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Deepening Intraregional Trade and Investment in South Asia: The Case of the Textiles and Clothing Industry

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Working Paper No. 213

Deepening Intraregional Trade and
Investment in South Asia
The Case of the Textiles and
Clothing Industry

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April 2008



Deepening Intraregional Trade and Investment in South Asia The Case of the Textiles and Clothing Industry

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Foreword

In an era of growing regional cooperation, economic integration, and common markets worldwide, South Asia stands out as a region that is among the least integrated. The commonly held view is that the region's complicated political economies, deep burdens of history, powerful protectionist lobbies, a maze of opaque rules, negative lists, and a slew of para-tariffs and non-tariff barriers prevent a freer flow of information, investment, goods, and people needed to realize a dynamic regional market across South Asia. Yet, evidence on the ground shows that there is active and rising trade – often concealed and quasi-legal, nonetheless dynamic – that is increasingly tying private sector companies and labor markets across SAARC borders. A host of intermediaries have emerged beneath the official radar screen as has a new generation of younger entrepreneurs, workers and business professionals who share a cross-cutting global worldview that could transcend the region's divided history.

This paper, originally prepared for and supported by the Asian Development Bank, explores the emerging possibilities of deepening intraregional trade and investment in South Asia. It focuses on the textile and clothing industry as lens through which to examine these prospects.

By drawing on extensive field work that highlights both the conundrums as well as the shifting terrain on the ground, it is hoped that the evidence provided by this paper can nudge the conversation about regional cooperation in South Asia in new directions.



(Rajiv Kumar)
Director & Chief Executive

April 7, 2008

Abstract and Summary

This paper draws on recent field work within South Asia and an extensive review of secondary data to examine the dynamics of cross border trade and investment in South Asia, exploring the potential for, and obstacles to, such trade through the lens of a sector that is salient throughout South Asia: Textiles and Clothing. Despite the growing competitiveness of this sector in the SAARC region, there is very little regional inter-linkage within South Asia's textile and clothing industry. Currently less than 4% of SAARC's global T&C exports are traded within the region. There is growing evidence of widespread substitution of South Asia by East Asia as the sourcing hub of fabric and accessories by the region's major clothing exporters. Over 80% of the fabric needs of Bangladesh and Sri Lanka, for example, come from outside the region even though India and Pakistan are net exporters of textiles.

At one level the history of external ties matters: the long standing role of East Asian suppliers and quota-hopping garment manufacturers in the origin of apparel exports in parts of South Asia, the institutional embedding or 'bundling' of sourcing practices and input supply, as well as the role of global buyers in designating or mandating preferred input and accessory suppliers have all generated inertia in altering existing relationships. At another level, the burden of mistrusts embedded in the region's own history, the structure of its textile industry (narrowly cotton-based, not very diverse, relatively high cost), and high trade costs exacerbated by complicated rules of origin, frustrating layers of bureaucratic and administrative oversight, poor transportation, and a long list of non-tariff barriers that disrupt the movement of goods and personnel across South Asia have prevented the emergence of either a common market or regional production networks in the SAARC region.

Despite these barriers, there is growing evidence that with recent shifts in the nature of the textile and clothing industry, especially post-MFA, as well as changing intra-regional dynamics there are emerging possibilities for cooperation and collective action in the region. The drivers of this potential lie in the growing importance of the domestic market and the rise of organized retail in South Asia, the rise of a new generation of younger entrepreneurs in South Asia who are increasingly professional, globally aware, and schooled in a shared cultural worldview that helps cut across traditional barriers of region and history, the emergence of new knowledge networks and an interpenetrated regional labor market in skills in the South Asian garment industry and the possibility of leveraging strategic regulatory shifts and upcoming 'demands for structural change' post-2008 to foster greater regional cooperation.

The paper argues that SAARC members – along with civic organizations and private sector industry associations – need to build upon and support the positive trends already underway. In addition, SAARC could enhance interregional integration in textiles and clothing by creating the conditions for greater cross-border investment within the SAARC region, first in textiles and accessories and then apparel, by expeditiously establishing a credible investment protocol in the region, while simultaneously pushing forward with trade facilitation reforms. India, in its current role as SAARC Chair should take a leading role in facilitating these reforms.

Key words: South Asia, Trade, Investment, Textile and clothing, Regional Cooperation.

Jel Classifications: F15, F14, F59

List of Abbreviations and Acronyms

ADB	Asian Development Bank
ASEAN	Association of South-East Asian Nations
BGMEA	Bangladesh Garment Manufacturers Association
BKMEA	Bangladesh Knitwear Manufacturers Export Association
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, also known as the Bangladesh India Myanmar Sri Lanka Thailand Economic Cooperation.
BOI	Board of Investment
Centad	Center for Trade and Development, India
CIF	Cost, Insurance and Freight
CMT	Cut-Make-Trim
Comext	A harmonized and comparable statistical database for intra and extra EU trade
Comtrade	United Nations Commodity Trade Statistics Database
CPD	Center for Policy Dialogue, Dhaka, Bangladesh
EU	European Union
FDI	Foreign Direct Investment
FOB	Free on Board
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GI	Geographic Indication
GSP	Generalized System of Preferences
HS	Harmonized System codes (HS) Commodity Classification
ICRIER	Indian Council for Research in International Economic Relations, New Delhi
IP	Intellectual Property
IPS	Institute of Policy Studies, Colombo, Sri Lanka
ITC	International Trade Commission
JAAF	Joint Apparel Association Forum, Sri Lanka
LDC	Least Developed Country
MFA	Multi-Fibre Arrangement
MoU	Memorandum of Understanding
NIFT	National Institute of Fashion Technology, New Delhi
NTB	Non-Tariff Barriers
NTM	Non-Tariff Measures
OPT	Outward Processing Trade
PRC	People's Republic of China
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Agreement
SAPTA	South Asian Preferential Trade Agreement
UNIDO	United Nations Industrial Development Organization
VA	Value Added
WTO	World Trade Organization

1. Introduction

In a world where regional trade agreements proliferate and market consolidation is a growing trend, South Asia stands out as an exception. Despite a multitude of regional cooperation and trade agreements under various stages of implementation (South Asian Association for Regional Cooperation [SAARC], the South Asian Preferential Trading Arrangement [SAPTA], the Bay of Bengal Initiative for Multi-Sectoral Economic Cooperation [BIMSTEC] involving Bangladesh, India, Myanmar, Sri Lanka, Thailand, Nepal and Bhutan] and since 2004 the South Asian Free Trade Area [SAFTA]) the potential of an integrated trade, investment and production space that the region's geography and its complementary comparative advantages promise, still remains a distant ideal. The widely held view is that the region's complicated political economies, powerful protectionist lobbies, a maze of opaque rules, negative lists, notorious exclusions from tariff liberalizations, specific duties, and a slew of para-tariffs and non-tariff barriers prevent a freer flow of information, of investment, goods, services and people which is needed to realize a dynamic regional market across South Asia. Yet, evidence on the ground shows that there is active and rising trade – often concealed and quasi-legal, nonetheless dynamic – that is increasingly tying private sector companies and labor markets across SAARC borders. A host of intermediaries have emerged beneath the official radar screen to facilitate this less visible trade, estimated by some to run in billions of dollars (Taneja and Sawhney 2007).

This study takes a closer look at the existing dynamics of cross border trade and investment in South Asia, exploring the potential for, and obstacles to, such trade through the lens of one key sector in which nearly all countries in the region have robust comparative advantage – Textiles and Clothing. Despite the global competitiveness of this sector in most SAARC members, there is very little regional inter-linkage within South Asia's textile and clothing industry. Currently less than 4% of SAARC's global T&C exports are traded within the region. Thus a significant, but so far unrealized potential exists to deepen intra-regional linkages within South Asia's textile and clothing sector and make it a powerful global hub of production and exports in this sector.

a. Purpose of the study and methodology

Drawing upon the “inventory approach” developed by the Asian Development Bank, the study uses field work in concert with secondary literature and industry trends emerging from trade data to understand the existing structure and state of play of intra-regional trade and investment in the South-Asian textile and clothing industry. The goal is to identify where in the textile and clothing sector's complicated supply chain is there greatest potential for expansion of intra-regional trade and investment and for the emergence of regional production networks, and where the bottlenecks to this process of regional integration lie. This micro-regional analysis of a single sector is of critical importance so that efforts may be targeted in feasible directions, building upon areas of greatest mutual benefit first, while making room for more complex maneuvers later and over time.

This question was approached in two ways: (1) through an analysis of trade data at the two and six digit level looking at: what is being traded in this sector, where, how, and how much; where does the most demand lie; what are the varied and complementary strengths of key member countries (for the sake of this study limited to India, Bangladesh, Sri Lanka and Pakistan) across the textile and clothing supply chain, and what are the product segments where they compete. (2) Through an institutional approach to analyze the empirics of the sector on the ground, complemented by an ethnographic understanding of the processes of exchange that are taking place in the region. To get a sense of the processes on the ground, the author conducted a total of 44 interviews in Sri Lanka (Colombo), Bangladesh (Dhaka) and India (New Delhi, Gurgaon, Bangalore, Chennai) in July and August 2007, and drew on an additional 16 interviews conducted with global buyers (such as H&M, Target, Marks and Spencers, Sara Lee, Ikea, Tesco, Li & Fung and others) in India in late 2006 and early 2007, as well as with local suppliers. These latter interviews were conducted as part of a larger project carried out in partnership with the Indian Council for Research on International Economic Relations, New Delhi. The names of interviewees contacted specifically for this project are listed in Appendix one, and include clothing and textile producers, global and local buyers, retailers, a variety of intermediaries such as forwarders, buying agents, buying houses, industry and trade associations, government officials in a variety of agencies – textile related line departments, think tanks, Boards of Investment, Export Promotion Bureaus, training and design institutions and monitoring agencies. The author's field work in Sri Lanka was facilitated by the Institute of Policy Studies (IPS) in Colombo; for field work in Bangladesh the author received the support of the Center for Policy Dialogue (CPD) in Bangladesh, and her field work in India was supported by the Indian Council for Research on International Economic Relations (ICRIER) in New Delhi.

A review of existing studies was also conducted, based especially on our current understanding of the major perceived barriers to regional integration in South Asia, specifically negative lists and exemptions from tariff reform, trade and transactions costs, including specific duties, para-tariffs, non-tariff barriers (NTBs); issues of connectivity and infrastructure, spatial and regulatory, poor presence of cross border production networks, Free Trade Agreements (FTAs), rules of origin, as well as questions about standards and institutional norms. The goal of the primary and secondary research carried out for the project was to identify policy priorities in fostering greater regional integration in the South Asian textiles and clothing industry through enhanced trade and investment.

b. Organization of the study

Section 1 briefly reviews key issues in the existing literature. Section 2 examines the structure of the South Asian textile and clothing industry. Section 3 examines the performance of South Asia's T&C sector in the US and EU markets. Section 4 examines intra-South Asia trade, product level regional specialization, and a value chain analysis of the region's T&C industry. Section 5 examines buyers view about regional competitiveness and complementarities. Section 6 examines the problem of sourcing and 'substitution.' Section 7 examines the issue of backward linkages and rules of origin in the various GSP (General System of Preferences) schemes applicable to the region.

Section 8 examines market access, Section 9 looks at investment, and Section 10 concludes with policy recommendations.

c. Review of key issues in the existing literature

Compared to other regional trade groupings around the world, South Asia is the least economically integrated. Intra-SAARC trade was estimated to be barely 5% of the region's total trade in 2004 versus ASEAN's 25%-30% and European Union's over 60% intra-regional trade flows (Taneja 2007). Political differences stemming from the region's colonial past and the dynamics of partition have complicated the deepening of explicit (official) economic ties between member nations.

To address these issues, and after numerous attempts to enlarge economic cooperation within the SAARC region (such as through SAPTA, BIMSTEC), the implementation of SAFTA began in July 2006. The aim is to cut tariffs. Specifically, SAFTA's goal is to bring tariffs down to the 0-5% range by 2015 for India, Sri Lanka and Pakistan, and for Bangladesh, Nepal and others by 2018. Several studies have predicted that there are high potential gains to trade to be had from tariff liberalization and growth in intra-regional trade. For example, in a study based on CGE models, Sengupta and Banik (1997) predict that intra-SAARC trade would increase by 30%, and that it could expand by as much as 60% if the illegal trade that takes place in the region is also counted and pulled into official channels. Others, using the gravity model (e.g. Batra 2004) have argued that for at least among some SAARC member countries where trade ties are minimal (e.g., between India and Pakistan), there are gains of as high as \$6.6 billion to be had by expanding trade. In 2003, India's trade with Pakistan stood at only 8% of its trade with SAARC, compared with 20%, 32% and 38% respectively with Nepal, Sri Lanka and Bangladesh respectively (Batra 2004: 17), hence there is scope for growth. Yet others have cautioned that gains from intra-regional trade liberalization and trade facilitation may in fact be overstated because trade in these countries is often more heavily constrained by supply side factors rather than tariff and non-tariff barriers to trade (e.g., see Nanda 2005), and the costs of compliance (with various rules of origin, for example) may sometimes outweigh the real gains to be had in terms of incomes, employment and welfare.

In light of this mixed debate, it is useful to examine more closely the actual processes taking shape on the ground in South Asia with respect to regional integration. The lens through which we will undertake this examination is sectoral, focusing on the textile and clothing industry and asking what is taking place in South Asia with respect to regional inter-linkages in this important sector. Textiles and clothing is one of South Asia's core manufacturing and export sectors. It is South Asia's single largest manufacturing employer and revenue earner, and is strongly present in every country in the region. South Asia has a demonstrated comparative advantage in textiles and clothing vis-à-vis the rest of the world, especially after the removal of quotas after December 31, 2004 when export shares rose sharply across the region. Focusing on the potential for intra-regional trade, investment and production in South Asia's T&C industry therefore provides an important window into the region's overall industrial competitiveness.

2. The Structure of the Textiles and Clothing Industry in South Asia

Textiles and clothing is South Asia's largest manufacturing sector, a major employer and a leading export sector. In 2005 South Asia¹ exported over \$38.3 billion in clothing and textiles, a 3% share in the global T&C market, and imported US\$ 6 billion worth of textiles and clothing, accounting for 1% of the world's total imports in this sector. The region's T&C industry collectively employed over 55 million people directly and nearly 90 million indirectly in 2005. This included an estimated 38 million in India, 15 million in Pakistan, 2 million (8 million indirect) in Bangladesh, 300,000 (1.5 million indirect) in Sri Lanka, and over 200,000 in Nepal.²

Table 1: Exports of Clothing and Textiles from South Asia in 2005 (Value in US Dollars)

	Clothing	Textiles	Total	Share of Clothing	Share of Textiles
India	9,228,099,920	8,480,875,845	17,708,975,765	52%	48%
Pakistan	3,633,952,245	7,087,991,344	10,721,943,589	34%	66%
Bangladesh	6,295,713,559	596,477,036	6,892,190,595	91%	9%
Sri Lanka	2,876,598,194	135,906,889	3,012,505,083	95%	5%
TOTAL	22,034,363,918	16,301,251,114	38,335,615,032	57%	43%

Bangladesh data are for 2004; Source: UN Comtrade database

Table 2: Imports of Clothing and Textile into South Asia in 2005 (Value in US Dollars)

	Clothing	Textiles	Total	Share of Clothing	Share of Textiles
India	73,699,477	1,946,885,709	2,020,585,186	4%	96%
Pakistan	26,759,335	469,816,213	496,575,548	5%	95%
Bangladesh	360,121,215	1,484,024,671	1,844,145,886	20%	80%
Sri Lanka	107,335,975	1,548,205,461	1,655,541,436	6%	94%
TOTAL	567,916,002	5,448,932,054	6,016,848,056	9%	91%

Bangladesh data are for 2004; Source: UN Comtrade database

¹ The reference to South Asia in this report includes four key countries: India, Pakistan, Bangladesh and Sri Lanka, unless stated otherwise.

² Source: Ministry of Textiles, India, JAAF, Sri Lanka, World Bank, 2006, Center for Policy Dialogue, Dhaka 2007.

Tables 1 and 2 demonstrate two patterns. One is that there is a rather clear division of labor in terms of the region's sectoral composition and specialization in textile and clothing exports. Sri Lanka and Bangladesh's exports are dominated by the clothing sector which accounts for 95% and 91% of the country's T&C exports respectively. By contrast, Pakistan's exports are dominated by textiles which comprised two-thirds of its T&C exports in 2005. India is in the middle, with a rough parity in its clothing and textile exports, with clothing accounting for a 52% share and textiles a 48% share in its 2005 T&C exports. In other words, clothing exports are the engine of growth for Bangladesh and Sri Lanka's T&C sector, while textiles form an important part of the T&C export sector in Pakistan and India.

The second pattern echoes the first, in that South Asia exports more than it imports and thus its textile and clothing exports have low import intensities. In Table 3 we see that South Asia's T&C import intensity is only 16%, indicating that much of the textile value chain is localized *in the region*. Of this 16% the bulk of the imports are of specialized fabric, yarn, and accessories. Very little clothing is imported or traded in the region. Within the region, Pakistan has the lowest import intensity - of just 5%; India is next with 11%. Bangladesh and Sri Lanka have larger import shares -- 27% and 55% of their exports respectively. As Table 3 shows, among the clothing producers in the region, Bangladesh has succeeded in generating more extensive backward linkages than Sri Lanka. Interviews with Bangladeshi garment associations revealed that Bangladesh manufactures 80% of its knitwear fabric locally and meets about 20% of its woven fabric needs.

Table 3: Import Intensity³ of South Asia's Textile and Clothing exports in 2005

India	11%
Pakistan	5%
Bangladesh	27%
Sri Lanka	55%
TOTAL	16%

Calculated from Tables 1 and 2, Comtrade data; Bangladesh figures are for 2004.

Table 4: Trade Balance in South Asia's Textile and Clothing Sector in 2005

	Clothing	Textiles	Total
India	9,154,400,443	6,533,990,136	15,688,390,579
Pakistan	3,607,192,910	6,618,175,131	10,225,368,041
Bangladesh	5,935,592,344	(887,547,635)	5,048,044,709
Sri Lanka	2,769,262,219	(1,412,298,572)	1,356,963,647
TOTAL	21,466,447,916	10,852,319,060	32,318,766,976

Calculated from Tables 1 and 2, Comtrade data; Bangladesh figures are for 2004.

³ Import intensities are calculated by dividing total textile and clothing imports into a country by total textile and clothing exports from that country – i.e., imports as a percentage of exports.

Table 4, which show the trade balance in South Asia's textile and clothing industry in 2005 (the first full year after the removal of quotas), clarifies this even further, reinforcing the point about the apparent 'division of labor' noted earlier. First, it shows that all four countries in the sample have a strong comparative advantage in the clothing sector. They are net exporters of clothing. But South Asia imports very little clothing – both from the rest of the world or from within the region.

The second column in Table 4, on textiles, shows the purported division of labor among the major South Asian countries, and the extent of backward linkages each has within the textile sector. Bangladesh and Sri Lanka are net importers of fabric, yarn and textiles, while India and Pakistan are net exporters of fabric, yarn and textiles. On the face of it, therefore, India and Pakistan could potentially more than meet Bangladesh and Sri Lanka's textile needs. As noted in Table 3, here too we see that Bangladesh has slightly deeper backward linkages than Sri Lanka (as demonstrated by a smaller trade deficit despite larger clothing exports than Sri Lanka). At the level of the region as a whole (the four countries taken together) there is trade surplus in each country for textiles and clothing taken together.

What does the structure of the textile and clothing sector look like in each of the region's major producing and exporting countries? A country-specific examination provides greater insight into the potential complementarities and specializations emerging within the region's textile and clothing sector.

India, the largest economy in South Asia, is a latecomer to T&C exports compared to its neighbors. Yet, it has integrated rapidly in the global market in the past fifteen years following extensive deregulation of its textile industry in the mid 1980s. These domestic reforms were followed by trade liberalization in the early 1990s. By 2005 India exported over \$17 billion worth of clothing and textiles, a figure that rose to \$20 billion in 2006 by some estimates (Ministry of Textiles 2007). While textiles used to historically dominate India's exports, clothing exports have now overtaken textiles and comprise more than half the sector's export share. Imports have also grown in recent years, from historical lows of 1.2% of exports in 2000 to 11% in 2005. Most of this import growth is accounted for by a rapid rise of fabric and textile exports after the elimination of quotas. Today, India's textile imports are the largest in South Asia, of over \$2 billion, despite the existence of vast domestic production capacities in India (see Tewari 2006 and Ministry of Textiles 2007). Textiles and clothing contribute 4% to GDP, 26% to manufacturing output, 15% to exports and 18% to industrial employment. The sector hires 38 million people directly, and employs an additional 53 million indirectly and in allied services. India's primary markets are the US and EU, with EU accounting for 45% of its clothing exports and 35% of its textile exports and the US accounting for 33% of its clothing exports and 26% of its textile exports (Directorate General of Foreign Trade, Interview, New Delhi, 2007). Cotton dominates India's fabric and fiber base, and hence its exports. India is the largest cotton yarn producer in the world, and over all, in all fibers taken together has a 13% share in the world, the second largest after PRC (Ministry of Textile 2006).

Rapid shifts in and diversification of its large domestic market has been a major source of growth in the sector in recent years. Seven products constitute 51% of India's clothing exports: Knit T-shirts and vests (Harmonized Schedule (HS) 610910), woven women's shirts and blouses (620630), men's boys shirts of cotton, non-knit (620520), women's and girl's skirts, non-knit (620452), men's/boy's knit shirts (610510) men's/boy's cotton woven trousers and bottoms (620342), and women's girl's knit blouses (610610).

Bangladesh's textile and clothing sector began to grow in the mid-1970s and has grown dramatically in the past twenty years. Its total exports have grown rapidly post-MFA contrary to widespread predictions that quota elimination would harm its clothing exports. By some accounts (CPD, 2007) Bangladesh's T&C exports nearly doubled from \$6.2 billion in 2004 to an estimated \$12 billion in the first quarter of 2007 (Interview B14, Dhaka, 2007). As we noted, ready made garments dominate the structure of output in Bangladesh's T&C industry. Clothing accounts for 80% of Bangladesh's exports, contributing 10% to GDP, 30% to manufacturing output and 17% to total imports (James 2007, World Bank 2005). The sector employs 2 million people, mostly women, directly and another 8 million indirectly.

Bangladesh's main markets are the EU (64% share) and the United States (30% share), together accounting for nearly 95% of the country's clothing exports. Tariff free access to the European and Canadian markets are important drivers of growth in the sector. As we saw above, Bangladesh has been quite successful in fostering backward linkages into spinning and weaving in its economy, and today about 25% of the country's woven textile needs and nearly 80% of its knitwear inputs are generated locally. The sector overall used to be split between 80% woven exports and 20% knitwear, but knitwear has grown rapidly in the last five years, at the rate of 33% per year (CPD, Dhaka, 2007) so that today the sectoral composition is nearly 50 -50 knitwear and woven, and industry analysts expect knitwear exports to overtake woven clothing exports in 2007-8. This has important implications for local linkages and multiplier effects from the sector's growth, since knitwear is much more deeply integrated in the domestic textile value chain, and the growth of this sub-sector will also ensure much better value retention under EU's General System of Preferences (GSP) schemes. Cotton dominates the regions' fiber base, but there is a mix of blends, impregnated, coated and other man-made fibers through imported inputs.

Five product categories dominate Bangladesh's exports to the world market: Knit T-shirts (HS610910), men's and boys cotton shirts knit (620520), and non-knit (610510), men's and boy's trousers (620342), and pullovers of wool (611300) and man-made fiber (611010).

Sri Lanka is distinct in South Asia in that its T&C industry is dominated not by a cotton fiber base, but by sophisticated blends and man-made fibers, even though cotton is also important. Sri Lanka has carved a niche for itself for the production of lingerie, swimwear and suits and sets. It is also known for its leadership in corporate and social responsibility, and has the highest textile sector wages in South Asia. An effort is underway to set itself apart from Asia's other low-wage clothing exports by branding

itself as the source of ‘Garments without Guilt’ and ethical sourcing. The government and industry associations and the country’s largest firms are fully behind this new initiative (interviews, Sri Lanka, JAAF and others 2007). Clothing dominates Sri Lanka’s textile and clothing sector. Clothing exports constitute 95% of its T&C exports, and in 2006 it exported \$3 billion worth of clothing primarily to the US (56% in 2006) and secondarily to the EU (39% in 2006).

Sri Lanka’s clothing exports rely heavily on textile imports. In 2005 textile imports constituted 94% of Sri Lanka’s total T&C imports, thus giving its clothing exports a high import intensity of 55 % (UN Comtrade database, 2007). Textiles and clothing contribute 8% to Sri Lanka’s GDP, 45% to export revenues, 33% to manufacturing employment and 67% to industrial exports. In 2006 the sector employed 300,000 people directly and 1.5 million people indirectly. Growth has been good, though not as good as some of its competitors. In 2006 the US market for Sri Lanka’s exports grew by 9% in the first quarter and the EU market grew much faster at 21% in the same period (JAAF, 2007). Within the EU, UK, Italy, Germany and France are its largest buyers. The dominance of these countries as Sri Lanka’s clothing export destinations is reflected neatly not only in Sri Lanka’s clothing export statistics, but also in its *textile* import statistics indicating that for the kind of lingerie, swimwear and formal clothing imported by these Western markets, a good share of the base fabric that Sri Lankan exporters use is also supplied by its main European and US buyers. The US, UK, Italy, Germany and France are Sri Lanka’s largest Western *suppliers of fabric* and accessories (UN Comtrade database, 2007).

Sri Lanka’s top exports to the world include: Lingerie (HS621210), men’s boys cotton trousers not knit (620342), knit T-shirts (610910), women’s and girls trousers of cotton (not knit) (620461) and of other materials (620469), men’s boys cotton shirts (non-knit) (620520) and cotton pullovers (611020).

Pakistan’s T&C industry is dominated by the textiles sector. Although Pakistan exported \$3.6 billion in clothing in 2005, it exported more than double that value in textiles – nearly \$8 billion. Pakistan imports little fabric, and has a quite comprehensive cotton-based T&C value chain. Textiles and clothing contribute 68% to export earnings, 9% to GDP, and 38% to employment (roughly 15 million people) (Centad 2005 and Taneja 2007). Pakistan’s main markets are the United States (where it has preferential market access, especially post-9/11) followed by the European Union. Pakistan’s top exports are dominated by textiles and made-ups: Bed-linen (HS630231), toilet and kitchen linen (630260), cotton yarn (520512), men’s/boy’s cotton knitted shirts (610510), woven fabrics of cotton (520819), men’s and boy’s cotton trousers non-knit (620342) and plain weave cotton fabrics (521051).

Intra-South Asia Exports

Intra-South Asia trade in textiles and clothing is low, but as Tables 5 and 6 below demonstrate, it has been growing in recent years.

Table 5: Evolution of Intra-South Asia Exports in Clothing 2001-2005 (HS 61-62)*Values in US\$ '000s*

Exporting Country	B'desh		India		Pakistan		Sri Lanka		World	
	2001	2005	2001	2005	2001	2005	2001	2005	2001	2005
B'desh*			341	3344	86	189	145	241	4443695	6,295,714
India	1957	19844			475	1081	17192	37115	5062358	9228100
Pakistan**	958	1870	470	1073			1583	3695	2445702	3633952
Sri Lanka	12	247	216	510	0	40			2336351	2876598

*Source: Calculated from PC-TAS UN Comtrade data*** Data pertain to 2003 and 2004; ** Data pertain to 2003 and 2005; Value in thousands of US Dollars***Table 6: Evolution of Intra-South Asia Exports in Textiles 2001-2005 (HS 50-60, 63)***Values in US\$ '000s*

Exporting Country	B'desh		India		Pakistan		Sri Lanka		World	
	2001	2005	2001	2005	2001	2005	2001	2005	2001	2005
B'desh*			346	28627	23150	27069	1469	2236	527695	596,477
India	186692	364792			1368	77578	100109	182990	5404314	9259948
Pakistan**	152399	194078	12343	46385			58471	99061	6180405	7274242
Sri Lanka	1614	5264	4388	9227	836	1004			231936	182812

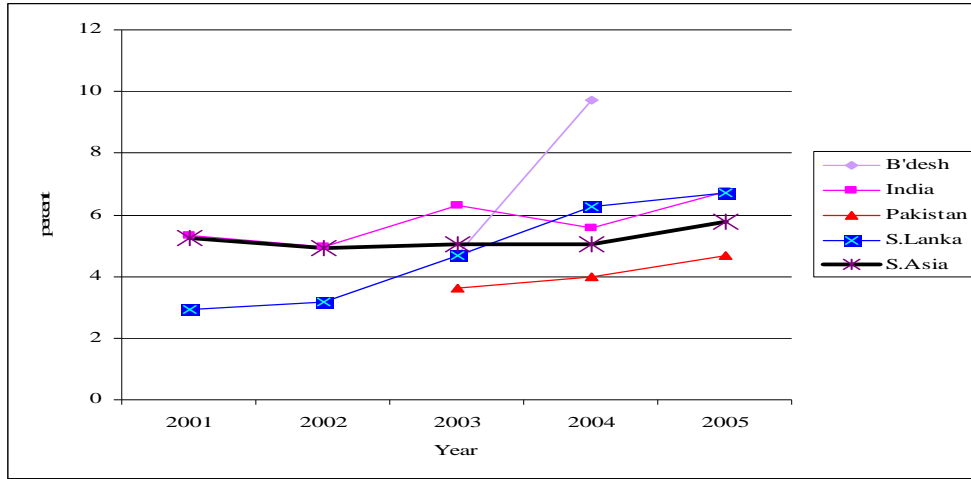
*Source: Calculated from PC-TAS UN Comtrade data*** Data pertain to 2003 and 2004; ** Data pertain to 2003 and 2005; Value in thousands of US Dollars*

As Tables 5 and 6 show, there was a significant increase in intra-South Asia exports in both clothing and textiles between 2001 and 2005. While all countries increased their exports to their South Asian neighbors, Pakistan and India dominate the region's textile exports, but even between them, exports from and to India dominate the net increase in intra-SAARC trade in both textiles *and* clothing in absolute terms.

