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Research Report

Comparative country study of the development of textile and garment sectors: Lessons for Tanzania

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Report

Comparative country study of the development of textile and garment sectors

Lessons for Tanzania

Neil Balchin and Linda Calabrese

May 2019



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Acronyms

AGOA	African Growth and Opportunity Act
BGMEA	Bangladesh Garment Manufacturers and Exporters Association
CMT	cut, make and trim
DBE	Development Bank of Ethiopia
EBA	Everything But Arms
EPZ	export processing zone
ETIDI	Ethiopian Textile Industries Development Institute
EU	European Union
FDI	foreign direct investment
FOB	free on board
FYDP II	National Five-Year Development Plan
GDP	gross domestic product
GMAC	Garment Manufacturers Association in Cambodia
GSP	Generalised System of Preferences
GTP	Growth and Transformation Plan
GVC	global value chain
ILO	International Labour Organization
LDC	least developed country
LNDC	Lesotho National Development Corporation
MFA	Multifibre Arrangement
RMG	ready-made garment
SACU	Southern African Customs Union
SADC	Southern African Development Community
URT	United Republic of Tanzania
UK	United Kingdom
US	United States

Executive summary

This study aims to identify the main actors and factors necessary to develop the textile and garment sector in the United Republic of Tanzania. It draws on the varying experiences of six countries – Bangladesh, Cambodia, Ethiopia, India, Lesotho and Madagascar – to pinpoint what is required to establish an integrated value chain, from cotton to clothing, and raise local ownership of textile and garment manufacturing.

We show, through the varied experiences of the case study countries, that no single model can be isolated as a definitive route to success. Nevertheless, these models provide six key lessons for Tanzania.

First, **openness (both to trade and foreign investment) and export orientation are important drivers of growth along the cotton-to-clothing value chain.** Bangladesh, Cambodia, Ethiopia, Lesotho and Madagascar have all capitalised on the benefits of preferential access for exports to key markets; in some cases, such as Ethiopia, this has been facilitated by a very strong export push. India's sector was more inward looking during the early stages of development, but this was made possible by access to an enormous domestic market that limited the need to export to achieve economies of scale. The Indian state has proactively supported domestic producers as the country has opened up.

Second, **openness to inward investment is especially important.** Export-oriented foreign direct investment has helped enable access to global value chains (GVCs) and international production networks, particularly in Bangladesh, Cambodia, Ethiopia and Lesotho, but also in Madagascar. It has also facilitated the upgrade of technology, machinery and equipment in some cases. Inward investment into Bangladesh has been central to skills development and knowledge transfer and helped drive the development of a local cadre of garment experts who have eventually gone on to set up domestic garment firms of their own.

Third, **the precise nature of the inward investment has important implications for backward integration and the development of domestic productive capabilities.** In most settings, the investment of Asian transnational firms with disembedded production units has been primarily motivated by a desire to access rents on offer from preferential market access. This investment has generally brought little backward integration or supply chain upgrading. In contrast, regional investors with regional production networks and diaspora investors have been more locally embedded (e.g. in Madagascar). In Bangladesh, inward investment has been used strategically to develop capabilities in textile and garment production that were not initially present domestically.

Fourth, **an open investment regime, along with industrial parks, special economic zones (SEZs) and export processing zones (EPZs), often combined with early-stage incentives for investors, can serve as effective tools for proactively attracting and channelling domestic and foreign investment into textile and garment production.** This has been especially relevant in the development of garment production in Ethiopia, Lesotho and Madagascar.

Fifth, **preferential access to key markets through trade agreements provides a compelling platform for attracting investment to export-oriented textile and garment production, but it can also create vulnerabilities and reduce incentives for diversification into higher-value products or investment in skills development and upgrading.** Preferential market access is important in the initial stages of textile and garment sector development, but after the sector is established active steps need to be taken to promote upgrading.

Sixth, **governments have a role to play in shaping these factors.** This may involve:

- proactive industrial policy (e.g. Ethiopia)

-
- active sector promotion (e.g. Lesotho)
 - the provision of an investor-friendly regime (e.g. Cambodia)
 - government-financed innovation and infrastructure to support an expanding domestic private sector (e.g. Bangladesh).

When assessed against the current context within the cotton-to-clothing value chain in Tanzania, this evidence suggests the long-term development of Tanzania's textile and garment sector could be supported by:

- promoting an export-oriented textile and garment production model, focusing on high-value markets
- business environment improvements, along with better investment promotion, attraction and aftercare
- targeting the right type of investors, focusing on those willing to make long-term investment commitments, help build local capabilities and develop backward linkages
- actively endorsing backward linkages into yarn, fabric and other intermediate inputs, as they may not simply follow from growth in garment exports
- speeding up progress in developing industrial parks and SEZs
- trust and mutually beneficial dialogue between the United Republic of Tanzania (URT) and the Tanzanian private sector.

1 Introduction

The United Republic of Tanzania has placed significant policy emphasis on the domestic textiles and garment sector, which is included among the priority sectors in the National Five-Year Development Plan (FYDP II) 2016/17–2020/21, with the cotton-to-textiles value chain listed as a priority area for the first stage of FYDP II implementation. Sector-specific strategies have also been designed to develop an integrated value chain and boost domestic cotton, textile and garment production. The plan of action detailed in Tanzania’s Cotton-to-Clothing Strategy, for instance, contains the following aims:

- raise the profitability of cotton production
- boost the efficiency and competitiveness of the country’s cotton-to-clothing value chain
- improve the competitiveness of Tanzania’s textile and clothing firms through enhanced productivity and product diversification
- focus more on investment as a vector for growth and integration in the value chain and strengthen the capacity of firms to diversify markets and raise their profitability (URT, 2016).

However, there remains some uncertainty about the most appropriate model to promote the development of Tanzania’s textile and garment sector and achieve these objectives. One approach is to focus on building local capacity and capabilities, often by protecting domestic producers. Recent moves by the URT suggest it may be looking to protectionist models. These include its stance on second-hand clothing imports – which has softened on the back of threats to its eligibility to export duty and quota free to the United States (US) under the African Growth and Opportunity Act (AGOA)

– and the persistently high tariffs placed on imports of new clothing. Alternative, export-led manufacturing models (in textiles and garments and other sectors) have often been combined with efforts to attract foreign direct investment (FDI). These have proved successful drivers of transformation and employment in countries such as South Korea, Singapore and Mauritius (Balchin et al., 2017).

This suggests more attention needs to be paid to unpacking the merits and potential pitfalls of different models and approaches to promote the development of Tanzania’s textile and garment sector, develop integrated value chains, drive local ownership of garment manufacturing and secure the sector’s long-term growth. This desk-based study draws on the experiences of other countries that have managed – or, in certain cases, failed – to develop textile and garment sectors, and extracts relevant lessons for the Tanzanian context. It has the following goals:

- to identify the main actors (and their roles)
- to discover the key factors necessary to support the establishment of an integrated value chain from cotton to clothing in Tanzania
- to raise local ownership of textile and garment manufacturing.

In Chapter 2, we focus on six country cases: Bangladesh, Cambodia, Ethiopia, India, Lesotho and Madagascar. The insights from these case studies are consolidated to draw key lessons for Tanzania, which are elaborated in the conclusions of Chapter 3 and the recommendations in Chapter 4. These provide suggestions for a model, grounded in long-term reforms, to secure the growth of Tanzania’s domestic textile and garment sector.

