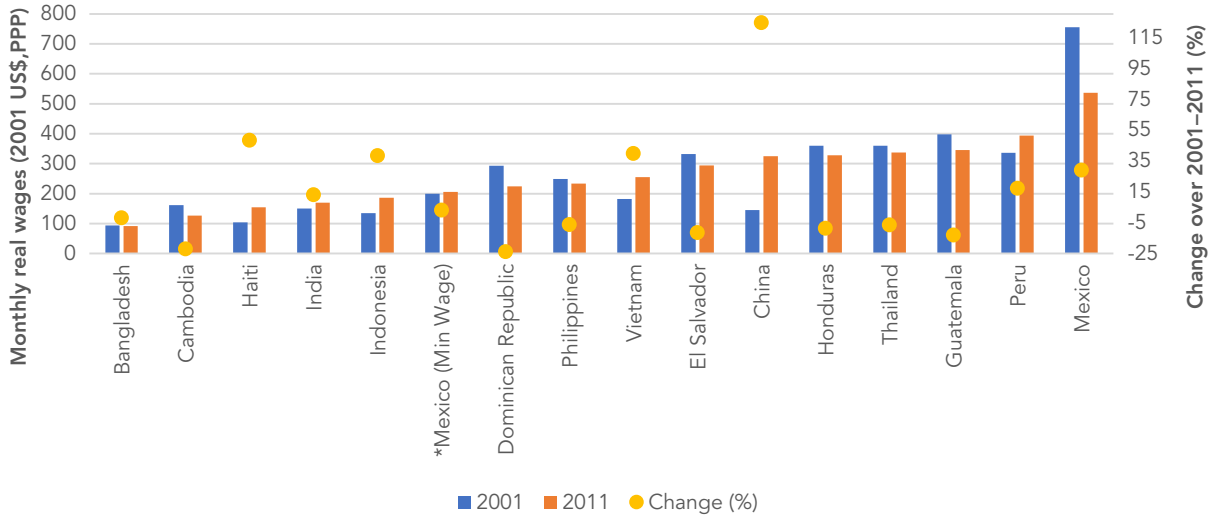
China has been the largest producer of apparel in the world. Initially starting off as a low-wage assembly producer, the garment sector in China progressed towards "greater capacity, vertical and horizontal integration, higher utilization rates, product specialization, increasing familiarity with technology, and large learning-by-doing effects".[147] As a result, China has been able to offer progressively improved quality of garments at internationally competitive prices, produced in an industry with widespread economies of scale.

146 IGC (2014)
147 Zhu & Pickles (2014), p. 22

Since the early 2000s, however, firms in China have increasingly confronted difficulty in maintaining low production costs. With an appreciation of China's currency, inflation, higher cost of raw-materials and shortages of water and electricity led by increasing industrialization, China faced a surge in the cost of production. Moreover, increasing labor costs in Eastern provinces, shortages of labor as workers shifted to better paying job, labor protection laws and activism also directly or indirectly contributed to escalating input costs, due to which export-oriented firms have particularly suffered.[148]

From 2001 to 2011, China's apparel wages increased by 124% (Figure 5-6), and spiked 64% from 2011 to 2015, reaching $3.60/hr.[149] This has made China less attractive than cheaper countries such as Bangladesh and Cambodia. In turn, China is taking progressive action by investing in the cheaper western provinces. For example, the government has invested $8 billion in the cotton-growing region of Xinjiang, closest to Pakistan, in an attempt to re-locate its textile and apparel industry from the East to the West. The government is also offering rent and power subsidies as well as tax benefits in the central provinces to ease pressures from higher levels of industrial activity in the main economic regions of the country.[150]

FIGURE 5-6 Monthly real wages in 15 of top 21 apparel exporters to the US



Source: Center for American Progress/ Worker Rights Consortium; https://cdn.americanprogress.org/wp-content/uploads/2013/07/RealWageStudy-3.pdf

In 2016 alone, raw materials prices in China went up 7.8 per cent, labor costs rose 6.8 per cent, and rents increased by 9.7 per cent, on average.[151] Soaring cost of production have resulted in protracted tightening of profit margins, and erosion of competitiveness. This has led to industrial restructuring and relocation; Chinese manufacturers and global value chains are moving to economically viable countries with cheap labor in large numbers. Figure 5-7 shows that 74 per cent and 62 per cent of sourcing executives surveyed by McKinsey Chief Purchasing Officers (CPO) in 2017 and 2015 respectively responded that they expected China's share of their companies' sourcing to strongly decline by 2025.[152]

148 Zhu & Pickles (2014)

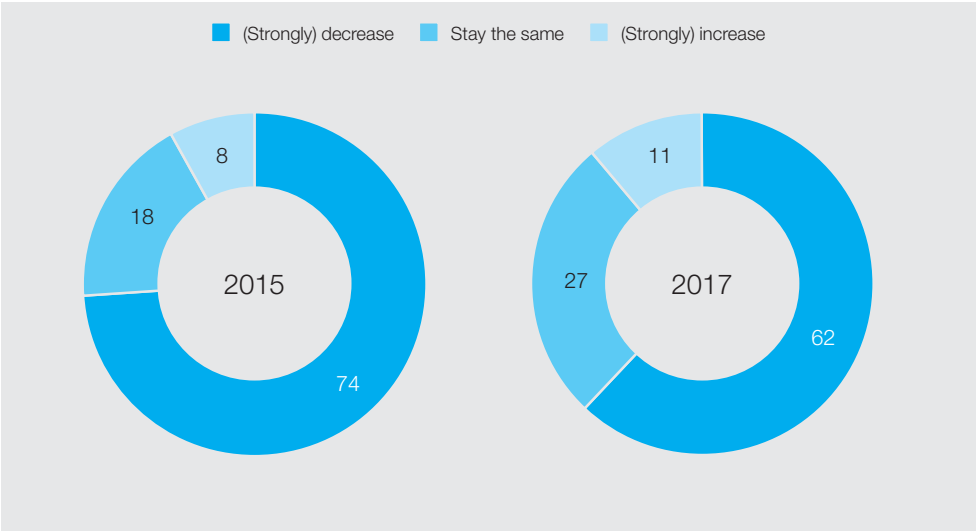
149 CNBC (2017, February 27)

150 Lu, Sheng. (2018). Apparel industry issues in the year ahead. Retrieved from https://shenglufashion.com/2018/01/09/outlook-2018-apparel-industry-issues-in-the-year-ahead/

151 Tang (2017, August 4)

152 McKinsey CPO survey 2017 reflects perspectives of 63 CPOs who together are responsible for a total sourcing value of over $137 billion in garments. A diverse set of respondents are included in the survey – vertical apparel retailers, hybrid wholesalers, and sportswear companies. In 2015, 40 CPOs were surveyed. https://www.mckinsey.com/~/media/mckinsey/industries/retail/our%20insights/digitization%20the%20next%20stop%20for%20the%20apparel%20sourcing%20caravan/the-next-stop-for-the-apparel-sourcing-caravan-digitization.ashx

FIGURE 5-7 Sourcing Executives Opinion of expected share of China in their sourcing



Source: McKinsey Apparel CPO Survey, 2015 and 2017

Since 2015, Chinese manufacturers have proactively been building, acquiring or partnering with production facilities in countries such as Vietnam, Myanmar and Cambodia, while entering into strategic partnerships in Indonesia and Bangladesh.[153] Even brands such as Nike and Adidas, which are world's leading footwear and clothing companies, and Japanese clothing chains such as Uniqlo have shifted their operations to Southeast Asian countries, such as Bangladesh. Sourcing decisions are based on three main criteria: factor costs, lead times (from factory to market) and sustainability of production.[154]

As per the 13th five-year plan of Chinese Government for 2016 to 2020 period, China is strategically moving towards more value-added technology intensive products, to allow product differentiation from its low-cost competitors. Industries in China are investing in technology upgrading, rather than in economies of scale, as they have already exhausted the gains from the latter. Automation and advanced robotics are also being adopted in production processes, as a replacement for high-cost scarce labour.[155] For example, a Chinese T-shirt manufacturing company, Tianyuan Garments Co., is opening a factory where machine vision-based sewing robots will be used to produce apparel for Adidas.[156]

5.5 Opportunities for growth and collaborative investment

The CPEC LTP mentions joint ventures as a potential mode of industrial cooperation between Pakistan and China. It also states that Chinese and Pakistani enterprises would jointly invest to establish where Pakistan may provide the land or established buildings, while the Chinese side would invest in technology and equipment. At the same time, China has demanded for public sector sponsored industrial parks, therefore, there is ambiguity regarding who would be investing in land.[157] Moreover, the investment requirement vis-à-vis land is nominal if the land is subsidized, and this not only diminishes Chinese interest to look for a local partner but is likely to result in a small equity contribution by local enterprises.[158]

153 Young (2016, February 29).
154 Nikkei Asian Review (2018, March 31)
155 Young (2016, February 29)
156 Bhattacharya (2018, June 5)
157 IGC (2014)
158 IGC (2014)

There is a need to promote more meaningful joint ventures, where local industry can provide some concrete complementary support, through existing access to local market, trained workforce, licensing, existing supply chain, etc and benefit from Chinese expertise in the RMG sector. Owing to benefits of joint ventures in terms of transfer of technology and broadening of industrial base, joint ventures should be promoted for all potential investments.[159]

Another route that can potentially be used by Pakistan is via outward investment by Pakistanis in China. This can allow Pakistanis to acquire R&D, intellectual and technology resources, branding knowledge and other elements that are missing in local markets. Technology partnerships between Pakistani firms and Chinese firms can also plug the gaps in Pakistan's required to access the foreign markets that China has traditional access to but is now moving out of due to rising labour costs.

159 IGC (2014)

CHAPTER 6

International Insights

Considering the export momentum generated over 2016-17, the sector may finally have the chance to realize its economic potential (chapter 1), in light of the opportunity presented by projects under CPEC and their various spillover effects in terms of attracting investment and technology. Pakistan is not unique in facing the challenges that are preventing its garments sector from taking-off. Analyzing the policy tools used by other countries to overcome similar problems could aid Pakistan in its attempt to raise a world export share that has stagnated at 1 per cent over the last 15 years and stay relevant in global garments trade.

6.1 Relevant examples

For this purpose, a diverse set of countries has been selected, including Bangladesh, Cambodia, Vietnam, India, Turkey, China and Sri Lanka. The situation across these countries is varied, with mature exporters (Turkey, India, Sri Lanka, and China) participating in high value-added exports, while others are exporting from the low to mid value-added, mostly assembly, end of garments production (Cambodia and Vietnam, respectively). At the same time, Bangladesh enjoys a unique position of producing value-for-money garments in bulk, by combining its cost advantage with medium to high quality, i.e. in the mid-market price point segments. These countries have at least 30-40 years of experience in global garments trade, with late entrants like Cambodia learning quickly to become part of the global garments value chain.

TABLE 6-1 Snapshot of garments exporters

	Stage of value-addition	Textile value chain capability		Technology level exports
		Natural fibres	Synthetic fibres	
Bangladesh	OEM	Partial backward integration in fabric stage (esp. knits)	Negligible value chain capability	Basic value for money
China	OBM	Complete value chain	Complete value chain	Basic, value-added and high-end
India	ODM	Complete value chain	Partial value chain capability	Basic and value-added
Vietnam	CMT	Negligible value chain except garments	Negligible value chain except garments	Basic and value-added
Cambodia	CMT	Negligible value chain except garments	Negligible value chain except garments	Basic
Sri Lanka	ODM	Negligible value chain except garments	Negligible value chain except garments	Basic and value-added
Pakistan	OEM	Complete value chain	Negligible value chain except garments	Basic and some value-added
Turkey	OBM	Complete value chain	Complete value chain	Value added and high-end

Source: Ministry of Textiles, India, (2016)

Turkey has used its high-skilled labour, "green" production and close proximity to big markets to become a strong manufacturer of high value-added garments (especially womenswear) for fast retailing at the OBM level, while Sri Lanka has attracted FDI by creating a market image of an "ethical" and environmentally sustainable producer of specialized value-added goods (active wear and children's wear) to target niche markets. On the other end of the spectrum are Vietnam and Cambodia, which engage in cut-make-trim/assembly of garments and export garments made from both cotton and man-made fibres. Vietnam put in place a policy framework in 2001 to allow the transition to more value-added goods through developing backward linkages, upgrading technology and human resources under its "Speed up Strategy", allowing it to export more value-added jackets, coats and anoraks as well as bottom-wear (trousers, shorts, and skirts) of MMF. Cambodia uses its cheap labour to attract global players who cannot enter into JVs in China (due to strict internal policies) and exports mostly synthetic knitwear jerseys, T-shirts, women's trousers and shorts, as well as babies' garments of cotton.