But in relative terms, smaller countries such as Sri Lanka and Bangladesh increased the volume of their T&C exports to the rest of South Asia at higher rates. For example, India's textile exports to Bangladesh doubled between 2001 and 2005, rising from US\$186.7 million to nearly US\$365 million, but Bangladesh increased its textile exports to India 83 times – from only US\$ 346,000 in 2003 to US\$ 29 million in 2004, increased its textile exports to Pakistan four-fold and doubled its textile exports to Sri Lanka. Similarly it increased its clothing exports to India 10-fold, doubled its clothing exports to Pakistan and increased its clothing exports to Sri Lanka by 66%. Similarly, Sri Lanka increased its clothing exports to Bangladesh and Pakistan 21 times and 40 times respectively – both from very small bases, but nonetheless a striking increase.

Figures 1 and 2, and the attached tables (below), reinforce these points and are another illustration of the fact that slowly but steadily, a growing share of South Asia's T&C export is now traded within the SAARC region.

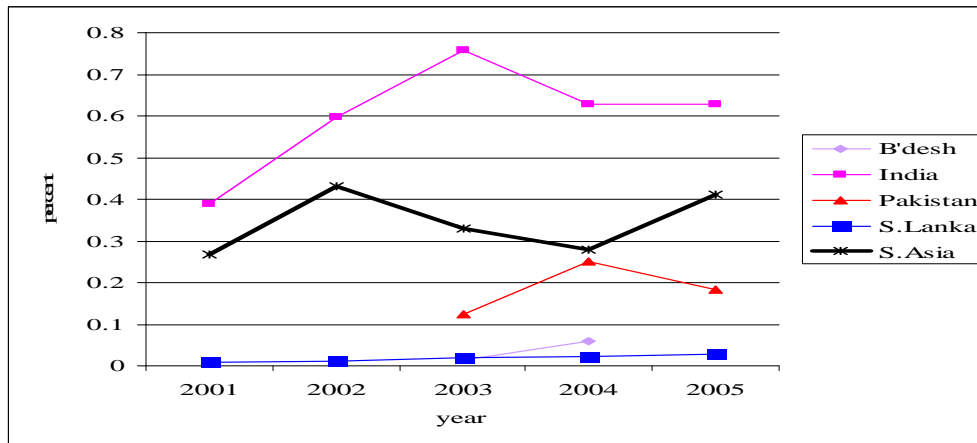
Figure 1: Intra S. Asia Exports in Textiles as a Share of S. Asia's Trade with the World (50-60, 63)



	2001	2002	2003	2004	2005
B'desh			5	10	
India	5	5	6	6	7
Pakistan			4	4	5
S.Lanka	3	3	5	6	7
S.Asia	5	5	5	5	6

*Intra-S. Asia share of textile trade as a percent of each country's global textile exports (%)
Calculated by author from PC-TAS*

Figure 2: Intra S. Asia Exports in Clothing as a Share of S. Asia's Trade with the World (60-61)



	2001	2002	2003	2004	2005
B'desh			0.01	0.06	
India	0.39	0.60	0.76	0.63	0.63
Pakistan			0.12	0.25	0.18
S. Lanka	0.01	0.01	0.02	0.02	0.03
S. Asia	0.27	0.43	0.33	0.28	0.41

*Intra-S. Asia share of clothing trade as a percent of each country's global clothing exports (%)
Calculated by author from PC-TAS*

Taken together, Tables 5, 6 and Figures 1 and 2 highlight three issues:

(1) First, that despite all the problems in the region, intra-SAARC trade in textiles and clothing has grown robustly in at least the last five years – growing at rates higher than the rate at which the region’s T&C exports to the world have grown.

(2) Second, this suggests that market access is beginning to open up within South Asia.

However, two distinctions are important to make here. First, that India, not surprisingly, dominates the net (absolute) increases in intra-SAARC T&C trade. This reinforces the importance of opening India’s market to its South Asian neighbors in light of the intra-South Asia trade-inducing effect that this can and will lead to. Second, there is a distinction in the contribution of textiles versus clothing in this growing volume of intra-regional T&C trade in South Asia. A bulk of the value of the increased trade comes from textiles, not clothing exports. Less than *half percent* of the US\$ 22 billion worth of clothing that South Asia exported in 2005 was exported to other South Asian destinations. By contrast, at least 6 % of the region’s textile exports (of US\$ 16 billion) were traded locally within SAARC member countries.

Thus, *textile trade is likely to be the key driver of intra-regional integration in the T&C sector in South Asia*. Clothing trade by contrast, is an important driver of *extra-regional* integration of South Asia’s T&C sector with the global economy.

Market access and intra-regional investment are likely to bear greatest results in terms of region wide integration if they are associated with the textile sector rather than clothing.

(3) Third, as noted above, while Pakistan and India dominate the region in textile exports in absolute terms, some *smaller countries*, such as Bangladesh and Sri Lanka that are better known for clothing production, have surprisingly, increased their intra-regional share of textiles exports at a rapid pace in the last three to four years. Bangladesh’s textile exports to India rose by over 8000%, and its share of textile exports to SAARC rose sharply from 5% in 2003 to 10% in 2004. Sri Lanka also increased its intra-South Asia textile exports noticeably.

These data on growing textiles exports from Sri Lanka and Bangladesh to India and Pakistan by huge magnitudes (though from a small base) is *evidence that backward linkages are indeed taking root in these two countries*.

In the next subsection we examine how the four South Asian countries studied here performed in their main markets – the US and EU after the removal of quotas. We examine this issue to gauge the global competitiveness of South Asia’s textile and clothing industry. We will focus on two parameters, market share and unit value.

3. South Asia's clothing export performance in the US and EU markets post-MFA

As noted earlier and as summarized in Table 7 below, the US and EU are the main markets for all of South Asia's major clothing exporting countries. The EU and US taken together account for 94% and 95% of Bangladesh and Sri Lanka's clothing exports. India exports 78% of its clothing to the US and EU. As Table 7 shows, the EU dominates over the US as a destination of South Asia's clothing exports.

Table 7: Share of the US and EU in South Asia's Clothing Exports in 2005

(%)

	EU	USA	EU+US
India	45%	33%	78%
Bangladesh	64%	30%	94%
Pakistan	na	na	na
Sri Lanka	56%	39%	95%

Source: Calculated from UN Comtrade database; Bangladesh data are for 2004.

Does this mean that SAARC member nations compete with each other for market share in their most important Western markets? This section explores the nature of South Asia's exports to the US and EU at a disaggregated level to make the point that although SAARC members share common markets, there are subtle but important differences in their clothing export baskets so that they are in less direct competition with each other than would first appear from global statistics. This bodes well for the possibilities of greater inter-regional collaboration and the formation of regional production networks.

In a recent paper James (2007) carries out a useful analysis of what South Asia made of the "[PRC] Safeguard Opportunity" that presented itself after the US imposed restraining quotas and duties on PRC in 2005. Table 8 summarizes James' findings.

James found that PRC's shipments to the US in the items that were restricted in 2005 totaled \$9700.5 million or 18% of the world's shipments in these categories. He then examined how SAARC shipments in these restricted categories behaved after 2005. He found that between 2004 and 2005 SAARC members' shipments in these categories rose by \$1156 million, or 20%. In volume terms they rose by 19%. Pakistan's exports to the US in the restricted yarns rose by 14% in value terms and India's exports in the same categories rose by 86%. Overall, SAARC member's volume share in the US in the restricted categories rose from 9% to 12% and in value terms SAARC's share rose from 10% to 14%. In other words, SAARC members made gains in the US market both in volume and especially in value terms. As James noted, the rise in value shares for SAARC members is a hopeful finding, indicating that some degree of upgrading in product quality did take place (James 2007).

Table 8: South Asia’s performance in categories restricted by the US for PRC under “Safeguards: Changes in market share in volume and value terms

	2006		2004	
	Volume Market Share (%)	Value Market Share (%)	Volume Market Share (%)	Value Market Share (%)
SAARC	12	14	9	10
Bangladesh Market Share	6	4	5	3
India Market Share	5	4.5	4	3.4
Clothing	4	4.5	3	3.4
Cotton Clothing	5	6		
Yarn	5		<1	
Fabric	4	3	2	2
Pakistan Market Share	7		6	
Clothing	3	2		
Cotton Clothing	5	>3	4	<3
Made-ups	12	10	10	8
Sri Lanka Market share	1	<2	>1	

Source: Adapted from William James 2007

Did the same occur in the EU market? From an analysis of COMEXT data carried out by the author (not of safeguard categories, but of exports overall), the finding was that SAARC members performed well in the European Union post-MFA, expanding their market share and also improving their unit values.

The figures below illustrate and summarize these findings. First, as Table 9 shows, India and Bangladesh were among the top five exporters to the EU (15) in 2005. While India’s relative rank fell from 3rd position in 1995 to 4th in 2005, it was an improvement over its performance in 2000 when it dropped from the ranks of EU’s top five clothing exporters. Bangladesh on the other hand secularly gained market share in the EU in volume terms.

Table 9: Top 5 exporters to the EU 15 over time by Quantity (in 100kg)

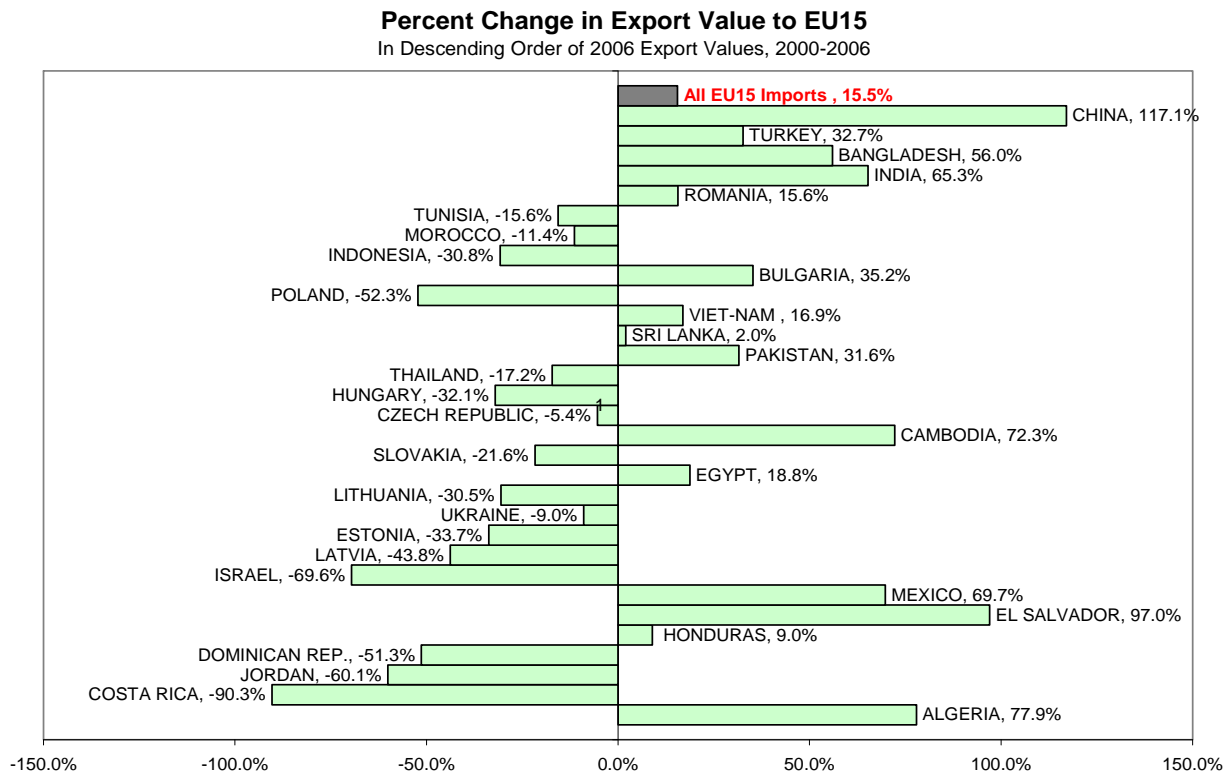
1995			2000		2005	
1	PRC	2,480,275	PRC	3,803,580	PRC	14,909,505
2	Turkey	1,676,373	Turkey	2,949,167	Bangladesh	4,501,302
3	India	1,080,687	Bangladesh	2,399,114	Turkey	4,164,579
4	Morocco	948,992	Morocco	1,363,559	India	2,083,488
5	Tunisia	930,588	Tunisia	1,297,714	Romania	1,540,151

Source: Calculated from COMEXT

Bangladesh led South Asia in exports to the EU 15, and beat out Turkey in 2005 for second highest quantity of exports to the EU 15 (of the countries studied in this analysis). In fact, Bangladeshi exports grew over time from about the same quantity of production as India in 1995 to almost double Indian export quantity in 2005. India exported the fourth highest quantity (among the countries studied) to the EU 15 from 1995 to 2005, remaining a main player for the EU 15 market. Pakistan had the lowest export value from 1995-2005, and Sri Lanka (not reported in the table) had the lowest export quantity of all South Asian countries. Pakistan, Sri Lanka, along with Viet Nam, Cambodia, and Mexico had a relatively small share of the EU 15 market in 2005. (Source: Eurostat, 2007.)

The picture in value terms was slightly different, although the same two South Asian players – India and Bangladesh outperformed other SAARC members in the EU market. India’s quantity and value exported to EU 15 grew increasingly from 1995 to 2005. Values increased 19% from 1995 to 2000, from 1.8 billion Euros to 2.2 billion Euros, respectively. From 2000 to 2005, the values increased 44%, from 2.2 billion Euros to 3.2 billion Euros. In the South Asia region, only Bangladesh increased export values faster. See Figures 3, 4, and 5 (Source: Eurostat, 2007. Adjusted to 2005€)

Figure 3: Percent change in value of clothing exports to EU 15



Source: Computed from COMEXT

Figure 4: South Asia Exports Values

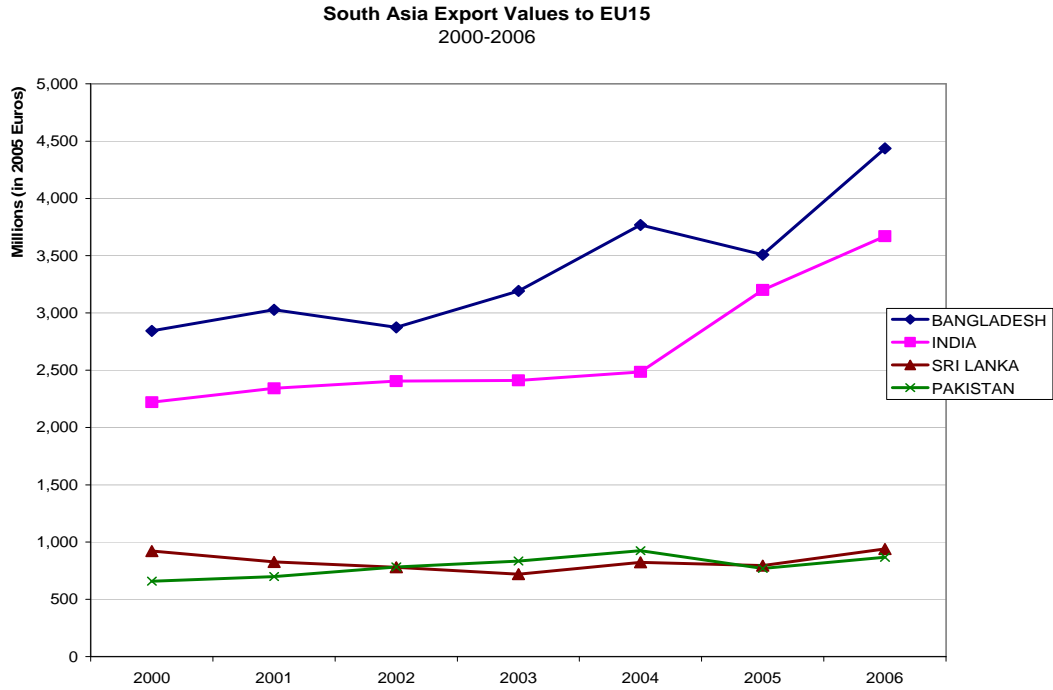
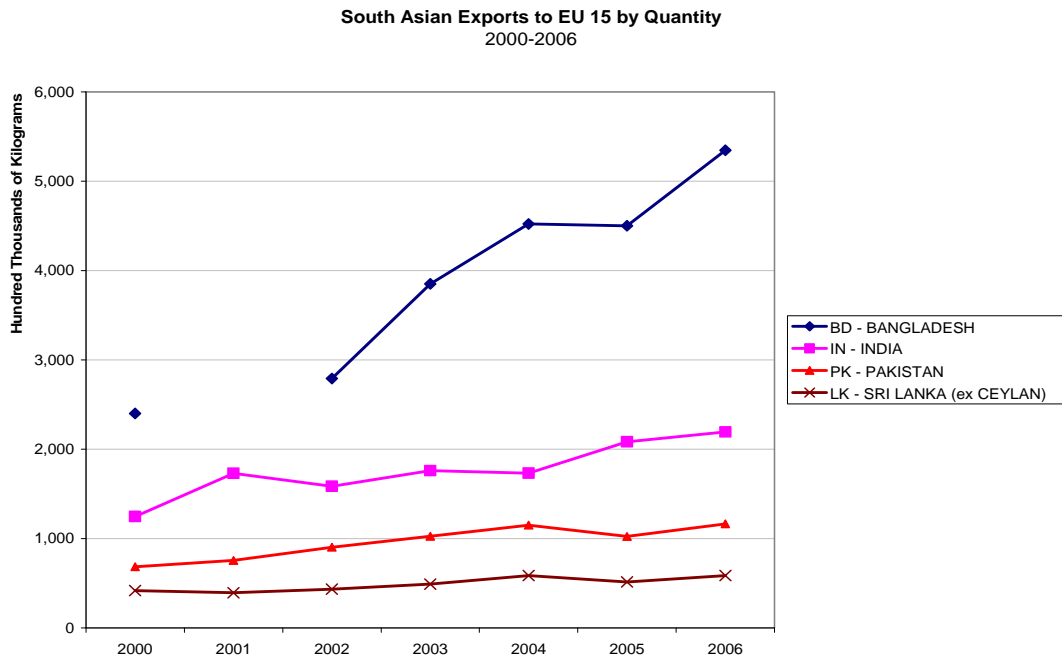


Figure 5: South Asian exports to the EU by Quantity



Bangladesh’s performance in the EU is striking, as seen in the Figures 4 and 5 above. It far outstripped all other South Asian exporters in terms of its volumes – and values – in the EU; an impressive achievement by any account.

The next Table (10) makes an important point about differences in export quality and strategy among SAARC member countries in the EU. It shows clearly that there is a difference in export strategy among SAARC’s exporters. India and Sri Lanka’s unit values (Euro/100kg) in the EU were almost double the unit value of T&C exports from Bangladesh and Pakistan in 2005, indicating a PRC-like strategy for the latter two, of exporting large volumes of relatively low value products. Sri Lanka and India by contrast appear to follow an export strategy of shipping smaller volumes and shorter runs of relatively higher value products.

Table 10: 2005 Unit Values of Clothing Exports to the EU for SAARC member Countries

2005 Unit Values (€/100kg)	
Sri Lanka	1545.7
India	1536.2
Bangladesh	779.6
Pakistan	753.4
Turkey	1886.7
Mexico	1839.3
Viet Nam	1338.5
Cambodia	1338.3
PRC	1101.3

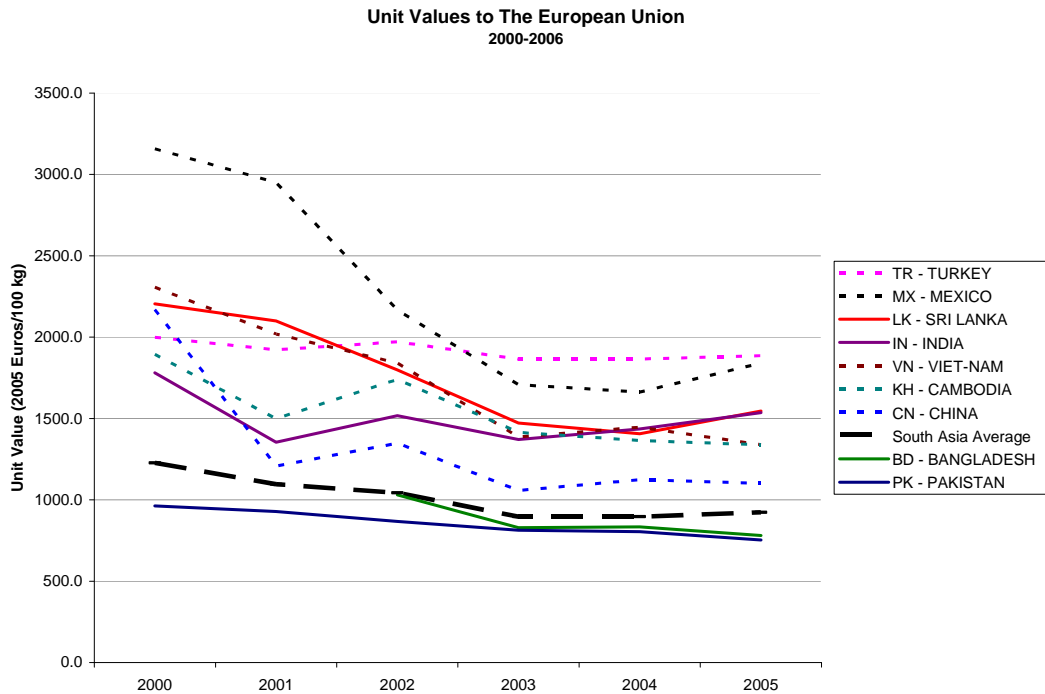
Source: Calculated from Comext data

This has implications for the kinds of products that different SAARC countries specialize in. In the previous section we saw that one of the top exports of all four countries are knit T-shirts. On the face of it, T-Shirts are a product category in which all member nations compete with each other. But the above analysis and Table 10 suggests that there may indeed be qualitative differences in the *kinds* of T-shirts shipped by each country. India and Sri Lanka likely export higher value, or design intensive product varieties relative to Bangladesh and Pakistan. Moreover, we already know that there are differences between Sri Lanka and India as well – the former specializes in man-made fiber and blended products while India specializes in cotton. The bottom line is that there may be more complementarities between the range of products exported by SAARC members than aggregate data suggest.

Figure 6 places the 2005 unit value figures within a longer time horizon. It suggests, that despite differences in unit value realization, all South Asian countries have experienced a secular decline in their unit values. Only Sri Lanka and India seem to have reversed the

trend and started on a slight upward trajectory after 2004. The opposite seems to be the case for Pakistan and Bangladesh (Source: Eurostat, 2007. Adjusted to 2005€)

Figure 6: Unit values of Clothing Exports over time



Overall, this brief comparative analysis showed that South Asian exporters have fared well in the EU and US market after the removal of quotas, though some countries have clearly outperformed the others. The T&C sector therefore is a leading growth sector for all of the four countries studied here.

Although all SAARC members rely quite heavily on the EU and US markets—and hence compete with each other for market share—there are important differences in the structure of the clothing exports of each country to these markets. For example, India and Pakistan are exporters of textiles as well as garments. Sri Lanka and Bangladesh export primarily garments. Even within garments, India and Sri Lanka appear to follow a strategy of higher value exports in relatively smaller runs, while Bangladesh is clearly following a “[PRC] strategy” where it is pushing large volumes of relatively low value products. This strategy has served it well as it has succeeded in doubling its export value to the EU relative to India in just ten years. By contrast, Pakistan’s greatest success has been in cotton made-ups – bed linen, yarn and fabrics. Companies such as IKEA source practically all their fabric (that they procure from SAARC) from Pakistan. Finally, it is striking that there is very little penetration of Japan or Oceania by South Asian exporters. Collectively they export less than 2% of their clothing and textile output to Japan, relative to just under 40% by PRC (UN Comtrade database).

In the next section we take a deeper look at product level differences in South Asia's textile and clothing export sector.

4. Regional Value Chain Analysis: What do sub-sectoral specializations tell us about regional complementarities?

As we noted above, all SAARC members export clothing to the same key markets – the US and EU; we also saw how at least two countries, Pakistan and India export cotton-based textiles and fabric to a variety of destinations. At the same time we saw that the export baskets of member countries differed from each other in important ways. In this section we take a deeper look at these differences and how and to what extent there may be complementarities in the region's clothing and textile exports. We first return to take a second look at intra-South Asia trade in textiles and clothing relative to the region's global exports; then we examine product level differences in the export shares of each country, and finally take a look at the structure of their value chain.

a. Intra versus Extra Regional Trade in Textiles and Clothing

What does intra-South Asia trade in textiles and clothing look like relative to the region's global exports?

Table 11: Intra South Asia* Exports in Textiles and Clothing as a Share of South Asia's* Global T&C Exports

			2001	2002	2003	2004	2005	% Change 2001-2005
Textiles								
50-60, 63	Total	INTRA S Asia*	295007	308754	708027	723328	964884	2.3
50-60, 63	Total	World	5636250	6292394	14049427	14232609	16534190	1.9
	Intra South Asia as Share of world		5.2	4.9	5.0	5.1	5.8	
Apparel								
61-62	Total	INTRA S Asia*	19852	34344	50802	49585	64678	2.3
61-62	Total	World	7398709	7956566	15456210	15815275	11644532	0.6
	Intra South Asia as Share of world		0.3	0.4	0.3	0.3	0.6	
T&C TOTAL								
	Total	INTRA S Asia*	314859	343098	758829	772913	1029562	2.3
	Total	World	13034959	14248960	29505637	30047884	28178722	1.2
	Intra South Asia as Share of world		2.4	2.4	2.6	2.6	3.7	

Source: Calculated by author from PC-TAS UN Comtrade database; 2005 data excludes Bangladesh.
Value in US\$ '000; Share in percent; * South Asia here Includes Pakistan, Bangladesh, India and Sri Lanka only⁴

⁴ Note: In this table Intra South Asia apparel trade as a percentage of global trade is 0.6%; In Figure 2, the corresponding value is shown is 0.41%. This latter figure is lower because it excludes data from Bangladesh.

Table 11 is an important summary of the level of intra-South Asia trade in textiles and clothing, its evolution over time, and the magnitude of intra-regional trade as a share of the region's global textile and clothing trade. The table illustrates **three important points**.

First, it shows how South Asia's regional trade in textiles and clothing is dwarfed by the region's T&C trade with the world. In 2005, the intra-South Asia share of T&C trade was only 3.7% of the region's global share.

Second, and as noted in section 2, trade in clothing is miniscule within the South Asian region. Each of the four SAARC countries examined here essentially exports its clothing output beyond the region. But South Asia accounted for only 0.6% of SAARC's trade in clothing in 2005. Whatever glue there currently is between South Asia's T&C industry is provided by intra-regional trade in textiles. About 6% of the region's textile output is locally traded within SAARC member countries. Though small, this number overshadows the regions intra-South Asia clothing exports.

Finally, though the base of intra-regional trade in textiles and clothing has historically been small in South Asia, there is cause for optimism. Since the last five years, intra-South Asian trade in clothing and textiles has grown faster than the region's global exports. Intra-regional trade in T&C grew by 2.3% between 2001 and 2005 relative to 1.2% for the region as a whole. Indeed, intra-regional trade in clothing grew the fastest (though from a very small base) – clothing trade within South Asia grew nearly four times (3.8 times) faster than the region's clothing exports to the rest of the world between 2001 and 2005. In other words, the pattern of stagnation in South Asia's intra-regional trade in the T&C industry appears to be changing in recent years.

b. Product level variation

On the supply side, and based on interviews with sixteen global buyers who source from the region, there are some important differences in how buyers see each country's comparative advantage in South Asia. Even though all countries produce clothing and some textiles, as Table 12 below shows, each has a niche where it excels over others in the eyes of buyers.

Buyers look to Pakistan primarily for Bed-linen, home furnishings, carpets and some basic men's wear. Other south Asian countries look to Pakistan primarily for yarn, fabric and home-furnishings.

Buyers turn to Sri Lanka for lingerie and swimwear and formal wear – even though the Island produces a lot of knits, T-shirts, shirts, and women's wear.

Bangladesh is best known for its cotton and man-made-fiber men's wear – tops (shirts) and bottoms, T-shirts, pullovers and anoraks. Knitted sports wear and active wear

(sweatshirts, pants, spandex tops and bottoms) is also an increasingly important line of products that buyers are sourcing from Bangladesh.

India is good primarily in women’s tops, blouses, skirts, and embellished and embroidered clothing. It is also making forays in men’s bottoms. However, the recent appreciation of the Rupee is likely to steer orders away from basic goods towards embellished or higher value products. Technical textiles (geo textiles, medical textiles, space textiles, and non-wovens) are a nascent area of recent investment by private firms (giants such as Reliance) and policy attention by the government.