2 Country case studies

In this chapter we analyse different country experiences (both successes and failures) in developing and growing textile and garment sectors. We focus particularly on the role of inward investment in these sectors and the approaches taken in specific countries to develop integrated value chains, facilitate backward linkages, embed foreign investment in local production structures, and promote the development of local ownership of textile and garment manufacturing.

We considered the merits of the following countries during the case study selection process: Bangladesh, Cambodia, Egypt, Ethiopia, India, Kenya, Lesotho, Madagascar, Morocco, Myanmar, Pakistan, Tunisia, Turkey and Viet Nam. This list was narrowed down by focusing on interesting experiences (whether successes or failures) in relation to one or more of the following areas:

- adding value to cotton (or other relevant raw materials)
- the role of actors in promoting textile and garment sector development
- export-oriented versus domestically focused development models
- developing integrated value chains from cotton to textiles and garments
- cultivating local ownership of textile and garment manufacturing
- the role of inward investment in supporting the growth of the domestic sector.

Considering these elements, the following countries were selected for in-depth case study analysis: Bangladesh, Cambodia, Ethiopia, India, Lesotho and Madagascar. An overview of the textile and garments sectors in each of these countries is presented in Table 1, focusing on the following:

- domestic production, trade in textile fibres, yarn, fabrics and clothing (looking at the respective shares of textile fibres and their waste, textile yarn and related products, and apparel and clothing accessories in exports and imports)
- the number of jobs supported by the sector
- the current growth phase.

Ethiopia and Tanzania both had large deficits in overall trade in textile fibres, yarn, fabrics and clothing in 2017, while Madagascar registered a smaller deficit.

2.1 Bangladesh

Bangladesh is a large textile producer and exporter. In 2016, the contribution of manufacturing sector value added to national gross domestic product (GDP) was 18%, of which 51% was generated by the textile and garment sector (2011 data; World Development Indicators). In 2015, the country exported \$28 billion worth of textiles and clothing (HS 50-63; UN Comtrade data), corresponding to 3.6% of global exports, which made Bangladesh the sixth-largest textile and garment exporting country in the world.

Bangladesh's exports rely heavily on textiles and garments: in 2015, textile and garment exports constituted almost 90% of total exports. Around 96% of that \$28 billion in exports were garments (divided almost equally into knitted and non-knitted apparel, HS 61 and 62), while the remaining 4% were textiles. Conversely, of the \$11.8 billion worth of garments and textiles imported in 2015, only 8% were garments, while the remaining 92% were textiles.

The success of the Bangladesh ready-made garment (RMG) industry has been attributed to the presence of the multifibre arrangement (MFA) quota system, the availability of labour at low cost and the existence of a domestic garment industry upon which to build (Fernandez-Stark et al.,

Table 1 Summary overview of production, trade, employment and growth in the cotton-clothing value chain in the six case-study countries

	Selected domestic production statistics	Export value of textile fibres, yarn, fabrics and clothing in 2017 (\$ millions)	Share of exports by product category	Import value of textile fibres, yarn, fabrics and clothing in 2017 (\$ millions)	Share of imports by product category	Number of jobs in the formal textile and apparel sector	Growth phase
Bangladesh	Cotton lint: 18,600 tonnes (2014) ⁷ Yarn: 730,000 tons (2016/17) ⁸ Fabric: 4.4 billion metres (2016/17) ⁸ Textiles (gross output): \$8.59 billion (2012) ⁹ Wearing apparel (gross output): \$21.85 billion (2012) ⁹	31,576.2	Apparel and clothing accessories: 93.4% Textile yarn: 5.6% Textile fibres and their wastes: 1.0%	13,463.1	Apparel and clothing accessories: 4.0% Textile yarn: 66.9% Textile fibres and their wastes: 29.1%	3.57 million ¹	Established
Cambodia	Cotton lint: 86 tonnes (2014) ⁷ Garment and footwear value added: \$1,915 million (current prices) ¹⁰	7,680.0	Apparel and clothing accessories: 98.2% Textile yarn: 1.6% Textile fibres and their wastes: 0.2%	3,563.3	Apparel and clothing accessories: 5.2% Textile yarn: 93.3% Textile fibres and their wastes: 1.5%	350,000 ² (apparel only)	Accelerating (export segments)
Ethiopia	Cotton lint: 38,000 tonnes (2014) ⁷ Yarn: 102,000 tons ¹¹ Woven fabric: 207 million metres ¹¹ Knitted fabric: 50 million kg ¹¹ Woven garments: 28 million pieces ¹¹	109.2	Apparel and clothing accessories: 67.9% Textile yarn: 30.3% Textile fibres and their wastes: 1.8%	836.9	Apparel and clothing accessories: 60.1% Textile yarn: 35.9% Textile fibres and their wastes: 4.0%	37,000 ³	Accelerating

Table 1 Summary overview of production, trade, employment and growth in the cotton-clothing value chain in the six case-study countries (cont'd.)

Selected domestic production statistics	Export value of textile fibres, yarn, fabrics and clothing in 2017 (\$ millions)	Share of exports by product category	Import value of textile fibres, yarn, fabrics and clothing in 2017 (\$ millions)	Share of imports by product category	Number of jobs in the formal textile and apparel sector	Growth phase
India						
Cotton lint: 6,188,000 tonnes (2014) ⁷	38,025.6	Apparel and clothing accessories: 48.1%	7,203.6	Apparel and clothing accessories: 11.9%	2.4 million ⁴	Established
Man-made fibre: 1,364 million kg (2016/17) ¹²		Textile yarn: 45.2%		Textile yarn: 58.6%		
Spun yarn: 5,662 million kg (2016/17) ¹²		Textile fibres and their wastes: 6.7%		Textile fibres and their wastes: 29.5%		
Cloth: 63,894 million square metres (2016/17) ¹²						
Fabric: 64,421 million square metres (2016/17) ¹³						
Textiles (total output): \$57.1 billion (2015/16) ¹⁴						
Wearing apparel (total output): \$18.8 billion (2015/16) ¹⁴						
Lesotho						
Yarn: 18,000 tons ¹⁵	536.6	Apparel and clothing accessories: 86.7%	308.2	Apparel and clothing accessories: 21.5%	46,500 ⁵	Established (export segment)
Fabric: 15.6 million linear metres ¹⁵		Textile yarn: 8.6%		Textile yarn: 69.3%		
Denim jeans (woven bottoms): 23,304,000 pieces ¹⁵		Textile fibres and their wastes: 4.7%		Textile fibres and their wastes: 9.2%		
Woven garments (non-denim, non-workwear): 6,360,000 pieces ¹⁵						
Industrial workwear: 11,003,800 pieces ¹⁵						
Knit garments: 115,143,600 pieces ¹⁵						

Table 1 Summary overview of production, trade, employment and growth in the cotton-clothing value chain in the six case-study countries (cont'd.)