China has used its world class manufacturing capabilities and unmatched garments supply chain to attract global fast fashion and fast retailing brands to China. In the most recent phase of textile and clothing sector re-structuring, the government is propelling technological innovation through its 'Special Fund to Go Global'. Value-addition has been continuous, and the sector is on its way to become an OBM (especially for children's wear) through brand development funds created by the government. Although not at the OBM stage like China, India has used its high-skilled labour force to tap into the lucrative and fast-paced womenswear market (woven uppers and bottom-wear) of both man-made fibres and cotton as well as knitted children's wear to compensate for its high labour costs as an ODM producer. More importantly, it has diversified production into functional wear— woven cotton tracksuits, ski suits as well as knitted special garments (professional and sporting).[160] As children's wear and sportswear are projected to lead apparel growth till 2025, India seems to be well-placed for the next decade.[161]

Bangladesh is currently following a strategy of consolidating its export gains by strengthening its capacity and maintaining competitive prices to grow its world export market share to 8 per cent by 2021 (roughly $50 billion in exports).[162] Using the financial cushion from the economies of scale it currently enjoys in the production of low-value added bulk clothing, it is strategically planning to transition to modern (medium-value) apparel and ultimately, to functional (high-value added) apparel. To offset its infrastructural weaknesses, the government has drafted attractive policies for the Special Economic Processing Zones (SEZs) and Export Processing Zones (EPZs) to use expatriate white collar labour from Sri Lanka, India, China and Singapore. In the meantime, it is actively developing its skilled labour force through big government sponsored and public-private partnerships to improve worker productivity to create an adequately skilled labour force to replace these foreign workers.[163]

Due to overlapping objectives, each of these country's experiences provide relevant valuable lessons to Pakistan. Some of these countries, particularly Bangladesh, have similar underlying institutional structures and impediments. In this context, learning from Bangladesh and other countries could prove to be an effective way for Pakistan's garment sector to attain its underlying potential.

6.2 Successful policy support and interventions by role models

This section will explore how challenges faced by regional role models were addressed in their garments sector, with special emphasis on government role and technologies.

160 TDAP (2016). Sectoral competitiveness and value chain analysis: Readymade garment value chain analysis in Pakistan. Ministry of Commerce, GoP

161 EuroMonitor (2018). Key facts: Apparel and footwear in 2018. Retrieved from https://blog.euromonitor.com/2018/02/key-facts-apparel-and-footwear-2018.html

162 Rahman, A. (2014). Vision 2021 for RMG. Retrieved from http://hawkerbd.com/news_details.php?news_id=387753

163 Patwari, A. (2015). Skill gap in textile & RMG industry and Vision 2021. Retrieved from Skills https://www.textiletoday.com.bd/skill-gap-in-textile-rmg-industry-and-vision-2021/

6.2.1 Improved Supply Chain

The ability of a country to upgrade and add greater value to their garments sector depends on the length and strength of their internal supply chains.[164] China is perhaps the biggest example of stockpiling large inventories of cotton to respond quickly to market opportunities. It has also recently developed a novel way of helping clusters secure inputs across the supply chain by funding a network of raw material banks through government bonds. It also provides transport subsidies for firms located in far-away areas.

The Bangladesh experience also lends interesting insights. The country started off exporting woven garments in the 1970s and 80s. However, the government actively pushed firms to develop backward linkages in the knitwear sector to meet exporting requirements of the EU, a key trade partner of Bangladesh.[165] Till 2005, FDI was contingent on accompanying investment in backward linkage industries such as spinning, knitting, dyeing and finishing, and by mid-2000s, knitwear surpassed woven-wear exports. As a result of these interventions, Bangladesh could domestically source 95 and 50 per cent of knitted and woven fabric, respectively by 2016.[166]

Currently, the Bangladesh government has re-positioned policy support through the revised Textile Policy 2011, that seeks to further strengthen back-end textile capabilities in an evolving global textile sector. Centrally bonded warehouse facility has recently been extended to allow Bangladesh exporter textile mills to import raw materials, chemicals, and dyes at zero customs duty. Cash subsidies were also given to protect spinners from fluctuations of cotton input prices from partner countries.[167]

6.2.2 Import regime for raw materials and machinery

The duty-free access to inputs provided to garment exporters since the 1980s under the central Bonded warehouse facility in Bangladesh lowered the cost and risk associated with imported inputs significantly.[168] This allowed them to use previously imported inputs, including raw-materials, chemical and dyes, stored in a warehouse without paying any customs duty. For non-exporters, they could delay paying taxes until actually used, rather than upfront tariff payments. This gave firms reliable access to imported input which critically improved supply chain responsiveness.

Additionally, it lowered the inventory management risk of individual manufacturers (drop in demand would not affect firms as they did not need to maintain large inventory stocks), as well as the input price volatility manufacturers faced in import markets due to global downturns, shortages, or exchange rate fluctuations. This allows Bangladesh firms to remain competitive over a wider range of prices, i.e. they can squeeze their profit margins significantly to attract international demand, without resorting to quality cuts.

Other countries have also offered rebates (as a value of exporter prices) to compensate for local taxes paid on inputs—China offers a 16 per cent drawback on FOB price to offset value-added tax on manufacturing inputs, while Bangladesh applies lower taxes on other imported inputs such as the equipment & spare parts needed by effluent treatment plants.[169]

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164 Gereffi, G., Fernandez-Stark, K. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

165 Up till 2010, only domestically produced fabric could be used for garments exports to the EU under double transformation (yarn to fabric and fabric to garment) rules of origin. Kathuria, S. and Malouche, M. (eds). (2016). Strengthening competitiveness in Bangladesh—Thematic assessment: A diagnostic trade integration study. Directions in development. Washington, DC: World Bank. doi: 10.1596/978-1-4648-0898-2.

166 Kathuria, S. and Malouche, M. (2016). Thematic Analysis: Export Constraints and Potential in Selected Sectors Toward New Sources of Competitiveness in Bangladesh. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0647-6

167 Kathuria, S. and Malouche, M. (2016). Thematic Analysis: Export Constraints and Potential in Selected Sectors Toward New Sources of Competitiveness in Bangladesh. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0647-6

168 Kathuria, S. and Malouche, M., eds. (2016). Strengthening Competitiveness in Bangladesh—Thematic Assessment. A diagnostic trade integration study. World Bank Group: Washington, D.C. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0898-2

169 Kathuria, S. and Malouche, M., eds. (2016). Strengthening Competitiveness in Bangladesh—Thematic Assessment. A diagnostic trade integration study. World Bank Group: Washington, D.C. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0898-2

Finally, instead of offsetting higher input tariffs through cumbersome rebates, or making imports duty-free, Vietnam government rationalized existing tariffs to assist manufacturer exporters. It applies MFN tariffs where applicable. Duties on synthetic filaments range from 0-3 per cent, yarn from 0-7.5 per cent, and fabric either 12 (MFN) or 18 per cent (non-MFN). Cambodia is an extreme case, with filaments and yarn imported duty-free, and a 7 per cent tariff on synthetic woven cloth.

6.2.3 Access to credit

Firm ability to export depends critically on trade financing.[170] The success of Bangladesh's garment sector and its rise to the world's 2nd largest exporter in 30 years can be attributed mostly to its trade financing schemes. The government provided back-to-back (BTB) L/Cs in 1986-87 that allowed garments manufacturers to use their export orders as collateral to borrow money for importing intermediate goods. This was only available to firms that exported more than 80 per cent of their output. This policy disproportionately increased the exports of smaller and medium-sized firms, as they could now acquire L/Cs that were otherwise difficult to attain due to inadequate collateral.[171] This system provides almost 70 per cent of the working capital requirements of Bangladesh garment exporters and is considered by the RMG sector as the most critical determinant of their growth. As financing is not done through public funds, it is not subject to changes on account of budget cuts. Equally importantly, working capital requirements of firms were now much lower, as banks directly deducted import payments, interest, etc. from firm's export earnings. Moreover, firms did not have to bear the burden of financial transactions for arranging inputs, as the banks would directly make adjustments against export proceeds.

Many countries provide further credit assistance through corporate loan guarantees and export credit insurance (China), export project performance security and investment credit guarantees (Vietnam), whereas Bangladesh also offers export credit of up to 90 per cent (through L/Cs) for working capital flows. Moreover, the Bangladesh government is committed to providing the lowest interest rates (less than 5 per cent) and smallest L/C commission for export credit.[172]

170 Gereffi, G. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

171 Kathuria, S. and Malouche, M. (2016). Thematic Analysis: Export Constraints and Potential in Selected Sectors Toward New Sources of Competitiveness in Bangladesh. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0647-6

172 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

TABLE 6-2 Broad policy support for garments sector

	Tax rebates & financial benefits	Technology innovation support	Brand building support	Financing support
Pakistan	No tax rebates provided to incentivise garment manufacturers	Availability of low-cost loans for technology up gradation	promotion of retail outlets in other countries, market development support and development of world trade centre	Export financing via subsidized loans at 7.5% interest
Bangladesh	*Tax holidays and exemption of up to 10 years in EPZs *Cash subsidy for new apparel products *Accelerated depreciation	No specific policy	Market missions in other countries	*Availability of back to back letter of credit for garmenting *Interest rates 5% lower than market
China	*Provision of export tax rebate of up to 15% *Tax exemption and rebates for investment in Xinjiang province	*Special technology Innovation funds *Tax rebates on R&D activities	Low cost loans available from govt. banks	Brand building support fund available
India	Tax rebate only for Export units in designated SEZs	Low cost loans and capital subsidies for technology up-gradation in textile sector	Support for Indian exhibitions abroad under market development scheme	Interest subvention at 3 per cent up till 2020
Vietnam	Tax rebates available only for investment in deprived areas	No specific policy	Not present	Export credit at 4% lower interest rate
Cambodia	*Export tax exemption of up to 3 to 5 years *Accelerated depreciation at 40% on plant and machinery	NA	NA	NA
Turkey	Tax rebate varying from 15-55% depending on industry zone and geography	No specific policy	Branding support for "TURQUALITY"	Low cost loans subsidy of up to 5%

Source: Ministry of Textiles, India, (2016)

6.2.4 Technology

As discussed in chapter 3, the market failure of technology adoption is closely tied to the unavailability of credit. In Bangladesh, the facility of back-to-back letter of credit (L/C) creates a stable business climate which is critical for investing in technology—firms need to be sure that key policies remain unchanged as acquiring and learning about technology takes time. Additionally, commercial banks provided loans for technology upgradation on such terms that incentivised firms to effectively absorb new technology to pay back their loans.

Sri Lanka historically relied on large and guaranteed future export orders from its four leading international apparel clients to make the transition from CMT to ODM supplier. Asset-specific investments in technology were made by firms in anticipation of strong future demand from these big buyers resulting in product and functional upgrading: specialization in value-added and sophisticated products.[173] Other countries such as India and Pakistan offered government-provided capital subsidies (cheaper loans in technology upgradation funds) or venture capital in Bangladesh (from Export Promotion Fund). China is the leader in terms of policy support, undoubtedly due to its large government budget. It has set up multiple technological development funds, as

173 Gereffi, G. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

well as short-term capital through government bonds or seed money from commercial banks. However most of this support is for the technical textiles sector (yarn manufacturing, dyeing and chemical fibre sectors). This restructuring from apparel to textiles means many manufacturing facilities will soon become obsolete.[174]

In India and Bangladesh, to allay risks about technology, not only are imports of textile machinery allowed at reduced rates but so are the raw materials and parts needed to manufacture those same machines domestically. This helped increase the absorption of new technology, as technicians used raw materials and parts for maintenance and repair. In Pakistan, while textile machinery imports are duty free at the moment, spare parts are not.

To provide R&D support, Indian government co-funds research contracted by the garments sector in India, while Vietnam provides grants for sustainable production, new materials, as well as innovation. Turkey provides tax exemptions on salaries of R&D personnel and on revenues associated with R&D in Technology Development Zones. China has the most comprehensive schemes, ranging from grants to income tax rebates of up to 50 per cent.[175] Pakistan could provide tax credits that firms could use to fulfill other tax obligations.

6.2.5 Labour productivity

The products that countries are currently exporting depend partly on their skill profiles.[176] For countries such as Pakistan that lack an outright labour cost advantage, better quality human capital can provide a competitive edge over low-wage countries. Regional experience provides good examples of how to maintain (Bangladesh, Vietnam and Cambodia) and upgrade (Sri Lanka and Turkey) country positions in global value chains by raising labour productivity.

Vietnam and Bangladesh are among the most active in terms of interventions for raising worker productivity at the lower rungs of the garments value chain. The ILO-funded Better Work program in Vietnam had significant impacts on firm profit margins, with revenue-to-cost ratios rising by 25 per cent in four years.[177]

Bangladesh is a good example of private-sector assisted skills development by lead buyers and industry associations. Initial skills training for garments sector workers (in the 1980s) was led by the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), the Bangladesh Knitwear Manufacturers and Exporters Association (BKEMA) and provided by donor agencies, especially in foreign-owned EPZ firms. As demonstrable effects of training emerged, local firms started similar on-the-job training helped by their global buyer firms. As foreign firms recognised the private value for money of these trainings, the government further encouraged them to set up in-house programs (the H&M scheme trained 1000 workers, for example) and more increasingly, external training centres as part of their tax deductible corporate social responsibility (CSR). The Bangladesh Institute of Fashion and Technology (1999) is the most successful example of an external training institute established by BGMEA and donor support. With government providing land and building, BIFT machinery, material, food and board, donor-funded foreign instructors, and guaranteed employment from BGMEA members, BIFT had 100 per cent placement records, moving from donor- to self-financing in the space of a few years.