Table 12: Product Level Specializations: Comparative Advantage of South Asia’s leading players in the T&C Sector

	Comparative advantage from the perspective of global buyers	Share of top 5 items in total T&C exports*
Pakistan	Mid-to-course gauge cotton yarn, Bed Linen, Home furnishings , Carpets, basic menswear and hosiery	54%
Sri Lanka	Lingerie, swimwear of man-made fibers and cotton blends, formals	30%
Bangladesh	Knit and woven Menswear - sports and casual wear (shirts, trousers, T-shirts), pullovers	46%
India**	Cotton knit and woven women's tops, blouses and skirts, embellished and embroidered, fine-yarn	44%

*Source: Interviews with 16 global buyers and calculated from PC-TAS UN Comtrade database
*Export shares include shares to the US and EU markets only, ** share to the world market.*

The point of this discussion is to underscore the fact that although there is considerable mutual competition among SAARC members for global market share, the leading buyers do see important differences in the product level competitiveness of each country. This quasi-specialization suggests that each country may have slightly distinct pathways to international competitiveness – and that their mutual competition need not be cut-throat.

The next set of tables (13 and 14) presents further evidence to support this point. These tables provide information at the six digit HS level on the top five exports of South Asia

to its main markets. The main point is to illustrate the differences, at the product level, of each country's textile and clothing exports. I focus here on the US market only.

Table 13: Top 5 Clothing Exports of Sri Lanka, Bangladesh, Pakistan and India to the US market (HS 61, 62). (Value in US\$ '000s; Share in Percent.)

Sri Lanka's Top Five Export to US (61-62)

S.No	pro_cd	Product description	2003	share_03	pro_cd	Product description	2004	share_04
1	620520	M/B shirts woven cotton	95346	6	620520	M/B shirts, woven cotton	102877	7
2	620462	W/G trousers & shorts, woven	81035	5	621210	Brassieres & parts thereof, of	95458	6
3	621210	Brassieres & parts thereof, of	77865	5	620462	W/G trousers & shorts, woven	78678	5
4	620469	W/G trousers & shorts, woven	73814	5	620469	W/G trousers & shorts, of other	76474	5
5	620342	M/B trousers & shorts, of cotton	72553	5	620342	M/B trousers and shorts, woven	69643	5
		TOTAL of Top 5	400613	27		TOTAL of Top 5	423130	27

Bangladesh's Top Five Export to US (61-62)

S.No	pro_cd HS	Product description	2003	share_03	pro_cd HS	Product description	2004	share_04
1	620520	M/B cotton knit shirts	178266	10	620520	M/B shirts of woven cotton	194396	15
2	620342	M/B trousers, shorts knit cotton	153616	9	611300	Garments of impreg.coatd.coverd c	95992	8
3	620590	M/B woven shirts of other textile n	110199	6	610510	M/B shirts of knit cotton	92036	7
4	620462	W/G trousers, shorts, woven cotton	71960	4	610610	W/G blouses & shirts, knit cotton	68196	5
5	620349	M/b trousers, shorts, of other woven	71221	4	621040	M/B garments nes,made up of imp	48868	4
		TOTAL of Top 5	585262	34		TOTAL of Top 5	499488	40

Pakistan's Top Five Export to US (61-62)

S.No	pro_cd	pro_desc	2004	share_04	pro_cd	pro_desc	2005	share_05
1	610510	M/B shirts of knit cotton	326136	27	610510	M/B shirts, knit cotton	436489	28
2	620342	M/B trousers and shorts, of woven	111286	9	620342	M/B trousers & shorts, woven	213661	14
3	611490	Knit Garments nes, of other textile	91002	8	610910	T-shirts of knit cotton	127155	8
4	610590	M/B shirts, of other textile m	86951	7	611520	Women full-l/knee-l hosiery,	84108	5
5	610910	T-shirts, singlets knit cotton	67564	6	620520	M/B shirts of woven cotton	64392	4
		TOTAL	682939	56			925805	59

India's Top Five Exports to US (61-62)

S.No	pro_cd	pro_desc	2004	share_04	pro_cd	pro_desc	2005	share_05
1	620630	W/G blouses & shirts of woven	284014	8.9	620630	W/G blouses & shirts of cotton	383426	8.1
2	620520	MB shirts of woven cotton	257874	8.1	610910	T-shirts of knit cotton	277872	5.8
3	610910	T-shirts of knit cotton	166821	5.2	620520	MB shirts of woven cotton	271868	5.7
4	610510	MB shirts of knit cotton	131787	4.1	620452	W/G skirts of woven cotton	245032	5.2
5	620452	W/G skirts of woven cotton	78031	2.4	610510	MB shirts of knit cotton	219201	4.6
		TOTAL	918527	29			1397399	29

Source : Calculated from PC-TAS

Note: Value of exports in US \$ '000. Share in percent

In 2005 (and 2004 for Sri Lanka and Bangladesh), there were only four out of fourteen distinct products at the six digit level that were common between each country's top-five clothing exports. These were all basic items: (i) men's and boys woven shirts, (ii) men's and boys knit cotton shirts, (iii) Cotton knit T-shirts; (iv) men's/boys cotton trousers.

Sri Lanka and Bangladesh had only one product in common (out of 10): men's/boys cotton shirts (woven). Sri Lanka and Pakistan also had only one common export (men's/boys woven cotton shirts). Bangladesh and Pakistan also had only one common item: men's/boys cotton knit shirts in their top five exports. Bangladesh and India had two: men's/boys cotton shirts (woven) and men's/boys knit cotton shirts. India and Sri Lanka also had two common clothing exports (men's/boys cotton shirts woven, and women's cotton trousers). Pakistan and India had the most overlaps – four in all. However, as we saw in the section on unit values, Pakistan and India's exports even of the same products are of quite different unit values. India's unit values are higher than Pakistan's. By proxy, this may signify different levels of quality and value addition. Thus, despite overlaps there may be little direct competition.

The same difference is also apparent in the textile sector. India and Pakistan's top five textile and fabric exports have barely any overlap. This distinctiveness in export baskets is significant because it means that anywhere between 20% and 50% of South Asia's textile exports do not compete head to head against each other in key overseas markets (such as the US). See Table 14.

In other words, the structure of exports and product level specialization within SAARC has subtle but important variations. These variations can be strategically leveraged in thinking about nurturing regional production networks and supporting niche investments in ways that do not pit countries in the region against each other in export markets. For our purposes, the main point is that there is room for South Asia to collaborate regionally by building on what each does best, without competing against each other in overseas markets or losing export market share in products for which they have individual comparative advantage.

Table 14: India and Pakistan's top textile exports to the US

Pakistan's Top Five Textile Exports to US (50-60,63)								
S.No	pro_cd	pro_desc	2004	share_04	pro_cd	pro_desc	2005	share_05
1	630231	Bed linen, of cotton, nes	279983	17.82	630231	Bed linen, of cotton, nes	501266	23.8
2	630260	Toilet&kitchen linen of cotto	222783	14.2	630260	Toilet&kitchen linen of cotto	294421	14.0
3	630710	Floor-cloths,dish-cloths,clear	118170	7.5	630710	Floor-cloths,dish-cloths,clear	158040	7.5
4	520819	Woven fabrics of cotton,>=85%	106240	6.8	630232	Bed linen, of man-made fibre	134391	6.4
5	570110	Carpets of wool or fine anim	97748	6.2	630210	Bed linen, of textile knitted n	122437	5.8
		TOTAL	824924	52.5			1210555	57.6

India's Top Five Textile Exports to the US (HS 50-60, 63)								
S.No	pro_cd	pro_desc	2004	share_04	pro_cd	pro_desc	2005	share_05
1	630492	Furnishing articles nes, of cottor	225630	7.1	630492	Furnishing articles nes, of wove	368206	7.7
2	630790	Dress patterns, made up articles,	193311	6.0	630790	Dress patterns & made up article	195456	4.1
3	500720	Woven fabrics of silk/silk waste	88206	2.8	570110	Carpets of wool or fine animal h	148752	3.1
4	570110	Carpets of wool or fine animal h	87978	2.8	630419	Bedspreads of textile materials, i	113099	2.4
5	630260	Toilet&kitchen linen,of terry tov	82303	2.6	500720	Woven fabrics of silk/silk waste	95633	2.0
		TOTAL	677428	21			921146	19

Source : Calculated from PC-TAS

Note: Value of exports in US \$ '000. Share in percent

c. Value Chain analysis

Table 15 below summarizes the clothing value chain in three South Asian countries: India, Bangladesh and Sri Lanka. In each case, based on field level analyses carried out by third parties, the chain of value addition, distribution of costs and final price of cotton shirts is analyzed. Though it is not possible to say that the same type of cotton shirt is analyzed in each case (the final value is clearly different), nonetheless, these analyses give us a good idea of the dynamics of production in each region and its implications for regional competitiveness, as well as the possibilities of building regional production networks.

The first point to note is that in countries where raw materials are imported (such as Bangladesh and Sri Lanka), input costs are a higher proportion of total costs than in countries where fabric is produced locally (or where only a subset of inputs are imported). In Bangladesh input costs account for as much as 78% of total production cost; in Sri Lanka the figure is 65%. By contrast input costs are 45% of total production cost in India where fabric is locally sourced.

Similarly, in countries where raw materials are not available locally, *import* costs become an important component of total cost, in addition to the time it might take to source inputs overseas (see the data for Bangladesh in Table 14 below). As revealed in field interviews, sourcing inputs overseas can easily add an additional six to eight weeks, and no less than a month to the procurement process relative to local procurement.

Table 15: Distribution of Value Added across the Indian, Sri Lankan and Bangladeshi Clothing Chain

INDIA – Cotton Shirts and Trousers		
Men's cotton shirts/unit	Men's Khaki casual trousers/unit	Cost Ranges
Global Retail (c.i.f.) Value: \$11.38 VA: 57%	Global Retail (c.i.f.) Value: \$18.75 VA: 61%	Raw material cost: 45%
Manufacture Value: \$4.93 VA: 23%	Value: \$7.25 VA: 19%	Energy costs: 7-10%
Weaving Value: \$2.35 VA: 12%	Weaving Value: \$3.75 VA: 14%	Labor costs: 7-10%
Spinning Value: \$1.03 VA: 5%	Spinning Value: \$1.13 VA: 3%	Transportation cost: 4-6%
Fiber Value: \$0.05 Value added: 4%	Fiber Value: \$0.05 Value added: 3%	Admin costs – 7%
		Design and prototype: 5%
		Logistics: 2%
		Profits: 10-15%

*Source: Calculated from KSA Technopak's analysis of value added at each stage of processing in India of Men's cotton shirts and khaki trousers. * All costs, except retail, are based on input and manufacturing costs in India. Reported in: Singhal et. al. 2004, "Creating Value in the Textile and Clothing Supply Chain," Textile Outlook International, January-February 2004 pp. 141. ** Poplin power loom fabric.*

Bangladesh: (Cotton Shirt)		Sri Lanka (Cotton Shirt)	
Production Costs (FOB) (100%)		FOB Costs	CMT Model
Material:	77.96%		
Cutting and Layering:	0.78%		
Sewing/Assembly:	4.76%	\$4.8 (60%)	Cost of Fabric \$0 0%
Finishing:	1.57%	\$0.4 (5%)	Cost of Accessories \$0.2 10%
Packaging/loading:	3.00%	\$1.6 (20%)	Labor Cost \$1.2 60%
Admin.	11.99%	\$0.8 (10%)	Overheads \$0.4 20%
		\$0.4 (5%)	Profit Margin \$ 0.2 10%
Energy Costs:	19.5%	\$8.0 (100%)	TOTAL COST \$2.0 100%
Labor costs:	67%		
Maintenance:	14%		
Import Costs (100%)			
Cotton fabric:	93%		
Import Costs:	4%		
Accessories:	3%		
Export Costs (100%)			
Export charges:	27%		
Interest:	21%		
Overhead:	12%		
Profits:	41%		

Source: Fonseka and Fonseka 2004.

Source: World Bank 2005

Thus, expansion of textile production capacities within South Asia, and especially in Sri Lanka and Bangladesh, can significantly lower overall production costs and enhance the region's global competitiveness.

Second, as noted widely in the literature on global commodity chains (e.g., Gereffi, 1994; 2004), different amounts of value addition take place at different nodes in the clothing chain. For example, as the Indian example in Table 15 shows, about a quarter of a garment's value is added in the spinning, weaving and textile segment of the value chain; another quarter in manufacturing, but design and branding add about half the value of the product. Those who control design and branding will also control a major share of value added. It is thus important to note that in at least two South Asian countries, Sri Lanka and India, design is emerging as a new source of competitive advantage. This ongoing upgrading is important to support as it will enable the region – and the region's firms – to retain more of the value of the products they produce.

However, how much value is extracted at each node depends on the structure of the value chain. Table 15 (above) illustrates two contrasting patterns that currently coexist in South Asia (i) the cut-make-and trim (CMT) assembly production; and (ii) full package or FOB (free on board) production model. As the two Sri Lankan examples in Table 15 show, CMT production is the quintessential example of the classic buyer-driven chain where powerful global retailers decide who produces what, where, when and how. They control design, distribution, sourcing and product specification, and the supplier merely assembles pre-cut or pre-sourced inputs. Since production, finishing and packaging are the only activities that the supplier controls, labor cost is the main component of total production cost. As in the Sri Lankan example, labor cost can be as high as 60% in CMT chains, and input cost as low as zero if the buyer provides the supplier with inputs. By contrast, input and material costs dominate production in the FOB or full package model. Suppliers have discretion over the sourcing of materials as well as the responsibility to ensure timely deliveries. As the Sri Lankan case in Table 15 shows, input costs can be as high as two-thirds of product costs in the FOB model.

The CMT model dominates much of South Asia's clothing production (such as in Bangladesh and parts of Sri Lanka). But this form of production is also the most vulnerable to footloose capital. Because labor costs are the largest expense in this model, wage costs drive sourcing decisions. Buyers thus constantly scour the globe for sites with cheaper labor and relentlessly force suppliers to cut costs and margins are continuously under strain. There are also no incentives in this model for upgrading through product development, design or research and investment unless outside actors such as the state or associations broker these shifts. Energy costs, transportation costs are also important variables over which policy has control. Better roads, cheaper and consistent power can lower production and inventory costs and add to the sector's competitiveness. Coordinated efforts at improving physical infrastructure across South Asia would thus facilitate intra-South Asia trade and development. The same can be said about import and trade costs. Trade facilitation and the deepening of local sourcing networks are therefore important policy levers that the governments can use to improve

the competitiveness of the region's clothing and textile industry and move it beyond assembly (CMT or cut-make-trim) and towards full-package production.

5. Complementarities: a ground-up view of regional competitiveness from global buyers

This section draws upon a detailed buyer survey that the author conducted between late 2006 and early 2007 with the Indian Council of Research on International Economic Relations, New Delhi, where sixteen major buyers who source clothing and textiles from South Asia, as well as other parts of Asia were interviewed. The goal was to understand how buyers rate their suppliers in the different countries from whom they source, and how they make their sourcing decisions. During field work in Sri Lanka, Bangladesh and India for the current project in July and August 2007, the same survey questions were put to a subset of global buyers based in these countries.

The buyers that were interviewed included giant discount chains such as Wal-Mart, Tesco and Target, department stores such as H&M, branded merchandisers such as Sara Lee, MAST, Nike and others, as well as buying houses and buying intermediaries such as Li and Fung, William E. Connor (a buyer for Dillard's), Otto and Agn, Mondial and others. Large branded buyers in the domestic market such as Reliance, Arvind Brands, and the retailer Pantaloons and Big Bazaar were also interviewed.

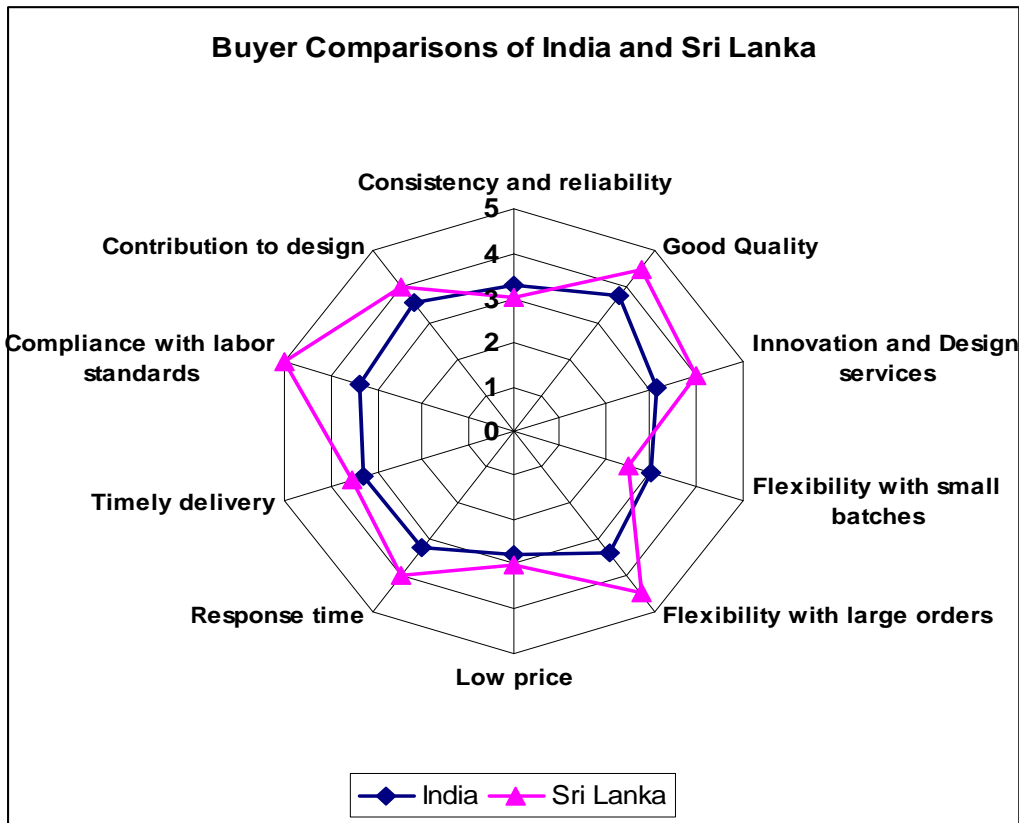
The methodology and parameters were simple. Buyers were asked to compare their suppliers in **India, PRC, Sri Lanka, Bangladesh, Pakistan and 'other developing countries'** along ten key dimensions of competitiveness based on current market conditions:

- (1) Consistency and reliability of supply; (2) Good quality; (3) Innovation and design services; (4) Low price; (5) Flexibility with small orders; (6) Flexibility with large orders; (7) Response time; (8) Timely delivery; (9) Compliance with labor standards; and (10) Contribution to design.⁵
- (2) Buyers were asked to rank each country on each of the above parameters on a Likert scale of 1 to 5, where 1 = weakness and 5 = strength. The results are presented below in a set of radar maps.

In addition, buyers were asked questions about logistics (quality of infrastructure), bureaucratic efficiency, and availability of various inputs (such as locally manufactured fabric and yarn). In contrast to the above questions, not all buyers responded consistently to these three sets of questions, therefore they are treated separately in the discussion below. Buyers were asked questions about fabric sourcing and supply as well, but only about half the respondents answered those questions fully and therefore those questions are not included in the radar charts below.

⁵ The buyer survey and some of the parameters were inspired by the study by Hubert Schmitz and Peter Knorringa called "Learning from Global Buyers."

Map 1: India and Sri Lanka



Source: Tewari/ICRIER Buyer Survey, 2007

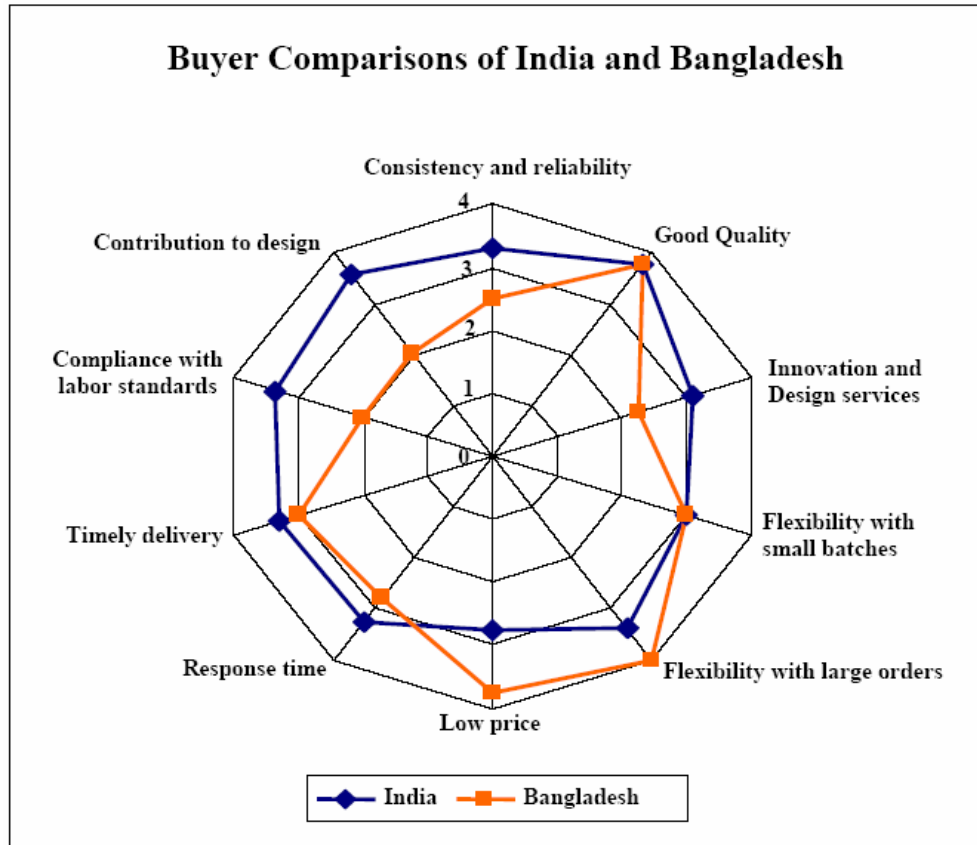
Within South Asia, Sri Lanka is a star performer in the clothing sector in terms of quality, and its winning traits clearly stand out in the above diagram. Sri Lanka leads India in flexibility with large orders, Innovation and design services, Good quality, Response time and most importantly in terms of compliance with labor standards and contribution to design. Indeed, the country's new vision is to become known for producing credence goods – 'clothing with a conscience' and 'garments without guilt.' The above charts show that global buyers perceive Sri Lanka as having made gains in that direction.

Sri Lanka is known as the design hub of South Asia. Its contribution to design, as reflected above, underscores that reputation. India is no better than Sri Lanka in any of the ten measures, except in terms of flexibility with small batches. Even there, Sri Lanka is not far behind.

In terms of a regional strategy, therefore, this suggests that Sri Lanka's trajectory is a movement toward progressively higher value added and specialized (lingerie, swimwear) clothing that is compliant with increasingly stringent labor and environmental laws. The map also suggest that Sri Lanka and India can potentially emerge as South Asia's design

hubs with their design training and educational institutions and past investments by the state and industry.

Map 2: India and Bangladesh

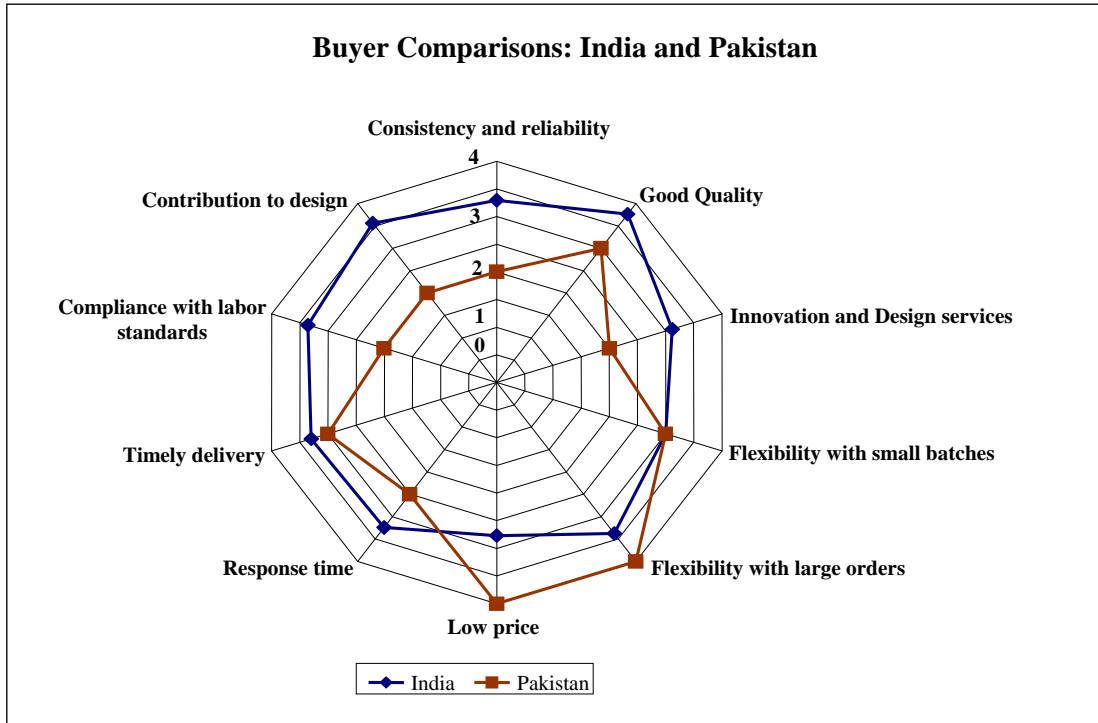


Source: Tewari/ICRIER Buyer Survey, 2007

Contrary to all expectations, Bangladesh has been spectacularly successful post-MFA. This success comes from its production efficiencies that combine low prices and mass-production with good quality and timely delivery.

As the above chart shows, Bangladesh outperforms India in terms of flexibility with large orders and low price. It equals India in terms of quality and flexibility with small batches – a potential area that many consider to be a good niche for India. Where India beats out Bangladesh is in terms of innovation and design services, compliance with labor standards, contribution to design, consistency and reliability, and to some extent, response time and timely delivery. Though Bangladesh has been a steady performer post-MFA, the narrow basis of its advantage is evident – it excels in the production of basic menswear in knits and woven fabrics. But the very consistency of its performance and its outstripping India in several areas should give pause to Indian industry in terms of areas that need to be strengthened and upgraded.

Map 3: India and Pakistan

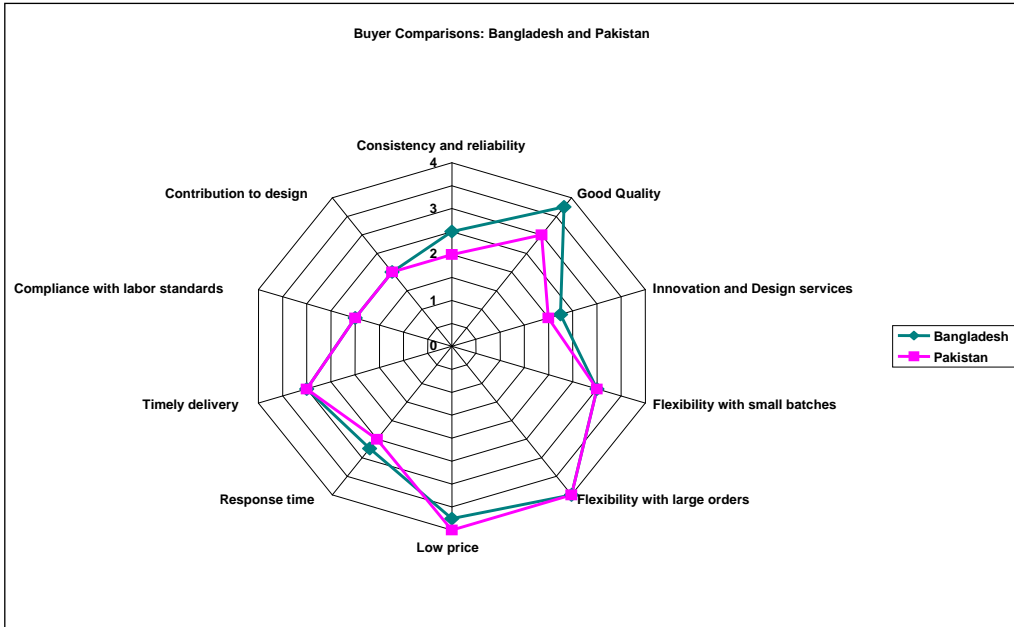


Source: Tewari/ICRIER Buyer Survey, 2007

In many ways Pakistan is similar to India in that both countries export large amounts of textiles and fabric to South Asia and the world, and both countries also have strong clothing exports. Yet, as the map above shows, scale and price are significant advantages that Pakistan has over its rivals, especially India. However, it lags behind other countries like India and Sri Lanka in design, innovation, quality and reliability.