Selected domestic production statistics	Export value of textile fibres, yarn, fabrics and clothing in 2017 (\$ millions)	Share of exports by product category	Import value of textile fibres, yarn, fabrics and clothing in 2017 (\$ millions)	Share of imports by product category	Number of jobs in the formal textile and apparel sector	Growth phase
Madagascar						
Cotton lint: 5,000 (2014) ⁷	561.5	Apparel and clothing accessories: 91.9%	583.6	Apparel and clothing accessories: 13.1%	50,000 ⁶	Recovering
Textiles and clothing (% of value added in manufacturing: 30.2% (2009))		Textile yarn: 3.9% Textile fibres and their wastes: 4.2%		Textile yarn: 72.4% Textile fibres and their wastes: 14.5%		
Tanzania						
Cotton lint: 81,000 (2014) ⁷	210.0	Apparel and clothing accessories: 12.8%	601.2	Apparel and clothing accessories: 38.2%	16,000	Recovering
Cotton yarn: 4,330 tonnes (2015) ¹⁶		Textile yarn: 49.9%		Textile yarn: 47.5%		
Woven fabric: 80,164,000 square metres (2015) ¹⁶		Textile fibres and their wastes: 37.3%		Textile fibres and their wastes: 14.3%		
Knitted fabric: 20,332,000 square metres (2015) ¹⁶						
Knitted garments: 5,446,000 pieces (2015) ¹⁶						
Textiles (gross output): \$256.9 million (2015) ¹⁶						
Wearing apparel (gross output): \$16.5 million (2015) ¹⁶						

Source: UNCTADStat (for export and import data, shares by product category are own calculations).

Employment data: ¹ Lopez-Acevedo and Robertson (2016); ² Lopez-Acevedo and Robertson (2016); ³ Ambastha (2017); Lopez-Acevedo and Robertson (2016); ⁴ ⁵ Tralac (2017); ⁶ Just Style. Domestic production data: ⁷ FAOStat; ⁸ US Department of Agriculture (USDA) (2017); ⁹ Bangladesh Bureau of Statistics (BBS) (2013); ¹⁰ International Labour Organisation (ILO) (2016); ¹¹ ITC; ¹² Ministry of Textiles, Government of India; ¹³ CIT India; ¹⁴ Government of India Annual Survey of Industries 2015–2016; ¹⁵ Tralac (2017); ¹⁶ NBS (2015); ¹⁷ International Trade Centre (ITC) (2015).

2011). Bangladesh's garment exports are mostly to the European Union (EU) (56% of total exports) and the US (21%) (see Figure 1). Bangladesh benefits from access to the EU's Everything But Arms (EBA) initiative, which allows duty- and quota-free access to the EU market for all products (except arms and ammunition).¹

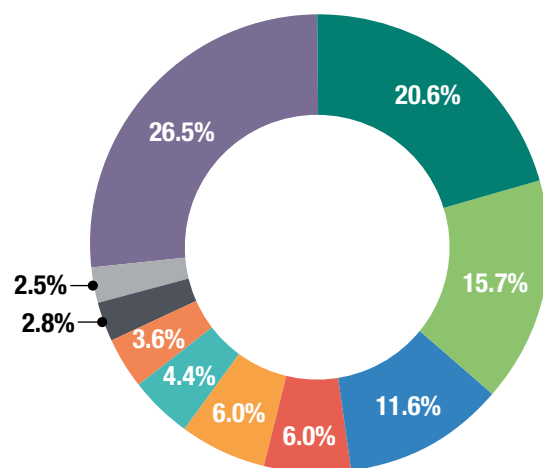
2.1.1 Key factors shaping the development of the textile and garment sector in Bangladesh

The Bangladesh textile and garment sector mostly focuses on the RMG industry, both knitwear and woven. The sector has been growing since its inception in the 1970s (Yunus and Yamagata, 2012) and has survived both the introduction of quotas under the MFA and their elimination,² remaining internationally competitive (Mottaleb and Sonobe, 2011; Rhee, 1990). In fact, the end of the quota system helped Bangladesh consolidate its position as an export manufacturing centre.

The garment industry in Bangladesh dates back to the late 1970s. Prior to that, the country had limited garment production capacity. Between 1947 and 1971, most of the productive capacity was in West Pakistan, with most companies in East Pakistan (which later became Bangladesh) owned by West Pakistanis. After the liberation of Bangladesh in 1971, these were nationalised (Lorch, 1991). Towards the late 1970s, fewer than a dozen companies were in operation, producing 8–9 million garments a year (Spinanger, 1987). In the 1970s, South Korea reached the limit set for its garment exports under the MFA and started looking for other opportunities to export garments to the US, which ultimately came in the form of a partnership with Bangladesh (Reinhardt and Herman, 2014). In 1977, Desh Garments Ltd was founded through a collaboration agreement between a Bangladeshi business person and South Korean conglomerate Daewoo (Rhee, 1990). The creation of Desh Garments Ltd is regarded as the turning point for the

Figure 1 Bangladesh textile and garment exports by destination, 2015

US Germany UK Spain France
Italy Canada Belgium Japan Other



Source: UN Comtrade data.

RMG industry in Bangladesh. A total of 130 Bangladeshi workers and managers were trained in South Korea for six months, returning to start producing garments for export in Bangladesh, in a factory built according to Daewoo's specifications (Yunus and Yamagata, 2012).

The Bangladeshi government played an important role in supporting the RMG industry. The industrial policy framework inherited from Pakistan meant the market was strictly controlled by the government, which limited investment. After the liberation of Bangladesh in 1971, these controls were gradually removed. Limits on foreign investment were lifted in 1978, which allowed firms like Daewoo to enter the market. In the 1980s, the government also issued investment licences to import machinery for duty-free garment production (Yunus and Yamagata, 2012). The government established the Bangladesh EPZ authority in 1980 and EPZs were created in Chittagong and Dhaka in 1983 and 1993, respectively (Fernandez-Stark et al., 2011).

1 Bangladesh does not qualify for the US Generalized System of Preference (GSP) scheme, which does not cover garments.

2 The success of the Bangladesh RMG sector prompted the introduction of quotas on its products by the UK, France, the US and Canada (Spinanger, 1987).

The Bangladeshi government was also highly responsive to the needs of the private sector. Some measures, such as the introduction of back-to-back letters of credit and bonded warehouses, were introduced by the government based on the indications of private entrepreneurs (Yunus and Yamagata, 2012). Back-to-back letters of credit were introduced relatively early on, in 1980, allowing further development of the sector. In addition, the government revised and rationalised tariffs, taxes and interest rates to catalyse the growth of the RMG sector.

Overall, it encouraged the creation of an integrated value chain by supporting domestic and foreign investment in backward linkages between manufacturers and suppliers, along with the development of the textile sector (*ibid.*), which is discussed further in the next section.

Some analysts note that the Bangladeshi government has controlled the growth and direction of the industry in favour of domestic producers. For example, all investment in textiles and garments (except those in the EPZs) require approval by the Bangladeshi Board of Investment in consultation with the Bangladesh Garment Manufacturers and Exporters Association (BGMEA; Bargawi, 2005). This is often only allowed in sub-sectors where domestic production is not deemed to be competitive, causing Bangladesh to forego FDI-related benefits, such as the introduction of new technologies and managerial capabilities (Yang and Mlachila, 2007).

The role of the BGMEA in the development of the garment sector in Bangladesh is worth highlighting. The BGMEA was founded in 1982 to promote the interests of the sector. The association has represented factory owners effectively and has an important voice in the policy process and negotiation of quotas. The association is also empowered to deal with sectoral issues, such as concerns related to the use of child labour (Yunus and Yamagata, 2012; Hassan and Raihan, 2017).

2.1.2 Value addition and value chain development in the textile and garment sector in Bangladesh

The industry in Bangladesh began with garment production, but managed to develop backward

linkages to a certain extent. Fernandez-Stark et al. (2011) distinguish three types of garment manufacturer in Bangladesh:

1. Those engaged in integrated manufacturing, with factories importing the cotton and completing the rest of the process up to the production of garments (mostly for knitwear).
2. Factories that import yarn and complete the rest of the manufacture (mostly for knitwear).
3. Factories that import fabric and assemble it into garments (cut, make and trim, or CMT, mostly for woven items).