By 2005, the government shifted its focus from garments to textiles to expand its full package capabilities

174 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

175 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

176 Gereffi, G. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

177 Hearle, C. (2017). Skills, Employment and Productivity in the Garments and Construction Sectors in Bangladesh and elsewhere. Oxford Policy Management. Retrieved from https://assets.publishing.service.gov.uk/media/5977616f40f0b649a7000022/Skills_productivity_and_employment.pdf

after the MFA phase-out and introduced textile technology and engineering courses at all existing technical universities and training centres. It also created the Bangladesh Institute of Textile Technology. Post 2007, the Bangladesh government has once again solicited foreign technical assistance to build capacity of public training centres in the form of multi-sector initiatives comprising a consortium of foreign buyers, local garments manufacturers and government support (Benefits for Business and Workers Programme 2011-2013).[178]

In Sri Lanka, a comprehensive training manual (*Competence and Beyond*) allowed educational and training providers to streamline their course offerings with current and future industry needs. This manual was the joint outcome of a government-garments sector association (the Joint Apparel Associations Forum or JAAF), and it allowed the sector to systematically identify current and future skills gaps by creating national "certifications for product and process upgrading". Weaknesses and appropriate means of addressing them were based on the standardized set of skills, standards and knowledge embodied at each job level. This was done mostly by collaborating with foreign technical (e.g. in marketing with Chartered Institute of Marketing) or educational institutions such as University of Leeds and of Manchester (in textile, clothing and clothing technology). Graduates with technical, marketing and leadership degrees were produced, while skill upgradation was done using extension diplomas. Most importantly, a North Carolina State University (NCSU) College of Textiles agreement with the two national vocational institutes brought Sri Lanka's workforce up to international qualities of supply chain development and industrial engineering.

Growing gap: Middle management

A skilled level of middle management is essential for all three types of upgrading— guiding firms to make more complex products, developing more productive and efficient manufacturing techniques, and for transitioning to higher value functions/services such as designing and branding. Cambodia is an illustrative example, where the apparel industry was invited to participate in a government-created, donor-funded ($3.4 million) Garment Industry Productivity Centre (GIPC) over 2006-2008. Its objective was to develop the skills of supervisors and middle managers in industrial engineering, and secondly, to create a steady supply of local technical trainers/advisors that firms could rely on. In the Cambodian context, the latter was very important, as an initial pool of 5000 Chinese technical workers and supervisors had allowed Cambodia to enter and establish themselves in garments world trade. With Cambodia's exports expanding rapidly, demand for local supervisors rose and the government had to step in.

The Center used local consultants and trainers to implement training based on input from foreign experts who had critically assessed the sector. The benefits were substantial—between a 20-30 per cent increase in production efficiency, The government advertised the results to create more demand for Center trainings to cover operational costs. Empirical analysis suggests that for low technology countries (such as Pakistan and Cambodia), improving management variables can have the same impact on firm-level worker productivity as upgrading technology.[179]

6.2.6 Functional Upgradation

For a long-term perspective to improve design and development capabilities, it is instructive to see how Turkey, Sri Lanka, and India managed to functionally upgrade, and put in the requisite policy framework well ahead of time to help Pakistan functionally upgrade to ODM stage. Turkey and Sri Lanka leveraged their pre-existing ties with key global players to expand into OBM and ODM, respectively, while India's functional upgrading into ODM was driven by a large domestic market. On the whole, these countries were largely successful as they were able to modify their production from low-value to high-value goods from an overall share of 80 to 50 per

178 Ibid.

179 Gereffi, G., Fernandez-Stark, K. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

cent over 2000 to 2008.[180] Along with India, these countries have managed to substantially increase exports of both functional (activewear, technical wear, professional wear) as well as fashionwear. It would be instructive for Pakistan to follow Sri Lanka's example of 2002, where it created a detailed five-year plan to help restructure its industry in response to the ending of quota trade in garments.

Initiatives such as TURQUALITY (Turk Professional Qualifications Authority, 2009) allowed the garments sectors of Turkey to upgrade to the original design stage. TURQUALITY involved provision of branding incentives and support to the manufacturers, particularly fashion designers, ranging from reduction in cost of brand registrations, marketing and PR activities, opening up stores and warehouses to paying the rental costs at fairs and decoration costs of franchise stores.[181]

6.2.7 Attracting FDI: Favorable business climate

Four of the seven regional competitors of Pakistan began as FDI-driven manufacturers of garments. Initial FDI was critical to the success of Sri Lanka, Bangladesh, Vietnam and Cambodia. Cambodia is the regional leader in attracting FDI through its investor-friendly policies, such as the Qualified Investment Program (QIP), which provides a 3-year profit tax exemption along (plus more, based on investment size). In addition to QIP benefits, Special Economic Zones (SEZs) enjoy other advantages as well, such as expedited customs clearance within the SEZ to reduce transport costs and times.[182]

It is worth noting however that joint ventures or foreign-owned enterprises are only successful if backward and forward linkages are encouraged, as in Bangladesh, where FDI was restricted to backward-linkage industries up till 2005. As a result, by the 1980s, the majority of firms in Bangladesh were locally owned, while most are foreign-owned (Hong Kong, China and Taiwan) firms in Cambodia, with little local spillovers.

There are factors that make countries attractive destinations for FDI, other than dedicated policies. For instance, creating an investor-friendly environment would require lowering Pakistan's corporate tax rates from a regional high of 33 per cent to moderate levels such as 25 per cent in China. The corporate income tax rate for Bangladesh has been lowered from 20 to 12 per cent in 2017 per cent, and is much lower in Turkey and Cambodia (20 per cent).[183] This is because the high taxes in Pakistan add considerable profit margins for producers in lower tax countries, increasing their competitiveness vis-à-vis Pakistan.

Other examples of business-friendly policies followed in the region are the rebates to exporting firms in India's SEZs and the 10-year tax holidays for firms in Bangladesh's EPZs. Bangladesh provides extensive support like China, although the latter is driven more by tax breaks and tax preferences for restructuring industrial activity (to lower production costs) and sustainable production technologies.[184]

EPZs and SEZs

Industrial parks are attempts to integrate local value chains, overcome infrastructural deficits, and realize economies of scale, scope, and agglomeration. With construction of Pakistan's 'Quaid-e-Azam Apparel Park' beginning, other countries in the region offer excellent examples of the policies that have maximized the return on such investments.

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180 Gereffi, G., Fernandez-Stark, K. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

181 Tac, N., & Aglargoz, O. (2007). Turquality: An innovative unique model for making global brands out of Turkish products. SEER: Journal for Labour and Social Affairs in Eastern Europe, 10(1), 127-137. Retrieved from http://www.jstor.org/stable/43293204

182 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

183 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

184 Ibid.

EPZs have played an important role in Bangladesh's take-off through FDI-driven production in the Chittagong and Dhaka EPZs created in 1983 and 1993, respectively.[185] The government provided tax holidays and allowed firms to import machinery, equipment, and raw materials at zero customs duty. Textile parks have similarly been used in India to provide common infrastructure, while China has used a host of policies to raise occupancy in its many industrial parks. These include financial compensation for relocating to these parks or industrial zones, government provisions to retire obsolete factories, as well as financial support for building new units in these zones. At the same time, China is providing subsidized credit for constructing textile industrial parks in other countries as part of its "Go Global" strategy of 2000.[186] The latter could be of interest to Pakistan, especially in light of CPEC.

The leading example in the region of cluster development is China, which is currently focusing on creating textile and apparel value chains in Central and Western China to lower production costs and relieve pressure on over-burdened coastal manufacturing cities. Several incentives have been given, ranging from tax to credit to transport subsidies. Policies pertaining to Xinjiang, closest to Pakistan on the CPEC axis, are given below

i. Overall support of $3.2 million per year

ii. Freight subsidy of $ 31.7 per MT of local cotton, if it is used to make any of the 32-yarns that are being supported by China's government in its textile upgrading scheme

iii. Income tax holiday for 2011-2016

iv. Five-year tax exemption from real estate and urban land tax for firms with sales exceeding $3.2 million

6.2.8 Export promotion

All governments assist their exporters of garments, mostly in the form of duty re-imbursement on some of the imported inputs used for exports. However, the rate of rebate varies from 7 per cent (Pakistan) to 100 per cent (Bangladesh, India, and Turkey) to a maximum of 15 per cent for China.

Industry associations have been given considerable power in Bangladesh, with the textile mills association determining which members can use bonded warehouse facilities and how to determine training curricula. Importantly, BGMEA and BKMEA have been given the authority to issue customs certificates by the government—this has made it easier for firms to import raw materials and technology. In contrast, this power lies with the Federal government in Pakistan, and even where regional offices have been created, such as IOCO office in Lahore, there is always need to revert to headquarters for approval.[187] This makes importing cumbersome and time-consuming.[188]

Other export promotion policies followed vary, with some more comprehensive and effective than others. China and Bangladesh lead the group in terms of export promotion initiatives. For instance, China allows

i. Tax rebate of up to 15 per cent on apparel export
ii. No VAT on exports of clothing
iii. Refund of input VAT on material used in apparel export

185 Gereffi, G. and Frederick, S. (2011). Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries. Duke University Center on Globalization, Governance and Competitiveness (Duke CGGC).

186 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

187 Hamid, N. and Nabi, I. (2017). Implementing policies for competitive garments manufacturing. IGC Final Report F-37211-PAK-1

188 Kathuria, S. and Malouche, M., eds. (2016). Strengthening Competitiveness in Bangladesh—Thematic Assessment. A diagnostic trade integration study. World Bank Group: Washington, D.C. Retrieved from http://dx.doi.org/10.1596/978-1-4648-0898-2

iv. Provision of export credit insurance to develop textile clusters
v. Special funds for brand development and marketing

The concluding chapter draws on regional best practices discussed above to suggest a way forward for the garments sector of Pakistan.

CHAPTER 7

Recommendations

There is need to have cohesion and clarity in government's vision, and a strong state capacity to identify, target, administer and manage policy interventions that do not distort incentives or prices, and instead of hand-holding, are able to provide the push that garment sector needs to take-off.

7.1 Capitalizing on CPEC related opportunities

To leverage CPEC, policymakers in Pakistan need to adopt a proactive approach so that garment sector can play to its strengths and derive support from China in weaker areas, instead of waiting for China to dictate the terms of this critical economic relationship. In order to ensure that local industry does not suffer, there is a need to respond to local industry's reservations. The policy measures should both target specific areas to encourage collaboration with Chinese industry as well as general investment climate constraints.

Capitalizing on China's Shifting Trade Patterns

Pakistan's garment exports to the world can significantly increase in the coming years, as a window of opportunity is opening up in the garments sector as China slowly pulls out of the sector. Recent years have highlighted a decreasing trend in China's garment exports, from US$ 173 billion in 2014 to US$ 146 billion in 2017. This is in part due to increased labor costs, which have eroded China's competitiveness in the international market. It has been estimated that the average labor cost of an operational hour in the coastal and inland regions of China had risen by 2010 to US$ 1.88 and US$ 1.44 respectively, which was thrice the cost in Vietnam and Pakistan, twice that of India and six times that of Bangladesh.[189] Pakistan, if positioned strategically, can capitalize on China's exit, and expand market share and exports.

Using CPEC for technology up-gradation

Pakistan can use CPEC to leapfrog and climb the technology ladder in RMG sector. This could happen through joint ventures with Chinese companies that utilize Chinese expertise in RMG and Pakistan's low cost labour; outward investment by Pakistanis in China to acquire intellectual and technology resources (similar to what China itself did in the auto sector); technology partnerships with Pakistani firms in which Chinese firms provide the gaps required to access the foreign markets that China has traditional access to but is now moving out of due to rising labour costs. But Pakistan needs a few success stories to catalyse this shift. If a few large Chinese garment exporters successfully set up manufacturing facilities in SEZs in Pakistan, it will change the perception of Chinese businesses about Pakistan. Consequently, other garment manufacturers, presently relocating to Southeast Asian countries such as Vietnam, Cambodia, Myanmar, etc., will consider Pakistan as

189 Nabi et al. (2013)

a viable option as well. Once this process initiates, it will result in spill overs to other parts of the textiles sector, leading to growth in Chinese investment, especially in areas which have substantial demand, such as synthetic fibres, or where Pakistan is already a major player, such as denim garments and home textiles.[190] For Chinese industry that locates here, incentives should be offered that encourage them to hire local labour and engage local firms in their value chains.

Better terms in renegotiations of Pak-China FTA

For the Pak-China FTA to play a significant role in enhancing garments trade, the concessions offered to Pakistan by China should at least be at par with those offered to ASEAN countries. Moreover, these concessions need to be more relevant for Pakistan, both in terms of the coverage and variety of products traded. There is a need to renegotiate better access with China, especially for products that are common in export basket of Pakistan and import basket of China. These include stockings, socks and other hosiery (HS 611595); t-shirts, singlets and other vests (HS 610910); knitted/crocheted men's or boys shirts (HS 610510); women's trousers, bib and brace (HS 620462); and men's trousers, bib and brace overalls (HS 620342)– three of which are currently not given any preferential tariffs under the FTA. Since these categories comprise 20.8% of China's garment imports, improved tariffs would give Pakistan an opportunity to significantly increase their exports to China.

7.2 Lower Production Costs and Better Access to Raw Materials

To be able to avail this opportunity, however, Pakistan needs to stay competitive in terms of production costs and availability of labor and energy.[191] The degree of ease of importing inputs, such as man-made fibers and exporting garments also needs to be enhanced. Improved efficiency along the value chain, such as integration between textile and apparel, and improvement in social and environmental compliance by introducing better human resource practices will also help attract manufacturers.[192]

Central bonded warehouse facilities

Pakistan may consider establishing central bonded warehouse facilities. These can be used to store duty-free imported raw materials such as man-made fibres, yarn and fabric, accessories, dyes and chemicals, along with RMG and textile machinery and spare parts as per forecasted demand. Exporters can then purchase these inputs from the warehouse duty-free according to their export orders. This would reduce lead times to markets by ensuring a readily available and competitively priced supply of inputs. The model was successfully tested in Bangladesh where they helped in product diversification and timely exports by significantly shortening the order cycle times of firms to sample, prototype and roll-out orders as all inputs were already available in the warehouse facility. Additionally, it lowered the inventory management risk of individual manufacturers (drop in demand would not affect firms as they did not need to maintain large inventory stocks), as well as the input price volatility manufacturers faced in import markets due to global downturns, shortages, or exchange rate fluctuations.