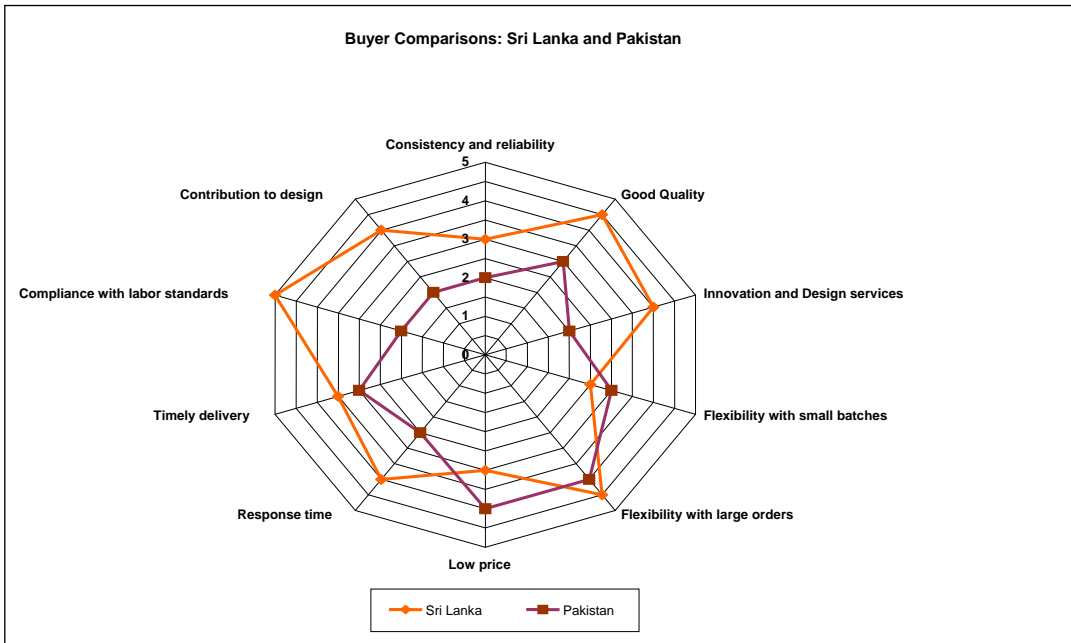
Nearly half of the sixteen buyers responded to questions comparing India and Pakistan's fabric, yarn and textile exports. Pakistan was these buyers' favorite South Asian sourcing destination for bed linen and home furnishings, especially in the US market, but also in Europe. Pakistan's advantage lay in its large volumes, its high quality fabric (in course counts needs for bed-linen) and the broad gauge of its widths. Indian fabric is produced in smaller volumes than buyers (of home furnishings, curtains, comforters, kitchen linen and bed linen) felt was viable and India's superiority lay in the mid-range and finer counts than in the standard weave. Printing technologies in Pakistan were also judged to be better than India's. Pakistan also did better than India in man-made fiber fabrics, in flannel and in fleece.

Map 4: Bangladesh and Pakistan



It is striking how similarly buyers rated Pakistan and Bangladesh in terms of innovation and design, price, ability to execute large orders, compliance with labor standards (room for improvement in both) and timely delivery. Where Bangladesh edges out Pakistan is in quality (by a significant measure), consistency, response time and ‘design’ services.

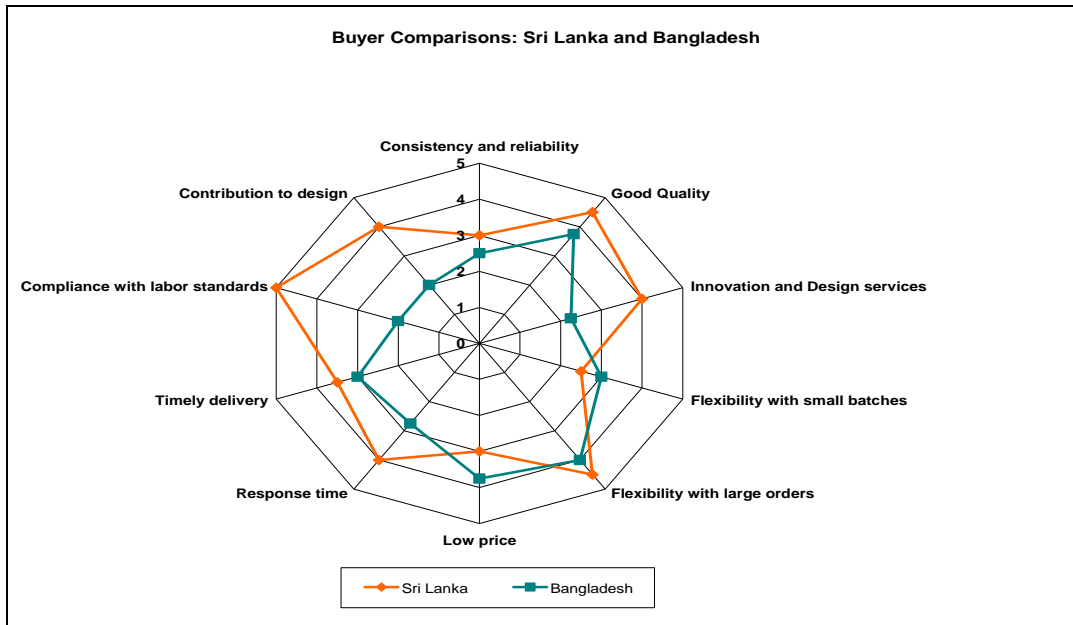
Map 5: Sri Lanka and Pakistan



Source: Tewari/ICRIER Buyer Survey, 2007

Map 5 shows the striking differences in the strengths and capabilities of Sri Lankan and Pakistani producers, at least in the minds of buyers.’ Except for price and the ability to execute large orders, as well as small-volume production Pakistan lags behind Sri Lanka in virtually all categories. A subset of buyers who source fabric from Pakistan considered the local availability of fabric as a major advantage for Pakistan. The same pattern is reflected in the comparison in Map 6 below between Sri Lanka and Bangladesh.

Map 6: Sri Lanka and Bangladesh



Source: Tewari/ICRIER Buyer Survey, 2007

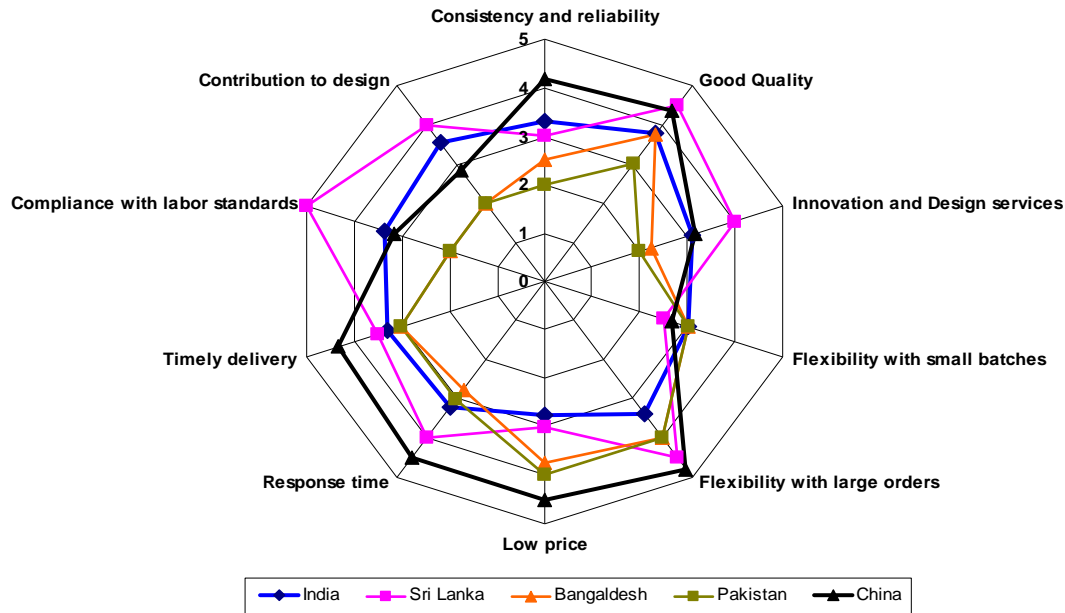
Sri Lanka clearly leads all other South Asian nations in the capabilities that buyers increasingly value in their full package suppliers. Yet it is striking that Sri Lanka has achieved these quality and design intensive standards without fully internalizing the establishment of backward linkages in textiles. The Sri Lankan case therefore illustrates that it is possible to move away from cut-make dependencies and vulnerabilities by deepening one’s ‘soft’ skills while still following an import intensive production strategy.

In the last chart in this series we benchmark South Asia’s leading T&C exporters (India, Bangladesh, Sri Lanka and Pakistan) against PRC.

This chart reveals several points. PRC outperforms South Asia on 60% of the attributes measured in the above chart. Only two South Asian countries – Sri Lanka and India perform better than PRC in any of the ten attributes measured here.

Map 7: South Asia benchmarked against PRC

Cross-country comparisons within South Asia Benchmarked Against China



Source: Tewari/ICRIER Buyer survey 2007

PRC is superior to India on six of the ten attributes studied: flexibility with large orders, timely delivery, consistency and reliability, response time, good quality AND prices. The only traits where India clearly beats out PRC is in its perceived contribution to design. Similarly, Sri Lanka performs better than PRC, and all other South Asian countries, in three areas: Compliance with labor standards, innovation and design services and contribution to design. Sri Lanka, India and Pakistan are also slightly better than PRC and Bangladesh in their flexibility with small orders.

Unlike claims that PRC is good at low end and low price point products, the quality of PRC's products is perceived by buyers to be better than India. While PRC's perfect score on flexibility with large orders is not surprising, it is noteworthy that PRC is no worse than India in terms of flexibility with small batch production, and innovation and design services. Similarly, in contrast to perceptions among policy-makers and industry interests that labor standards are slack and poorly upheld in PRC, India is no better than PRC in compliance with labor standards (and PRC no worse), while Bangladesh and Pakistan are perceived by buyers as lagging far behind PRC and other South Asian countries. Sri Lanka alone out-competes the rest of South Asia and PRC in this important area of competitiveness.

Implications for Policy

The policy implications of this comparison is that the existing areas of strength in South Asia are fragmented, relative to competitors like PRC: Countries like Bangladesh, Sri Lanka and Pakistan come close to PRC in terms of their ability to supply large orders and offer economies of scale. Sri Lanka and India by contrast can compete with PRC in terms of flexibility with small batch sizes, and in their contribution to design. However, PRC remains a much more efficient *executor* of T&C products and services. It provides buyers much greater levels of consistency and reliability, better prices, lower response time, timely delivery and scale economies. South Asia's textile firms need to do much more to improve their performance in these key areas. Governments in South Asia can also make it a priority to promote design services in the region, and build up this emerging area of competitive advantage for the region. Pakistan, Bangladesh and India need to also do more to improve their product quality and response time.

Finally, Sri Lanka clearly leads all other South Asian nations in the capabilities that buyers increasingly value in their full package suppliers. It is all the more impressive that Sri Lanka has achieved this benchmark despite ongoing political disturbances and even while it is still reliant on imported inputs. Despite this reliance on imports, it has increased its unit value realization and upgraded its design and quality standards, as well as its labor conditions. The entire industry and government collaborated to change the image and substance of its labor strategy. The Sri Lankan case therefore illustrates that it is possible to move away from the vulnerabilities associated with deep insertion in buyer-driven global value chains by deepening one's 'soft' skills and labor relations.

Next we turn to a field-based qualitative analysis of intra-regional trade dynamics within SAARC member countries in the T&C sector, looking first at trade, then market access and finally investment.

6. SAARC Sourcing Patterns in Textiles and Clothing: The Growing 'Substitution' Problem

In section 2 we saw that on the face of it, there is a rather clear division of labor between clothing exporters and textile producers in South Asia. Pakistan and India are the major fabric and yarn producers, while Bangladesh and Sri Lanka are primarily textile users and clothing exporters. Yet, as the Tables in section 2 show, there is very little intra-regional trade in textiles (and clothing) within South Asia. Both the clothing exporters of Bangladesh and Sri Lanka procure an overwhelming proportion of their textile and fabric needs (83% and 86% respectively) from outside the region.

Figure 7 and 8 below show these patterns clearly. Bangladesh sourced only 17% of its textile needs from within South Asia in 2004, the same proportion as in 1990. Over the same period its textile purchases from PRC have grown from 3% in 1990 to 37% in 2004. Similarly, Sri Lanka's textile procurement from Hong Kong, China and PRC taken together has risen from 29% in 1990 to 41% in 2005 – far outpacing the increase in its intra-SAARC textile sourcing which grew from 6% in 1990 to 14% in 2005.

Figure 7: Top sources of textile imports into Bangladesh



Source: Based on US Comtrade data. Breaks are due to missing data in 1994 and 1999.

East Asia dominated South Asia as the source of textile imports for Bangladesh and Sri Lanka’s clothing industry throughout the 1990s. This in part reflects the origins of Sri Lanka and Bangladesh’s clothing industry in the MFA-induced quota hopping investments by East Asian starting in the early 1970s. Investors and buyers from Hong Kong, China, and Taipei, China seeking sites with underutilized quotas fuelled the rise of Sri Lanka’s garment export industry starting in 1974. Similarly, investors and buyers from the Republic of Korea were the primary drivers of garment assembly and exports in Bangladesh. These export platforms gained strength throughout the 1980s and 1990s. Given the strong early role of East Asian producers and buyers in organizing these export platforms, East Asia was also the major supplier of raw materials, fabric and other textile inputs to garment exporters in Bangladesh and Sri Lanka in the early decades of growth.

As figure 7 shows, Bangladesh’s fabric imports initially came from Hong Kong, China and the Rep. of Korea. In 1990 Hong Kong, China supplied 27% of Bangladesh’s textile imports, and the Rep. of Korea another 26%. Asia n.e.s. (Taipei,China) supplied 20% (See Table 15). From within South Asia, Bangladesh imported textiles and fabric from Pakistan and India, but at much lower levels compared to its East Asian imports. Pakistan and India had a 4% and 13% share in Bangladesh’s textile imports respectively in 1990; and India’s share actually fell to 5% in 1991, while the share of Hong Kong, China and other East Asian exports rose to 32% each. East Asia was Bangladesh’s primary supplier of textiles throughout the early 1990s.

This pattern continued till the mid-1990s. A brief reversal occurred in 1997, when amidst the chaos of the Asian currency crisis Bangladesh’s imports from East Asia fell sharply (as they did across the board in several sectors) and it turned to India for the first and only time to source two-thirds of its textile requirement. By the next year, 1998, East Asian

exports to Bangladesh had rebounded, and textile imports from India had fallen back to their historically low levels of the early 1990s. Bangladesh's purchases from Pakistan followed a similar trajectory.

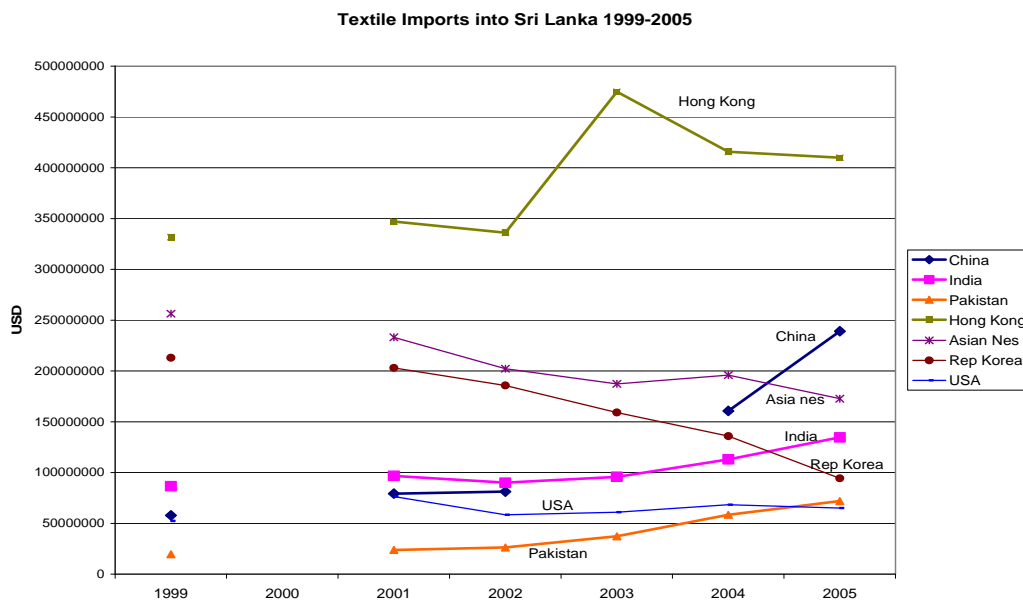
The most striking change occurred after PRC's accession to the WTO. From 2001, PRC emerged as Bangladesh's single largest supplier of textiles and fabric, with a 37% share in 2004, up from just 3% in 1990 (Table 16). In 2004-5, India was Bangladesh's third largest supplier of textiles, and Pakistan was its sixth largest, but their share remains small. Bangladesh sources only 18% of its textiles from South Asia (12% from India and 6% from Pakistan) relative to 51% from PRC and Hong Kong, China taken together, and another 23% from Taipei, China (Asia n.e.s.), Rep. of Korea, Thailand and Indonesia combined.

Table 16: Share of leading suppliers in Bangladesh's textile imports (HS 50-60, 63)

Country	Hong Kong, China	PRC	Asia n.e.s.	Rep of Korea	Thailand	Indonesia	Singapore	India	Pakistan	Sri Lanka
1990	27%	3%	20%	26%	3%	1%	1%	13%	4%	0.3%
1995	34%	13%	na	17%	1%	2%	2%	10%	9%	0.0%
2000	18%	24%	24%	10%	2%	4%	2%	6%	2%	0.1%
2004	13%	37%	11%	6%	3%	3%	0%	12%	5%	0.1%

Source: Calculated from UN Comtrade data

Figure 8: Textile Imports into Sri Lanka



Source: Calculate from Comtrade data. Missing data in 1994 and 1999 for Bangladesh and 2000 for SL.

This pattern is echoed in the case of Sri Lanka, South Asia's other net importer of textiles and fabric. In the early 1990s, when the Sri Lankan garment industry was growing

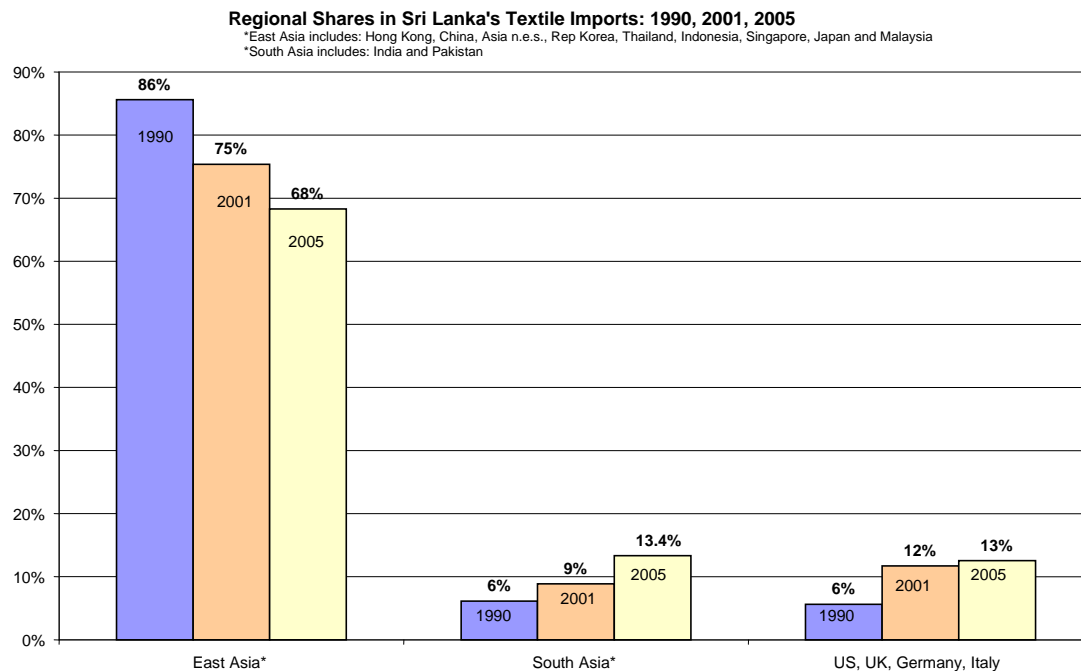
rapidly, it imported 97% of its textile raw materials from only 16 countries, nine of which were in East Asia. These East Asian countries together accounted for 86% of Sri Lanka's textile imports (led by Taipei, China 26%, Hong Kong, China 22%, and Rep. of Korea 16%); only 6% came from within South Asia (3% each from India and Pakistan). In 2005, the pattern remained roughly similar. Although East Asia's dominance has diminished somewhat, and South Asia's contribution has increased a little, the reduction in East Asia's share has been picked up by key Western countries such as the USA, UK, Italy and Germany that have increased their Sri Lanka's textile imports to 13% from 6% in 1990. While East Asia still contributes 68% of Sri Lanka's Textile imports, South Asia contributes only 13.4% (See Table 17 and Figure 9 below).

Table 17: Share of leading suppliers in Sri Lanka's textile imports (HS 50-60, 63)

	Hong Kong, China	PRC	Asia n.e.s. ⁶	Rep of Korea	Japan	S.E. Asia	India	Pakistan	Sri Lanka	West (US, UK, Italy)
1990	22%	7%	26%	15%	7%	8%	3%	3%	na	6%
1999	25%	4%	19%	16%	3%	10%	6%	1%	na	10%
2001	26%	6%	17%	15%	2%	10%	7%	2%	na	12%
2005	26%	15%	11%	6%	2%	8%	9%	4.4%	na	13%

Source: Calculated from UN Comtrade data.

Figure 9: Regional Shares in Sri Lanka's Textile Imports

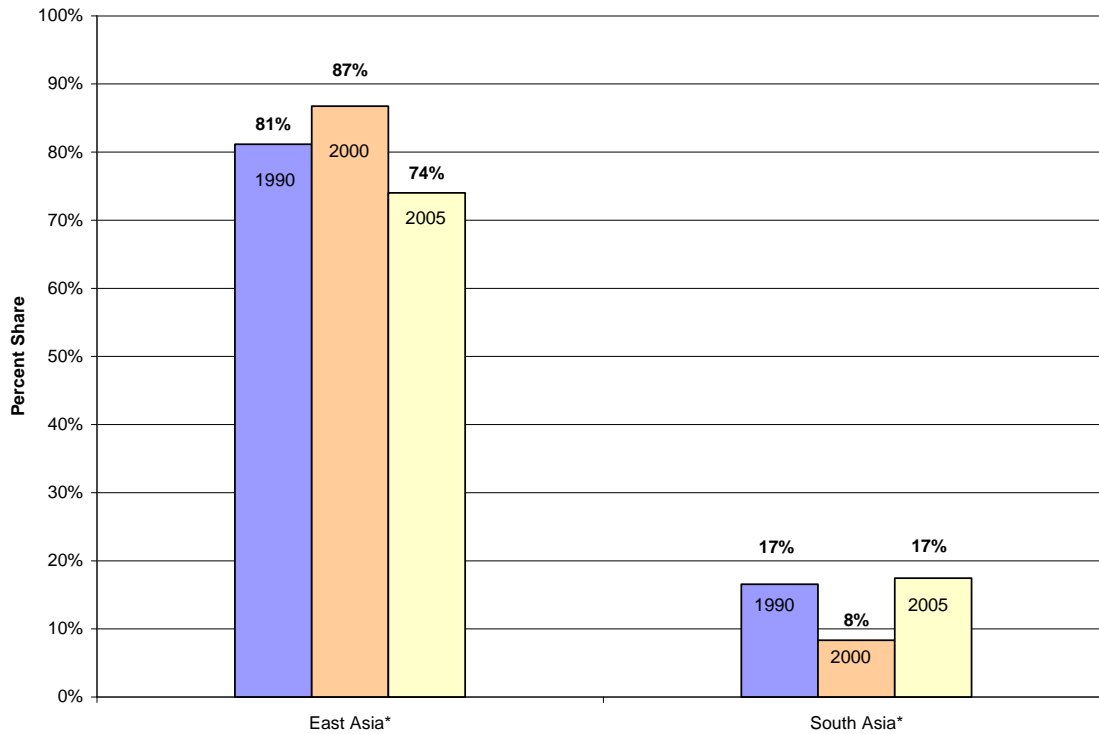


Source: Calculated from Comtrade data.

⁶ N.e.s refers to 'Not elsewhere specified.'

Figure 10: Regional Shares in Bangladesh’s Textile Imports

Regional Shares of Bangladesh's Textile Imports 1990, 2000, 2005



Source: Calculated from UN Comtrade data

**East Asia includes: Hong Kong, China, PRC, Asia n.e.s., Republic of Korea, Thailand, Indonesia, Singapore, Japan and Malaysia. South Asia includes India, Bangladesh and Pakistan.*

Figures 9 and 10 clearly show the extent to which East Asia continues to be the primary supplier of textiles to Bangladesh and Sri Lanka. Despite some growth in intra-South Asia sourcing in the last five years, 74% of Bangladesh’s textile imports and 81% of Sri Lanka’s textile needs continue to come from outside the region. Tables 14 and 15 above underscore this point

The major point that this pattern suggests is while South Asia’s share in Sri Lanka and Bangladesh’s textile imports has increased, there is a clear substitution of supply going on from outside the region. Bangladesh and Sri Lanka rely far more centrally on textile imports from PRC and East Asia than on South Asia, despite the latter’s proximity and shared geography. E.g., Bangladesh imports only 17% of its textiles from South Asia, and Sri Lanka imports even less, 14 % from South Asia.

Why is this the case? Does price drive this difference? Or does South Asia lack the product variety and quality that Bangladesh and Sri Lanka (and their final buyers) demand? In interviews with suppliers and buyers across Sri Lanka, Bangladesh and India several answers emerged.

a. Initial conditions, institutional inertia and transactions costs

The first reason for low textile imports from South Asia relates to the importance of history and past experience. Both Bangladesh and Sri Lanka have many more years of experience working with suppliers from East Asia, especially in Hong Kong, China, Republic of Korea and Taipei, China, relative to India and Pakistan which were relatively closed to trade in the late 1970s and 1980s when clothing exports first began taking off in Bangladesh and Sri Lanka.

As respondents in Colombo explained, Sri Lanka's readymade garment industry first began to expand in 1977 after the country's liberalization, and when quota-hopping East Asian industrialists began to establish their garment making firms there post the Multi Fiber Arrangement of 1974. Because of this early East Asian influence on the growth of its readymade garment industry, Sri Lanka's earliest links were with East Asia, and not South Asia. Sri Lankan firms have built ties of familiarity with buyers, intermediaries and sourcing networks in East Asia over the last thirty years, and in a quasi-path-dependent fashion, this makes it easier and cheaper to continue to do business with existing partners today. "The kinks have been worked out, transactions costs are lower," (Interview, S7, Sri Lanka, August 2007).

Sri Lanka, like Bangladesh, began its clothing exports as a CMT assembler and an assembly platform. Most assemblers in Bangladesh and Sri Lanka have traditionally had little say in whom to procure inputs from. "It was a tailoring job here. The inputs came from outside. Because East Asian industrialists drove the growth of Sri Lanka's garment industry, most of the inputs, such as fabric, accessories, buttons, zippers, and machines, all came from East Asian countries -- specifically, the Republic of Korea, Hong Kong, China and Taipei,China. So we did not have that many links with South Asia in the readymade garment industry at the start," (Interview S1, Sri Lanka, 2007).

Given this long history of business ties, there is thus institutional inertia in shifting to suppliers in a new country.

b. Designated Suppliers and networks of commissions

If the very origins of Bangladesh and Sri Lanka's garment industries are bound up in East Asian influence, then their place as CMT assemblers in buyer-driven clothing value has constrained their ability to diversify their input supply base over time. In buyer-driven global chains, assemblers have little say in determining product specification, quantity volume and sourcing decisions. Buyers and the large retailers (such as Nike, Liz Claiborne, Sears) designate input suppliers and decide whom their suppliers should source raw materials from. Many of these designated suppliers of Western buyers are in Hong Kong, China, Taipei,China, Singapore, Indonesia and Thailand (and now in PRC), where American and European buyers have a long history of immersion.

Thus, shifting to new input suppliers is not a decision that is solely the garment assembler's to make. Buyers who exercise control over the supply chain will have to be

involved in the process. To shift to new fabric suppliers while serving the same European and US buyers that a firm has long worked with, they would have to lobby their buyer to nominate new suppliers. As a Sri Lankan respondent explained, shifting to suppliers in India or Pakistan is a cumbersome process. “Sri Lanka will have to canvass a lot of buyers to nominate [new] suppliers in South Asia. The business that Sri Lanka [has] is buyer-driven and most of the fabric is manufactured to meet buyer specifications so our suppliers are nominated by the buyers. Without buyer nomination an assembler would not touch fabric from a different source,” (Interview, S1, Sri Lanka, Aug 2007).

Moreover, the cut-sew assembler who typically has relatively weak bargaining power in the value chain will have to be sure of the quality and reliability of the suppliers they are recommending, and this can induce risks that an assembler may not be in a position to take. “We have to give assurance of quality, timely delivery, price [and replenishment to the buyer]. Those are the main things,” and with new suppliers you never know. “You cannot bear the responsibility. Otherwise you are wasting time because [if you get bad quality inputs] that can really cut into lead times,” (Interview, S12, Sri Lanka, August 2007). As a result garment exporters in Sri Lanka and Bangladesh, especially larger ones have sought locally based joint ventures with suppliers designated by their buyers more frequently than branching out to new relationships. Examples of this include MAS Holdings and Brandix in Sri Lanka.

A second issue relates to the pecuniary ties that bind buyers, fabric suppliers and assemblers across the textile and clothing value chain. Money, in the form of commissions, flows between buyers, fabric suppliers and assemblers. This generates extra-economic benefits that interested parties want to keep intact, and these below the surface ties further tend to perpetuate existing relationships. “[Buyers and suppliers] want to keep [the networks they have] because they get commissions at every point. If you nominate a supplier then we have to buy from that person and the nominated supplier gives a commission to gain goodwill. All the big companies have nominated input suppliers,” (Interview, S1, Sri Lanka, August 2007).

Thus there is little incentive to disturb existing ties. However, with the rise of Free On Board (FOB) production in South Asia, where leading firms in Sri Lanka and Bangladesh are moving towards full package production that gives them greater autonomy to make sourcing decisions, the buyer no longer dictates where you buy the fabric or where you buy the buttons. With this changing organization of production, and growing flexibility, sourcing relationships can also change. It is thus not surprising to find that in recent years Sri Lankan and Bangladeshi clothing producers have begun to source a greater share of fabric and accessories from within South Asia (India and Pakistan) than previously and intra-SAARC sourcing of textiles has gradually increased.