The highest levels of integration are achieved in knitwear, rather than the woven sector.

The country only produces limited amounts of cotton, which fulfils 3% of the national demand (Mortuza, 2014). The remaining 97% needs to be imported from other countries. In 2015, Bangladesh imported \$7 billion worth of cotton (HS 52), more than half of which came from China and India (UN Comtrade data).

Despite its limited cotton production, Bangladesh has achieved some degree of progress in upgrading its value chain. According to Fernandez-Stark et al. (2011), this has been driven by the requirements of the EU's EBA scheme, under which Bangladesh exports. The EBA used to require a two-stage transformation entailing substantial in-country value addition, which has since been removed (Ahmed, 2012).

Bangladeshi firms have developed a textile sector providing inputs to garment production. Moazzem and Sehrin (2016: 5) state that '[b]etween 2004 and 2013, the production capacity for yarn increased from about 460 million kg to 1.1 billion kg, while that for fabrics increased from 3.1 billion m to 7.3 billion m [...] Such development in backward linkage textiles has contributed to increasing local value addition in the apparels sector, particularly by knitwear firms.' This was beneficial for manufacturers, as it reduced lead times and improved their competitiveness (Moazzem and Sehrin, 2016). Bangladeshi firms have also upgraded their technological bases and improved workers' skills. Moazzem and Sehrin (2016) cite the following reasons for the upgrades:

- Government policies have been introduced that specifically aim to create backward linkages, including financial incentives for the import of raw materials and machinery for setting up a domestic textile industry. In particular, EPZ regulations have required backward linkages (spinning, weaving/knitting, dyeing and finishing) and therefore encouraged the establishment of knitwear factories (Fernandez-Stark et al., 2011).
- There has been public investment in trade logistics, including the improvement of hard and soft infrastructure (including customs systems).
- Foreign investors have been buying in advanced technologies and production processes, which has supported increases in productivity and efficiency.
- There is now an upgraded labour regime, which has improved workers' rights, encouraging investment in technologies that facilitate process upgrading.

Government policies aimed at upgrading/value-chain development have included the following measures (Moazzem and Sehrin, 2016):

- a facilitation of the import of raw materials using a back-to-back letter of credit facility
- a duty-free import allowance for capital machinery, raw materials and intermediate products used in export-oriented industries
- a cash subsidy of 5% of the value of the fabrics to manufacturers of indigenous fabrics supplying their products to 100% export-oriented garment industries
- financial support, including subsidised credit under an Export Promotion Fund and a bonded warehouse for exporters to invest in technology, machinery and products.

EPZ firms have received additional support for upgrading, including (Moazzem and Sehrin, 2016):

- 10-year tax holiday for newly established industrial firms (although firms set up since 2012 enjoy 100% tax exemption for the first two years, 50% for the third and fourth years and 25% for the fifth year)
- duty-free imports of construction materials, machinery, office equipment and spare parts

- relief from double taxation
- improved customs processes, such as secured and protected bonded areas, off-shore banking, back-to-back letters of credit, and customs clearance at factory sites
- support to import on a documentary acceptance basis.

2.1.3 The catalytic role of Desh Garments in the textile and garment sector in Bangladesh

The presence of a foreign player with a good understanding of the sector played a strategic role in the inception of the garment industry in Bangladesh, though the industry is now dominated by domestic firms (Fernandez-Stark et al., 2011). In the words of Rhee (1990), the Desh-Daewoo partnership was catalytic in kick-starting the domestic garment sector. This partnership supported the development of domestic production capabilities in several ways:

Building capacity and allowing for further training. The 130 Bangladeshi workers initially brought to Daewoo received excellent training in the operations of the garment sector. This not only included shop-floor skills, but also a good understanding of factory management, international procurement and international marketing (Rhee, 1990). In addition, the workers were exposed to the operations of Daewoo, a large and well-run conglomerate, and were able to learn about its systems and operations. The trainees were also shown how to train others in order to pass on the skills they had acquired (ibid.).

Transferring skills. The 130 trainees went back to work for Desh, but eventually left the factory for other occupations. Some of them went on to set up their own factories (Rhee, 1990), while those with little or no financial means to set up their own operations went on to become managers in, or traders for, newly established entrepreneurs (Mottaleb and Sonobe, 2011). This led to a rapid dissemination of skills and allowed those who did not take part in the original training to compete in the international market.

Building trust as a supplier. The role of Daewoo was critical in transforming Bangladeshi firms into trusted suppliers. Daewoo was an established firm, while Desh was a nascent producer. Daewoo initially mediated between

Desh and overseas buyers, which slowly allowed Desh to establish a reputation as a credible producer. This enabled Desh, and gradually other Bangladeshi firms, to access the international market (Rhee, 1990).

It is important to note that the role played by Daewoo in Bangladesh had little to do with financial investment. Desh Garments was founded through a collaboration agreement, not a joint venture (Rhee, 1990). Daewoo's biggest contribution to kick-starting Bangladeshi garment manufacturing was not providing financial resources, but building capacity and knowledge, and guiding its domestic partner through the production process and the complexities of the international market. Once these competencies were present in the Bangladeshi context, domestic entrepreneurs seized the opportunity to invest in the sector.

Foreign capital entered the Bangladesh garment sector at a later stage. To date, the Bangladesh garment sector still comprises mostly domestic entrepreneurs, and the government is trying to encourage and facilitate foreign investment by gradually lifting restrictions in strategic areas and creating a more open and competitive environment (Yunus and Yamagata, 2012).

2.1.4 Local ownership in the textile and garment sector in Bangladesh

While foreign investment initially played an important role in establishing the garment sector in Bangladesh, the industry is now dominated by domestic firms (Fernandez-Stark et al., 2011). How did the new investment by domestic entrepreneurs come about? In some cases, it was through former Desh employees who went on to set up their own businesses. A few years after the training at Desh, almost all trainees had left the factory, and those with the necessary means used their resources to try to replicate Desh's success (Rhee, 1990).

The extraordinary performance of the firm also generated interest from those with financial means who had not previously been interested in the garment sector. These entrepreneurs could provide finance and high levels of human capital, but had little knowledge and understanding of how these operations should be run. Very often, former Desh employees were hired directly

by these individuals to manage their firms, or worked with them as 'traders', passing on considerable additional knowledge on how to run these operations (Mottaleb and Sonobe, 2011). The general expertise and high education levels of these entrepreneurs allowed them to embed the necessary organisational changes, while the advice of the former Desh employees (workers, managers and traders) enabled them to flourish in an extremely competitive international market (Mottaleb and Sonobe, 2011). Thus, the garment industry in Bangladesh grew through a 'demonstration effect' generated by the success of Desh and through the 'labour circulation' of former Desh employees.

2.1.5 Conclusion

The garment industry in Bangladesh has an extraordinary history of growth, having started in the 1970s and survived both the introduction and the elimination of the MFA in 2004. The industry was kick-started by a partnership between a local entrepreneur and South Korean conglomerate Daewoo, to form Desh Garments Ltd. With active support from the Government of Bangladesh, the industry grew to become globally competitive. Interesting features of the Bangladeshi garment industry are its attempts to improve its value chain integration and its high degree of domestic ownership.

The Bangladesh RMG sector started as a result of the quota system existing at that time, which prompted Daewoo to work through Bangladesh. Preferential access to EU and US markets through AGOA and the GSP presents a similar opportunity for Tanzania.