Improved access to raw materials

Pakistan needs to import man-made fibers at competitive prices in short times, to be able to diversify its exports or destination markets. Currently Pakistan imports knitted fabric (mostly synthetic) from China, even though it could get cheaper synthetic fibers and fabric from India. However, since it falls on India's Negative List for Pakistan (items on the list cannot be traded with Pakistan), Pakistan cannot import from India. This is costly

190 Hamid & Nabi (2013)

191 Hamid & Nabi (2013)

192 Lopez-Acevedo and Robertson (2016)

not only since India is a large producer of synthetic knitted fabric and distance adds to cost of importing from China vis-à-vis India, but more so due to the new Rules of Origin for its Generalized System of Preferences scheme (2011).[193] A product from Pakistan qualifies for duty-free access to the EU market only if raw materials are sourced from Group III countries that Pakistan belongs to. Cumulation therefore means that Pakistan can only import such raw materials from India, Bangladesh, Sri Lanka, Bhutan, and Nepal in accordance with GSP Plus rules. By importing knitted fabric from China, Pakistan cannot avail GSP Plus duty-free access to EU markets for its knitted RMG. Similarly, apart from nylon filament yarn, all other MMF categories are on the No Concession List in the Pak-China FTA. While SAFTA has been a no-starter due to political tensions between India and Pakistan, it has also not availed preferential market access to Iran, Malaysia or Sri Lanka. Therefore, in the short-term, Pakistan must negotiate for removal of synthetic knitted fibres (and other key RMG inputs in which India is a global supplier) from India's Negative List for Pakistan, explore other markets like Sri Lanka for the same, and expand the knitted supply chain through targeted investment, FDI and joint ventures—especially Chinese, due to their experience in this field.

In the meanwhile, government should consider reducing customs duty on import of PSF. While duty on import of acrylic, viscose and nylon is zero, 7% customs duty is applied to PSF, which is a much more commonly used man-made fibre. Similarly, exporters are paying 11 percent customs duty, as well as 5 percent regulatory duty, on the import of filament yarn.[194] To bring about a change in the fibre mix which can lead to increased exports and diversification, it is important to reduce duty on polyester fibre and filaments.

Better power tariffs

To improve the cost effectiveness of Pakistan's garments in the international market, government must remove extra taxes on utilities to ensure a uniform power tariff rate that is not significantly higher than regional competitors. Another strategy is for government to promote energy efficiency through investment incentives or tax credits. Moreover, to support firms in re-structuring their existing energy system, support could also be earmarked under the Technology Upgrading Fund 2016-2019. Tax breaks can also be offered for restructuring industrial activity to lower production costs.

7.3 Right Product Mix and Diversification

Besides expanding exports to China in light of trade complementarities, Pakistan needs to focus on the right product mix and destinations to increase over-all exports to the world. Chapter 3 showed that Pakistan's exports have low adaptability to world demand, in contrast to Bangladesh and Vietnam, which have been particularly good at adapting to and taking advantage of global opportunities. Categorizing the top 20 products in Pakistan's current export basket across both sectors as champions (winners in growing international markets), and underachievers (potential winners that are currently losing in growing world markets) allows firms to identify easy export gains and the strategies needed to capture them. Correctly determining the product mix would enable firms to send more exports to growing markets, while simultaneously providing them with the revenue cushion needed to strategize for diversification. This is consistent with Bangladesh, which has followed a policy of producing value-for-money garments in large quantities to allow its exporters to earn the margins necessary to undertake the next step of value-addition and diversification.

Firms should focus on champions in the short term, i.e. products for which Pakistan's world export share has risen over the last five years. Appropriate policies can be devised within the year to further consolidate Pakistan's export shares. A more nuanced and medium-term approach must be taken for underachievers in

193 Hamid & Nabi (2013)

194 SBP (2018). *Special Section 2: Synthetic Textiles is Key to Sustaining Export Growth Momentum. State of Pakistan's Economy–Third Quarterly Report 2017-18.*

growing global markets. These products are extremely critical in helping wean Pakistan off its reliance on a few products and are the winners of tomorrow. The approach would have to be product specific, through an appropriate mix of industrial, trade and regulatory policies to comprehensively resolve issues that are weakening Pakistan's capacity to currently supply these products to growing global markets.

Across the top 20 exports in each of the knitwear and woven apparel sectors, roughly a third (14 out of 40) of products were destined for declining or stagnant world markets over 2013-17. This means that over the last five years, two-thirds of Pakistan's top exported product lines were moving in the opposite direction to world demand. This finding helps explain why Pakistan has not been able to meaningfully increase its relative world market share over the last five years.

Champions

Across both segments, there are a total of 10 products with increasing world export shares in growing sectors (worth $1.9 billion of exports in 2017). These products present easy wins for firms as their importance in global trade has been high in the last five-year period.
These are

i. HS 610339 (men's or boy's jackets and blazers, non-cotton)
ii. HS 610469 (women's or girl's trouser or shorts, non-cotton)
iii. HS 610990 (T-shirts, singlets and vests, non-cotton)
iv. HS 620322 (men's or boy's ensembles of cotton)
v. HS 620339 (men's or boy's jackets and blazers of textile material)
vi. HS620329 (men's or boy's ensembles of textile material)
vii. HS 620333 (men's or boy's jackets and blazers of synthetic materials)
viii. HS 620422 (women's or girl's ensembles of cotton)
ix. HS 620193 (men's or boy's anoraks, windcheaters, wind jackets of man-made fibres)

Except for two, these products cater to menswear, whereas world demand has risen faster for womenswear. A closer look (Annexure I) reveals that most of these products are based on synthetic, man-made or textile materials.

For example, in knitwear, Pakistan is already the world leading exporter (in terms of world export share) for men's non-cotton/non-synthetic trousers and shorts as well as jackets and blazers. Moreover, non-cotton trousers and shorts (HS 610469) has been the fastest growing knitwear product over 2013-17, indicating the tremendous opportunity available to Pakistan in this product. Pakistan has seen falling export prices in UAE and USA, so perhaps a different strategy is required that could improve quality, design, comfort and fabric performance. The U.A.E is the leading world importer, where Pakistan faces an ad valorem equivalent (AVE) tariff of 5 per cent, with an average unit price of $4.60/trouser, compared to India (its top export partner) which has an average unit value of $6.02 facing the same AVE tariffs.

Similarly, Pakistan's top woven RMG export, men's or boy's ensembles of cotton (HS 620322), is another champion product. Globally, Pakistan ranked 1st (in terms of value) in 2017, with exports of $1.3 billion. In terms of policy, Pakistan should broadly focus on easing supply-side constraints at the domestic level to consolidate its global export status as there is ample demand for these products.

Underachievers

Critically for Pakistan, it has lost world export share in 10 globally growing product markets, representing underachieving products. These products offer firms a clear path for capturing value based on world demand patterns over the last five years. These are the potential "winners" that firms can focus on to generate revenues,

as they are already exporting these products. The five most important product categories where Pakistan's export share has decreased despite high international demand are

i. HS 610342: men's or boy's trousers and shorts, cotton
ii. HS 610590: men's/boy's shirts (excluding of cotton or man-made fibres, nightshirts, T-shirts)
iii. HS 620342: men's or boy's cotton trousers and shorts
iv. HS 620349: men's or boy's trousers and shorts (of textile materials)
v. HS 620469: women's or girl's trousers and shorts (of textile materials)

These five products are potential winners that firms must focus on as they are either the largest traded category in apparel (HS 620342 men's or boy's trousers, breeches and shorts of cotton), or the fastest growing that Pakistan currently exports to (HS 620469 women's or girl's non-cotton trousers, breeches and shorts of textile material). The others are significant as they rank highly on Pakistan's export basket.

Losing export shares in growing global markets indicates opportunities availed by Pakistan's RMG competitors and a need to change the existing product mix. The most notable lost opportunity in woven exports is of HS 620469 (women's or girl's non-cotton trousers, breeches and shorts of textile material), the fastest growing world market that Pakistan currently produces for. While global imports grew by 9 per cent on average every year, Pakistan's world export share in it has contracted each year by 22 per cent on average to stand at $31.7 million in 2017 (21st global export rank). Currently, Pakistan's world export share is less than 1 per cent (0.9 per cent).

Men's or boy's trousers, breeches and shorts of cotton (HS 620342) had the highest world demand of $26.2 billion in 2017. Pakistan has lost world export share in this important market at an average rate of 11 per cent over 2013-2017, at a time when Bangladesh exports grew by 4 per cent per annum. Despite being the 2nd ranked export for Pakistan in woven RMG and having favourable global demand, Pakistan is currently ranked 15th in the world. Bangladesh and China are the leading exporters in this category, with roughly equal world export shares of 20.5 per cent, whereas Pakistan's share was 1.5 per cent in 2017. Similarly, world demand for HS 620349 (men's or boy's trousers and shorts of textile materials) grew by 7 per cent on average every year over 2013-17, while Pakistan's exports remained stagnant over 2013-17. India and Egypt were the largest exporters (19.3 and 11.3 per cent respectively), followed by Pakistan (8 per cent world export share).

The most important product in the underachieving category for knitwear is HS 610590 (non-cotton men's or boy's shirts), with exports of $310.7 million in 2017. Although, it is the leading world exporter in this category, it has been losing world export share at an average annual rate of 1 per cent over the last 5 years, at a time when the world market demand was growing at 7 per cent. Similarly, the export share of HS 610342 (men's or boy's trousers and shorts, cotton) fell by 12.5 per cent per annum over 2013-17 while world imports were growing by 12 per cent per annum. Pakistan was ranked 17th in the world in 2017.

It is noteworthy that world import demand has fallen sharply for cotton knitted menswear, particularly, shirts along with blazers and jackets (HS 610510 and HS 610332). Consistently high global import demand since 2013 for non-cotton knitted garments suggests that Pakistan must diversify its mix of cotton to blended material immediately.

New export products

To identify new export products which Pakistan could export, knitwear exports with consistently high import demand (at the HS 6-digit level) were analysed. World imports of men's and women's trousers and shorts of synthetic and man-made fibres (HS 610343 and 610463) have grown at rates exceeding 8 per cent per annum over 2013-17. At the same time, Pakistan could also consider the multi-billion dollar growing international market of technical wear, such as 611430 (specialised garments for professional, sports or other purposes, n.e.s. of man-made fibre), which grew at 7 per cent per annum over 2013-2017.

However, to enter these new product categories requires arranging a competitive and reliable source of synthetic materials and man-made fibres, which mostly originate from China, Taiwan and Korea. Pakistan would also benefit from trade normalization with India, as it has considerable world market share in some varieties of yarn, fibre and fabric that Pakistan cannot feasibly produce domestically.[195] Currently such items are on the India Negative List (cannot be traded) and Pakistan must negotiate for their removal as soon as possible. Not only would these be cheaper due to proximity, but it would also make exports to the EU more competitive as per Rules of Origin of the GSP Plus scheme. This could also allow it to enter the dynamic markets for women's synthetic suits (HS 610413) as well as coats and anoraks (HS 610230) which have grown at 11 and 7 per cent, respectively.

Demand has consistently been high over 2013-17 for woven products (in the range of 7 to 17 per cent per annum) such as HS 620444 (women's or girl's dresses of artificial fibres) and HS 620640 (women's or girl's shirts, blouses, and shirt-blouses of man-made fibres). As Pakistan does export products at the HS 4-digit level of these identified items, Pakistan has some revealed comparative advantage in export of similar goods. The next logical step should be arranging the inputs and developing the expertise and machinery to move up this product's value chain.

With respect to HS 620444 and HS 620640, namely ladies (artificial fibre) dresses and blouses (of man-made fibre), Pakistan already exports significant amounts of several HS 6204 sub-chapters. These include trousers, shorts, suits, ensembles, blazers and jackets made of cotton and textile materials. The market for shirts and blouses of man-made fibres and also for dresses of artificial fibres are quite substantial ($8.7 and $2.5 billion, respectively in 2017). Similarly, woven tracksuits for men and women of textile and man-made materials (HS 621134 and HS 621143, respectively, which have grown at roughly 8.5 per cent per annum over 2013-17) could also be produced as firms are already exporting tracksuits made from cotton, nes. Acquiring the necessary inputs of artificial and man-made fibres, reshuffling resources across products, and upgrading skills of labour may be quite doable in the next 2 years to allow Pakistan to start exporting.

This requires an immediate expansion of domestic supply chain through removal of bottlenecks, in both backward and forward linkages, connecting with key global Original Brand Manufacturers (OBMs) through joint ventures or technology acquisition, and a critical review of pricing and positioning strategies of successful competing suppliers.

OBMs can only be attracted if the investment and business climates improve. Low interest rates and tax breaks are insufficient to attract OBMs as factor costs, lead time and compliance are key sourcing criteria. Policies will have an important role to play in this regard. The cost of doing business must be lowered by creating autonomous and one-stop accreditation and awarding bodies for standards; rationalizing the internal tax structure of general sales tax, income tax, corporate tax, super tax, and withholding tax. At the same times, to reduce lead times, delays resulting from poorly connected supply chains, trading across borders, and cost/time to export and import must be reduced.

Regulatory support to improve productivity through PRGTTI co-funded skills training. Raising labour productivity is equivalent to lowering factor costs and has been the reason for China's continued dominance in apparel exports. China is still the cheapest sourcing destination, despite phenomenal increases in wages due to its high labour productivity and well-integrated supply chains.