An important implication of this shift is that in order to increase intra-SAARC sourcing more careful attention will have to be paid by policy-makers to help upgrade South Asia’s garment industry toward full package supply. As firms move away from the cut-sew-trim pattern of production toward managing their own supply and sourcing relationships, they will have greater discretion in sourcing inputs, raw-materials and

machines from countries of their choice, including from South Asia. Moreover, as we saw in Section 4, full package suppliers earn better returns and retain greater value than CMT assemblers.⁷

c. Product variety and range of choice

It is well known that Pakistan and India, South Asia's major textile producers, have large production capacities. India dominates the region's yarn spinning capacities followed closely by Pakistan. In 2000, South Asia accounted for over 30 per cent of the world's capacity of short staple spindles, 7 per cent of its long staple spindles and 8 per cent of open-end rotors. These totals have only grown in recent years. Between 1996 and 2005 roughly 5-6 per cent of the world's total shipments of shuttle-less and shuttle looms were absorbed by SAARC members as were almost 9 per cent of all circular knitting machinery shipments (William James 2007). Despite these vast capacities which are second only to PRC and in some cases the United States, intra-South Asia trade in textiles is very low. Why do South Asia's clothing producing countries (Bangladesh and Sri Lanka) not source more textile inputs from the region's key textile producing countries (India and Pakistan)?

One reason given by respondents in the field was that South Asia's textile production lacks the range and product variety that buyers are looking for. For one, South Asia's textile, yarn and fabric range is rooted in a primarily cotton base. While cotton yarn and cotton fabrics produced in this region are of excellent quality (coarser counts in Pakistan and mid range and finer counts in India), the lack of diversity in the region's fiber range and the virtual absence of a competitively priced variety of man-made-fiber and materials limit the reach of South Asia's textile exporters. The absence of non-cotton blends and versatile fabrics that are increasingly preferred by global buyers is an important lacuna that puts South Asia at a distinct disadvantage to its East Asian counterparts and PRC. For example, Sri Lanka specializes in lingerie, swimwear and other leisure outerwear that require a highly sophisticated non-cotton fabric base. This fabric is available nowhere in South Asia, except for the production capacities that Sri Lanka's own domestic and foreign invested firms have brought on board. Most of the fabric is currently sourced from East Asia or Western Europe and the US. Therefore an important reason behind weak intra-regional textile sourcing ties within South Asia is the region's lack of product variety that the region's clothing producers demand, and which countries in East Asia can readily supply. By focusing on a narrow product range South Asia's textile producers have excluded themselves from the networks of supply and demand that are emerging in the region.

Product diversification beyond cotton is thus an important priority for South Asia's textile industry if it wishes to move out of the narrow niches it is currently locked into. Industry associations and business intermediaries have an important role to play in this process, but so does the state. Anachronistic tax laws and excise duties on man-made

⁷ In the case of Sri Lankan cotton shirts discussed in section 4, we saw that the value of the final product increased three-fold from \$2 to \$6 per shirt when producers went from 'labor-job' or 'cut-sew' manufacturing to full package production.

fiber in India and Pakistan have militated against the expansion of non-cotton textiles in the region. For example, even today, after at least three rounds of tax revision in the textile sector, Indian laws still tax man-made-fiber at twice the rate (16% in excise tax) as they do cotton yarn (8%) (Ministry of Textiles, 2006).

Some respondents argue that in addition to high excise taxes (in the domestic market), high duty structures also militate against product diversification by obscuring from firms information about demand structures and shifting global market trends in ways that can skew investment patterns. According to one global buyer based in Bangalore, India, “Imports are an important part of the clothing business...The duty structure in the Indian context warps demand and excludes certain product groups from being shown to consumers [and local producers]. Since Indian manufacturers are not seeing competitive merchandise from these product baskets they will resist investing in these sectors under the incorrect assumption that demand is not there. For example, [aside from man-made fabric] Indian manufacturers are reluctant to invest in fine gauge knitting machines - 14 gauge and above – because of this reason. It is costly to import the fabric produced on these fine gauge machines due to the duty structure and thus demand is thwarted because of artificially inflated prices. The reality is that no fashion retailer in the West, East or Europe can do without these products. So these high duty structures are especially harmful for the future growth of the export industry since the capabilities to produce these garments are not being developed,” (Buyer Interview, I6, Bangalore, 2006). The state can help resolve this problem in part by restructuring incentives and tax structures so that product diversification is encouraged rather than discouraged.⁸

d. Bundling

The attractiveness of PRC, Hong Kong, China, the Republic of Korea and Taipei,China, as suppliers of textile inputs to Sri Lanka and Bangladesh over South Asia is deepened by the possibility of “bundling” the sourcing of a variety of inputs and manufacturing services within the same trade relationship. For many South Asian producers PRC, Taipei,China, and the Republic of Korea are important sources not only of fabric, but also accessories, trims and textile machinery. The relationship began with the sourcing of fabric from East Asia as a result of the designated supplier process discussed above and gradually spread into other areas, such as East Asian fabric suppliers giving advice to their South Asian clients about what kinds of machines were best for what kinds of fabrics. At first, in the early and mid-1990s the Republic of Korea and Taipei,China were the main producers of these relatively low cost machines, but in the last half decade, the People’s Republic of China (PRC) has become the main source of machinery imports into South Asia, especially into Sri Lanka and Bangladesh.

⁸ Historically the high duties and excise rates on man-made fibre and fabric were a defensive measure to protect the domestic handloom and powerloom industry from competition. But several studies have by now documented the resilience of the local handloom and powerloom base in the face of stiff competition. There is thus ample room to accommodate great product variety and diversity in the industry.

Firms visited in both Bangladesh and Sri Lanka, as well as several in India, had made major investments in purchasing new machines from PRC. As one Sri Lankan respondent put it, “PRC not only produces clothing and textiles, produces cheap copies of all the sophisticated equipment [they once imported] from Europe and Japan. [They] have taken all the technology, absorbed it and are now putting it into manufacturing....Their huge domestic market helps them to build the machinery, develop it, and test it. Today they are a recognized supplier of equipment to the clothing industry. Any machine you want, you can buy from the Chinese at a fraction of the price. And the quality is not all that bad and you can [even] afford to throw it away in a few years...People who were using the French, German and Swiss textile machinery, particularly in spinning, and weaving, now have Chinese equivalents. (Interview, S1, Sri Lanka, August 2007).

Thick channels of trade in one area (such as fabric and accessories) have thus facilitated the transfer of knowledge and goods in other spheres as well (such as higher order technology and know-how). Latecomers in the machinery market (such as India and Pakistan) will need to do more to catch up with their East Asian competitors to compete for intra-regional business not only in fabric but also in textile equipment.

This thickening of ties is in part because inter-regional trade relationships have been turning into FDI relationships as PRC and other East Asian countries increase their investment in the production of textiles in Bangladesh and Sri Lanka. As some respondents explained, PRC and Taipei Chinese firms as well as those from the Republic of Korea, and Indonesia have been steadily setting up *textile* plants in Bangladesh and Sri Lanka in the last five years. Thai firms are also now following suit. A significant amount of fabric is still imported, but as Asian investors locate fabric making plants within Bangladesh and Sri Lanka, they also import machines and accessories from East Asia while producing textiles locally. About 40% of the overseas investment in the textile and clothing sector in Sri Lanka is from East Asian investors (Board of Investment Interview, Sri Lanka). By contrast, intra-South Asia investments by SAARC members amount to less than 2% of total FDI in textiles and clothing in the region (BOI, Sri Lanka and Bangladesh 2007).

e. Price

How does price play into these sourcing dynamics and to what extent does it overcome distance and proximity at a time when timely delivery is key to global competitiveness in the clothing industry? Opposing strands of evidence emerged from the field. On the one hand, a subset of global buyers said they were moving to consolidate their regional sourcing from South Asia to match more closely the patterns of local fabric availability. At a time when costs and speed to market are increasingly important parameters of exports, “buyers are not interested in moving [large volumes of] fabric around the world, so local capacities are very attractive to us,” (Sourcing officer of a major U.K. based retail chain, Interview, I3, Bangalore). He said, for example, that they were looking ...to move nearly 40% of their East and South Asian sourcing of casual bottoms and cotton shirts to India “because of the local availability of [appropriate] cotton fabric ... and dramatic recent improvements in the quality of middle range materials in India.” On the

other hand, not all buyers felt this way. For some it is the bottom line that dictates whether to buy local fabric or import it especially when small amounts of diversified material or specialized fabrics are involved. They note that world class fabric quality is available in just a handful of South Asian firms, that too in a narrow range of fiber and finishes, principally cotton-based. The same goes for Pakistan. Even in a country like PRC, with its richly diversified fiber and fabric base, a large amount of fabric still continues to be imported. So for a significant subset of buyers it is price and quality that determines whether to source fabric locally or not (Interview I16, Delhi office).

The overwhelming finding from numerous interviews in Bangladesh and (especially) Sri Lanka was that despite proximity to India and Pakistan, and the much greater distance between them and PRC and other East Asian countries, **“it is cheaper for us to source from PRC [and East Asia] than it is to source from India or Pakistan.”** The difference is not only in absolute costs, they said, but includes energy costs, the bureaucratic costs of sourcing and transporting goods from and within South Asia versus from PRC or East Asia, and the myriad tariffs, para-tariffs, infrastructure gaps, port costs and other non-tariff barriers that make it costly to source fabric efficiently even from across a contiguous border as in the case of Bangladesh and India, or India and Pakistan, relative to other parts of Asia.

For example, according to a buyer for a major US department store, “In polyester fabric, an Indian firm can sell the fabric at a basic cost of \$1.50 per meter, whereas a Chinese firm can do the same fabric at \$0.80 cents per meter. At the higher end of the fabric, Chinese pricing is better than India’s by 5% to 10%,” (Interview, I15, New Delhi). In many other areas, such as denim and worsted fabric and blends, India’s price disadvantage with respect to PRC ranges anywhere from \$1 per meter to \$7 per meter (Interview, S12, Sri Lanka, 2007). What accounts for these price differences? Respondents pointed to at least five reasons.

High energy costs. One source of the price difference lies in high energy costs in many parts of South Asia, especially in India and Pakistan, relative to PRC and East Asia. “The cost of power is becoming a big problem. In fact power cost has increased by 100% in the last 5 years [in India]. India is about 20% to 25% more expensive than [PRC]. Due to quality and consistency problems [in the state’s power supply] we have our own captive power units, but then our capital is vested in the power units and that again adds to our operating cost indirectly,” (Interview, I12, India). For some firms the price difference can be as high as 50%. One producer calculated that “Very roughly, on an average in our plant power cost per unit is Rupees 3.30, and in [PRC] it is the equivalent of Rupees 2.20 per unit,” (Interview, I8, Mumbai, 2007).

Low scales of production and low productivity. Other respondents pointed to non-price determinants of higher product prices in South Asia – low scales of operation and low productivity. A leading European buyer who sources heavily from South Asia as well as East Asia noted that India in particular suffers from the twin problems of “poor scalability and low productivity” which lead to high prices. In cotton, India has vast production capacities, but low yields per acre - much lower than Pakistan and PRC and

half the level of the United States... “In mass consumption items like, trousers, shirts, ladies shirts, India has to compete with countries like [PRC], and Bangladesh which have better prices because they have larger scales of operation, and use modern methods in lean manufacturing.” In textiles power-looms keep productivity low while limiting the quality and volume of output. “India has high finishing [post-treatment] cost, high cost of transportation, high port costs, and, a convoluted tax structure with toll tax, excise tax, and a very high tax rate,” (Interview, I17, New Delhi, 2007). All of these lower production efficiency, add to the cost of production and hence to final prices.

Specific duties, high tariffs and customs costs. Similarly, in the case of some non-cotton products, such as Poly-Viscose fabric, the import duty in India can vary from 15% to 200% depending upon the product category. This wide range leads to tremendous misclassification by smaller and ‘fly-by-night’ operators that creates problems for the entire industry. This is exacerbated by complex custom clearance rules. “Custom clearance is highly bureaucratized in India, comparatively, there is far less bureaucracy and much easier custom-handling in Sri Lanka and even Bangladesh,” (Interview, I10, August 2007). Others point out that on paper India is considered cost competitive because of low labor costs, “but then, Indian garment exporters have to pay 18%-34% duty,” which neutralizes any factor cost advantage that the industry may have. Specific duties imposed by countries like India on a significant range of textile and garments are an added burden on importers. These compounded duties use an ad valorem rate to calculate a specific duty that is imposed (generally) on low value products for which domestic demand is high (Taneja and Sawheny 2007). In addition to all of these, India imposes a variety of countervailing duties (of 16.3%) on most items, and a variety of cess charges. All of these duties serve to raise product prices.

Transportation costs. Transportation bottlenecks similarly add to lead time and inventory costs thus inflating risk and raising production price. A Mumbai-based supplier gave an illustrative example: “I am 450 kilometers from the Bombay dockyards. In my plant in Thailand, situated 500 km from the port, the container gets on board the same day or the following day. Every day in the evening at 5.00 o’clock the container will leave the company gate and reach the dock next morning, by normal course, no follow-up required. In India it takes three days to cover 450 kilometers [which should take no more than 1 day]. On the fourth day they load the container. So it takes more than four days [for my shipment to be dispatched], and for one week the goods are lying around. This is a very high inventory cost to bear,” (Interview, I8, Mumbai, 2006). Thus infrastructure-induced bottlenecks add to lead times and raise the cost of inventory that producers need to carry. When passed down to consumers, this can raise prices to uncompetitive levels.

Harmonization of standards and trade rules. As others have noted in the literature, shipment speeds are also slowed down by the varying levels of duty prevalent across the Harmonized System (HS) of product schedules in various member countries and the time required for the verification of the detailed product category to which the item belongs (James 2007, Taneja 2007). While 6-digit HS categories are globally standardized, 8 and 10 digit HS categories are country-specific. The same 8 digit category in India and Bangladesh may mean very different final products (Interview, Directorate General of

Foreign Trade, New Delhi, July 2007). This opens up numerous loopholes when bilateral rules have to be meshed with region-wide protocols and/or implemented on a reciprocal basis. This is also precisely where a clash between intra-regional norms and domestic regulations and tax regimes creates tremendous space for delays and mis-implementation (James, 2007, Karmakar 2007). A problem that was cited repeatedly by garment firms in Bangladesh and Sri Lanka who export to India are the non-tariff barriers to market access imposed by India's complex testing protocols. For example, a firm exporting garments from Dacca via Petropole must send its samples and items to Chennai, more than 1100 km away for testing. In the interim, there are no bonded warehouses at the customs station for the importer to store their products. This arbitrary assignment of testing centers adds significantly to the inconvenience and cost of exporting to India and puts potential investors off.

The consequence is price escalation and spiraling upward creep of inventory risk. Sometimes this is passed on to the consumer – making the producing country's product less competitive, and at other times when the price escalation is not fully passed on, it erodes the producers' bottom line.

These price differences have also affected the GSP schemes run by the EU and their rules of origin. A brief example from Sri Lanka illustrates the point. In July 2005, just after the Tsunami devastated much of South East and Southern Asia, Sri Lanka became the first South Asian nation to qualify for EU's 'GSP Plus' scheme. This scheme represents the new EU preferential terms of trade for vulnerable developing countries (European Commission 2006). To benefit from this scheme countries need to demonstrate that their economies are 'poorly diversified and therefore vulnerable and dependent.' That is, the five top segments of GSP-covered imports to the EU must account for 75% of the beneficiary's total GSP-covered imports. In addition, the beneficiary nation would have to have ratified and implemented the 16 core conventions of human and labor rights and at least 7 out of the 11 conventions on good governance and protection of the environment. These latter requirements set the GSP-Plus scheme apart from EU's other GSP schemes for developing countries, and has been used to specifically benefit developing countries that had faced environmental calamities such as the Tsunami (see the European Commission's 2005 press release for more details).

The GSP-Plus scheme provides Sri Lanka fast-track and duty free access to the EU. But like other GSP schemes for poor countries, Sri Lanka must meet EU's 'double transformation' rules of origin – of moving from yarn to fabric and fabric to garments locally within the country. In 2005, EU expanded the local rules of origin to include all of SAARC. Sri Lankan got these benefits under GSP-Plus as well. It imports from SAARC would still count towards its GSP benefits. On the face of it this makes perfect sense as a mechanism to expand intra-regional economic cooperation. But Sri Lanka's readymade garments industry has been lobbying against SAARC cumulation, and for *super-cumulative rules of origin* that would allow them to source inputs from countries beyond SAARC as well – specifically, ASEAN plus PRC, Japan and the Republic of Korea. This is because of the prevailing view among a majority of Sri Lanka's garment producers that certain fabrics, finishes, and inputs are cheaper to source from East Asia

and PRC than from South Asia, and that a reliance on SAARC would make them globally uncompetitive. This has created complications in the implementation of the region's GSP agreements with the EU.

Bangladesh has similarly rejected EU's SAARC cumulative rules of origin on the same grounds that without flexibility to access cheaper inputs from PRC or other East Asian countries, they risk becoming uncompetitive.⁹ Improving the price competitiveness of South Asia's textile industry is thus a critical priority.

As this section has shown there are several powerful reasons why there is weak and fragmented textile sourcing from within South Asia. Even today, after attempts to integrate the region through SAFTA, SAARC and EU's SAARC cumulation rules, member states still prefer to source textile inputs, accessories, and machinery from PRC, select East Asian countries and the EU, rather than from their more proximate neighbors. This is despite the existence of large textile production capacities in the region.

To meaningfully counter this trend of SAARC moving away from the region in terms of procurement and trade, at least in the textile industry, it will be crucial to make improved trade facilitation the center stage of SAFTA implementations going forward. Improved trade facilitation as well as domestic upgrading efforts would help member countries improve the efficiency of their textile industries and lower their product prices. SAARC, under India's current Chairmanship, should prioritize the discussion of finding concrete ways to simplify tariffs, rationalize para-tariffs, remove specific duties that countries like India impose on importers, lower energy costs so that South Asia is at least at par with its Asian neighbors, improve import and export intermediation procedures at ports and land routes (such as Petrapole), and facilitate transportation and infrastructure reforms. A recent study by Mirza and Hertel (2007) provides compelling evidence for the need to reduce non-tariff trade barriers within the region. The authors show that trade facilitation reforms can increase intra-regional trade in South Asia by nearly 64% (from US\$ 2.5 billion to US\$ 3.9 billion).

A good place to start would be to revisit the long negative list that SAFTA's trade liberalization programme allows member countries to retain. Numerous recent studies have pointed out that more than half - almost 53% -- of the total import trade between SAFTA members is subject to the negative lists of member countries (Taneja and Sawhney 2007). This has not only limited the scope and viability of the SAFTA regime, but textile and clothing trade has been particularly hard hit as a result of exclusions carved out under the negative list. Fully 34% or over one third of the items on the negative list belong to the textile and clothing product category. This must be discussed immediately under SAFTA and at SAARC in time-bound fashion. Another item that should be targeted for immediate removal is India's anachronistic specific duties on textiles and readymade garments. Finally, despite tariff reforms, textiles and textiles articles account for some of highest tariff lines (on the sensitive list) in a majority of

⁹ The experience of central American exporters with NAFTA and CAFTA's binding Rules of Origin that force them to use expensive American yarn and fabric is evidence that these fears are not unfounded.

South Asian countries. India's tariff lines in textiles and clothing are among the highest, at 34.2% (Nepal is the highest with 37%); Bangladesh is next at 31.6% and Pakistan at 24% (Taneja and Sawhney 2007). All these countries should follow Sri Lanka's lead, which has a tariff rate of 1.9%, and lower tariff lines on textiles and textile products in the sensitive list. Simplification of customs rules as well as the installation of bonded warehouses at customs stations along the Indian border would be another concrete measure to improve goodwill, lower costs and improve cross-border movement of goods.

Other than prices and trade costs, this section also identified low scales of operation, low productivity and poor product variety as problems that limit intra-regional textile trade in South Asia. Textile line agencies and business associations need to mount a serious program of product diversification and upgrading in the region. An important measure to enlarge product variety could be to use programs such as India's Textile Technology Upgradation Fund (TUF) in a strategic and targeted way to promote product diversification. But more than that, it is important that textile firms are able to access up to date information about market demand so as to learn about industry trends and make informed investment decisions. Toward this end, it may be worthwhile to have South Asian governments partner with industry and multilateral organizations such as the ADB to fund the visit of a South Asia wide team of textile producers to cutting edge hubs of textile production such as in Prato,¹⁰ Italy, Turkey, Hong Kong, China and PRC.

While low scales of operation are not a problem in and of themselves (witness Italy's highly successful textile industry that is dominated by sophisticated small and medium firms), economies of scale and scope should nevertheless be leveraged – at the level of an industrial district or geographic cluster, as well as individual firms. Rather than viewing scale as merely a proxy for low value, standardized mass production or a source of dangerous rigidity in volatile global markets, South Asian firms would do well to learn from Hong Kong, China's example where large scales of operation did not always produce rigidity. Instead, firms used technology and work-organization reforms as well as inter-firm relationships strategically to produce multiple lines of products within a single factory floor. As Berger and Lester (1997) note, some yarn makers in Hong Kong, China produced over seventy different kinds of yarn variety, simultaneously, on a single shop floor (Berger and Lester 1997). A key to this was how they organized the shop floor (in a modular system), how they deployed technology (flexible, computer numerically controlled machines where patterns can be switched rapidly without wastage and down-time) and the firms' deep embeddedness within world class distribution networks. Scale economies and productivity are therefore not only a characteristic of technology and the level of capitalization, but it is important to emphasize that the *realization* of scale economies is also an organizational attribute. Competitive firms, or clusters of firms should be able to both increase scale efficiencies as well as enlarge product variety and quality, individually and collectively. Indeed, even in South Asia, innovative programs launched by business associations such as ACMA (Automotive Components Manufacturers Association of India) and UNIDO in related industries such as automotive components has helped raise the productivity and performance of a large

¹⁰ Prato is a major textile-making center in Italy known for its wool industry.

number of small auto-component makers (Tewari 2007). Lessons can be learnt from such programs for diffusion to the textile sector.

The next section builds upon the above discussion to take a deeper look at some specific intra-regional divisions that have been blocking freer market access to member countries so as to enhance intra-regional trade and investment in the region's clothing sector.

7. GSP, Backward Linkages, and the Rules of Origin Conundrum

Rules of Origin, costs of compliance and their indirect effects

As alluded to in the previous section, one of the central issues that emerged as a major hurdle to freer trade between SAARC member countries, at least in the textile and clothing industry had to do with compliance with Rules of Origin. As observers including James (2007) have noted, costs of complying with the rules of origin are an important determinant of how much of the trade that occurs within SAARC actually benefits from the preferential concessions available under SAFTA and other preferential trading regimes such as the European GSP. Indeed, the examples discussed in this section raise questions about the logic of some of the rules of origin that undergird tariff-free access not only under SAFTA, but also under other Generalized Systems of Preference of the EU that invoke SAFTA's and SAARC's geographic space. Drawing on examples from Bangladesh and Sri Lanka with respect to EU's GSP, and tariff-free access to the Indian market under SAFTA this section illustrates how and under what circumstances the costs of compliance with rules of origin can be a limiting factor to encouraging intra-regional trade within SAARC.

A primary conundrum is the political costs of fulfilling rules of origin that clash with each country's desire to develop backward linkages. To take the case of Bangladesh first, section 1 showed that Bangladesh's clothing industry began as an assembly based export platform initially for quota-hopping East Asian garment exporters. Its cut-sew-and trim model was supported primarily by fabric imports – it had no textile base of its own. Initially, when clothing exports began in 1974-6, the lions share of garments exported from Bangladesh were woven shirts and pants. Much of the woven fabric was imported because Bangladesh had few backward linkages into textiles domestically. In woven garments, 75% to 80% of Free On Board price of a garment is material or fabric cost. Thus, three-fourths of the cost of the garments assembled in Bangladesh constituted imports. This structure made Bangladesh very sensitive to import tariffs and fabric price in competing supplier countries. Consequently, at the start of Bangladesh's clothing exports, East Asian countries (notably Hong Kong, China and the Republic of Korea) were its primary fabric suppliers. Throughout the 1990s, the export composition of Bangladesh's garment industry was 80:20 woven garments to knitted garments, therefore access to fabric, and import costs were a key issue for importers and domestic policy makers. The more successful the garment industry became, and the more it exported, the faster its imports grew.

Several policy initiatives fuelled the growth of Bangladesh's clothing sector. First, the external trading regime of quota-restrictions instituted under the MFA in 1974 brought in garment producers from the Republic of Korea who invested in numerous joint ventures in Bangladesh, set up large mass-production units, trained the local workforce, and got Bangladesh's modern clothing industry going in the first place (Rhee 1990). Second as exports grew, and fabric imports grew simultaneously, the government of Bangladesh instituted two domestic reforms to lower import costs. It brought down average tariffs drastically – from 65% to as much as 30%, and subsequently even lower, it removed various restrictions to imports, and allowed duty-free imports for export purposes. And, it introduced the facility of bonded warehouses for the benefit of the ready-made garment industry. With a Bonded warehouse, a garment exporter could essentially forget about the cost of the fabric. Under a master LC (Letter of Credit, that constitutes a formal contract) from a buyer, a garment firm could import fabric with payments deferred till after final sales were concluded. At that point the buyer paid both the input supplier and the garment assembler. Under conditions where fabric costs constituted 75% of a garment's FOB price, local firms could begin production with just 25% of the total value needed to set up a garment factory. They could bring in fabric without paying for it, nor did they have to any duty on the fabric. This lowered the barriers to entry drastically and encouraged the rapid growth of the domestic garment industry.

Two external policies further fueled the growth of the industry: the workings of the MFA, specifically, the progressive expansion of quotas under the MFA in the US and EU market up to 1995, and then the continued expansion of quotas in the ten year phase-out period from 16% to 17% to 25%. And the granting by the EU of GSP facilities and tariff free market access to Bangladesh on account of its least developed country (LDC) status.¹¹ Both of these market-expanding external regulations stimulated rapid expansion of clothing export in Bangladesh. As exports grew, fabric demand within Bangladesh also grew. This exploding demand for fabric, and the heavy inflow of imports, created the incentives in the mid-1990s, and the pressure, to develop backward linkages into textiles. A few clothing exporters who had accumulated capital (including those with East Asian partners) began to invest in domestic fabric making facilities – both for knitwear, for which capital costs were lower, and for woven fabric. This gave rise to a small but increasingly strong and 'nationalistic' domestic textile lobby within Bangladesh for the development and further sheltering of backward linkages within the country in the mid to late 1990s.

To deepen these emerging industrial linkages between the clothing and textile sector the government of Bangladesh instituted a set of "output related incentives" including a 25%

¹¹ The European Union's Generalized System of Preferences (EU GSP), a system of preferential trading arrangements through which the EU extends preferential market access to developing countries came into effect in 1971 following UNCTAD's recommendation of a GSP system to industrial countries in 1968. The EU GSP was revised and refined several times, but by the time Bangladesh's clothing industry took off in the 1980s and qualified for tariff free and quota-free access to the EU under the 'Everything But Arms Initiative,' that the EU offered to 50 of the world's poorest and 'Least Developed' countries the standard rules of origin involved a 'double transformation' principle. To benefit from the GSP, two value added jumps had to be carried out within the beneficiary country.

cash incentive for export oriented firms that used locally produced inputs and met certain value addition stipulations (such as 25% value addition domestically for basic garments and 15% - 20% for higher priced garments (valued at \$60 or higher) that fell under non-quota and quota categories respectively (CPD 2007 and 1999). These cash incentive policies however did not take into account the depth of local content in the domestically made inputs and textiles, such that cotton and yarn continued to be imported. The emerging textile industry was also supported by low (subsidized) interest rates and government support in terms of investment in land development, power and infrastructure (CPD 1999).

A dualistic and contradictory set of incentives built into the EU's GSP system further fuelled this process of backward integration. This was the double transformation rule, and the fact that the EU GSP was based on a 'stages of production model' rather than on a model of value addition. Exporters in Bangladesh qualified for a full 100% exemption from the 12.5% tariff in the EU only if they carried out two 'jumps' locally – the conversion of yarn to fabric and of fabric to clothing. In woven clothing, where 75% of the fabric was imported, this double transformation was hard to achieve. If a firm imported fabric from a third country, even within South Asia, it did not get GSP benefits. In the mid-1990s, therefore, the garment industry lobbied the Bangladesh government and EU to alter the rules of origin so that local producers of woven exports, Bangladesh's leading exports, could benefit from the GSP.

The EU did accede to a change, and in 1995 and again in 2001 offered the regional cumulation amendment, whereby, exporters could avail of the same GSP treatment as a localized firm as long as they imported fabric from within the region to which they belonged – i.e. from SAARC member countries in the case of Bangladesh. These intermediate imports would be treated as 'domestic production' under the revised GSP. But two developments led to a rejection of the SAARC cumulation rule by Bangladesh. First, by the time this change came on board, there was a significant domestic lobby of textile producers both of knit and woven fabric. Whereas in the early 1990s local producers were able to meet only 4% of the industry's fabric requirement, by the mid-to late 1990s they were able to meet 20% of the industry's total fabric requirement. Later, by the early 2000s the domestic textile industry was able to meet 80% of the country's knit fabric needs, and 20-25% of its woven fabric requirement. The textile lobby was thus gaining strength. They strongly rejected the regional cumulation agreement, arguing that it would disrupt their growth, benefit Indian and Pakistani fabrics exporters and undermine the development of backward linkages in Bangladesh. With national interest and the sentiment of self-sufficiency versus dependence thrown into the mix, it became politically difficult for the government of Bangladesh to support the regional cumulation rule. "The Bangladesh government did not take any position on the issue and in fact we did not go for regional cumulation for this reason," (Interview, B17, Dhaka, August 2007).