The presence of a foreign company was fundamental to Desh's learning about the production process and building networks of suppliers and customers. It also helped build trust in the 'Made in Bangladesh' label in international markets. Subsequent companies relied on these networks and on this reputation. Similarly, Tanzania could rely on well-established producers to access suppliers and customers, and build a good reputation in the global market.

The relative success of Bangladesh in value chain development is due to a number of factors. The first is that the rules of origin of the EBA

scheme (now modified) required a two-stage transformation. The second is the role played by the second-generation Bangladeshi firms that entered the sector following the first wave of foreign investment and helped to develop linkages with the local economy.

The role of the BGMEA was also very important. The organisation has significant political clout and is able to influence the policy process around the garment sector and represent its interests.

Lastly, the active role of the Government of Bangladesh in listening to and responding to the requests of entrepreneurs was fundamental to facilitating further growth. Similarly, the Government of Tanzania should be open and willing to introduce innovative measures and policies that could stimulate productivity in the sector.

2.2 Cambodia

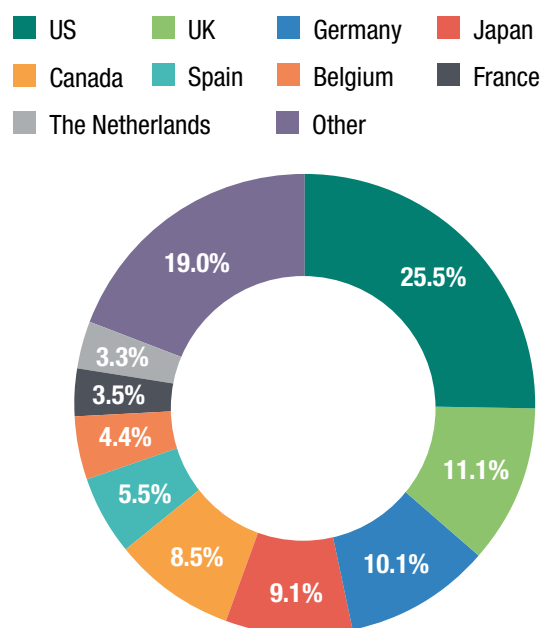
Cambodia is a relatively recent garment producer compared with its neighbours, but has grown considerably since the mid-1990s. In 2016, garment and textile products made up 68% of Cambodia's total exports – one of the world's highest ratios.

Cambodia's garment and textile exports have been increasing since 2010. In 2016, the country exported nearly \$7 billion worth of garments and textiles (of which 99% were garments). The country also imported \$4.2 billion worth of garments and textiles (98% of which were textiles).

The majority of Cambodia's garment exports go to the US, Europe, Canada and Japan (see Figure 2). Cambodia benefits from duty-free and quota-free market access to a number of GSP schemes, including the EBA scheme for least developed countries (LDCs).

The industry currently employs an estimated 600,000 workers (Kane, 2015a). It is characterised by a high presence of foreign firms: 90% of investment in the sector is from foreign sources. Data for 2015 indicate the presence of 559 garment and textile factories, many of which are subsidiaries of other Asian companies (*ibid.*). The majority of these factories currently employ between 500 and 2,000 workers (Hossain, 2010). There are also a number of 'cottage factories'

Figure 2 Cambodia's textile and garment exports by destination, 2016



Source: UN Comtrade.

that are subcontracted during peak season, but these are not formally registered, so their exact number is difficult to quantify (Kane, 2015a). The majority of these factories operate on a CMT basis, while a smaller number operate on a free-on-board (FOB) basis and via subcontracting arrangements. Many foreign buyers source their products from Cambodia (*ibid.*).

2.2.1 Key factors shaping the development of the textile and garment sector in Cambodia

Cambodia produced silk and cotton during the colonial period (1863-1953), but modern industrial production began after independence (Bargawi, 2005). Unlike other countries in the region, Cambodia did not have an import-substitution industrialisation strategy during this time. In the mid-1990s, the country moved instead from a planned market system to a free market economy (Hossain, 2010). It also oriented towards an investment regime that was very open to FDI. This allowed foreign investors to easily 'set up shop' in the country, allowing them to enjoy the same benefits as domestic producers.

In 1994, investors from Hong Kong, Taiwan, Malaysia and Singapore were constrained by quotas on exports to the US and started setting

up export-oriented factories in Cambodia. According to several sources (such as Bargawi, 2005), market access was the most important reason for doing this, while low wages had limited importance compared with market access.

The industry began to grow rapidly after 1997, when Cambodia was granted ‘most favoured nation’ status by the US and signed a framework cooperation agreement with the EU that gave it access to EU markets under the GSP. The US placed quotas on Cambodia’s exports in 1999, under the framework of the bilateral Trade Agreement on Textiles and Apparel (Bargawi, 2005). These quotas were generous and fast-growing, which facilitated rapid growth of the Cambodian garment sector (Asuyama and Neou, 2012).

The quotas imposed on China were another factor that influenced the growth of the Cambodian garment industry. In 2005, the EU and US re-imposed quotas on exports from China. Therefore, many Chinese producers re-allocated part of their production to Cambodia (Asuyama and Neou, 2012). Quotas on China were lifted in 2008, but this coincided with an increase in wages in China and Viet Nam, which prompted producers to continue choosing Cambodia for their production (Asuyama and Neou, 2012).

Cambodia’s investment framework was, and still is, very open to foreign investment. Following the signing of the 1991 Paris Peace Accords, the Royal Government of Cambodia introduced a series of economic reforms. These included integration into the global trading system, opening up to foreign investment and the privatisation of state-owned enterprises (Bargawi, 2005). In particular, the law on investment passed in 1994 included a wide range of taxation concessions and incentives for approved investment activities, including tax holidays, low corporate tax rates, tax-free reinvestment of profits and tax-free repatriation of earnings (Hossain, 2010). In addition, manufacturers were given import duty exemptions for export-oriented projects. Furthermore, the Royal Government of Cambodia made it easy to obtain work permits for foreign experts (Bargawi, 2005).

Some scholars have also highlighted the strong role played by the Garment Manufacturers Association of Cambodia (GMAC) in shaping

the development of its textile and garment sector, which actively lobbies the government to support improved conditions for producers and undertakes a number of export promotion activities (Asuyama and Neou, 2012).

In May 2000, ILO launched the Better Factories Cambodia programme. The programme aimed to improve working conditions in factories by strengthening policy-making and monitoring. This helped to showcase Cambodia as an ethical sourcing destination for the garment industry (Sibbel and Borrmann, 2007).

In conclusion, the combination of an initial lack of quotas, an open trade regime and an FDI-friendly investment regime formed the cornerstone of the export-oriented garment sector in Cambodia. In addition, Cambodia currently enjoys EBA access to the EU. These factors have shaped the sector, including its strong export orientation, as well as its reliance on the CMT model. All materials are imported and then stitched together in Cambodia for export. Fabrics and accessories are imported from China, Hong Kong, Taiwan and the countries that form the Association of Southeast Asian Nations (Asuyama and Neou, 2012).

2.2.2 Value addition and value-chain development in the textile and garment sector in Cambodia

The Cambodian garment sector has had limited success in terms of value-chain development so far. Cambodian garment firms predominantly operate in a very narrow segment of the value chain. Around 60% of producers work on a CMT basis, receiving all materials and inputs, and cutting the fabrics and stitching them together to produce a final product (Natsuda et al., 2010). The value added and profit margins of the CMT part of the value chain are low and mostly comprise labour costs (Bargawi, 2005). In this respect, Cambodia is different to Bangladesh and Viet Nam, which have relatively more developed textile industries (Hossain, 2010).