Finally, lead firms such as H&M, Zara, Tesco, Walmart, Asda, and Uniqlo must be invited to Pakistan through government and PRGMEA joint efforts. Industry stakeholders posit that Pakistan's commercial attachés at diplomatic missions abroad perform very poorly in comparison to India, Bangladesh or Sri Lanka. The

195 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf

government must sponsor leading exporters to participate in yearly trading fairs where latest technologies are on display. At the same time, there is a need to aggressively promote a progressive image of Pakistan as a profitable market for doing business.

7.4 Industrial Policy Measures Targeting Key Impediments

Pakistan needs appropriate and targeted industrial policy measures to support garment sector. Since Pakistan's industry comprises a large share of SMEs, it can follow India's example, where government is pitching its SME garments sector globally as a flexible way for big clients to cost-effectively produce small, customizable lots. Similarly, medium sized firms could take advantage of improvement in ICT to hold stocks in Pakistan for clients to lower their inventory costs. This requires providing support to SMEs so that they may offset their scale disadvantage through access to a reliable supply of inputs and competitive credit. Government should provide assistance in acquiring internationally recognized quality and safety certifications to increase SMEs export-readiness.

Demand-based skills training

In order to improve value added exports, Pakistan must focus on increasing labour productivity, reducing production costs and increasing productivity. Most countries in the region have achieved this through a combination of investment in better machines, worker skills along with IT and logistics. Pakistan's garments industry needs to take the lead in providing demand-based training, not just at the entry level, but also for upgrading skills of existing workers. With many firms highlighting the significant absence of skilled middle management, the government could create a common training center for middle managers, while more technical skills could be offered on factory premises, on an appropriate cost-sharing basis. In this area Pakistan can learn from Vietnam, Bangladesh and Sri Lanka. The ILO-funded Better Work program in Vietnam had significant impacts on firm profit margins, with revenue-to-cost ratios rising by 25 per cent in four years. Bangladesh undertook private sector-assisted skills development by lead buyers and industry associations especially in foreign owned firms, which were then emulated by local firms to provide on-the-job trainings. Another successful example in Bangladesh is BGMEA Institute of Fashion and Technology (BIFT) where with government providing land and building, BIFT machinery, material, food and board, donor-funded foreign instructors, and guaranteed employment from garment associations, BIFT had 100 per cent placement records, moving from donor- to self-financing in a span of a few years. In Sri Lanka, through collaboration between government-garments sector association (Joint Apparel Associations Forum), a training manual (Competence and Beyond) was created to streamline training courses to industry need. In collaboration with foreign technical and institutions, current and future skills gaps were identified by creating national "certifications for product and process upgrading" and extension diplomas offered to impart those skills.

Technology Upgradation Fund & Other Incentives

For technology up-gradation, schemes such as the Technology Upgradation Fund included in both Textile Policies have not been effective, as they do not reduce the risks associated with technology adoption. In India and Bangladesh, to allay risks about technology, not only are imports of textile machinery allowed at reduced rates but so are the raw materials and parts needed to manufacture these machines domestically. In India, the government co-funds research contracted by the garments sector in India, while Vietnam provides grants for sustainable production, new materials, as well as innovation. Turkey provides tax exemptions on salaries of R&D personnel and on revenues associated with R&D in Technology Development Zones. China has the most comprehensive schemes, ranging from technology development funds, short-term capital provision to grants and income tax rebates of up to 50 per cent for select qualifying R&D expenses.

Other proposed measures may include incentives for quality certifications, branding and marketing to ease firms' transition into original design and brand manufacturing. To incentivize firms to upgrade their inputs, matching grants schemes or challenge funds can also be used. Turkey's TURQUALITY program allowed the garments sector to upgrade to the original design and brand stages through branding incentives and support to the manufacturers, particularly fashion designers, ranging from reduction in cost of brand registrations, marketing and PR activities, opening up stores and warehouses to paying the rental costs at fairs and decoration costs of franchise stores. In addition, product development and innovation centres can also prove helpful.

7.5 Improving Access to Finance

Back-to-back L/Cs

In order to improve access to credit, government may consider introducing back-to-back L/Cs. Through such L/Cs firms can use lead firm export orders in foreign banks (master L/Cs) to open L/Cs with domestic banks. This credit is used to import intermediate inputs without having to pay directly, as the payments and interest are deducted from export proceeds once they are realized. In addition to helping larger firms, this will also release working capital for smaller and medium-sized exporters so that they can respond to opportunities in world markets. Other measures for credit support may include credit assistance through corporate loan guarantees and export credit insurance used in China, export project performance security and investment credit guarantees as implemented in Vietnam, or offering export credit, low interest rates and smallest L/C commission for export credit, as done in Bangladesh.

Interest on pending refunds

To resolve the problem of delays in refunds under drawback schemes, firms should be paid interest on pending refunds that have exceeded the permissible time limit (as in Singapore and UK) or to allow firms to adjust delayed refunds against other (current) tax liabilities. The latter would mean instead of government making any payments, it would be offsetting them. Trade policy support should also be given in the form of exemptions, rather than refunds.

7.6 Trade and Customs Facilitation

There is a need to make custom procedures more business friendly by improving their efficiency and effectiveness. Custom procedures should be simplified to expedite clearance processes and avoid costly delays, and presence of custom officials in 24/7 customs clearance service monitored, to ensure potential benefits of the service materialize. Modernization and automation in custom procedures can also help mitigate corruption, reducing incentive for illegal trade. Web Based One Customs (WeBOC) has provided exporters an online facility for customs clearance, however glitches need to be worked out to prevent frequent shut downs and clearing agents and custom officials need to be trained to handle the system. Additionally, IOCO set up in Lahore should be provided adequate manpower and jurisdiction so that they do not have to refer to Karachi office for approvals required to import fabric and yarn under DTRE, as this increases lead-times.

Pakistan may also consider enhancing role of industry associations. Industry associations have been given considerable power in Bangladesh. For instance, the textile mills association determines which members can use bonded warehouse facilities and how to determine training curricula. Industry Associations for garments in Bangladesh have also been given the authority to issue customs certificates by the government—this has made it easier for firms to import raw materials and technology.

Annexure I

Exports: Identifying Winners

This section attempts to identify RMG products (at the HS 6-digit level) in Pakistan's export basket that it should focus on in the short, medium and long-term. This is done by comparing—over the last five years (2013-2017)— how fast international demand has grown for a product and whether Pakistan has participated actively in world markets (through exports) to meet that rising demand. Global demand for a product is measured by the average annual nominal growth rate of world imports over the last five years. If five-yearly average world imports of that product have grown faster than overall world imports, demand for that product is rising. At the second step, Pakistan's RMG sector performance is compared to world demand for that product—this captures dynamism of Pakistan RMG products in globally growing product markets. This dynamism is approximated using the average annual five-yearly (nominal) growth rate of Pakistan's world export share in that product. Pakistan has gained world export share in a product if Pakistan's exports have on average grown faster every year than the world import growth rate of that same product for the last five years.

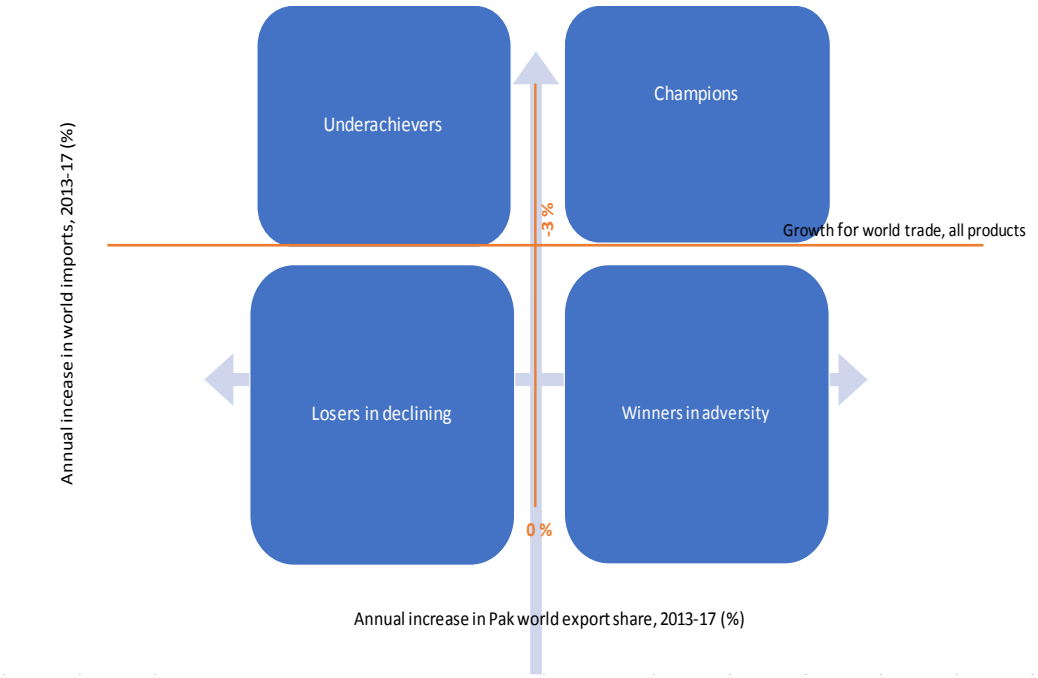
The selection parameters can therefore be summarised as follows. The first is categorising knit and woven RMG products from the top 20 exports of Pakistan according to whether its world imports have grown faster than the total world import growth rate. For 2013-2017, world imports grew at -3 per cent per annum on average: RMG products with average annual growth rates exceeding -3 per cent are categorized as "growing" and "declining" otherwise. At the second cut-off, products are categorised by whether Pakistan's world export shares of those products have increased or decreased over 2013-17. Products are thus classified as "winners" or "losers" in global exports. This provides a comprehensive and dynamic picture of export performance of the RMG sector in terms of the most recent trade data available. The two-way positioning of exports yields four broad categories of export performance, much in line with the Boston Matrix model, i.e. the growth-share model for a firm. In this case the matrix applies to world trade in products. With reference to performance over the last five years (2013-17), products can be classified as:

- Champions: winners in growing international markets, exports of these products increased at rates faster than both world trade in all products as well as world market growth in that particular product—Pakistan increased its export share in the world.

- Achievers in adversity: winning products in declining global markets, where exports have grown despite international demand that is growing below the five-year world average. Export shares have increased in products whose market share is declining globally

- Underachievers: losers in growing international markets, they have underperformed with respect to world trade, growing slower than both general and product-specific trade, with Pakistan world export shares falling.

- Losers: Losers in declining markets, export shares have decreased in dwindling global markets.



To summarise, this allows us to hone our analysis by making export performance of Pakistan RMG exports contingent on two parameters: world import demand and Pakistan world export shares. While it was also possible to have selected the top 20 fastest growing world RMG imports over 2013-17 and analysed Pakistan's performance, a proper assessment is only possible by cross-referencing with Pakistan's export shares. Otherwise products could be selected that Pakistan does not have any comparative advantage in. Instead, this gives RMG players a more practical roadmap that allows industry to identify champions, underachievers, and niche markets to determine appropriate action plans.

The analysis proceeds as follows:

i. To identify the products Pakistan should focus on in the short term, we identify champions within the growing segment of the world market for each sector, i.e. for which Pakistan's world export share has risen over the last five years. Appropriate policies can be devised within the year to further consolidate Pakistan's export shares.

ii. At the same time, a short- to medium-term approach must be taken for achievers in adversity, i.e., for products that belong to markets with declining world demand but where Pakistan has managed to increase its world export share over 2013-2017. Appropriate niche marketing strategies are required to increase global demand for such products.

iii. On the other hand, it would be best to slowly withdraw support of losers in declining world markets. As these products have not grown in a dynamic sense either in world trade or world product markets, offering a sunset provision (cutting off support in the next two years) for example could push firms to restructure, diversify and cut their losses. This approach could offset the allocative inefficiencies due to misuse of scarce resources, rent-seeking or lobbying, and transition of labour from one product market to another.

iv. A more nuanced and long-term approach must be taken for underachievers in growing global markets. These products are extremely critical in helping Pakistan wean its reliance on a few products. The approach would have to be product specific, through an appropriate mix of industrial, trade and regulatory policies to comprehensively resolve issues that are weakening Pakistan's capacity to supply these products to growing global markets.

Knitted garments: HS 61

As per the first cut-off indicating growing versus declining sectors, four of the top 20 HS 61 6-digit categories of Pakistan fall in the declining sector, while two are stagnant. At the second cut-off, there are three champion products with increasing world export shares in growing sectors. These are

x. 610339 (men's or boy's jackets and blazers, non-cotton)
xi. 610469 (women's or girl's trouser or shorts, non-cotton)
xii. 610990 (T-shirts, singlets and vests, non-cotton).

These products could present easy wins for Pakistan as their importance in global trade has been high in the last five-year period. These products have contributed to export revenues as Pakistan has increased its world export shares of the same over the last five years. In terms of policy, Pakistan should focus on easing supply-side constraints at the domestic level to consolidate its global export status as there is ample demand for these products. These products represent easy solutions for increasing export revenues, as Pakistan has a significant export presence already—indeed it is ranked as the leading exporter (in terms of export share) for men's/boy's jackets and blazers (non-cotton), 9th in women/girl's trousers and shorts, and 27th in the exports of T-shirt (non-cotton). To improve its world export rankings, Pakistan requires an immediate expansion of domestic supply chain through removal of bottlenecks, in both backward and forward linkages, connecting with key global Original Brand Manufacturers (OBMs) through joint ventures or technology acquisition, and a critical review of pricing and positioning strategies of successful competing suppliers. Trade policy could provide support through lowering tariffs on imported raw materials (to 0 per cent on goods not produced competitively in the local market), intermediate goods and machinery; by improving Pakistan's market access through better negotiation, follow-up, and implementation of existing free trade agreements in key RMG and associated tariff lines (especially synthetic fibres, chemicals and dyes); improved export credit through double-backed LCs and so on (See section on Trade Policy). Regulatory support could be in the form of strengthening PRGMEA and PRGTTI through co-funding key initiatives such as export fairs, aggressive branding of Pakistan and skills training. At the same time the cost of doing business must be lowered by creating autonomous and one-stop accreditation and awarding bodies for standards; rationalizing the internal tax structure of general sales tax, income tax, corporate tax, super tax, and withholding tax; and proper exchange rate management.