The second reason why public and industry sentiment militated against SAARC cumulation was that under the rule, the rate of concession depended on where in the region (in which country) the value addition was highest. "The regional cumulation rule

was such that if I import fabrics from India the EU will give me GSP benefits because it has been procured from within SAARC but the rate of concession will be determined by that country where the value addition has been highest. In the woven sector, [where 75% of the cost of production is fabric cost] if I import fabric from India the value addition is roughly 75% in India and 25% in Bangladesh. So I will get GSP not according to the eligibility of Bangladesh (Zero tariffs) but according to the eligibility of India. But India being a developing country gets not 100% rebate from the 12.5% tariff, but only a 15% rebate. So, why should I bother if I get 15% rebate and not 100% rebate? (Interview B17, CPD Dhaka, 2007).

But the issue is not as monolithic as it might first appear. The issue ultimately is one of political stalemate and contestation between opposing domestic factions. There are important cleavages and differences among interest groups across the textile value chain. For example, garment exporters in Bangladesh, in contrast to the textile producers, would stand to gain from any cost reductions that GSP application would bring. Garment exporters thus argued in the late 1990s that even if they got a 15% rebate that was something. It gave them an advantage of 2% that they could pass on to their buyers and gain favor and market share. “The EU importer would have to pay not 12.5% duty, but 10% duty, and that can go a long way toward benefiting exporters.” But even while garment exporters are a majority in terms of numbers, the textile elite are far more affluent, have deeper pockets and much greater political reach and influence. In combination with the nationalistic sentiment generated by the backward linkage debate, and a volatile and fluid political scene, the small but vocal infant industry protection lobby of textile producers ‘won’ out, and persuaded the government of Bangladesh to forgo regional cumulation.

In Sri Lanka, this same debate erupted when EU extended the GSP-Plus scheme to Sri Lanka after the Tsunami in 2004. But in that context, the local demand was for the extension of the SAARC cumulation rule to include East Asia as well, and the creation of super-cumulative rules of origin. As seen in the previous section the issue here was less overtly about backward linkages, but rather about costs and competitiveness. Exporters in Sri Lanka feel that it is costlier for them to source fabric from South Asia compared to East Asia and the PRC. The fabric range in South Asia is also inadequate. Consequently they argue that being forced to rely solely on South Asia’s fabric base will make them globally uncompetitive. This is a high cost to bear for regional integration.¹² Similar concerns about the cost of compliance with rules of origin have emerged in the context of SAFTA and the individual trade agreements being negotiated by member countries, such as Sri Lanka-Pakistan, Sri Lanka-India and India-Bangladesh FTAs. Sri Lankan and Bangladeshi importers have protested against India’s demands that the fabric for garments exported duty-free to India either be produced locally or purchased from India (Interviews, Sri Lanka 2007, Bangladesh 2007).

¹² As noted before, the experience of countries like Mexico and their concern with NAFTA rules of origin which force them to either source fabric locally (from a poorly developed textile industry) or from (high cost) US companies shows that the concern about costs is not unique to South Asia.

Today, this debate, especially about the EU GSP is once again the focus of intense lobbying not only by Bangladesh and Sri Lanka but many LDCs as they put pressure on the EU to revise its GSP and rules of origin. The argument is that there is only 50% usage of EU's GSP by LDCs (Interview, B17, Bangladesh, August 2007). Critics argue that this suggests that the rules are too complex and GSP benefits do not reach the intended beneficiaries. According to respondents in Bangladesh and Sri Lanka, what is the point of the EU claiming that it gives concessions to the poorest nations when only half of its concessions can be utilized them. So there is mounting pressure on the EU to simplify its rules. One proposal under consideration is to bring down the local content requirements, and change the system from a 'stages of production' model to a 'value addition' model.

This discussion illustrates four points.

First, as demonstrated by Bangladesh's rejection of the SAARC cumulation rule under the revised EU GSP, it shows that the distributional consequences of regional integration (displacement and intensified import competition) can often seem orthogonal to the demands of local development (such as the development of backward and forward linkages). Regional integration can put pressure on nascent local producers, expose them to direct competition with experienced outside producers, and complicate the fostering of local linkages. This is primarily because the goals of regional collaboration and local development are often perceived as zero-sum tradeoffs that can be hard to reconcile. The challenge is to find ways to transform these supposed trade-offs into more positive sum outcomes, strategies and sequences (Tendler 2006). This can be done by searching for, and building upon areas of common, overlapping interests that can generate wider linkages and spillovers across the region, rather than to focus on differences. Subsequent sections we will discuss whether cross border investments can achieve such spillovers, and what kinds of institutions might help foster them.

Second, even if the goals of regional cooperation are laudable, high costs of regional trade and local production inefficiencies can make the dynamics of regional cooperation unworkable, as illustrated by the Sri Lankan case and its demand for super-cumulative rules. For regional cooperation to work, local production networks must be individually strong and efficient. Regional integration thus cannot come at the expense of developing and deepening local capabilities. In the South Asian case this means both, improving the competitiveness of the textile industry in individual countries (such as in India and Pakistan), lowering their product prices, as well lower the costs of intra-regional trade through trade-facilitation reforms.

Third, as some observers have noted, there is immense wariness in the smaller countries of being overwhelmed by India's market size, its potential investments and control over resources and local markets. There are thus real concerns in South Asia's smaller countries about opening up their borders to fuller trade and investment from India. If borders are opened, what will be left behind and what will be denuded? Thus the onus is on India, the largest economic power in the region, to lead the way by simplifying its rules of origin, improving product prices and diversifying its product range in ways that

are relevant for the region's garment industry. Only when individual members see that their individual benefits are tied up with the growth of the region as a whole, can regional integration be sustainable.

In this regard it would seem that the SAARC cumulation rules under the revised EU GSP are good for promoting regional cooperation, but are not workable under the current conditions of high regional trade and production costs. Some argue that the EU should not compromise by acceding to Sri Lanka's push for super cumulative rules, or tinker much with its revised GSP for Bangladesh. Bangladesh's rejection of SAARC cumulation rules, they argue, indicates that SAARC cumulation rules will indeed facilitate greater regional trade and investment, and this may be a threat to the domestic textile industry which is why local textile makers object to them. Instead efforts should be targeted toward pulling up the productivity and performance of South Asia's textile producers by lowering production costs, increasing efficiency and inducing strategic technical and organizational modernization, and of course, by lowering the administrative costs of intra-regional trade. For its part, the EU could consider modifying the rate at which value addition is measured within beneficiary countries, allowing countries like Bangladesh to enjoy fuller tariff exemption on intermediates imported from within the SAARC region.

Finally, a larger point that this discussion illustrates is the power of agency and local politics in shaping the nature of regional integration. It shows how contention and confrontation between actors located at different nodes of the clothing value chain – e.g., Bangladesh's garment exporters versus its textile lobby – influence (and are influenced by) the wider trajectories of trade and investment dynamics. It is striking the extent to which relatively small countries like Bangladesh and Sri Lanka can compel much larger powers, such as the EU, to change or alter their GSP rules (even if marginally) through continued resistance. In 1995 the EU came up with the SAARC cumulation rule under the revised GSP in response to regional pressures. It is once again considering simplifying its GSP, and is said to be moving towards adopting value-added rules of origin rather than the traditional double transformation principle. This illustrates how seemingly weak actors on the 'periphery' can re-shape apparently invincible trade rules put in place by powerful actors who drive global value chains today.

8. Investment: Is cross-border investment an answer to the conundrum of weak intra-regional trade?

If trade is tricky, what about investment? If backward linkages, costly rules of origin, and the fear of trade leakages prevent the expansion of regional textile trade in South Asia, can intraregional investment be a way to overcome the tariff costs, trade costs, and mindsets illustrated in the examples presented above? If so, why is there such little intra-SAARC investment in the clothing and textile sector?

Only two South Asian firms (both Indian) have invested in Bangladesh's clothing and textile industry (Arvind Mills is one) according to the Board of Investment of Bangladesh (Interview B28, Dhaka, August 2007). And as Table 18 below shows, three South Asian

textile firms have invested in Sri Lanka and two Pakistani firms have invested in Bangladesh. Ironically, the largest intra-S.Asia investment is from a large Sri Lankan clothing exporter, Brandix, which is developing an integrated fabric and final goods making clothing park in India's Andhra Pradesh state. This 1000 acre park in Vishakhapatnam's export processing zone, was initiated in 2005 with an investment of US \$750 million. The total investment in the park is expected to grow to \$3 billion in five years (Brandix, Sri Lanka).

Table 18: South Asian investment in Textiles and Clothing in Sri Lanka, Bangladesh and India as of August 2007

In Sri Lanka

Name	Ownership Structure	Product	Employment
Jay Jay Mills (Pvt) Ltd (India)	Joint venture FDI: Sri Lankan Rupees 42 Million Local Investment: Rupees 40 Million	Manufacture of Textiles and Fabric	47
Victory Enterprises (Pvt) Ltd (India)	100% foreign owned Rupees 10 Million	Bed Linen	Not disclosed
Hitex International (Pvt) Ltd (Pakistan)	100% foreign Owned Rupees. 14.775 Million	Bed Linen	Not disclosed

Source: Board of Investment, Sri Lanka, August, 2007

In Bangladesh

Name	Ownership Structure	Product	Employment
Arvind Mills (India)	Under negotiation FDI: Not available	Manufacture of Textiles and Fabric	Not available
Prime Textiles (Pakistan)	Not available FDI: Not available	Bed Linen And Fabric	Not disclosed
Bexim Co. (Pakistan)	Not available FDI: Not available	Bed Linen and Textile fabric	Not disclosed

Source: Board of Investment, Bangladesh, August, 2007

In India

Name	Ownership Structure	Product	Employment
Brandix (Sri Lanka)	100% foreign owned FDI: US\$ 750 million	Clothing park Including facilities to Manufacture fabric	Not available

Source: Brandix company, Sri Lanka

a. Why firms in South Asia want greater intra-SAARC investment

There is an important disjuncture in the reality and rhetoric of intra-regional investment in the SAFTA region. On the ground, and as the above table shows, there is relatively meager intra-South Asia investment in the clothing and textile industry. Yet, in interviews, firms and policy makers offered numerous reasons why they *want* more South Asian investment in the textile industry and why there is general enthusiasm for sourcing intermediate inputs such as fabric and accessories from within South Asia. There are at least six reasons emerging from the interviews below. These reasons pertain specifically to benefits that firms see as accruing to them due to the proximity, cost and time savings and economies of scale generated by intra-SAARC investments. Firms see these benefits as contributing to the production of regional production networks (of textiles and clothing) that would make South Asian firms as a whole more globally competitive, helping them compete more effectively with extra-South Asian competitors in export markets as well as at home.

(i) Leveraging economies of scale

First, in interviews with companies like Brandix officials said that the company's interest in setting up the 'Brandix clothing city' in India was to harness the Indian government's investment support in creating a common infrastructure pool in the region so as to generate an agglomeration of related companies in the clothing park. In setting up its own yarn and fabric making plant for sophisticated, fashion-driven swimwear and lingerie, the company not only wants to supply fabric to its own plants in Sri Lanka, but use the large and growing size of the Indian market to achieve economies of scale and new markets (Interview, S3, Sri Lanka, August 2007).

(ii) Lead times and the time pressures of customization

Second, policy makers and firm owners in Sri Lanka and Bangladesh spoke of the need for greater South Asian (and extra-South Asian) investment in textile and fabric production within their borders. This would not only create backward linkages within their clothing chain, but would cut down the cost and time of sourcing textile inputs overseas. It can take up to a month or more to source fabric, and in an industry where delivery times are becoming shorter and shorter, this is a liability. As one Sri Lankan respondent noted, "The main investment Sri Lanka is looking for is in the textile sector. We need more investment in the fabric area. Indian and Pakistani firms can set up joint ventures with Sri Lankan partners and cater to the diversification of the domestic readymade garment industry as well as promote exports. They can invest not only in fabric, but accessories such as buttons, buckles, corrugated cartons, or machinery. All such investment are welcome," (Interview, S1, Sri Lanka 2007).

Bangladeshi officials and firms made similar arguments. "There are opportunities for Indian investments here and Pakistan is showing a lot of interest to invest in Bangladesh in the textiles sector. Within the region there is such a large captive market, particularly

in the woven wear sector. Bangladesh exported \$4 billion worth of clothing [in 2006] year. If 75% of this constitutes fabric, then \$3 billion worth of fabric is required. Out of that only 20%, or \$600 million, is currently made locally. So there is a 2.5 billion dollar worth of fabric market over here. That is why people are eyeing Bangladesh: Pakistan is coming and the Indians are also showing some interest in investing here,” (Interview, B17, Dhaka, 2007).

For many firms, the greatest advantage of greater intra-regional investment in textiles is the cost and time that would be saved if the sourcing of fabric could be made more proximate and local. The growing air connectivity between South Asian countries certainly has the potential to make imports speedier, but customs costs and delays add significant uncertainty and leave a lot to be desired. “Nothing compares with local sourcing,” one respondent emphasized. Local investment would not be much faster, but it would allow greater interaction between suppliers and buyers. This would lower the risk of losses of time and money through miscommunication of specifications, quality and design requirements, but it would allow for greater customization at lower costs. In an industry where market volatility and demands for greater variety require producers to be responsive to quick changes in design and product variety, the ability of buyers and suppliers (of intermediates) to interact closely can be an important source of competitive advantage. While Bangladesh currently specializes in longer runs of more standard products, the Sri Lankan and Indian cases show that upgrading and higher returns are associated with the ability to diversify flexibly into the production of both long runs and shorter batches of variable designs.

(iii) Inventory costs and risks

Third, in the clothing industry, where nearly 70% of production costs are accounted for by intermediate inputs such as fabric and textiles, a related reason for more proximate access to intermediate inputs is the need to cut down the costs of holding inventories in transit as well as in storage. As the literature on lean retailing (Abernathy et. al 1999, Nordas 2004) has shown vividly retailing and production practices in the clothing industry have changed significantly in the past fifteen years. With growing consumer preference for greater variety and shorter fashion cycles, retailers have sought ways to reduce their risk of holding inventories of items whose demand may wane quickly. This has led to the model of lean retailing and very short procurement cycles. Using sophisticated communication technologies such as Electronic data interchange (EDI) technologies that relay point of sale information from the retail floor to the supplier located thousands of miles away, as well as more refined and fine-grained demand forecasting techniques, more and more stores replenish their shelves with new items on a weekly basis, and some like Zara (and even some Walmart Stores) on a daily basis. This has pushed suppliers --who have to source inputs such as fabric and accessories much more frequently and in smaller volumes to keep up with this shortened product cycle -- look for ways to reduce their own inventory risk. Abernathy et. al 2004 find that in-process and in-transit inventories are as risky as traditional inventories of stocks held. That is, firms that succeed in competing in this volatile world of short cycle procurement are those that hold the least amount of input inventories as well as stocks. This means

that the time it takes to procure intermediate inputs is a critical variable in a supplier's cost competitiveness. If it takes one month to source fabric, it may well be too long for a company if it specializes in goods that need to be replenished on a weekly or shorter term basis.

Although a majority of South Asia's clothing exporters operate on a 60 day production cycle, the trend is moving toward far shorter turnaround times and being stuck with obsolete inventories is a growing risk. Several leading exporters in Sri Lanka, Bangladesh and India spoke of the pressure to vertically integrate backward into fabric making to deal with these pressures, or to build relational ties with locally based fabric producers. Intra-regional investments in textiles that would deepen the availability and choice of locally fabric producers within South Asia is a high priority for many clothing exporters.

(iv) Specialization

Akin to the "flying geese" model of East Asia's regional investments, others spoke of regionally specialized investment that could help create regional production networks within South Asia, or at least specialized sourcing hubs for fabric and accessories. The goal of such production networks is not only to allow investments to flow to areas where comparative advantages in particular tasks are greatest, but the goal is also to improve the size, quality, cost-competitiveness and diversity of the textile sector in South Asia. One respondent compared the processes to ASEAN's experience with the Proton car. "When the Proton car was being manufactured, the tires were done in Thailand, the seats were done somewhere, the assembly was done in another country. This type of specialization can be taken up by South Asia in garment production, say Sri Lanka does lingerie type of garments very well, India does another type of garments very well, if that type of thing can be worked out with effective South Asian cooperation, it will be very good for the region with much more exchange of garment accessories and inputs in addition to the traditional fabrics and yarn" (Interview, S1, Sri Lanka, 2007).

Some noted that South's Asia's existing comparative advantage in basic (cotton) fabrics and made-ups could be played up more with better regional collaboration. "Even if you don't go through the specialization route, there are certain fabrics that can be bought at far cheaper rates from South Asia than from other regions such as East Asia. For example, when it comes to basic fabrics like towels, bed sheets and cotton yarn, the fabric and yarn coming from India and Pakistan is the cheapest even now. For a different kind of fabric, such as synthetics, specialized fabrics with lycra, some denims, East Asia may be cheaper, but South Asia has its own advantages" (Interview, S1, Colombo, 2007). These advantages cannot be leveraged fully unless production is expanded and streamlined. Streamlining production also means adopting harmonized and compatible standards across the region. This induced modernization would allow for the adoption of more state of the art and effective technologies and ERP schemes that could lower costs, cut turnaround times and increase product diversity.

(v) Modernization

Yet others are looking for South Asia-based lead firms to help modernize SAARC's T&C sector, upgrade its supply chain and underwrite the risks of adopting new standards and technologies. They point to how the giant Indian company Tata's recent purchase of Tetley (the UK based company with stakes in many South Asian tea estates) had helped spark significant changes and modernization in the South Asian tea industry. "Likewise if one of these big garment giants purchases enterprises in one South Asian country and then tries to create links to suppliers in other South Asian countries, there will be better prospects of growth for South Asia.," (Interview, S1, Sri Lanka, 2007). The arrival of Sri Lanka's Brandix holding company into India, and Arvind Mills' forays into Bangladesh hold similar promises for supply chain upgrading in each region.

(vi) GSP benefits

Finally, as noted earlier, GSP benefits in South Asia's most lucrative markets such as in the EU, are associated with local and intra-SAARC sourcing. Given the high costs of tariffs in the region, the high costs of trade, and historically driven local resistance to ratcheting up imports from South Asian neighbors, many firms felt that increased intra-regional investment in textiles would be a way for clothing producers across South Asia's poorest countries to benefit to a much greater extent from GSP schemes such as those of the EU.

b. Why is there so little intra-regional investment despite professed interest?

Despite these possibilities and potentialities, there is very little intra-SAARC investment in textiles, especially compared to investments by East Asian countries (PRC, Taipei, China, the Republic of Korea, Indonesia and Thailand), US and Europe. For example, East Asia and PRC account for 40% of textile investment in Bangladesh and Sri Lanka (now under BIMSTEC)). The US and Europe also have large shares, especially in Sri Lanka's clothing sector. Since 2003, PRC's investments in Sri Lanka have included not only production related investments, but also over \$20 million in the re-construction of small harbors and ports, including the launching of a major project involving the development of Hambantota port. Of the leading 20% of foreign invested Sri Lankan firms that account for nearly 90% of the country's clothing and textile investments, at least four are from the Republic of Korea, one from Indonesia, four from Hong Kong, China, five from the UK, four from the US and one from Japan (Board of Investment data, August 2007). By contrast, as seen in Table 18, only three South Asian firms have invested in Sri Lanka's clothing sector. The picture in Bangladesh is no different.

Why has greater regional investment from South Asia not been forthcoming in a sector that has a 'natural' division of labor in the region – with two countries demanding fabric and two countries able to supply¹³ and despite the professed interest on the part of several regional firms to wanting to see more intra-regional investment in textiles.

¹³ One hint of the potential for such investment and even trade to exist are reports of tremendous concealed trade between West Bengal and Bangladesh that has grown rapidly in the last decade. In fact one

(i) Inward Orientation

On the face of it, two reasons for this lack of more robust investment by India and Pakistan in clothing exporting countries like Bangladesh and Sri Lanka are obvious: the first is the long years of inward orientation in both India and Pakistan. India for example was preoccupied with meeting domestic demand for cheap cloth throughout the 1970s and 1980s and forced a domestic focus on its textile industry through high export tariffs and domestic hank yarn obligations as well as by declaring the sector an essential commodities sector, hence bringing it under the purview of strong government control that restricted both imports and exports. Later, as the country opened up in the 1990s, firms sought to build ties with Western markets over and above local and regional ties, as well as meeting domestic demand which grew rapidly throughout the 1990s.

(ii) Conflict

The second, rather obvious reason is the security situation in Sri Lanka and Pakistan. As several Sri Lankan respondent noted, “The top [issue] in Sri Lanka is this uncertainty in the business environment and incentive regime that has come about due to the war. If the war was not there the garment industry would have been doing far better than what it has been doing,” (Interview, S1, IPS, Colombo, 2007). These uncertainties, one can argue, created disincentives to South Asian investment in Sri Lanka, Bangladesh and Pakistan. But the same uncertainties of war and the same security concerns did not deter the East Asians from investing quite heavily in Sri Lanka and Bangladesh.

(iii) Quasi-legal and bureaucratic barriers to investment

On the face of it there are few obvious legal barriers to intra-regional investment in textiles and clothing in South Asia. There is no overtly discriminatory legislation on the books in any country. But factually, what is unwritten is perhaps as important as what is written down, and what does not happen is as important as what does happen. Though the rules do not bar investment from any South Asian neighbor, in reality there is a lot more scrutiny of proposals from some South Asian neighbors relative to say, investors from the US or Europe or PRC or East Asia. There are longer delays, files get “lost” or are arbitrarily put on hold as “new evidence” is sought (as explained by an interviewee at the Bangladesh Board of Investment in the case of the investment proposals from a large Indian multinational), or motives are pondered over. These factors related to the burden of history discussed in the next section and the “x-factor” that many say comes to play with regard to mutual dealings within some South Asian neighbors. If these problems would be put in the context of a specific legal instrument that hampers investment, it would be the lack of a credible investment protocol or treaty or MoU within SAARC which can safeguard cross border investment in the region.

government official said categorically that there is fabric being dumped in Bangladesh by Indian textile firms at such low rates that the lack of deeper backward integration in Bangladesh is in no way a cost-disadvantage to them.

(iv) Burden of history

The deeper reasons for low intra-regional investment therefore lie elsewhere. They lie in what happens on the ground when South Asian countries seek to invest regionally. Arguably this problem is sharper for India, given the threat others in the region perceive from its large size, its regional dominance and the subcontinent's traumatic history. Nonetheless, the problems of history are manifest throughout the region. Two Indian firms, Tatas and Arvind have been trying to invest in Bangladesh (Tatas not in textiles) for the last three years, but nothing has moved on the ground. For one reason or another Bangladesh authorities have stalled making decisions. As the officials of the Board of Investment in Bangladesh themselves admitted, "There is some 'X'-factor in the Tata case....It is a behemoth. It wants to enter into the power and natural resources sector which are sensitive sectors for Bangladesh. Their request came in unsolicited, not through any competitive bidding process. People are naturally wary,"(Interview, BOI, August 2007). But why are people not wary of similar investments by the US and U.K. in power and natural resources? Thus inescapably one arrives at the legacy of history; of partition and of the see-saw effect of party-positions – some political parties are pro-Pakistan, some are pro-India, some are pro-Bangladesh, some are rightist and some are neutral – on regional dynamics. Most of the higher ranking political and policy personnel that I had occasion to speak with said that the industrial and political elites in the country are simply uncomfortable with allowing in Indian investments, or even prioritizing a SAARC framework of investment over ties with other countries, particularly, with the US, EU, East Asia, and the PRC. "You don't want to get tied down [within the region]," (BOI, Interview August 2007).

As one large entrepreneur who had just built a state-of-the-art modern vertically integrated spinning, weaving and garmenting facility in Dhaka explained, "there is no logic to this." He spoke of having been approached by Indian, Pakistani and Thai firms in the very recent past for setting up joint venture partnerships for the production of fabric and garments. The firm-owner had turned down both the Indian and the Pakistani firms. He said, "If I have to choose between a Pakistani investor, an Indian investor and a Thai investor, I will pick the Indian over the Pakistani, but I will pick the Thai any day over the other two. It is just my history," (Interview, B21, Dhaka, 2007)

Despite the pessimism this invokes, an astute Sri Lankan respondent noted the different dynamic that exists between the subcontinent and Sri Lanka when it comes to establishing and maintaining regional ties. "We can work with Pakistan quite easily, with India and with Bangladesh. India can't do that. Pakistan can't do that. Bangladesh can't do that. India cannot work either with Pakistan or with Bangladesh. [But] it would be very easy for Indian businessmen to come and work here, and through Sri Lanka work with Bangladesh and Pakistan. It would be the same for a Pakistani or a Bangladeshi. India has a lot of resources but Sri Lanka has the flexibility and a certain set of forward linkages with the region politically...." (Interview, S7, Sri Lanka, 2007).

c. Leveraging new opportunities to overcome the burden of history

The ‘important political forward linkages’ that Sri Lanka has with the region’s other key members hints at the depth of history that the region must overcome. But how “structural” are these difficult histories of the past? This is where, I would argue, it is useful to move beyond static, narrow and historically determined categories of difference to think more innovatively and dynamically at identifying sequences of events, or sets of conditions that will break these historical bottlenecks and convert preconditions (such as the need to build trust and so on) *into outcomes*. That is, can we think of situations and circumstances or sequences that will help generate just those missing ingredients (e.g., trust) that we assume we need before we can even move forward? How can feuding and mistrustful members of the region be brought together as partners without waiting to sort through all of their histories and contentious past?

In this regard some events that can potentially break some of these “structural bottlenecks” specifically in the textile sector, may well just be in the offing. One example of such a pressure point is the impending end of safeguards on PRC in 2008.

(i) Demand for structural change: E.g., the post-2008 opportunity vis-à-vis PRC

There is a strong sense among some garment producers in Bangladesh and Sri Lanka, as well as India, that the expiration of Chinese safeguards imposed by the EU and US in 2008 will represent an important turning point for the region. Suppliers and some policy analysts in Bangladesh pointed out that after PRC entered the WTO in 2001, Bangladesh’s exports to the US had begun to decline. Between 2001 and 2005, Bangladesh’s exports to the US declined by about \$400 million (James 2007, B17, CPD, Dhaka, August 2007). So that tells us something about what might happen once the safeguard measures go in 2008. There might be demand for structural change in the industry post-2008.

The lifting of safeguards on PRC would intensify international competition. This would push countries to go for more cost cutting. That might make the case for greater risk sharing, textile investment and regional cooperation in South Asia that much stronger. “You cannot compete with [PRC] by importing fabrics that cost 75% of the value. Indeed, the international cost of fabric may also go up if cotton subsidies in the USA are withdrawn,” (Interview, B17, Dhaka, 2007).

Many analysts and industry actors therefore are of the view that the market for textiles and clothing in South Asia is likely to undergo another structural change post-2008 which might put pressure on firms to forge cooperative ties, build joint ventures and deepen intra-regional investment to remain globally competitive. This ‘demand for structural change’ can be leveraged and may well create the conditions for greater cooperation between SAARC countries that have so far seen little need to depend on each other and take advantage of their shared geography and complementary competitive advantages.

Specifically, this means that regional cooperation will have to be led by investments in textile and fabric production. Secondly, the region will have to ramp up its production capacities – both in fabric and clothing, and thirdly it will need to better leverage the emergent design capabilities in Sri Lanka and India to offer greater product variety. The pressures will be to cut costs, improve quality, lower turn-around times (increase speed to market), and offer better variety and value. In other words, move towards full-package production at the level of the region. It will be important to strategically utilize the distinctive strengths of SAARC members: lingerie and fashion driven swimwear and formals in Sri Lanka, basic cotton and knit clothing and sports-oriented outerwear in Bangladesh, home furnishings and bed-linen in Pakistan and embellished garments, and design intensive products in India. In addition to upgrading production capabilities, the region will need to improve cross-border distribution and transportation networks, upgrade technologies and induce a greater inflow of capital into the T&C sector.

(ii) Investment agreements and mutual recognition of standards

In this regard, institutional supports to aid these processes will need to be put in place. The most important of these mechanisms is a regional investment protocol or agreement. Some efforts towards this are already underway in the context of SAFTA. There has been talk of getting a regional investment agreement signed soon, and many observers feel that a viable investment agreement will be signed at the next SAFTA Summit. In fact there was a proposal to set up a **SAARC Investment Fund** to give credit at low rates to encourage firms to invest within the region. India, with its current Chairmanship role has the opportunity to play an important brokering role in bringing this to fruition soon.

These investment agreements are an important institutional tool to dispel some of the mistrust that the region's history has sown within South Asia investors. The mutual suspicions described in the examples in the foregoing section, rest in part on the fear of losing control over the fair returns from investments made by the subcontinents industrialists in each other's economies. A strong framework of clearly written rules of engagement that help underwrite these mutual investments would raise the confidence of investors of getting a fair deal. Low interest rate credit to facilitate cross-border, intra-SAARC investments would serve as an important initial inducement to encourage first movers to take the 'risk' and make such investments. Over time as more firms from each country invest in each other's markets, common interests that cut across narrow national definitions of self-interest and competition can create just the positive sum business alliances across South Asia that the current zero-sum climate prevents. Once investors from member states perceive – and experience – the common interest, subsidized credit lines or even investment funds can be phased out.

The push for greater trade facilitation under SAFTA will also be important to promote cross-border investment more vigorously. As one respondent in Bangladesh said: "Trade facilitation will be a major factor for overall trade and investment in South Asia. If SAFTA gets a bit more effective then investment will follow but that will take more time...." (Interview, B17, Dhaka, 2007). But the political economy of the region is complicated. Local actors themselves realize that there will likely not be any radical

change over-night. “It will be incremental. It will take many years and there will be a lot of lost opportunities,” (B17, Interview, Dhaka, 2007).