The CMT sector relies almost exclusively on imported inputs. This holds for Cambodia, where the lack of a domestic textile industry does not allow for more integrated production. Materials are mostly imported from other countries in Asia, such as Hong Kong, Taiwan, China and

South Korea (Bargawi, 2005). Not only does CMT production provide limited opportunities for value addition, it also locates the decisions related to production away from Cambodia, such as those on sourcing materials, financing and exporting, all of which are taken by the foreign companies setting up there.

Hossain (2010) points out the presence of only two factories producing knit fabrics, also noting the presence of a small number of firms providing inputs such as embroidery, thread, elastic bands, labels, hangers, draw strings, screen printing, poly bags, paper cartons, buttons, laundry and washing, etc. This shows the limited development of the garment-industry ecosystem in Cambodia.

There are many foreign firms in Cambodia that are not vertically integrated and rely on international sourcing networks. Natsuda et al. (2010) argue that this stifles their need to invest in backward linkages domestically and makes value-chain upgrading in Cambodia a challenging process. In a country with a considerable number of domestic firms, upgrading often entails catching up with the foreign ones. However, the fact that the Cambodian market is dominated by foreign firms implies that those companies already have access to the best technology, meaning upgrading is mostly contingent on their sourcing choices. They also have access to established international sourcing networks and sourcing decisions are typically made by headquarters rather than locally. For instance, companies headquartered in China may decide to source their fabrics there, leaving little need to invest in the upgrading of local suppliers.

Another factor behind Cambodia's limited upgrading is its reliance on the US market. This is very competitive, with small profit margins. Manufacturers, therefore, keep their designs and specifications simple in order to minimise costs. Its reliance on supply to the US pushes Cambodia towards the lower end of the market and limits chances for upgrading (Natsuda et al, 2010). However, the export destinations for Cambodian garments are more diversified now than they were a decade ago and include the European and Japanese markets, which require more complex products.

Increasing the integration of the domestic value chain in Cambodia would entail developing

several capabilities. For example, it would involve not only developing a textile industry, but one capable of producing various types of material, to feed into a garment sector that would respond to sophisticated and rapidly changing global demands (Bargawi, 2005). In addition, it would require managerial capabilities to take decisions on exports, sourcing and financing (including accessing trade finance).

2.2.3 The role of inward investment in the textile and garment sector in Cambodia

Encouraged by the presence of global quotas in the garment industry, foreign firms have invested heavily in Cambodia. Around 90% of investment in the sector is foreign, with the majority of investors from China, Taiwan, Hong Kong and South Korea (Hossain, 2010). This high share of foreign investment played a central role in enabling Cambodia to set up a garment industry, almost from scratch, in a relatively short period of time during the 1990s (Asuyama and Neou, 2012).

While the quota system was important in Cambodia during this nascent period, the presence of an investment regime open to foreign investors was critical to attracting large numbers of foreign firms. In contrast to Bangladesh, where the government mostly allows investment in sectors where domestic firms lack capacity, Cambodia's investment regime today is fully open to foreigners. Foreign firms receive the same treatment as domestic firms, with investment encouraged through a series of incentives (as detailed in section 2.2.1).

Despite equal treatment, the pre-existing conditions allowed foreign companies to thrive much more than their domestic counterparts. Foreign companies had access to capital and expertise that Cambodian companies, weakened by years of civil war and the presence of a limited financial system, did not have. Foreign companies also had access to networks of clients and sources of inputs. They could also rely on their expert managers and skilled labour (Asuyama and Neou, 2012).

2.2.4 Local ownership in the textile and garment sector in Cambodia

Because of its origins, the Cambodian garment industry is largely dominated by foreign firms.

Domestic ownership is less than 10% of total investment. As discussed in section 2.2.2, foreign firms have several advantages over domestic firms. There have been no clear efforts to promote domestic investment in the garment sector.

This is also reflected in the composition of the GMAC. Of the 615 member companies, only 45 have Cambodian owners, while 118 are Taiwanese-owned and 65 are Hong Kong-owned (GMAC, 2018).

2.2.5 Conclusion

While Cambodia is a latecomer to the global garment industry, its production and exports have grown rapidly to make the country an important garment exporter on the world stage. The fortuitous absence of quotas (and, subsequently, generous quota allocations) led to development of the sector, encouraging foreign firms to produce in Cambodia. Another important factor in this success, early on, was the investment regime, which offered generous incentives for export-oriented firms and national treatment for foreign investors.

The Cambodian garment industry is currently focused on CMT production and has very limited integration along the value chain. Cambodia does not produce cotton or textiles, and imports are sourced abroad by foreign companies. Thus, domestic value addition is limited. Encouraging more domestic value addition will mean moving from CMT towards FOB, to relocate some of the processes and decision-making to Cambodia.

The quota system was instrumental for kick-starting the garment industry in Cambodia in the 1990s and early 2000s, as foreign firms used the country as a platform for production. In conjunction with the 2001 ILO Better Factories programme, which promoted the image of Cambodia as an ethical sourcing destination, this system helped build the image of Cambodia as a garment producer. Tanzania's access to the US market through AGOA could provide a similar opportunity.

The FDI-friendly environment has facilitated large amounts of foreign investment in Cambodia. However, the lack of proactive government policy to facilitate domestic investment, either in garments or in the upstream sectors, has maintained an imbalance in favour of

foreign investors and has not encouraged value addition to help the country graduate from the existing CMT system.

2.3 Ethiopia

Ethiopia is increasingly regarded as an emerging African success story in terms of economic development (Smith, 2013; Pilling, 2016). The economy has registered double-digit growth in most years over the past decade and per capita GDP has more than doubled since 2005, albeit from a low base. The expansion of the economy has been supported by a boom in export-led growth – between 2000 and 2016, the total value of commodities exported from Ethiopia to the rest of the world increased from \$482.3 million to more than \$1.7 billion (UN Comtrade data).

The Ethiopian Government has favoured a state-led development model since the early 2000s, based around a succession of large-scale development plans (Nicholas, 2017). These plans feed into an ambitious goal for Ethiopia to become a lower middle-income country by 2025. While economic activity is still heavily based around agriculture, the development of light manufacturing capabilities is earmarked to play a key role in achieving this goal.

Within light manufacturing, the textile and garment sector is expected to be a particularly important driver of growth. The Ethiopian Government is looking to develop the garment industry into a global sourcing hub and has set ambitious targets to grow garment exports. These targets include expanding export earnings to \$1 billion by 2020 and boosting the share of garment and textile exports to 22% of total exports (de Haan and Theuws, 2018).

While Ethiopia is still a long way from achieving these targets, rapid growth in the garment industry in recent years has heralded its emergence as a noteworthy newcomer among garment exporters in sub-Saharan Africa. The number of textile and garment factories operating in Ethiopia has grown from less than 20 firms in 1991 to an estimated 122 currently (Van der Pols, 2015; de Haan and Theuws, 2018). The sector is an important generator of employment. In keeping with Ethiopia's long history of textile production, large numbers of

farmers and rural workers are currently involved in informal activities related to the production of traditional wear. Data for 2013 suggest that when those involved in these informal activities are included, up to 450,000 people are engaged in activities across the sector, the majority of them (416,913 people) in the textile segment (ITC, 2015). Of this total, around 37,000 workers are employed in the formal textile and apparel sector (Ambastha, 2017).