For products in which Pakistan has export winners in adversity, i.e. markets with declining import growth, such as HS 610439 (women's or girl's non-cotton, non-MMF blazers and jackets) and HS 611090 (non-cotton, non-MMF jerseys, cardigans, pullovers, and waistcoats), Pakistan needs to adopt niche marketing strategies. These products cannot be ignored as their export shares have been growing at an average annual rate of 31.1 and 26.7 per cent respectively since 2013. To promote these products, a short to medium-term horizon is required for marketing (increasing attractiveness of these products) i.e. to revive world demand through innovations in design, functionality and quality. As "green" technologies become the norm, Pakistan could use this to signal commitment to sustainable production techniques.

At the same time, there are 2 products for which Pakistan is currently doing well, but that have exhibited stagnant world demand over the last five years. Such products require a medium-term focus from Pakistan as their global share in world trade has not changed much over time. The most important product for Pakistan exhibiting stagnant world demand is women's or girl's blouses and shirts (non-cotton, non-MMF), HS 610690, with Pakistan ranked 1st in terms of world export shares and having exports of $71.7 million in 2017. The other product, 611020 or cotton jerseys, pullovers, cardigans, and waistcoats with exports of $37 million in 2017 could also benefit from trade promotion efforts to create demand in new markets.

The long-term focus however must be on the underachievers, i.e. the 5 HS categories where exports are growing at less than international demand (on average) over 2013-2017. These knitted garments belong to the following categories:

vi. 610349 (men's or boy's trousers and shorts, non-cotton)
vii. 610590 (men's/boy's non-cotton shirts)
viii. 610342 (men's or boy's trousers and shorts, cotton)
ix. 610462 (women's/girl's cotton trousers and shorts)
x. 610910 (cotton T-shirts, singlets and vests)

The most important product in the underachieving category for Pakistan is HS 610590 (non-cotton men's or boy's shirts), with exports of $310.7 million in 2017. It has been losing world export share at an average annual rate of 4.5 per cent over the last 5 years, at a time when the world market demand was growing at 11 per cent. Similarly, the export share of 610349 (men's or boy's trousers and shorts, non-cotton) fell by 1.64 per cent per annum over 2013-17 while world imports were growing by 22 per cent per annum. This a cause of serious concern, as Pakistan is clearly facing supply bottlenecks which must be resolved in order for Pakistan to be a part of the growing RMG sectors. Consistently high import demand since 2013 for non-cotton knitted garments suggests that Pakistan diversify its cotton to blended material mix immediately.

The analysis reveals that overall, global demand for knitted non-cotton RMG has consistently increased over the last five years and Pakistan is facing problems due to relying on a cotton-heavy mix in knitted RMG. This becomes clear when observing that two of Pakistan's sizeable export categories have on average lost world export shares over the past five years in cotton knit segments, global demand for which has fallen on average by roughly 7 per cent since 2013, i.e. HS 610510 and 610332 (men's or boy's cotton knit shirts and men's/boy's cotton knit blazers and jackets).

TABLE 3: Dynamic performance of Pakistan's exports, HS 61 (2013-2017)

Knitted category	Product	Value exported in 2017 ($000)	Annual growth in value between 2013-2017 (%, p.a.)	Annual growth of world imports between 2013-2017 (%, p.a.)	Share in world exports (%)	Rank	World market	Pak exports
'610590	Men's or boys' shirts of textile materials, (excluding of cotton or man-made)	310704	6	11	45.5	1	Growing	Underachiever
'610910	T-shirts, singlets and other vests of cotton	197757	-1	0	0.7	27	Growing	Underachiever
'611090	Jerseys, pullovers, cardigans, waistcoats and similar articles, of textile materials	195778	22	-7	13.4	2	Declining	Winner in adversity
'610349	Men's or boys' trousers, bib and brace overalls, breeches and shorts of textile materials	175670	20	22	28.2	1	Growing	Underachiever
'610510	Men's or boys' shirts of cotton (excluding nightshirts, T-shirts, singlets).	168344	-11	-4	3	11	Declining	Loser
'610339	Men's or boys' jackets and blazers of textile materials (excluding of wool, fine animal hair, cotton)	146525	6	4	47.7	1	Growing	Champion
'610990	T-shirts, singlets and other vests of textile materials (excluding cotton)	106416	13	3	0.7	27	Growing	Champion
'610690	Women's or girls' blouses, shirts and shirt-blouses of textile materials	71688	17	-3	15.1	1	Stagnant	Niche
610469	Women's or girls' trousers, bib and brace overalls, breeches and shorts of textile materials (not cotton)	59012	12	6	4.1	9	Growing	Champion
'610342	Men's or boys' trousers, bib and brace overalls, breeches and shorts of cotton	47036	-2	12	1.1	17	Growing	Underachiever
'610439	Women's or girls' jackets and blazers of textile materials, (excluding cotton)	39666	9	-14	8.3	2	Declining	Winner in adversity
'610332	Men's or boys' jackets and blazers of cotton, (excluding wind-jackets etc).	33773	-14	-10	1.8	4	Declining	Loser
'610462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton	32150	-10	-1	0.4	21	Declining	Underachiever
611020	Jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton	37589	-1	-3	0.2	35	Stagnant	Niche

Source: Data sourced from ITC TradeMap

Market expansion and diversification

For the 5 products (identified above) in which Pakistan is underachieving in terms of losing world export shares, i.e. HS codes 610590, 610349, 610462, 610342, and 610910, prospects for market expansion and diversification are explored. Two approaches are taken. The first is to identify opportunities to expand trade with Pakistan's existing import partners. This offers short-term expansion opportunities to aggressively consolidate export shares for established trade partners. Firms could take advantage—within 6-9 months— of existing textile export incentives offered by the government in December 2017 (which were extended in May 2018 till 2020) to grow their exports to such markets. This would be feasible since a trade relationship already exists with prior knowledge of consumer preferences, tariff, non-tariff barriers, internal duties, binding regulations pertaining to environment, labour and so on. To do this, for each product the top three import markets are selected based on their average annual world import growth over the last five years as compared to Pakistan's export share for that partner in 2017. These reflect existing markets for which Pakistan's export growth has been slower than the partner's import growth from the world.

The second is a more medium-term approach— spanning 1 to 2 years— and involves scoping out markets that are leading world importers in a HS 6-digit category that Pakistan exports are losing world share in, despite high global demand. To make up for lost world export shares over 2013-17, Pakistan could diversify its export market to include such countries. This requires an examination of competing suppliers that currently supply to that country to better understand export prospects. Results from expansion and diversification analyses are presented below.

i. HS 610590, men's/boy's shirts of textile material (non-cotton, non-MMF):

Pakistan is the leading world exporter with an export share of 45.5 per cent, mostly destined for the EU market. To assess opportunities for expanding existing trade with partners, Pakistan could look to export more to the UK, since UK world imports of the same increased by 6 per cent. Demand (proxied by per annum average world import growth over 2013-17) grew even faster in Denmark (46 per cent), Australia (22 per cent), Ireland (17), Netherlands (13 per cent) and Sweden (11 per cent). Except for Australia which levies an *ad valorem* equivalent (AVE) tariff of 5 per cent for Pakistan, Pakistan enjoys duty-free market access. From a price perspective, Sweden offers better opportunities: while the world average unit value in 2017 for HS 610590 is $4.27 per shirt for Pakistan, it could get higher values in Sweden ($5.23/shirt). Bangladesh is the main competitor in Sweden and also enjoys zero duty. Pakistan is the 6th ranked import partner for Sweden,

To increase world export shares through market diversification, Pakistan must simultaneously address internal constraints to improve flexibility and quality of production and secondly, diversify its market to include non-traditional partners such as Malaysia, Saudi Arabia, and Hong Kong which are the 2nd, 3rd, and 6th largest importers in the world (top importers that Pakistan already trades with are excluded from the analysis). Currently, Pakistan is the 19th largest exporter to Malaysia. Although it faces an average estimated tariff of 0 per cent like its other supply competitors, it is well behind (ranked 24th) the top six of China, Thailand, Vietnam, India, Indonesia and Bangladesh. Similarly, Saudi Arabia's market is dominated by China, India, Vietnam and Bangladesh. Again, the average tariff applied by Saudi Arabia is the same for all countries, at 5 per cent, nevertheless Pakistan's exports are 0. With respect to Hong Kong, Pakistan is not amongst its export partners—the market is dominated by China, Italy, France, Switzerland and Turkey. Pakistan must explore this market opportunity as Hong Kong levies 0 per cent duty on imports from Pakistan.

ii. HS 610349 and HS 610342 (men's/boy's trousers & shorts of textile material and of cotton, respectively)

World average per annum imports have grown at 22 and 12 per cent respectively, and Pakistan is ranked 1st and 17th in global exports. Worryingly, average yearly annual growth over 2013-17 in quantity terms is faster than in value terms, indicating that Pakistan's exports in this category are attracting lower values internationally. This is especially true of Italy, Denmark, and Spain. As a first step, traditional markets where Pakistan could potentially expand in textile material trousers & shorts are U.A.E, Netherlands and U.S.A, where world imports have risen by greater than 18 per cent per annum over 2013-17. However, Pakistan has seen falling export prices in UAE and USA, so perhaps a different strategy is required that could improve quality, design, comfort and fabric performance. The U.A.E is the leading world importer, where Pakistan faces an AVE tariff of 5 per cent, with an average unit price of $4.60/trouser, compared to India (its top export partner) which has an average unit value of $6.02 facing the same AVE tariffs. Pakistan could also seek to diversify its exports to Malaysia, the 2nd largest importer with imports of $34.9 million in 2017, of which Malaysia reports imports of only $40000 from Pakistan,[196] Malaysia FTA notwithstanding. Currently, Malaysia imports from China, which account for 89.5 per cent of Malaysia's imports. China and Bangladesh are the top two suppliers to Malaysia, and both have duty-free access like Pakistan, so penetrating this market would require a careful study of China and Bangladesh product characteristics and marketing.

Similarly, Canada's imports amounted to $2.1 million in 2017, with top exports from China ($1.1 million), followed by Bangladesh ($0.16 million), while imports from Pakistan (as reported by Canada) were only $23000. However, while Bangladesh has duty-free access to Canadian markets, Pakistan and China must pay an average tariff of 18 per cent. At the same time, Iraq and China represent further opportunities for diversification. China's world imports grew by 78 per cent per annum since 2013, with imports of $6.2 million, yet Pakistan's export share was zero, with exports of only $19000, as many garment tariff lines are not covered under the Pak-China FTA. China applies an 8 per cent AVE for Pakistan (ranked 12th in China's import basket), 0 per cent for Thailand and 16 per cent AVE tariff for Turkey, the two leading suppliers to the Chinese market. Pakistan must include this tariff line in its renegotiations of the Pak-China FTA.

Pakistan's top export partners of HS 610342, i.e. men's/boy's trousers and shorts of cotton, are Spain, USA, and UK, representing almost 60 per cent of Pakistan's exports of this category in 2017. Based on average annual import growth rates over 2013-17, Pakistan can expand trade with Poland, where it has an import share of just 8 per cent, despite having the lowest export unit value. Its ranking is 5th, below Bangladesh, China, India, and Cambodia. This is despite China and India having to pay a much higher tariff of 12 and 9.6 per cent respectively. The same is true of the Netherlands, where Pakistan ranks 6th, below India, which has double the import share of Pakistan despite facing a higher tariff of 9.6 per cent. In fact, Pakistan could also increase exports to Spain, as import demand has risen on average per annum by 24 per cent over 2013-17 and Pakistan comprises just 26.7 per cent of Spain's imports, with Bangladesh claiming 17 per cent. In terms of new markets, Pakistan must explore the possibility of exporting to Japan, as it was the 6th largest importer globally, while Pakistan had only a 1.3 per cent share in Japan's imports (ranked 8th). Pakistan has a severe disadvantage in this market, as it faces average tariffs of 10.9 per cent, while all the top suppliers of Japan (excluding China) like Indonesia, Vietnam, Cambodia and Bangladesh enjoy duty-free access. To offset this disadvantage in terms of market access, Pakistan's apparel industry and government must seek out innovative ways of levelling the playing field. It could be instructive for Pakistan to study the product characteristics, distribution and logistics networks of China, the top competing supplier to Japan in 2017, since it also faces the same tariff structure as Pakistan.

iii. HS 610910 and HS 610462 (cotton T-shirts and women's/girl's cotton trousers and shorts)

Pakistan ranked 27th and 21st globally in 2017, although exports of cotton T-shirts amounted to $197.8 million and were 6 times higher than the $32.2 million exports of women's/girl's cotton trousers & shorts. This

196 Although Pakistan reports exports of $220,000 in 2017.

reveals just how price-competitive the cotton T-shirts category is, with relatively lower value-addition: the average world unit value for Pakistan was $2.70 in 2017 as compared to $4.83 average unit value of women's/girl's trousers and shorts. It would be better for Pakistan to focus on the more value-added trousers & shorts category in the short-run if it wants to improve export earnings. To do so, it can concentrate on traditional markets such as Netherlands, Germany, Italy and France which have witnessed higher import growth over 2013-2017 from the world than export growth from Pakistan. This indicates excess import demand in these countries which Pakistan could meet if it addresses internal supply challenges, considering that it has 0 per cent duty access to these countries. Looking at Pakistan's competing suppliers to these EU markets is essential, revealing that in all but Italy, the top competitor in 2017 was Bangladesh (for Italy it was the 2nd). Pakistan's share in partner's imports is very small across these countries, despite having unit values in 2017 that are, compared to Bangladesh, 24 per cent lower in Italy, 5 per cent lower in Germany, and 6 per cent lower in the Netherlands. This implies that Bangladesh is competing on factors other than price in these critical traditional markets of Pakistan.