(iii) Harnessing the global linkages of a new generation of professional entrepreneurs

One of the most striking findings of the fieldwork was to come across a tier of young professionals, sons and senior managers of older family firms, or in some cases new start-ups, who shares a common professionalism, global linkages, education and a forward looking business ethic. This new generation of entrepreneurs has little hesitation in working with partners across borders in South Asia so long as their partners were professional and globally oriented.

For example, in the story cited earlier of a Bangladeshi firm owner that had rejected joint-venture overtures from an Indian company, and who had said if he had to choose between an Indian, a Pakistani and a Thai partner he would choose the Thai any day – had an important twist. His son, who had just joined him as a partner after completing an MBA from the United States expressed a different view. To him, what mattered was the partner’s business style and ethics, not his or her nationality. In fact, he had sought permission from his father to follow through on an independent deal to establish a joint venture in Bangladesh with a leading Indian garment manufacturer. That the top manager of the company on the Indian side was also educated abroad (in the United States, where both had lived and worked for several years), and was seen by this respondent as a thorough professional was also significant.

This example is a very hopeful one. It suggests that it may well take the next generation of entrepreneurs from the region to overcome the baggage of the region’s history and begin to work together, and to do business more professionally. But the good news is that this is beginning to happen, and what is especially striking is that this is occurring not only in the private sector but within government bureaucracies as well. Some of the younger officers in agencies such as the Board of Investment (in Bangladesh and Sri Lanka), marketing and trade promotion agencies, as well as business associations had the same professional outlook and shared experience overseas and greater exposure to each other’s markets. This trend must be encouraged by national governments, but especially by SAFTA’s leadership and by agencies such as the ADB and the World Bank. New forums should be created to allow for and induce greater interaction and inter-mingling between the region’s younger entrepreneurs and government managers. Joint marketing trips, joint leadership development courses, joint exposure to cutting edge business practices and technologies, exposure to design and value addition, are examples of the kinds of forward looking activities that could bind the region’s emerging generation of professionals in the textile and clothing sector.

(iv) Leveraging an inter-penetrated regional labor market

Another example of a new and hopeful dynamic is the growing inter-penetration of South Asia’s textile and clothing labor market. Despite assumptions that South Asia’s textile and clothing industry is oriented away from each other rather than towards, I was

surprised to find a relatively high degree of inter-penetration in Sri Lanka, Bangladesh and India of skilled workers and managers from each other's labor markets. For example, a majority of managers and technical personnel in Bangladesh's leading and mid-sized garment factories are from Pakistan and India. A large number of quality control and design personnel and set-up consultants in the industry are from Sri Lanka (At least two of the four plants I visited in Bangladesh had Indian General Managers and Sri Lankan design and quality control consultants). Similarly, Sri Lankan consultants abound in India and according to respondents, in Pakistan as well. Numerous designers trained at India's prestigious National Institute of Fashion Technology (NIFT) work in Sri Lanka – with buying houses as well as in design departments of large companies such as MAS Holdings and Brandix. Some NIFT graduates work in Bangladesh. Many students from each country are studying in training institutions of other countries in the region. The growing trend toward 'Fast Fashion' for example has created great incentives on the ground to deepen design skills in South Asia, and students are vying for admission in Sri Lanka and India's emerging design education centers.

This broad and growing diffusion of managerial and technical staff across each others' markets is an excellent sign of the deepening integration in the region's T&C industry. This movement of personnel across borders is creating the conditions for the diffusion of ideas, best practices and exchange of information across SAARC borders. This in turn has the potential to create a common space and a shared language that may help overcome years of wariness by forging positive-sum joint dependencies. However, changes in and simplification of visa rules will be needed to keep this growing interpenetration afloat.

(v) Building on past successes

Finally, despite these difficult political economies, there are examples of success to build upon, not only in textiles and clothing, but in even more contentious sectors such as water sharing and riparian rights. As the former Foreign Minister of Bangladesh pointed out, "I never imagined there would ever be a water sharing agreement between Bangladesh and India. There were real problems on the ground. India's position was diametrically opposed to Bangladesh's. The early talks were non-starters, zero-sum negotiations. Yet we managed to pull it off" (Interview, B30, Dhaka, 2007). Then there was the Dhaka-Kolkata bus route that was successfully opened up, and the proposed train service along the lines of the already operational Pakistan-India train line. There is also recent forward movement on the Indo-Sri Lanka FTA on market access and investment. And as Table 18 has shown, there is indeed some growth in intra-regional investments in the Textile and Clothing industry in the last five years.

There are also signs of more coordinated efforts in easing cross-border trade. Important measures have been taken by India and Bangladesh on border points and water transport movement. Indian ships can come to Bangladesh with goods, and there has been important progress in the synchronized development of ports on both sides of the border. For example, both sides are trying to coordinate the development of major ports such as Petropol, Benapol, BanglaBond in a coordinated manner. There is also more coordination

with regard to storage facilities at customs points and the bringing of vehicles up to container depots at border crossings (Interview, B17, Dhaka, 2007). Although there are no immediate protocols or Memoranda of Understanding (MoU) on vehicular movement, which remains an important non-tariff barrier to trade between the two countries, other shifts are slowly taking place. Protocols are being negotiated and signed, and these are all major developments.

Going beyond the textile industry, there is also momentum, respondents point out, on the memorandum of understanding regarding the mutual recognition of standards. Although this measure does not relate directly to clothing, there are important measures related to certifications about the presence of Azo dyes that are relevant for the textile industry. “India has offered to give technical assistance for strengthening Bangladesh’s institutions and testing capacities. It has also eased other regulations. For example, earlier, if Bangladesh was exporting cement to Meghalaya (in the North East) the cement had to first go to Chennai [which is 1200 km away in the Southern state of Tamil Nadu] for testing. These problems have been eased. If this MoU [is signed] then another non-tariff barrier, a major and costly stumbling block is crossed,” (Interview, B17, Dhaka, 2007). The burden of history is thus not so onerous as to be insurmountable.

These small successes point to the importance of identifying opportunities for a public sector role which would not require the use of significantly more resources, or radically new ways of doing things, but rather a willingness to listen, persist and build on the region’s growing number of positive experiences rather than remaining trapped in old assumptions.

9. Market Access: first best?

Can growing intra-regional investment create the conditions for boosting intra-regional trade in textiles and clothing, and facilitate market access, rather than the other way around? Can such investments create inducement mechanisms that will help bring about a freer flow of goods and resources across borders by creating a shared stake and common interests in safeguarding members’ intra-regional investments that would require open trade? Is using FDI or cross border investment as a substitute for market access the “first best” option, as some observers may ask? If FDI reallocates production to the most efficient region within South Asia, it will also promote trade and hence market access would be quite important, so should market access not be targeted as the first best solution to regional integration? Market access is clearly important for both textiles and clothing. But the question is how to achieve greater market access within the SAARC region given the histories, frictions and inertias discussed in previous sections. At the very least, investment and market access may have to move in tandem or in recursive fashion, reinforcing each other, for the process of greater regional cooperation to move forward.

Currently, market access issues center around tariff rates, long negative lists, and high customs and trade costs that act as non-tariff barriers in the region. At a more pragmatic level, issues of market access in South Asia hinge on the degree of openness of India’s

large domestic market to its SAARC neighbors. Even while members feel overwhelmed by India's size, and don't want to be flooded by India's exports or even investments, they want market access. The main barriers are India's relatively high tariff rates, its long negative list where textiles and clothing have the largest number of excluded items (34.2%) and numerous non-tariff barriers as discussed in an earlier section. With MFN duties in the South Asia region still high – on average 44.4% in 2006 compared with 50% in 2000 (James 2007) – and ranging from 20% for India to 35% for Bangladesh, there is great interest in getting duty free access to each other's markets. Bangladesh in particular is interested in supplying to the “seven sisters” – or the seven North Eastern states in India to which it has much better access than India. Sri Lanka has interest in trading with the proximate Southern cone of India's Deccan Plateau, as well as fast growing consumer markets in the North and West.

At the present time market access into India is being negotiated bilaterally through the various FTAs that India has with Sri Lanka and Bangladesh. But this process is not going well. At issue is India's offer to allow Bangladesh and Sri Lanka to export eight million pieces of garments each to India duty free by January 2008. Both Bangladesh and Sri Lanka have had problems with the deal. There were three main problems: (i) restricted ports of entry; (ii) prior notification of detailed export content, and (iii) rules of origin.

Initially India wanted all tariff-free exports to enter India only through four ports. Its rationale was that not all the customs points have the capacity to keep records and ensure that the designated limit (of 8 million pieces) is not crossed. However, Bangladesh and Sri Lanka saw this restriction as a non-tariff barrier. Chennai and several Southern ports are very proximate to Sri Lanka, but it was required to enter India through Kolkata and Mumbai – both much further away and far more costly and congested ports. Similarly, Bangladesh was routed away from Kolkata, its nearest entry point, to ports much farther South. Bangladesh and Sri Lanka also argued that each port has different requirements that are cumbersome to keep track of, and some ports are more costly to use than others. Kolkata, for example, has high local taxes that must be paid over and above customs costs; Chennai does not have these high local taxes. Thus Sri Lanka and Bangladesh both rejected the restricted point-of-entry clause.

Similarly, on India's request for prior notification about the products that would be exported, Bangladeshi and Sri Lankan exporters argued that this would depend upon demand (at the six digit level) and there was no way they could forecast demand two seasons ahead and notify the government about what the content of the exports would be. India's logic was to safeguard its domestic producers from the potential flooding of the Indian market with tariff-free exports of eight million pieces of just one or two products. But as instituted, it proved impractical and unworkable.

There have been similar disputes regarding the rules of origin. In the Indo-Sri Lanka FTA, for example, India allows Sri Lanka to export five million pieces duty free as long as they meet the rules of origin requirements which require the base fabric to be sourced from either India or manufactured locally in Sri Lanka. The remaining 3 million pieces

would be allowed entry without any rules of origin requirements but at 50% preferential tariff. Sri Lanka has resisted these rules because they feel they cannot compete against local Indian producers under those conditions. According to Sri Lanka's Joint Clothing Association Forum (JAAF), the free trade agreement has languished because complying with the rules of origin is too costly. "Our production is costlier in the sense that despite the 50% tariff duty concession, when it gets to the Indian market and after you pay the para-tariffs i.e. the port charges, warehouse charges, landing charges and all that, they simply can't be competitive with the Indian readymade garments," (JAAF, 2007). Sri Lanka therefore did not sign on to the rules of origin MoU. The industry did not see it as being worth it. "We have got a better deal with Pakistan, and are pursuing a Trade and Investment Free Trade Agreement with the US," (JAAF, 2007). In the Bangladesh case, which came after the Indo-Sri Lanka FTA, similar issues came up. More recently, the Indian government has been more flexible, and has acceded to at least two of the three objections – it has relaxed the port of entry rule and the advance notification rule – and negotiations are underway about the rules of origin requirement. It remains to be seen how things actually work out in January 2008. Clearly, India, as the leading regional economy must take the lead to opening up the region's markets to SAARC members.

Missed opportunities: under-utilization of displaced demand

The broader point is one of perceived imbalances of size and political clout. Respondents in Sri Lanka and Bangladesh wonder why India, with its large market size cannot open its market to duty free access to its neighbors. Indian firms and officials point to the growing competitiveness of their neighbors as a potential threat to local capacities. In the midst of these squabbles, important opportunities are being squandered – such as of building up regional scale, expanding product variety and learning from each others' specializations and successes. As James' (2007) analysis shows, and Table 19 points out, even with the absence of PRC's full-force participation in textile exports due to EU and US safeguards, South Asia has not been able to take as much advantage of displaced demand as it could have. SAARC's performance in the US market (in terms of the market share of its T&C exports in value terms) was only marginally better in 2006 when PRC was restricted than it was in 2004 (see Table 19 below). Why?

The primary reasons for South Asia's inability to take advantage of the temporary lull in competition from PRC in the US market relate to at least five factors. **(1) The fragmentation of South Asia's production networks and small scales of operation.** Except for a handful of some 30-40 firms in all of South Asia, few firms have the capacity to produce world-class fabric at the cost, quality, consistency, speed and scale delivered by PRC. Even Viet Nam and Cambodia have better capacity than many South Asian countries. **(2) Inadequate investment by firms** not only in capacity expansion prior to the expiration of textile quotas in 2004, but in new technologies (such as shuttle-less looms or computer numerically controlled equipment) that could enhance productivity and quality. This inadequacy comes despite the presence of popular government programs like India's Technology Upgradation Fund which makes low interest technology loans to textile firms. These funds are too little and have come too late to benefit significant numbers of firms in the industry. Moreover, they constantly

operate under the threat of elimination. Every year, during budget discussions, there is uncertainty whether the program will continue to be funded in the future. South Asia is also notorious for its lack of adequate attention to investments in upstream and downstream operations such as wet processing, dyeing and finishing that can make or break the quality of the final product. Wet processing is widely seen as the weakest link in South Asia's textile and clothing value chain, but little progress has been made to modernize this phase of the textile production process.

Table 19: South Asia's market share in US imports of PRC restricted T&C (%)

Clothing	Volume			Value		
	2004	2005	2006	2004	2005	2006
Bangladesh	4.87	5.16	6.21	3.10	3.66	4.66
India	2.16	2.72	2.91	2.80	3.58	3.89
Nepal	0.13	0.08	0.06	0.14	0.09	0.07
Pakistan	2.38	2.52	3.17	2.02	2.16	2.42
Sri Lanka	1.46	1.71	1.88	2.00	2.35	2.47
SAARC Sub-Total	11.00	12.19	14.23	10.06	11.84	13.51
Textile Intermediate Products	Volume			Value		
India	0.86	3.79	7.62	0.93	2.16	4.13
Pakistan	3.51	3.30	3.75	2.45	2.11	2.50
Sri Lanka	0.07	0.05	0.07	0.09	0.04	0.03
SAARC Sub-Total	4.44	7.14	11.44	3.47	4.31	6.66
Textile Made-Ups	Volume			Value		
Bangladesh	0.42	0.35	0.31	1.27	0.87	0.89
India	2.39	2.53	2.48	8.86	9.29	10.28
Pakistan	5.98	5.20	4.17	8.31	7.32	7.60
Sri Lanka	0.09	0.11	0.05	0.31	0.20	0.15
SAARC Sub-Total	8.88	8.19	7.01	18.75	17.68	18.92
SAARC Grand Total	9.19	10.32	12.17	10.21	11.80	13.51

Source: James 2007, cf. United States Office of Textiles and Clothing Homepage: <http://www.otexa.ita.doc.gov/>

(3) High costs of production. Not only are production costs high, but as seen previously, a long list of additional duties, specific taxes and para-tariffs add significantly to production costs. Poor infrastructure and inadequate Real Services (transport, warehousing, logistics, credit, facilitation of buyer-seller meets, trade fairs, and subcontracting exchanges) further lead to heavy inventory costs and shipment delays that can push up the cost of doing business in much of South Asia. Sri Lanka leads the way in all of South Asia in trying to systematically break its infrastructural bottlenecks and other countries may do well to learn from Sri Lanka's experience. (4) Fourthly, tight labor markets for skilled workers are straining the industry's production capacities. It is ironic that in a quintessentially labor intensive industry, countries with surplus labor are facing labor shortages in several categories of skilled and managerial work. Bangladesh and

Pakistan routinely rely on managers from Sri Lanka and India, even as shortages of skilled workers continue to plague Indian and Sri Lankan firms. (5) Finally, South Asia's poor insertion in global distribution networks has exacerbated the region's ability to make sufficient inroads into global market. East Asia's 'triangle manufacturers' (Gereffi 1999) and sourcing intermediaries (such as Li & Fung) have directed unfilled orders from PRC to Viet Nam, Cambodia and other South East Asian countries after the imposition of safeguards on the PRC in 2005, rather than to South Asia.

For all of these reasons South Asia's textile and clothing industry lags behind its competitors in the global market (stuck with only a 5% collective share in the world market relative to a 27% share for PRC alone) and has been unable to really take advantage of the opening created by US and EU safeguards on PRC post-MFA.

10. Conclusions and Policy Recommendations

This paper examined the existing state of textile and clothing trade and investment within South Asia with the goal of identifying key patterns, obstacles and opportunities for enlarging regional integration in this important sector. In a WTO-driven world where regional trade agreements have come to proliferate as a way of marshalling local and regional advantage, South Asia stands apart as a region driven by centrifugal tendencies and fragmentation rather than coordination and collective action.

There is a vast literature that explains the variety of tariff and non-tariff barriers that bar greater cooperation in South Asia (James 2007, Taneja and Sawhney 2007, numerous RIS and ICRIER studies and those carried out by multilateral agencies such as the World Bank, ADB and the IMF). Anderson and van Wincoop (2004) have laid out the broader theories and policies associated with trade costs, which, in the context of the current study, have been customized for Asia (East and South) by James (2007). Therefore, while we know a great deal about the trade, customs and non-tariff barriers affecting South Asian trade, much less is known about the institutional roots of these persistent barriers or about the conditions under which they can be overcome. To fill this gap, this study built upon the large literature that inventories the incidence and restrictiveness of trade barriers in South Asia to explore institutionally and ethnographically some of the specific experiences pertaining to the dynamics of intra-regional trade and investment in South Asia. The study chose the region's textile and clothing industry, a key export sector in virtually every SAARC member state, as a lens into the processes that are shaping economic integration and the potential for the rise of regional production networks in South Asia.

a. Problems and Constraints

Some of the primary problems that the study identified as hindering intra-regional trade, and investment include:

(1) Substitution of South Asia by East Asia as the sourcing hub of fabric and accessories by the region's major clothing exporters. Despite the presence of major South Asian

textile producers such as India and Pakistan in the region, over 80% of the fabric needs of Bangladesh and Sri Lanka's export industry come from outside the region. South Asia's greater orientation towards East Asia rather than South Asia for fabric procurement has had an early start and a long history, originating in part with the arrival of quota-hopping East Asian garment manufacturers into parts of South Asia in the 1980s. The long-standing transactions of Bangladeshi and Sri Lankan clothing exporters with East Asian textile suppliers, who now also supply them with accessories and base machinery in addition to yarn and fabric, has created an inertia in altering existing relationships. Western buyers who source clothing from South Asia have reinforced these ties by designating suppliers for the purchase of intermediate inputs such as fabric and accessories. A majority of these buyer-nominated suppliers are based in East Asia and the PRC. The origins of Sri Lanka and Bangladesh's clothing industries as CMT assemblers for Western buyers gave them little autonomy in supplier selection. Furthermore, the flow of commission money between buyer, designated supplier and clothing assembler has further deepened the stickiness of these ties.

(2) Apart from the historical ties of South Asia's garment exporters with East Asia's textile suppliers, an important reason why there is limited intra-regional sourcing of fabric is the lack of product variety within South Asian textile producers due to a strongly cotton-centered production base and a narrow range of choice.

(3) High price and high production costs vis-à-vis their East Asian counterparts further add to the un-competitiveness of South Asia's textile industry. These traits are attributable in part to low scales of operation in the region, low productivity, high energy costs (power), transportation bottlenecks and administrative costs such as many layers of indirect taxes, all of which raise production costs.

(4) High trade costs, as well as an array of specific duties in countries like India further make local (intra-regional) sourcing costly. These include high tariff lines, custom clearance difficulties, poor vehicular linkages, specific duties, interstate taxes and para-tariffs.

(5) Some of the most trenchant problems that the study identified are rooted in difficult historical political economies that burden the region. A long history of political and social mistrust in the region has clouded the motivation of neighbors to do business with each other. However, the study also found that these ossified histories are changing, and are being dealt with in a variety of ways institutionally and privately. Three salient problems that run across all cases are addressed below as a lens into examining how the region may get past these bottlenecks.

(i) Rules of Origin and the struggle over backward linkages

The chief problem in South Asia's textile and garment sector is related to the trade-offs and contradictory incentives embedded in various GSP and preferential access schemes and the high costs of compliance with rules of origin associated with these schemes. Despite the presence of proximate resources in textiles and accessories within South

Asia, local exporters of clothing find it cheaper – and faster – to source from countries located hundreds of miles away in PRC and East Asia. The hard pecuniary gains of such long-distance sourcing trump the lure of tariff free market access to the US and EU markets based on regional cumulation and local sourcing rules. While the lure of tariff free access to these major markets has not pushed garment exporters in Sri Lanka and Bangladesh toward intra-SAARC sourcing, they have indeed fuelled a rush towards generating backward linkages in the local economy. This is not necessarily a “bad” development – after all the development literature is replete with case studies of how the fostering of industrial linkages and the localization of external value chains are key for national development and extracting the benefits of locally embedded economies of scale and scope. Nevertheless, the contrary logics of SAARC cumulation under the EU GSP scheme especially in light of histories of mistrust in the region, have at least for the moment, set South Asian countries on competing courses of growth and development rather than towards strategic collaboration.

Some policy makers wonder if the speed of development of the textile sector in Bangladesh for instance would have been as fast without the indirect pressures or inducements of 100% tariff exemption in the EU market through its GSP schemes and the double transformation rule, as well as the resistance within Bangladesh to sourcing from India or Pakistan. Others wonder about the high cost at which these linkages have been achieved. Without a domestic cotton base, with low scales of operation and the high cost of capital in Bangladesh, some policy makers wonder whether investing in a costly and heavily subsidized textile base is the best way to achieve self-sufficiency. In this regard, the contrast with Sri Lanka is striking. Despite some development of backward linkages, Sri Lanka continues to import much of its fabric requirement, in fact increasingly from Western Europe as well as from East Asia. Despite its reliance on imports, as we saw in the text of the report, Sri Lanka has achieved some of the region’s highest design and quality standards in its clothing sector. Its unit values are also amongst the highest in the region, signifying quality improvements. That Sri Lanka has achieved this without fully establishing backward linkages in textiles suggests that it is possible to move away from cut-make dependencies and vulnerabilities by deepening one’s ‘soft’ skills (such as in human capital, quality standards, rules and norms of fair and decent work-recall Sri Lanka’s garments without guilt strategy) while still following an import intensive production strategy.

As noted earlier, the resistance to intra-South Asia sourcing in countries like Bangladesh (e.g., its rejection of regional cumulation in the EU GSP) and Sri Lanka (its demand for super cumulative rules) is also a reflection of the relatively high cost of textile production in South Asia (primarily India and Pakistan). Apart from low productivity, low scales of operation and high energy costs, countries like India have a slew of tariffs, specific duties and para-tariffs that get added to FOB cost and make South Asian textiles uncompetitive (in price) relative to PRC and other competitors. As discussed previously, high transportation and trade costs further weaken the competitiveness of South Asia’s textile industry. Only a small number of firms in south Asia (less than 40) can produce world class fabric or clothing, and even here product variety is limited. South Asia’s narrow cotton base and the general unavailability of high quality non-cotton yarns, fabrics and

accessories reduces the ability of the region to compete effectively with far more diversified producers such as PRC and East Asia. It is no wonder then that the region's clothing exporters prefer to obtain fabric and inputs from outside South Asia. This substitution 'problem' (of sourcing most inputs from outside the region) has been exacerbated by the growing inflow of FDI into the textile sector of Bangladesh and Sri Lanka from PRC and East and South-east Asia. About 40% of South Asia's textile FDI is from PRC or East Asia; less than 2% is from within South Asia (Board of Investment, Sri Lanka and Bangladesh, 2007).

To encourage intra-regional sourcing, SAARC governments need to work with their respective industry actors and associations to lower the cost of production of the region's textile industry and make it more competitive. At the same time, trade facilitation reforms are critical to help move these goods across South Asia in a timely manner and at low cost. Toward this end, India should lead the way by eliminating its archaic regime of specific duties, narrowing down its negative lists and lowering tariff lines in the textiles and ready-made garments. India, Bangladesh, Pakistan and Nepal should also amend transportation protocols for overland routes and introduce bonded warehouses at customs points to facilitate inspection, review and shipments (India for example has no Bonded warehouses). India should also rationalize its variable and highly discriminatory inter-state taxes and amend its customs clearance, port-of-entry and testing protocols to make them more convenient, consistent, simpler and transparent.

(ii) The lure of larger external markets

All of the region's exporters seem more interested in cornering global rather than regional markets. While local market access is not unwelcome, the primary motivation is to break into more demanding and larger Western markets. Thus the offer of tariff free entry into the Indian market under a quota system of 8 million zero-tariff pieces a year has not generated much interest in countries in the region that export several million dozen pieces a year to the rest of the world.

As noted in the paper, intra-regional *clothing* trade is much lower than intra-regional *textile* trade in South Asia. In part the reason for this is that the clothing sector is strong in every South Asian country. It is a major job-generator and nurtured by all political parties in each country in the region. In part the reason relates to consumer tastes. As a region where tailor-stitched clothing was till recently the preferred choice of a majority of consumers, the consumption of ready made clothing has historically been lower than the consumption of textiles in South Asia. South Asian garment exporters have thus focused on extra-South Asian exports much more strongly than selling in the regional market.

One way to change this may be to pursue trade facilitation reforms more energetically. But the longer term issue is to realize that trade-facilitation problems are politically and socially embedded in the region's history and therefore new alliances and cross-border constituencies will have to be created to mobilize demand for reforms from the ground up. One example of such a constituency is the new wave of young entrepreneurs in the

region that will be discussed in greater detail below (in the section on potential drivers of integration.)

A second solution is to leap-frog over the problem of trade by encouraging focused investments in intra-regional textile production networks. That is, can cross-border investment be a way around barriers to trade in the region?

(iii) The burden of history

Despite the attractiveness in theory of greater intra-SAARC investments in textile production in the hubs where clothing is made, investment levels remain extremely low in reality, despite some positive growth in the last five years. The examples discussed in the paper suggested that the burden of history in the subcontinent, and the deep-seated mistrust and suspicion between neighbors, is an important reason why countries like Bangladesh, Pakistan and India prefer investment from outside South Asia rather than from each other: the 'x-factor' that many respondents evoked. A central challenge to expanding regional integration in South Asia therefore is to find ways to overcome the weight of history by finding and cultivating common ground, and identifying pathways to positive sum alliances, rather than waiting for the larger political and social environment to sort itself out.

In this regard East Asia's experience with regional cooperation is very important and instructive. While the conventional wisdom is that there are deep political and historical differences between PRC and Japan, Japan and the Republic of Korea and so on, yet 40% of PRC's total clothing exports are sold in Japan, which account for an overwhelming majority of Japan's garment imports. Similarly, the web of south-south investment that has bound East and South East Asia together has been critical to the rapid growth of the region and both trade and investment between and within the region has expanded (Amsden 2007). And all of this has been achieved despite East Asia's own burdens of history.

Indeed, field work in South Asia revealed that similar drivers exist on the ground even in this region which can help overcome the burdens of history and foster greater regional integration in region, especially in the textile and clothing sector. These potential drivers of integration are explored below.

b. Potential drivers of integration

(i) Growing domestic markets and the rise of organized retail in South Asia

First, India's growing domestic market and the rise of organized retail (e.g., of malls) in the country has created great potential for the region as a whole to grow in concert with the opportunities this creates. Mall space in India has grown from barely one million square feet in 2002 to an estimated 40 million square feet in 2007, and is expected to touch 60 million by 2008-end (Business India 2007). The rise of hundreds of acres of mall space in large and mid-sized cities across India (and eventually other parts of South

Asia), the emergence of giant retailers (such as Pantaloons, TATAs, Spencers, Reliance Retail), along with the income-elasticity effects of new demand for trendy, fashion-driven, ready-to-wear clothing from a new class of young consumers in the country's booming Information Technology and Business Process Outsourcing industries, has led to a proliferation of domestic brands and private labels in the Indian market over the last half decade (Mukherjee and Patel 2005, Tewari 2006). These brands include: Colour Plus, Atmosphere, Indigo, Pantaloon, Indus League, and many more. Domestic retailers are looking to fill their shelves with variety and replenish them with great speed. This is fuelling the creation of tight new supply chains and production networks in the region.

The proximate presence of highly experienced suppliers in Sri Lanka, Bangladesh and Pakistan, would be a natural source of advantage for all sides. Each country has product niches that it dominates – e.g., Bangladesh is specialized in men's, boy's shirts, T-shirts and pullovers, Pakistan in made-ups, and Sri Lanka in lingerie. The rise of private labels, the demand for variety, quick turnaround times, and rapid replenishment on the part of retailers dovetails with this regional specialization and geographic proximity. In interviews across New Delhi, Dhaka and Colombo, innovative firms and entrepreneurs said they were not only watching these new trends in retail keenly, but some Sri Lankan and Bangladeshi suppliers reported having already been approached by purchasing departments of large Indian retailers with orders and for the exploration of joint investments. If these trends deepen, they could create important opportunities for the development of intra-regional production networks in the region.

From a *program and policy perspective* this potential demand-pull for finished clothing from South Asia into Indian retail networks has two implications. First, the flow of clothing from the rest of South Asia into the Indian market will depend on the resolution of the several current problems associated with the existence of large negative lists, specific duties (which India may finally phase out in the near future), logistics, port and entry delays at the border, administrative costs, inspections, certifications and finally, within-border distribution which can be tardy due to poor infrastructure. None of these problems are easy to resolve, as experience has shown. But the potential demand for intra-regional clothing from some of the largest Indian retailers can create a strong lobby (of importers and exporters) that could bring new pressure to bear on the region's governments to improve trade facilitation in South Asia.

As a recent study by Mirza and Hertel (2007) shows, an improvement in trade facilitation in South Asia to the half-way level of middle income countries can bring about increases in intra-regional trade in textiles and clothing of 86 %. But this average masks highly variable benefits (in terms of exports) to different countries – e.g., Bangladesh's exports to the region increase by 112%, Pakistan's by 113%, India's by 71% and Sri Lanka's by 48%. In this regard, the formation of new pro-import lobbies within countries like India that have traditionally resisted regional imports, would be an important development.