Ethiopia's apparel exports have grown rapidly – from a very low base – since the turn of the century (see Figure 3). Between 2000 and 2016, the value of Ethiopia's exports of apparel and clothing accessories (HS 61 and 62 combined) grew from \$222,475 to more than \$63 million (UN Comtrade data). Ethiopia has also registered impressive growth in exports of yarn, grey fabric and traditional handloom products, and there is some early evidence of export product and market diversification (Van der Pols, 2015).

The country is also a major importer of apparel along with various fabrics, textile materials and other intermediate inputs, resulting in a huge trade deficit. In 2016, Ethiopia's total imports across the cotton-to-clothing value chain (HS codes 51-62) totalled more than \$706.3 million, creating an overall trade deficit of more than \$623 million (UN Comtrade data). The value of imports of apparel alone totalled more than \$413 million that year, along with substantial imports of man-made filaments obtained from strip and man-made textile materials (HS 54, \$152.8 million) and man-made staple fibres (HS55, \$45.7 million) (ibid.).

Several factors mark Ethiopia as an attractive destination for export-oriented textile and garment production. Principal among these are low input costs. At \$35-40 per month for entry level workers, wages are noticeably lower than in many competitor countries: the minimum wage in the sector in Bangladesh is \$68 per month, while Ethiopia's wage is around a quarter of the average monthly wage in China's garment industry (Yost and Shields, 2017). Garment and textile producers in Ethiopia also benefit from a large pool of trainable labour, along with cheap and reliable electricity, which Van der Pols (2015) suggests costs as much as 8-10 times less than

in some other manufacturing locations. Other benefits include:

- low costs for leasing land
- preferential access to key export markets, including duty- and quota-free access to the US for eligible apparel exports under AGOA
- preferential access to the EU as an LDC via the EBA scheme.

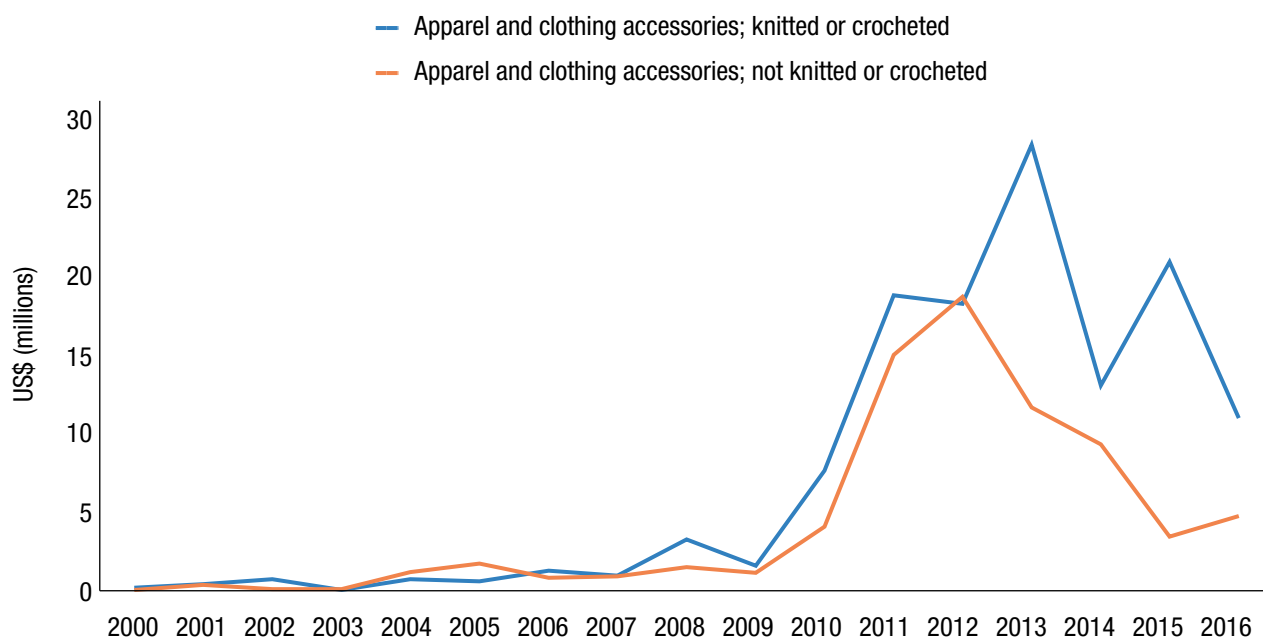
Despite these advantages, further growth in the sector is constrained by a number of challenges, with the following issues undermining competitiveness:

- low worker skills
- low productivity
- long cycle and delivery times (up to 150 days compared with 45–60 days in other countries)
- unreliable power supply
- poor infrastructure (particularly logistics)
- outdated technology and machinery (ITC, 2015).

Ethiopia's exports remain concentrated mostly in lower-quality cotton-based items with relatively low unit value and low value addition, and progress in diversifying exports has been limited (ITC, 2015; Staritz and Whitfield, 2017).

Even so, Ethiopia's increasingly successful efforts at transforming itself into a leading apparel sourcing hub warrant attention. Several major multinational brands – including Gap, H&M, Primark, Tesco, Walmart, PVH (the owner of well-known brands, such as Tommy Hilfiger and Calvin Klein) and Asda – source apparel produced in Ethiopia by contracting manufacturers based in the country. Contract manufacturers from a range of different countries, including India, Bangladesh, China and Turkey, have invested in production bases in Ethiopia. In some cases, buyers such as PVH and China's Jiangsu Sunshine Group have also built factories in Ethiopia themselves. These foreign investors work in tandem with the government (via a proactive, state-led industrial policy) and much can be learned from the role they have played in shaping the growth and development of the country's textile and garment production and exports. The influence of these factors, among others, is examined in detail in this case study.

Figure 3 Ethiopia's export of apparel and clothing accessories (HS 61 and 62), 2000–2016



Source: UN Comtrade data.

2.3.1 Key factors shaping the development of the textile and garment sector in Ethiopia

A state-led industrial policy involving different phases

Under Derg rule (1974 to 1987), Ethiopia's garment industry was predominantly inward-looking and largely focused on supplying the army, with limited private sector investment (Oqubay, 2015). Under the leadership of the Ethiopian People's Revolutionary Democratic Front in the 1990s, however, this approach gradually gave way to a labour-intensive, export-led industrialisation model, inspired by successful East Asian experiences. This shift in focus is reflected in the evolution of the government's industrial policy, particularly various iterations of the Growth and Transformation Plan (GTP), which focus on achieving rapid growth and structural change and prioritise industry with linkages to the agriculture sector. Textile and garment manufacturing is prioritised in these plans and is listed among the key industrial sectors in the GTP II (2015-2019).

In keeping with a wider state-led approach to development, the Ethiopian Government has played an active role in the development of the textile and garment sector since the early 2000s. This has been channelled through a bold

industrial policy targeting textiles and garments in three phases.

In the first phase, from the early to mid-2000s, the government focused on incentivising local investment in apparel production for export, primarily by providing preferential credit via the state-owned Development Bank of Ethiopia (DBE) and offering favourable land lease rates through access to land schemes. The government's encouragement of foreign investment during this phase was largely done on an ad hoc basis.

In the second phase, from 2008, there was a clear shift in emphasis towards attracting FDI. This was motivated, in part, by lessons learnt from the first phase. The government realised that the focus on local investment took place without a full understanding of GVCs in the garment sector. For instance, the belief that locally produced textiles would be used primarily in the production of garments for export was incorrect; instead, most textiles were imported (Staritz and Whitfield, 2017).