Japan once again presents an opportunity for diversification, with Pakistan ranked as the 12th most important source of Japanese imports. It faces a higher average tariff of 10.9 per cent, while Cambodia, Vietnam, Bangladesh and India are granted duty-free access. Pakistan faces the same tariff as China, the top supplier. These results suggest that it could be time to negotiate an FTA with Japan.

Product diversification: HS 61

To identify new export products in which Pakistan might have an advantage, the HS 61 product codes at the 6-digit level were analysed to select those categories in which world import demand has grown consistently. World imports of men's and women's trousers and shorts of synthetic and man-made fibres (HS 610343 and 610463) as well as men's or boy's nightshirts and pyjamas non-cotton and of man-made fibres (HS 610729 and 610722) have grown at roughly 17.8 per cent per annum over 2013-17. At the same time, Pakistan could also consider the multi-billion dollar growing international market of technical wear, such as 611430 (specialised garments for professional, sports or other purposes, n.e.s. of man-made fibre), which grew at 7 per cent per annum over 2013-2017. However, to enter these new product categories requires arranging a competitive and reliable source of synthetic materials and man-made fibres, which mostly originate from China, Taiwan and Korea. Pakistan would also benefit from trade normalization with India, as it has considerable world market share in some varieties of yarn, fibre and fabric that Pakistan cannot feasibly produce domestically.[197] Currently such items are on the India Negative List (cannot be traded) and Pakistan must negotiate for their removal as soon as possible. Not only would these be cheaper due to proximity, but it would also make exports to the EU more competitive as per Rules of Origin of the GSP Plus scheme.

Woven RMG: HS 62

Export performance is assessed in the same manner for the top 20 exports of HS 62 (at the 6-digit level) in 2017. Firstly, products are categorised, according to their global demand, as belonging to growing or declining product markets. Products with growing international demand in the woven RMG sector over the last five years are those where five-year average world imports of the product have grown faster each year than five-yearly world imports of all traded products. Comparing the top 20 woven RMG exports of Pakistan with average annual growth in world demand over 2013-2017 reveals that six out of 20 products belong to declining markets, i.e., their demand is growing slower than all traded products. World imports of two of Pakistan's exports, HS 620412 (women's or girls suits of cotton) and HS 620429 (women's or girl's suits and ensembles of textile materials (excluding wool, cotton, and synthetic materials) have contracted considerably over the last five years, by 14 and 22 per cent respectively. Pakistan's exports of these products in 2017 were $11.2 million and $23.8 million respectively. World import demand for the remaining five products decreased by 5 per cent

197 Ministry of Textiles, India. (2016). "Study on Enhancing Export Competitiveness in Textile Sector". Final Report V4. Retrieved from http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pd

on average every year between 2013 and 2017. As a rough comparison with the knit RMG segment, it appears that more of Pakistan's top woven exports are in markets with declining world demand.

Next, to gauge basic export performance, average annual growth in Pakistan's world export shares over the last five years are examined. At a first pass, export shares have grown in 13 out of 20 product markets. However, to measure dynamic export performance, growth rates of Pakistan's export shares must be compared with growth in world import demand. This is done not only for those woven (13 products) RMG apparel items that have persistently seen an increase in world demand over the last five years, but more importantly, for those which have not. Within the 13 promising products, champion performers are those with world export share growth rates that are higher than growth in global demand over 2013-17. The extent to which Pakistan has increased its world export share relative to growth in world demand is an instructive exercise in determining Pakistan's dynamic export performance in the selected woven RMG products.

To examine how Pakistan's exports have performed in growing and declining world markets, the second performance cut-off is applied: whether Pakistan has increased its exports at a faster (winning product) or slower (losing product) rate than world imports. This allows us to see if Pakistan has increased or decreased its world export share over the last five years. In growing world markets, Pakistan has increased its world export share for six products— winning products in growing international markets represent champions for Pakistan. Pakistan's top woven RMG export, men's or boy's ensembles of cotton (HS 620322), falls in this category. Globally, Pakistan ranked 1st (in terms of value) in 2017, with exports of $1.3 billion. However, the remaining 5 products (with combined exports of $124.6 million in 2017) constitute a much smaller world export share.[198] These products along with their exports (2017) are

i. HS 620322 (men's or boy's ensembles of cotton): $1.3 billion
ii. HS 620339 (men's or boy's jackets and blazers of textile material): $69.5 million
iii. HS620329 (men's or boy's ensembles of textile material): $18.5 million
iv. HS 620333 (men's or boy's jackets and blazers of synthetic materials): $15 million
v. HS 620422 (women's or girl's ensembles of cotton): $14.8 million
vi. HS 620193 (men's or boy's anoraks, windcheaters, wind jackets of man-made fibres): $6.6 mn

Clearly, the emerging pattern from this analysis reveals two things. Global demand for non-cotton products (other textile materials, synthetics, man-made fibres) has undoubtedly increased over the last five years. And while Pakistan has on average increased its world export share by almost 30 per cent every year since 2013 over these 6 product categories, it has not benefitted in a meaningful way due to its low export volumes (with the exception of the top earner of men's or boy's cotton ensembles). The reasons for this originate in poor weaving capacity, low domestic supply of cotton substitutes (synthetics, man-made fibres) and high import tariffs on inputs such as MMF or on chemicals such as PTA which is required to make MMF. Unsurprisingly, Pakistan maintains an edge in woven garments of cotton, demand for which grew lower than for garments made of textile materials, i.e. an annual average of 5 per cent compared with 7 to 9 per cent over 2013-17. In the short-run, Pakistan can increase its supply of cotton-based woven RMG champions, such as ensembles of cotton for women, which grew faster than overall world demand over 2013-2017. Pakistan accounts for only 5 per cent of world exports. Pakistan faces tough competition from China (52 per cent) and Italy (9.5 per cent). However, the remaining market is almost equally shared by Turkey, India and Pakistan, with not too much difference in terms of world exports. In the medium-term, Pakistan needs to arrange inputs from the cheapest sources to ensure competitive upstream textiles needed to produce final goods.

Pakistan also exports 7 products out of its top 20 woven RMG in products that have witnessed falling global demand over the last 5 years. Within these markets, Pakistan has increased its export share in 6 products over 2013-17—these products are winners in adversity. This does not bode well for the buoyancy of future exports, since world demand for these products fell by 5 per cent on average each year between 2013 and 2017.

198 The category of HS 621600— gloves, mittens and mitts, of all textile materials has been excluded from the analysis.

It is troubling that $118.4 million worth of woven RMG exports, or 4.8 per cent of woven exports in 2017 are intended for dwindling world markets where Pakistan export shares have increased. As world export shares have increased when international demand is low, this means that niche marketing is necessary, especially for the 2nd ranked woven RMG export of Pakistan, namely men's or boy's cotton trousers and shorts (HS 620342). Moreover, world demand fell the most for HS 620429 (women's or girl's ensembles of textile materials) which was Pakistan's most improved product in terms of world export shares (shares had grown by 190 per cent per year since 2013). Exports were $23.8 million in 2017, ranking 10th in overall woven RMG exports of Pakistan. At the same time, Pakistan lost world export share in the declining world market of HS 620462 (women or girl's cotton trousers and shorts), which is the 3rd most important category in woven RMG exports in 2017, accounting for exports of $197.1 million. Taken together, these 7 products (worth exports of $315.5 million) account for 12.8 per cent of total woven exports in 2017, i.e. roughly 13 per cent of Pakistan's top 20 exports of woven RMG are in products with falling global demand.

Critically for Pakistan, it has lost world export share in 6 globally growing product markets, representing underachieving products. Taken together with the 6 products above [where Pakistan export shares increased in the face of falling world demand] means that 60 per cent of the top 20 woven RMG export categories of Pakistan moved opposite to international demand. This finding helps explain why Pakistan has not been able to meaningfully increase its relative world market share (discussed in section 3.x)—on account of low adaptation, i.e. remaining out of sync with global demand. The six product categories where Pakistan's export share has decreased despite high international demand are

i. HS 620342 (men's or boy's cotton trousers and shorts)
ii. HS 620349 (men's or boy's trousers and shorts of textile materials)
iii. HS 620469 (women's or girl's trousers and shorts of textile materials)
iv. HS 620799 (men's or boy's singlets, vests, bathrobes and dressing robes of textile materials)
v. HS 620343 (men's or boy's trousers and shorts of synthetic materials)
vi. HS 621132 (men's or boy's cotton tracksuits and other garments, n.e.s.)

The first three products are important to Pakistan, as they are ranked 2nd, 4th and 7th in the woven RMG export basket. It is important to analyse such products as they represent lost export opportunities for Pakistan, owing to high global demand. The most notable lost opportunity is of HS 620469 (women's or girl's non-cotton trousers, breeches and shorts of textile material), the fastest growing world market that Pakistan currently produces for. While global imports grew by 9 per cent on average every year, Pakistan's world export share in it has contracted each year by 22 per cent on average to stand at $31.7 million in 2017 (21st global export rank). Currently, Pakistan's world export share is less than 1 per cent (0.9 per cent).

Market expansion and diversification

Losing export shares in growing global markets indicates opportunities availed by Pakistan's RMG competitors. This section looks at underachievers, i.e. products in growing global markets where Pakistan has lost world export shares over the last five years. This is done with a view to help businesses increase their world export shares in growing international markets by exploring these markets and their top supplying competitors. This can highlight opportunities for expanding and diversifying export markets for these 6 underachieving products. Expansion prospects are based on the comparison of growth of Pakistan's exports to that partner with growth in that partner's imports from the world. Prospective markets are those where imports from the world have grown faster than imports from Pakistan. Diversification, i.e. identification of new export destinations is done by looking at the leading world importers of an underachieving product of Pakistan, the tariffs it faces there, and the existing top suppliers. While expansion requires 6-9 months, diversification requires learning about export procedures, standards and certifications, preferences, connecting with buyers, and identifying appropriate logistics and distribution channels. It would take anywhere between 1-1.5 years before the first successful export order is made.

The market for HS 620342 (men's or boy's trousers, breeches and shorts of cotton) is the world's largest in the category of woven RMG, with total world imports of $2.6 billion in 2017. Pakistan has lost world export share in this important market at an average rate of 10 per cent over 2013-2017, at a time when Bangladesh exports grew by 4 per cent per annum. Despite being the 2nd ranked export for Pakistan in woven RMG and having favourable global demand, exports in 2017 were only $410.4 million. Pakistan is currently ranked 15th in the world. Bangladesh and China are the leading exporters in this category, with roughly equal world export shares of 20.5 per cent, whereas Pakistan's share was 1.5 per cent in 2017. Pakistan can expand trade with Spain, where it ranks 2nd, and the Netherlands, where it ranks 5th. Bangladesh is the main competitor in both markets, with an import share ranging from 23.7 to 24.6 per cent. Pakistan has the lowest export unit values after Bangladesh, 28.5 per cent lower in Netherlands and 9.7 per cent lower in Spain, whereas both face equivalent tariffs.

World demand for HS 620349 (men's or boy's trousers and shorts of textile materials) grew by 7 per cent on average every year over 2013-17. India and Egypt were the largest exporters (19.3 and 11.3 per cent respectively), followed by Pakistan (8 per cent world export share). Again, import growth has been fastest in the Netherlands and Spain, far exceeding export share growth of Pakistan. This is largely due to the predominance of China, Germany, Italy and India in the Netherlands, with Pakistan ranking 10th. Although Pakistan fares better in Spain, it was ranked 5th below Turkey, Bangladesh, China and Morocco in 2017. Prospects for market diversification are examined in Malaysia, Singapore, Ethiopia and Japan, non-traditional partners of Pakistan with considerable import demand. Malaysia has granted duty-free access to all partners, and Pakistan is ranked 12th behind ASEAN competitors and Bangladesh. Although Pakistan's rank in both countries is the same, it would be easier for Pakistan to penetrate Malaysia. While the market for men's trousers & shorts of textile material is not very segmented in Malaysia, it is dominated in Singapore by Bangladesh (46.4 per cent import share). The same is true of Japan, the 10th largest importer of HS 320649, suggesting that Pakistan should aggressively target Malaysia in the medium term.