A second alternative, and hence the second program implication, is to encourage joint ventures or cross-border equity stakes between importing country producers (e.g., India) and producers in other South Asian countries in areas in which the latter specialize – e.g.,

lingerie, menswear, and sports knitwear and so on. This may lower some cross-border movement costs, but any significant cross-border investment cannot happen without an investment treaty between the member countries. Institutions such as the ADB could work with SAFTA's leadership to push constituencies toward developing an investment protocol under SAFTA, and encourage the **formation of the SAARC Investment Fund** that is already being discussed under SAFTA.

(ii) Harnessing the growing professionalism, global exposure and education of the 'new entrepreneurs' in South Asia

The second potential driver relates to a new wave of professionalism and boundary-crossing exposure and education of the next generation of entrepreneurs in South Asia. One of the most striking findings of the fieldwork was the growing transformation of attitudes among the next generation of younger owners in Bangladesh, Sri Lanka and India. These young entrepreneurs, who just starting out on their own, or taking over control from their fathers, or joining them in managerial roles, are often educated abroad – in the US, U.K., and other parts of Europe. They have not only interacted more widely and openly with members of partner countries in third-country settings, but their education has infused in them a shared language and vision of progress, success and meaning. This common language, experience of interaction, and a different sensibility of what it means to succeed in the world today has made them much more willing to work with each other than their parents' generation had ever been. They are also more aware of what is going on in each 'rival' country.

Recall the example in section 8 of the young entrepreneur who expressed willingness and keenness to work with entrepreneurs and managers across the South Asia region (and beyond) who were innovative, educated, professional and forward looking. Unlike the resistance of his own father to joint ventures with Indian and Pakistani firms, he had traveled extensively to India and Sri Lanka and forged good working relationships with a number of South Asian firms. He found it easier and more compatible to work with other South Asians equipped with a level of professionalism that he could relate to, than with local partners who held more traditional and insular views.

This example suggests that it may well take the next generation of entrepreneurs from the region to overcome the baggage of the region's history and begin to work together. This challenge provides an opportunity to all those international organizations who work in the broad area of private sector development to join with government forces to provide a common platform for these young professionals and entrepreneurs to meet, and facilitate their interpenetration, exposure, and exchange in ways that can deepen the cross-border communications that are already taking place. Joint marketing trips, joint leadership development courses, joint exposure to cutting edge business practices and technologies, exposure to design and value addition, are examples of the kinds of forward looking activities that could bind the region's emerging generation of professionals in the textile and clothing sector.

Organizations such as the ADB could play an important role in laying the conditions for the broader development of the private sector by facilitating SAARC governments in further reducing NTBs and maximizing trade facilitation, as well as promoting regional cooperation.

In this context some specific examples of facilitative programs that SAARC member governments as well as organizations such as the International Trade Commission (ITC), UNIDO or the World Bank who support sectoral efforts can initiate include: executive training events focused on younger entrepreneurs and focused on salient issues that matter to them: such as global market development, design, branding and product development, management leadership, financial, technical upgrading, IT management (and so on). Young entrepreneurs and professionals from the region could be exposed to cutting edge, globally-based consultants, experts or industry leaders who can engage with the issues noted above. Other programs include competitive funding for collaborative projects, or taking cross-regional teams of entrepreneurs to third countries (main markets such as the US, EU, Japan or PRC) for market exposure and networking purposes. These programs could also involve setting up intra-regional ‘quality circles’ between teams of young entrepreneurs from each country in the region. With the help of officials or consultants firms could benchmark themselves against the best performing firms in the region and beyond. Finally, these programs could include joint skill-development and design-development training initiatives.

(iii) Knowledge networks and the labor market in skills

The high transactions costs of doing business with each other has dulled interest among many exporters to develop the regional market further, but it does not seem to have prevented a growing intertwining of the region’s labor market.

Despite assumptions that the T&C industries of SAARC members are oriented away from each other rather than towards, I was surprised to find a relatively high degree of inter-penetration across South Asia of skilled workers and managers from each other’s labor markets. For example, a majority of managers and technical personnel in Bangladesh’s leading and mid-sized garment factories are from Pakistan and India. A large number of quality control and design personnel as well as consultants in the industry are from Sri Lanka (At least two of the four plants I visited in Bangladesh had Indian General Managers). Similarly, Sri Lankan consultants abound in India and according to respondents, in Pakistan as well. Numerous designers trained at India’s NIFT (the prestigious National Institute of Fashion Technology) work in Sri Lanka – with buying agents as well as in design departments of large companies, and some are in Bangladesh. Many students from each country are studying in training institutions of other counties in the region. The growing trend toward ‘Fast Fashion’ for example has created great incentives on the ground to deepen design skills in South Asia, and students are vying for admission in Sri Lanka and India’s emerging design education centers.

This broad and growing diffusion of managerial and technical staff across each others’ markets is an excellent sign of the deepening integration in the region’s T&C industry.

This movement of personnel across borders is creating the conditions for the diffusion of ideas, best practices and exchange of information across SAARC borders. This in turn has the potential to create a space – or an intra-regional knowledge field – where firms and workers understand each others markets, each other’s production processes and norms better. A shared language in which to speak about experiences and production practices could emerge to the great benefit of intra-regional communication. It is just these kinds of developments that can chip away political barriers and make demands for broader change.

From a policy perspective, however, the proliferation of these skill and knowledge networks has run up against problems. Several Bangladeshi respondents – including two of the firms that had Indian managers – reported constantly being on tenterhooks when their managers went to India for holidays or to visit home. They were worried whether Bangladeshi authorities at the border would allow them to return and whether they would be granted visas, work permits and for how long. That visas can be highly debilitating NTB’s in service industries is well known. In the incipient and nascent creation of cross-border manufacturing services and interpenetrated labor markets in South Asia, it will be very important for reformist policy makers and progressive bureaucrats to fix this problem of visas before it disrupts the bridges that are being built organically, from the ground up.

(iv) Geographic Indication and IP in the textile sector

The fourth lever has to do with Geographic Indication (GI) and Intellectual Property (IP) rights in the textile and clothing sector. An important – and unexpected - theme that emerged from the fieldwork was a nascent, but growing common concern among producers in Sri Lanka, India and Bangladesh that some local textile and design traditions were at risk of being appropriated by entrepreneurs from outside the region. For example, some firms mentioned that Western designers were bringing to them fabrics, weaves or designs that were traditional to South Asia – like *Ikkat*, *Chicken and zari* embroidery that are specific to the region, as well as garments such as the *Sherwani*. While learning from each other is central to innovation in the garment sector and has long been a part of how business gets done in the fashion and design industry, some firms in Sri Lanka, India and Bangladesh pointed out how traditional South Asian silk products, or products such as the Ikkat-weave dresses, or quintessentially South Asian garments such as the ‘*kurta-pajama*’ made of light cotton and embellished with *Chicken embroidery* was being made in PRC and sold as ‘beach wear’ in stores like J. Crew and K-Mart. There are similar issues with regard to the use of certain looms and fabrics.

The European Union is the first region to come together to register a GI—in winemaking—at the WTO. Meanwhile, the South Asian experience with GI is the struggle over Basmati rice – a fraught and contentious battle that has divided the region rather than united it. Rather than have SAARC members fight amongst themselves about which products are local to which country in the region, could we think of IP in textiles as the glue to bring them together around a common regional brand, at least in some products and designs? Could working together to get Geographic Indication (at the

WTO eventually) in select textiles and products and processes traditional to the region be a way to develop regional identity, or at least could it initiate a process of working together toward a shared goal and documenting and learning about the region's shared specialties? There is very little existing research in the area of traditional knowledge and IP in the textile and clothing industry, but the issue merits a deeper understanding.

(v) Leveraging strategic regulatory shifts and upcoming 'demands for structural change' post-2008 to foster greater regional cooperation

As several studies (e.g., James 2007, World Bank 2006) have noted, EU and US restrictions on PRC had an important booster effect on the clothing exports of select SAARC members (specifically Bangladesh and Sri Lanka, but also Pakistan) in these leading markets, especially the United States. Industry actors and business associations in countries like Bangladesh acknowledge these dynamics by pointing to the fall in Bangladesh's market share in the US in the few years prior to the elimination of quotas in 2005. This downward slide was reversed after the imposition of safeguards on PRC in the summer of 2005.

With the upcoming elimination of these safeguards in 2008, many industry analysts and associations see a looming crisis. With competition from PRC intensifying after 2008, and the growing importance of Viet Nam and Cambodia as globally competitive exporters of clothing, South Asian firms will be under pressure to cut costs and shore up their profitability in international markets. As the push to cut costs and compete in volatile global markets grows more intensive, industrial actors feel that South Asian firms will have to come together and harness each other's comparative advantages to get local access to top quality fabric and inputs at the lowest possible cost. This demand for structural adjustment within the industry may create the space to foster closer regional cooperation than there has been occasion for in the past.

Organizations such as the ADB can form inter-regional focus groups and task forces comprised of young local entrepreneurs from the region to develop a common understanding of this problem as well as work out an agenda of action together. It can also play a brokering role with the region's governments by sharing information and tracking changes in trade flows, prices and demand over time. Finally, it can encourage SAARC governments to further streamline tariffs and negative lists and shore up the competitiveness of the regional textile industry by the diffusion of modern production methods, better technology and the removal of supply bottlenecks (of quality inputs and skilled human capital).

(vi) Where to begin? Intra-regional FDI in textiles as the driver of greater investment and trade within SAARC and beyond

Finally, it is necessary to address the question of where to begin and which new initiatives to start with? Based on the evidence presented in the paper it is clear that textile trade is the glue that potentially binds the region's member countries. About 7 % of the region's exports of textiles are consumed within the region, in contrast to less than

0.6% of the region's clothing exports that are absorbed locally. Most of the cross-border investment that SAARC members have made in the region to date has all been primarily in the area of textiles -- fabric and made-ups (bed linen). These investments are meant to cater to the local market in the country where the FDI is located, but are widely seen by investors as a step toward harnessing scale economies to export beyond the region (e.g., as Sri Lanka's Brandix group has announced it would do with its Indian investments). Recent modeling (GTAP) studies of South Asia, e.g., by Mirza and Hertel (2007) have also found that the textile sector is an important engine for regional growth and increased investment in textile can generate important growth multipliers for the regions textile and clothing industry as a whole, as well as boosting employment and exports. Encouraging the expansion of intra-regional investment, FDI, and trade in textiles in South Asia, and the careful promotion of technical upgrading in this sector, is therefore critical to boosting the regional competitiveness of South Asia's T&C sector. If the region can make world-class, low cost but good quality fabric of wide variety available to clothing manufacturers within SAARC, it will lead not only to improved international competitiveness within the region's textile and clothing industry, but also improved import competition and wider intra-regional trade.¹⁴

How can this be achieved? The central argument is that based on the dynamics of production and trade in the region, it is clear that while most of the bureaucratic efforts to date have been focused on improving market access in the SAARC region (e.g., by reducing tariffs, addressing non-tariff barriers and addressing trade-facilitation challenges), in reality reforms and efforts on market access must move in tandem with efforts to improve investment and facilitate regional FDI in textiles within SAARC. This is because the barriers to both market access and investment are linked and the mechanisms to get past them are intertwined in important ways.

As the paper has clarified, the impediments to a freer flow of investment across South Asia often act as special kinds of non-tariff barriers: there are perceptions that evoke mistrust about the motives of potential investors from within South Asia while non-South Asian investors carry no such historical baggage, a variety of legal ambiguities about investment safeguards create deeper risk-perceptions than may actually exist in reality, an absence of clearly agreed upon rules of conflict resolution or clear investment protocols have hindered the pace of cross-border investment. These same factors are at the root of a variety of non-tariff barriers that hinder trade – perceptions of mistrust, ambiguity with regard to storage rules and product testing and inspection requirement at the border, inordinately long bureaucratic delays, multiple taxation depending upon the port of entry, restriction of port of entry, visa loopholes and tariff levels.

Much of the real work in reducing these barriers of market access has so far been carried out at the level of the state through government-to-government interaction and negotiations within SAARC's political and inter-ministerial machinery. This has been a slow-moving process, although some progress has been made in recent years, more needs to be done and the pace of progress maintained. However the fieldwork reported in this

¹⁴ With regard to clothing, the emerging dynamic is more mixed. However, the rise of organized retail foreshadows the possible intensification of intra-regional trade in clothing in the coming years.

paper shows that this process can be moved along much faster if there is an additional constituency on the ground – a constituency composed of private and civic interests that can provide strong incentives to SAARC governments to move forward with greater speed on market access reforms. The emerging intra-SAARC investors who are starting to make cross border investments in textiles (and to a lesser extent clothing) within South Asia are an example of just such a constituency. As reported in the paper, these firms are making overtures to each other, across borders, to make joint or wholly owned investments. Younger entrepreneurs are already talking about joint ventures and breaking the barriers of mistrust and history. This market-driven, firm-led investment processes can not only move faster than any government process can, but it can powerfully aid the inter-governmental negotiations regarding market access: it is in the interest of the investors to be able to move their products more freely across borders as well as source inputs more freely from the region. Economies of scale would propel firms to markets beyond the regions where they invest. Thus if cross-border investments can be accelerated, the pressure on governments to push for serious market reforms can also be ratcheted up. Establishing investment protocols within South Asia, including protective guarantees and transparent rules that will protect cross-border investments can go a long way toward accelerating investment in textiles (and clothing) within South Asia, as well as fuelling market access reforms indirectly. This dynamic would need to be simultaneously reinforced by more direct market reforms – especially in the areas of tariff reduction, trade facilitation and the removal of non-tariff barriers.

The ‘flying geese’ model of investment and market access reform is an example of this joint dynamic at work where direct and indirect efforts of the state and market simultaneously helped create a common regional market and investment field in East Asia.¹⁵ The point, then, is that these two related but distinct institutional channels, of investment and market access, need to be leveraged in tandem. Efforts to generate greater market access are already underway both bilaterally and at the inter-Ministerial within South Asia. If, simultaneously, the region’s governments can agree upon and ratify an investment protocol for the SAARC region, they will, this report argues, be simultaneously harnessing the strength of private industry and market forces to boost the prospects of attaining market access and freer trade. Once private firms are invested in each other’s markets they are more likely to regard freer trade and market access as a positive sum outcome than a zero-sum game that pits one sheltered market in the region against another as is currently the case. Indeed, freer intra-regional trade that was a precondition for ‘flying geese’ FDI flows across East Asia, is seen in this report as a likely *outcome* of a combined process of simultaneously facilitating FDI and market access in the case of South Asia through public sector and market based efforts.

¹⁵ It is important to note, however, that there are important differences between East Asia and South Asia. An East Asia style ‘flying geese’ model of investment cannot be applied unqualified to South Asia. In East Asia extensive trade liberalization preceded free flows of FDI across the region. In South Asia significant barriers to cross-regional trade remain, and intra-regional investment is proposed in this report, alongside continued efforts to generate greater market access across South Asia, as a likely *facilitator* of freer trade in the region. What was a precondition for FDI in East Asia is seen in this report as a likely outcome of a combined process of FDI and market access in the case of South Asia.

SAARC governments could prioritize a few key market access issues and move forward on them in focused fashion. Our analysis suggests that some key priorities include lowering of tariffs, narrowing the negative list, simplifying the duty structure, filling visa loop-holes and introducing transportation and border-related movement reforms. While continuing to move forward on trade facilitation, tariffs and non-tariff barriers at the level of the government, it might be useful to bring in firms to add market-driven pressure to bear on the state from the investment side. India should take a leadership role given its current Chairmanship of SAARC in pushing forward both these agendas. Agencies like the ADB can become important partners in facilitating these goals.

With respect to investment, specifically, it is critical to expand textile production in Bangladesh and Sri Lanka. In this regard, Pakistani and Indian investment in Bangladesh would be a good start. However, many firms, especially those in small countries like Sri Lanka have pointed out that being in a place like India (or Pakistan) with their large domestic markets would be important to reap scale economies in textile production. These large markets would allow for the cost-effective development and diversification of their offerings, help to lower the costs of product development, and improve competitiveness. For example, Sri Lankan investors in South Asia would like to see the costs of investing in India and Pakistan lowered on the one hand (through the setting up of an investment protocol in the region, a simplification of cross-border investment rules, the removal of bureaucratic delays in the procedures surrounding the clearance and approval of investment proposals). On the other hand, they express an interest in removing transportation and policy barriers in sending fabric back to their Sri Lankan (or other South Asian) operations. This issue once again points to the close coupling of investment and trade-facilitation, as well as opening up market access to allow a smoother flow of intra-SAARC goods and services.

Paying attention to the existing strengths of each member country would be important in thinking about intra-regional investment and any effort to encourage the formation of regional production networks. E.g., lingerie in Sri Lanka, knit sportswear and basic garmenting (especially menswear) in Bangladesh, fabric, home-furnishings and pullovers in Pakistan; women's wear in India. But this does not mean that existing patterns are static or unchanging. Every region aspires to upward mobility, toward higher value added products, and fears being trapped in low-margin, low value niches. A goal of revitalizing South Asia's investment climate would be to also encourage and support the collective upgrading of T&C production in the SAARC region. A freer flow of trade and investment across SAARC, that interweaves the interests and specializations of the member countries would therefore encourage, not stymie this process of regional upgrading in the T&C sector.

Setting up a (public-private) regional investment fund (such as the proposed SAARC Investment Fund) to make credit available to firms in South Asia's clothing, Textiles, and other sectors would be an important step. Other early priorities would include efforts at brokering a viable risk-underwriting regional investment accord, MoU or investment protocol, that would work through problems of repatriation, ownership over assets created by non-natives, as well as creating institutions of conflict resolution involving

members of industry and government. Early multilateral investment in supporting region-wide training institutions and training programs would also be important. Flows of skilled personnel, knowledge and credit across borders would be crucial to enable this investment-led regional production geography of clothing and textile to take root. Institutions such as the ADB have a key role to play in facilitating this porosity.

c. Summary

As noted in the introduction of the paper, this agenda can be summarized in a set of specific mechanisms and policy actions.

(1) Moving forward in a targeted way toward deepening market access by undertaking time-bound reforms in reducing tariffs, shortening negative lists, and improving trade facilitation

(2) Creating incentives for strategic intra-SAARC investment in the production of fabric (and to some extent clothing) in key sites of consumption and exports in the region by negotiating an investment protocol (accord) for the region, creating (as initial inducement) special funds for cross-border investment in textiles and clothing (e.g., for the use of new technologies or the adoption of better standards), and creating clear rules of exit and repatriation.

Under current conditions, it would make sense to promote textiles as the focus of cross-border investment first, because access to a diversified base of good quality, low cost fabric is a priority for the global competitiveness of South Asia's clothing makers. The goal would be to enable South Asia to produce sufficient quantities of world-class fabric as economically as possible. Current patterns of clothing production in the region suggest that there is great demand in Bangladesh for firms producing woven and knit fabric from cotton and man-made-fabric blends (including grey fabric and specialized fabric such as denim, high quality knit fabric and fleece). Bangladesh Garment Makers Export Association [BGMEA] and Bangladesh Knitwear Manufacturers Export Association [BKMEA] would be important institutions to consult in this regard, bearing in mind that both institutions, especially the latter, represent the domestic industry and may resist efforts to allow competitors from India, Pakistan and Sri Lanka to come in. Without their involvement, the effort would be a non-starter. Sri Lankan exporters by contrast, require high quality printed fabric made of sophisticated blends (such as those used in lingerie and swimwear).

While deepening South Asia's textile base is a priority, it is important to realize that there is growing interest among Indian, Sri Lankan and Pakistani firms to be a part of Bangladesh's growing clothing export business. There are increasing numbers of inquiries about joint ventures in Bangladesh by South Asian clothing (and textile) makers to set up garment making facilities, not just textile production. A second stream of potential FDI into Bangladesh, then would be in the clothing sector, and should be supported. South Asian T&C FDI into India has so far taken the form of specialized

textile production (e.g., Sri Lanka's Brandix), but firms in Sri Lanka and Bangladesh have also expressed interest in producing garments within India for its local market.

As noted in the body of the paper, the likely "clustering" in the clothing sector that is evident on the ground today is as follows: lingerie, swimwear, formals and printed fabric in Sri Lanka; basic menswear (shirts, bottoms and T-shirts), pullovers and anoraks in Bangladesh; Bed-linen, home furnishings and fabric in Pakistan; and cotton-based fabric, women's blouses, skirts, embellished and embroidered garments, T-shirts, yarn and cotton fabric in India.

(3) Shoring up the intensity of labor training and exchange between member countries including, critically, the training of managers, quality control and technical personnel and designers. There are currently significant flows of skilled workers and managerial talent in the T&C sector across the major South Asian countries, and these need to be supported and nurtured. Sri Lanka and India are emerging as design hubs with the presence of important institutions providing graduate instruction in design and product development. These can be developed as regional centers by making it easier for students from across South Asia to attend these colleges and certification programs. Reforms in visa regulations would be a crucial first step in helping interweave South Asia's labor market in the T&C sector. Sri Lankan firms currently have to wait for several days before getting Indian visas, as do Indian and Pakistani workers entering Bangladesh. The rules of entry are not only complicated (for workers), they are also highly arbitrary which adds to the uncertainty of what to expect when workers try to return home for temporary visits or when they have to travel at short notice (Interviews in Sri Lanka, India and Bangladesh, August, 2007).

More stable and transparent visa rules can help streamline the movement of personnel across South Asia. These reforms must occur on a priority basis.

(4) Inducing public and private investments in building up (and modernizing) intra-regional marketing and distribution networks, which global buyers and buying houses are already in the processes of doing. Improving trade facilitation in the region can aid this process significantly.

(5) Opening up India's large clothing market (which is growing rapidly, fueled by the rise of organized retail in the country) to greater imports from the rest of South Asia would be an important gesture of trust building within Asia. In the last five years India has agreed to several of the changes related to market access demanded by Bangladesh and Sri Lanka under their respective free trade agreements. Most notably, in the context of the proposal to allow 8 million pieces from Bangladesh and Sri Lanka duty free into India, the government of India has demonstrated good will by dropping at least two of its demands that had complicated trade talks: restricting the points of entry, requiring advance notice of the detailed product-level content of the planned exports (a year ahead of time!), and is making headway towards resolving the third, namely its rules of origin (of requiring 5 out of the 8 million duty free pieces exported to use local inputs or those

imported from India.). But clearly much more remains to be done to enable greater access to India's growing domestic market by its South Asian neighbors.

(6) Focusing attention on turning points -- such as the upcoming expiration of US and EU safeguards on PRC in 2008 -- as structural events that could create the conditions for -- and demand for -- pan-South Asian collaboration in the T&C industry. For example, common South Asian concerns over competition from PRC post-2008 can be leveraged to trigger greater intra-regional cooperation to lower production and trade costs within South Asia.

(7) Creating platforms for the next generation of professionalized entrepreneurs from the region to interact build cross-regional business networks.

(8) Exploring possibilities for geographic indication and intellectual property protection of historical weaves, fabric and garmenting traditions common to South Asia that would create a wider and shared regional identity for SAARC's textile and clothing industry.

d. Questions for further investigation

As noted at the outset of this section, the inventory approach suggested by James (2007) and the ADB did not elicit detailed responses necessary to quantify the incidence, level and restrictiveness of the trade and investment barriers that continue to hinder deeper regional integration within SAARC member countries. Respondents said they would need more time to respond, and that 'other' sources would have better knowledge of what to say. To the extent that they did respond, the results are noted in the text of the report. The categorization of the responses of the buyer survey was one attempt to get parallel information on comparative advantage and specialization within the region's garment industry. It would be important to institute a brief follow up project that provides industry and value-chain respondents (and a significant number of them) sufficient time to respond to the inventory survey.

The field exercise reported in this paper then became an important window to view the actual experiences of firms and intermediaries across the value chain with respect to issues of intra versus extra-regional trade and investment in the Textile & Clothing sector. The following three issues emerged as important aspects to explore further in future studies on SAFTA and its ongoing implementation.

1. First, a number of actors -- primarily in government and in trade associations raised the question of what the reciprocal impact on *domestic producers* would be of removing all barriers (including specific duties and NTMs) to trade in key segments of the Textile and Clothing chain within the SAFTA countries, viewed at a disaggregated intra-sectoral level (e.g., cotton knitwear, women's wear, children's wear, menswear, cotton woven -- at least at the four to six digit HS categorization).

That is, how would knitwear versus woven garment manufacturers in India be affected if trade barriers with Bangladesh were to be removed in these sectors, especially knitwear

and men's wear where Bangladesh has a powerful competitive advantage over India? The same issues were raised with regard to shrimp farming, horticulture, leather, footwear and even automobiles.

2. A second issue that emerged pertained to revenue sharing, and compensation of revenue losses. If barriers are removed is there need for, or scope for, revenue sharing to compensate for competitive losses?

The issue plays out at least at three levels – at the sectoral level (losses to sectors in less competitive countries that lose out to penetration from more efficient producers), at the level of richer versus poorer SAARC members (Nepal versus India, Pakistan and Sri Lanka) and at the level of government revenues. Some (e.g., James 2007) have suggested studying the EU customs union model as a potential template for integrating member countries at different income levels. But as work by Pickles et al., Begg et al. on Outward Processing Trade (OPT) arrangements and EU enlargement shows there can be surprising and unanticipated traps that can complicate accession in this manner. Keeping a close eye on the institutional processes and monitoring the emerging geographies of production on the ground will be important.

3. The third issue relates to price comparisons. As noted above, numerous producers in the study's sample of interviewees said that it was costlier for them to source fabric from neighboring India and Pakistan than it was to source from East Asia. They did provide some initial evidence, but it was only illustrative. Documenting how import and production prices differ for South Asian producers for products and imports originating within South Asia versus in PRC or East Asia would provide more systematic evidence of this phenomenon.

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Appendix

Interviews Conducted in Sri Lanka, Bangladesh, India

Sri Lanka (July 31 – August 3, 2007)

1. Dr. Saman Kelegama, Executive Director, Institute for Policy Studies, Colombo, Sri Lanka
2. Mr. Turney Mohamed, Chairman, Sri Lanka Buying Office Association
3. Mr. Rohan Kuruppu, Managing Director, Brandix Lanka
4. Mr. Asoka Walpitagama, Training Manager, Brandix
5. Ms. Sanjana Kuruppu, Gap Go Beyond, MAS Holdings
6. Mr. Ravi Fernando, C.E.O. – Branding and Strategic Planning, MAS Capital, MAS Holdings, Sri Lanka
7. Prof. Lakdasa Fernando, Sri Lanka Apparel Institute
8. Ms. Nirmali De Silva, Course Director, Fashion Design, University of Moratuwa
9. Ms. Jeevani Siriwardena, Director, Sri Lanka Export Development Board
10. Siromi Fernando, Deputy Director, Product Management Division, EDB
11. Ms. Manel Panditsekere Rodrigo, Assistant Secretary General, Joint Apparel Association Forum (JAAF)
12. T.G. Ariyaratne, Secretary General, JAAF
13. Ms. Nilupul De Silva, Director (Promotion), Board of Investment of Sri Lanka
14. Dishan Fernando, Production Analyst, Nike, Sri Lanka
15. Kapila Mahanama, MAST Industries Inc.
16. Mr. A. Sukumaran, Managing Director, Star Garments Limited, Katunayake Investment Promotion Zone, Sri Lanka

Bangladesh (August 7 – 9, 2007)

17. Dr. Mustafizur Rehman, Center for Policy Dialogue (CPD), Dhaka, Bangladesh
18. Mr. K.G. Moazzem, CPD, Dhaka,
19. Dr. Debapriya Bhattacharya, Director, CPD, Dhaka
20. Barrister Anisul Islam Mohammad, Former Foreign Minister and Managing Director, Shasha Denims, Dhaka
21. Mr. Delawar Hossain, Chairman, Continental Garments Group
22. Mr. Munir Hussain, MD, Continental Garments Group
23. Zara Knit, Dhaka
24. Mr. Md Shahab Ullah, Vice Chairman, Export Promotion Bureau
25. Mr. Faridul Hassan, Director General, EPB
26. Md. Fazlul Hoque, President, Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA)
27. Mr. Mohammad Lutfullah, ADB consultant, Board of Investment
28. Mr. Mahmudul Islam, Director, Board of Investment
29. Mr. Mushtaq Uddin Ahmed, Executive Chairman, Bangladesh Board of Investment (BOI)
30. Mr. Annisul Huq, Former President, BGMEA

India

1. Sara Lee Sourcing Private Ltd, Bangalore
2. Marks and Spencers, Bangalore
3. Tesco, Bangalore
4. Arvind Brands, Bangalore
5. Himmatsingka Seide, Bangalore
6. Madura Garments, Bangalore
7. Wal Mart, Bangalore
8. Raymonds, Mumbai
9. Pantaloon/Big Bazaar, Mumbai
10. Reliance, Mumbai
11. Welspun, Mumbai
12. S. Kumars Nationwide, Mumbai
13. IKEA Trading, Gurgaon
14. Orient Craft, Gurgaon
15. William E Connor and Associates Ltd, Gurgaon
16. Li and Fung, New Delhi
17. H&M, New Delhi
18. Mr. Bishwanath Sinha, Ministry of Textiles
19. Associated Merchandising (Target), New Delhi
20. Mondial Orient Ltd, New Delhi
21. Otto-AGN, New Delhi
22. National Institute of Fashion Design, New Delhi (4 interviews with 4 faculty)
23. Rajendran Mudalier, CEO Colour Plus
24. Tinoo Joshi, Director, FIEO
25. Ministry of Commerce
26. D. K. Nair, Chairman, Confederation of Indian Textile Industry
27. Directorate General of Foreign Trade (3 interviews)
28. Gokuldas Exports, Bangalore
29. Loyal Textiles, Chennai
30. Ambattur Clothing Company, Chennai

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