As the fastest growing international product in Pakistan's export basket, HS 620469 (women's or girl's trousers and shorts of textile material) deserves immediate attention. Pakistan's world export share is less than 1 per cent and it is ranked 21st. Nevertheless, Pakistan exports grew by 9 per cent per annum over 2013-17, and there exists potential for market diversification with 13 out of Pakistan's top 20 current export partners. This includes the Netherlands (where imports grew by 38 per cent), Poland (32 per cent), Sweden (23 per cent), Germany (18 per cent) and Spain (15 per cent). As these are all existing trade partners which levy 0 per cent duty on Pakistan imports, Pakistan could potentially increase its exports in the short-run. The potential for expansion can be gauged from the fact that Pakistan does not feature in the top 20 import partners of these countries. The top competitors are China and Bangladesh, which face tariffs of 12 and 0 per cent respectively. The markets are characterised by different qualities which fetch different export prices, and the Bangladesh product is rather low quality, given that Bangladesh is actually exporting more units than China. A simple analysis reveals that the Germany and the Netherlands import the greatest amounts, while average export unit values were higher in Sweden and Poland. Pakistan could consider expanding to Sweden and Poland in the short-term to take advantage of these higher unit values. New export destinations such as Japan, 3rd largest importer in the world, are currently sourcing women's trousers and shorts of textile materials from China, Cambodia, and Vietnam. The Japanese market seems to be quality-conscious as the lower unit values and duty-free access of Bangladesh and Indonesia have not garnered them a greater export share than China or Vietnam, even though China faces a tariff of 9.6 per cent. This suggests that to compete with Bangladesh, Pakistan would need to improve quality. Although Canada is another market that Pakistan could explore (3 per cent of world imports), Pakistan should stay away as it is a very undifferentiated product market with similar unit values across countries.

TABLE 3-: Dynamic performance of Pakistan's exports, HS 62 (2013-2017)

Code	Product label	Exports 2017($mn)	Pak exports growth, 2013-17 (%)	World imports growth 2013-2017 (%)	Export share in 2017 (%)	Product is a
'620322	Men's or boys' ensembles of cotton	1291.8	86	5	86.3	Champion
'620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts, of cotton	410.4	-11	-1	1.5	Underachiever
'620462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton	197.1	-19	-4	0.9	Loser in declining market
'620349	Men's or boys' trousers, bib and brace overalls, breeches and shorts of textile materials	113.5	0	7	8	Underachiever
'620339	Men's or boys' jackets and blazers of textile materials	69.5	26	-1	6.7	Champion
'620791	Men's or boys' singlets and other vests, bathrobes, dressing gowns and similar articles	32.2	0	-5	12.9	Winner in adversity
'620469	Women's or girls' trousers, bib and brace overalls, breeches and shorts of textile materials	31.7	-15	9	0.9	Underachiever
'620332	Men's or boys' jackets and blazers of cotton	25.8	16	-4	1	Winner in adversity
'620799	Men's or boys' singlets and other vests, bathrobes and dressing gowns of textile materials	25	-6	3	16.6	Underachiever
'620429	Women's or girls' ensembles of textile materials	23.8	126	-22	6.6	Winner in adversity
'620329	Men's or boys' ensembles of textile materials	18.5	23	5	9.7	Champion
'620319	Men's or boys' suits of textile materials	16.3	4	-7	2.8	Winner in adversity
'620333	Men's or boys' jackets and blazers of synthetic fibres	14.9	8	1	0.5	Champion
'620422	Women's or girls' ensembles of cotton	14.8	18	0	5	Champion
'620343	Men's or boys' trousers, bib and brace overalls, breeches and shorts of synthetic fibres	14.4	-5	2	0.2	Underachiever
'620412	Women's or girls' suits of cotton	11.2	4	-14	10	Winner in adversity
'620891	Women's or girls' singlets and other vests, briefs, panties, négligés, bathrobes, dressing robes of cotton	9.1	8	-5	1.9	Winner in adversity
'621132	Men's or boys' tracksuits and other garments, n.e.s. of cotton	7.6	-3	-2	0.8	Underachiever
'620193	Men's or boys' anoraks, windcheaters, wind jackets and similar articles, of man-made fibres	6.6	18	3	0.1	Champion

Source: ITC TradeMap.

Although Pakistan is the world's 2nd largest exporter of HS 620799 (men's or boy's singlets, vests, bathrobes and dressing robes of textile materials) after China, with exports of $25 million in 2017, its exports have contracted

on average by 6 per cent each year over 2013-17. However, world imports of the same were growing at 3 per cent. Given that this is a relatively important market for Pakistan (it had a 16.6 per cent global export share in 2017), Pakistan should also aggressively target in the medium-run new markets such as Algeria, South Korea and Kenya (ranked 1st, 2nd, and 4th in global imports of 2017). Similarly, it should expand trade with the UAE, the 6th highest importer in this $0.12 billion market, as its imports grew the fastest at 33 per cent per year over 2013-17. Currently, Pakistan has a very small share of 2.2 per cent in UAE's imports, compared to India with a share of 66 per cent. Meanwhile, the fastest import growth in traditional partners was in Belgium (6 per cent) and France (3 per cent), but Pakistan was already the 1st and 2nd ranked supplier in these markets. On the other hand, Pakistan could focus on the USA, since its import share is only 1.2 per cent, and it is the 10th ranked partner, below China, Vietnam, Turkey, India and Bangladesh. Inferring from the large variation in the unit values of exports, the market appears to be segmented into different qualities. China clearly dominates at the lower quality end (with a 66 per cent import share) and Italy at the higher end.

Pakistan comprises only 0.2 per cent of the world's exports of HS 620343 (men's or boy's trousers and shorts of synthetic materials) and was ranked 43rd in 2017. The overall trend here is that Pakistan cannot seem to compete with China, Bangladesh and Vietnam in the area of synthetic trousers and shorts. This has to do with Pakistan's inability to competitively source its imports of synthetic fibres. Therefore, Pakistan in the short-run could try to improve its export position in some traditional export partners such as the EU markets. Specifically, based on average annual import growth of synthetic trousers and shorts, Pakistan can potentially expand its exports to Netherlands, Spain and Germany, where imports from the world grew much faster than exports from Pakistan. The top competing suppliers to the Netherlands are China, Bangladesh and Germany. Bangladesh is the lowest cost supplier, with a unit value 45 percent lower than Pakistan and a 15.6 per cent share in Netherlands' imports as compared to 1.3 per cent for Pakistan. In Spain, Pakistan faces considerable competition from China, Turkey, Morocco, Vietnam and Bangladesh. Although Vietnam's unit values are comparable to Pakistan, the latter's share is half that of Vietnam (in 2017, Vietnam had a 10 per cent share in Spain's imports versus 2 per cent for Pakistan). In Germany, Pakistan has a 1.3 per cent share in imports, where it is the 18th ranked partner. To put Germany's market size in perspective, Germany is the third largest export partner of Pakistan. China, Bangladesh and Vietnam equally share the market amongst them, despite China and Vietnam facing import tariffs of 12 and 9.6 per cent respectively. An indication of the tough competition Pakistan faces, Pakistan's exports have a unit value 9.5 per cent lower than Bangladesh and the same 0 per cent duty, yet the volume of imports from Bangladesh were 12 times that of Pakistan. In terms of new markets, Japan represents the 2nd largest import market in the world after USA, with an import share of 10.3 per cent in 2017. To negotiate better market access than the existing 9.6 per cent tariff levied on Pakistan's exports of HS 620343, the Pakistan government must, within the next 2 years, enter into a Free Trade Agreement with Japan. Not only is the tariff applied to Pakistan greater than the average tariff of 7.1 per cent it levies on all its import partners of HS 620343, but 80 per cent of its top 10 import partners get duty-free access to this market. This does not only apply to ASEAN countries, but also to India and Bangladesh. Unsurprisingly, Pakistan does not feature in Japan's imports—they are currently dominated by China and Vietnam (75 per cent), followed by Myanmar, Indonesia, Cambodia and Bangladesh. In the longer term, instead of focusing on the USA, despite it being the largest importer in 2017, Pakistan would do better to focus on Korea (ranked 5th globally in terms of imports), as unit values of exports are higher, tariffs faced are almost same (12.7 versus 13 per cent in USA and Korea, respectively), and Korea is more likely to extend duty-free access to Pakistan as compared to the USA, since it already does so for the world's top developing country apparel exporters such as Vietnam, Cambodia, Bangladesh, Thailand and India.

World imports of HS 621132 (men's or boy's cotton tracksuits and other garments, n.e.s.) amounted to $1.1 billion in 2017, of which Pakistan exported $7.5 million. Among existing partners, France (5 per cent), Denmark (41 per cent) and the Netherlands (2 per cent) are the countries where imports of cotton tracksuits and other garments have grown fastest on average every year over 2013 to 2017. This market is characterised by significant amounts of intra-EU trade, with China and India ranked 5th and 6th largest suppliers after the EU countries in top 4 positions. It is promising for Pakistan that it is better ranked than Bangladesh in Denmark,

even though the latter is a far bigger world exporter—it is ranked 10th, compared to Pakistan which is ranked 22nd globally. Pakistan export position is even better in Netherlands where it enjoyed a 2.9 per cent share in Netherlands' imports in 2017, ahead of India (the 7th largest exporter of this category), Vietnam (6th) and Bangladesh (10th). Pakistan is ranked 17th in this market, while the top 3 competitors are Tunisia, Morocco and China. Interestingly, Pakistan's export unit value is 71 per cent lower than Tunisia, signifying the low qualities of Pakistan's exports. In fact, by volume, Pakistan's rank is 10th versus 18th in terms of values of exports. The same is true of USA, the world's largest import market (23.5 per cent of world imports), where Pakistan gains 2 places (from 9th to 7th place) when its exports are ranked by volume rather than value. Pakistan has a low unit value of exports, about half the average unit value in US market. This indicates that Pakistan could significantly increase its export earnings by improving qualities, design innovations, marketing, and perhaps even branding. In terms of looking towards new markets, Iran's world imports of HS 621132 grew at an average yearly rate of 27 per cent over 2013-17. Despite their Preferential Trading Agreement since 2004, Pakistan's exports of HS 621132 face a tariff of 100 per cent in Iran. However, two positive developments indicate that trade with Iran could play a bigger role: the Pak-Iran Five Year Strategic Trade Cooperation Plan (2016-2021) signed in 2016 and the Pak-Iran FTA (PIFTA) signed in 2018. Pakistan must seek improved market access for this and other RMG items.

Product diversification

The top 3 fastest growing (in terms of five-year annual average increases in world imports over 2013-17) woven apparel items that Pakistan does not currently export significant amounts are considered in this section. The cut-off used is products with less than 25 per cent share in Pakistan's woven RMG exports at the HS 6-digit level. Demand has consistently been high (in the range of 7 to 17 per cent per annum) for 620722 (men's or boy's nightshirts and pyjamas of textile material); HS 620444 (women's or girl's dresses of artificial fibres); and HS 620640 (women's or girl's shirts, blouses, and shirt-blouses of man-made fibres). As Pakistan does export products at the HS 4-digit level of these identified items, Pakistan has some revealed comparative advantage in export of similar goods. For example, while Pakistan does not export significant quantities of nightshirts and pyjamas of textile material, in 2017, it did export $25 million of HS 620799, i.e. men's or boy's singlets, other vests, bathrobes, and dressing gowns of textile materials. The next logical step should be arranging the inputs and developing the expertise and machinery to move up this product's value chain. Similarly, with respect to HS 620444 and HS 620640, namely ladies (artificial fibre) dresses and blouses (of man-made fibre), Pakistan already exports significant amounts of several HS 6204 sub-chapters. These include trousers, shorts, suits, ensembles, blazers and jackets made of cotton and textile materials. The market for shirts and blouses of man-made fibres and also for dresses of artificial fibres are quite substantial ($8.7 and $2.5 billion, respectively in 2017). Acquiring the necessary inputs of artificial and man-made fibres, reshuffling resources across products, and upgrading skills of labour may be quite doable in the next 2 years to allow Pakistan to start exporting. The top exporters of blouses and shirts are China, Spain, India and Vietnam, while the top markets are USA, Germany and the UK. In two of these markets, Pakistan faces duty-free access, unlike China (12.6 per cent tariff) or India and Vietnam (9.6 per cent tariff). Quite similarly, the main exporters of dresses (of artificial fibres) are China, India, Italy, and Spain. The top three importers in 2017 were USA, UK and Spain. Although the USA represents 20 per cent of world imports of this product, 60 per cent of the market is divided amongst China and India, followed by Indonesia and Vietnam. Penetrating markets with such entrenched market shares of China and India would be difficult, so it is better for Pakistan to focus on UK and Spain, where it enjoys duty-free access as well. The UK export market would be easier to penetrate than Spain, as the two key suppliers (China and India) have a share of 21.5 and 16 per cent. While China and India are the top two exporters globally, Pakistan faces 0 per cent duty in the UK, compared to 12 and 9.6 per cent for China and India.

Annexure II

TABLE A-1 Documents required to trade in Karachi, 2010.

Export	Import
Bill of lading	Bill of lading
Packing list	Packing list
Certificate of origin	Certificate of origin
Inspection report	Pre-shipment inspection certificate
Insurance certificate	Technical standards certificate
Export General Manifest (EGM)	Form I
E Form (with Commercial Bank)	Import general manifest
Customs Export Declaration	Import declaration
Price certificate	SOLAS certificate
Phytosanitary certificate	
Gate pass	
SOLAS certificate	

Source: World Bank (2010). Subnational Doing Business Costs, 2010. Retrieved from http://www.doingbusiness.org/data/exploreeconomies/pakistan/sub/

TABLE A-2 Reforms to lower complexity and costs of trading across borders: 2011-18

Year	Measure	Coverage
2018	New container terminal and enhancement of its customs platform for electronic document submission	Karachi, Lahore
2017	Improvement in electronic "Web Based One Customs Platform".	National
2015	Introduction of automated, computerized system (the Web-Based One Customs system) for the submission& processing of export& import documents	Karachi, Lahore
2011	Equipment to improve electronic communication between Karachi Port authorities and private terminals	Karachi

Source: World Bank (2018). Subnational Doing Business Costs,

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