The third phase of Ethiopia's industrial policy has focused on channelling foreign investment into specialised industrial parks (Staritz and Whitfield, 2017). It is envisaged that foreign firms operating in these parks will be supported by local counterparts, with some emphasis

placed on attracting investors that are committed to fostering linkages with local firms (ibid.). However, it may be too early to tell whether this approach will prove successful.

The proactive, state-driven industrial policy model in Ethiopia differs, for example, from the approach taken in Madagascar, where industrial policy has been largely absent, save for the government's creation of an EPZ. The evolution of industrial policy in Ethiopia is also noteworthy. The government's shift in focus from incentivising local investment to proactive efforts to attract FDI is indicative of a refreshing willingness to learn lessons from industrial policy experiments and adapt accordingly.

The main measures put in place by the Ethiopian government to promote the garment sector are as follows.

Government emphasis on attracting FDI into labour-intensive, export-oriented manufacturing

Attracting FDI is a core element of Ethiopia's industrialisation strategy and regarded as key to accelerating the development of its manufacturing capacity (Nicolas, 2017). For example, the GTP II identifies FDI, which generates positive spillover effects through direct and indirect linkages to the local economy as a key priority for transforming manufacturing (Abebe et al., 2018). Higher value-added, export-oriented investment is prioritised, based on a strategic evaluation of Ethiopia's needs (Mihretu and Llobet, 2017).

To help entice investors, the government has lifted most sectoral restrictions on FDI and offers a range of incentives to prospective investors in manufacturing and export-oriented sectors. These include customs duty and income tax exemptions, allowances for carrying forward losses and favourable lease terms in industrial zones.

The Ethiopian government has also created, reformed or reorganised key investment-related institutions (Mihretu and Llobet, 2017). The creation of the Ethiopian Investment Board, for example, has elevated investment promotion to the heart of government and ensured Ethiopia's investment policy is led at the highest level. The Ethiopian Investment Board – the responsibilities of which include granting incentives, addressing barriers to investment and designating new

industrial parks – is chaired by the Prime Minister and includes senior ministers and key supporting agencies that have either direct or indirect roles in making key decisions related to investment (ibid.). The active involvement of senior officials and ministers is a feature of the government's commitment to attracting investment.

A two-pronged policy of import substitution and export promotion

Historically, textiles and garments were primarily manufactured in Ethiopia for the domestic market. Over the past two decades, however, the sector – and the garment industry, in particular – has become heavily export-focused. The Ethiopian Government has been central to this shift in focus, adopting a two-pronged strategy of allowing import substitution by protecting the domestic market while explicitly promoting exports (Staritz and Whitfield, 2017). Tariff protection for the sector remains relatively high (e.g. in special woven fabric or man-made filaments), but the government has gradually reduced import tariffs, and protection against imports is regarded as subordinate to export promotion (Staritz et al., 2016).

Duty drawback and voucher schemes are in place to encourage export-oriented production and bonded warehouses are available to alleviate bottlenecks in trade and logistics, thereby reducing unit costs and trade transaction costs. The government also actively pushes firms to export. For example, they are required to submit export plans on an annual basis and must meet preordained export targets to qualify for incentives (Staritz et al., 2016). Favourable incentives are also offered to local firms that export (Staritz and Whitfield, 2017).

The two-pronged policy of import substitution and export promotion has had some success in helping local firms to export garments. Around 40% of domestic demand for garments is satisfied by domestic production, with the balance imported (Ambastha, 2017). The higher prices on offer in the protected domestic market – where there is a tariff of 35% on imported fabric plus an additional surcharge and excise tax (each 10%) – have enabled some domestic firms to subsidise the cost of entering export markets (Staritz and Whitfield, 2017). These firms exploit

the stability of supplying the protected domestic market to accumulate capital and profits, which they can then direct towards improving the competitiveness of their exports. In addition, certain firms have used production for the domestic market as a learning exercise, with a view to developing the level of efficiency required to compete in export markets (ibid.).

An ambitious industrial park programme led by the government

The establishment of industrial parks, offering targeted incentives for exporting firms, has also been an influential mechanism for attracting foreign lead firms and manufacturers from key garment producing countries to Ethiopia (Oqubay, 2015; Staritz et al., 2016; Staritz and Whitfield, 2017). The government regards industrial parks as a gateway to FDI. Lacking resources for large-scale development, it also sees the establishment of these parks as a way to minimise the cost of infrastructure development, reduce pollution and make effective use of scarce land (Mihretu and Llobet, 2017).

To date, eight major industrial zones have been constructed, with development mostly led by the government. The development of most of these has been government-led. The construction of the flagship Hawassa Industrial Park, for example, was financed by the government through the sale of Eurobonds. PVH, one of the world's largest global apparel companies, played a major role in the planning and development of the park, motivated by a desire to establish a new Ethiopian garment sourcing network and a fully integrated vertical supply chain (Mihretu and Llobet, 2017; de Haan and Theuws, 2018). The presence of PVH serves as a strong signal of Ethiopia's willingness and ability to host leading companies in the sector. It also demonstrates what can be achieved from a close partnership between a multinational corporation in the private sector and an active, engaged and responsive government (Mihretu and Llobet, 2017).

Private companies are also allowed to lease land for industrial zones. One such example is the Eastern Industrial Zone, for which the

Ethiopian government provided land (on favourable lease terms) and infrastructure. The zone was built by a Chinese developer, has attracted an influx of FDI into light manufacturing and hosts a number of Chinese manufacturing firms, including Huajian Shoes, the world's largest manufacturer of women's footwear (Hai, 2016).

Government-owned institutes to support garment sector development

Dedicated institutes have been accorded an increasingly influential role in leading the development of key industries in Ethiopia. Among these, the Ethiopian Textile Industries Development Institute (ETIDI), established in 2010, helps to promote investment and provides training and technical assistance to firms: a training centre, the Textile and Apparel Institute, was established under its guidance. It also provides research and development, testing and quality evaluation services (ITC, 2015; Oqubay, 2015; Gebreeyesus, 2016). In tandem with the Ethiopian Kaizen Institute, the ETIDI is supporting supplier firms to implement Kaizen approaches³ that improve manufacturing processes. The ETIDI has also established a benchmarking programme that sponsors 17 textile and garment firms to receive direct support from international firms (Gebreeyesus, 2016). The establishment of the ETIDI was a significant proactive move by the government to address skills constraints affecting the industry and improve factor productivity and competitiveness (Mihretu and Llobet, 2017).

Using development banks to finance industrialisation

The Ethiopian Government has gradually begun to use banks as tools to support policy objectives, with a greater focus on the provision of loans to support industrialisation. The DBE now provides long-term loans to priority sectors at subsidised rates (Oqubay, 2015). The textile sector has benefited significantly from these loans – in 2012, as much as 30% of DBE loans went to the sector (ibid.). Certain DBE loans provide

3 Based on the idea that small, continued positive changes can bring about major improvements.

important support to finance expansion: a special investment loan, in which the DBE provides loans covering up to 60% of expansion costs, is available to local or foreign firms wishing to expand an existing factory (Staritz and Whitfield, 2017). Other DBE loans are available for technology upgrades. Similarly, the ETIDI offers loans to Ethiopian factories to support investment in machinery and technology required to upgrade production (Alderin, 2014).

The DBE also offers a pre-shipment financing scheme that aims to support upgrading from CMT to full-package apparel production. The core motivation for this support is to improve access to working capital – via a revolving fund – in order to finance the imports of inputs necessary to satisfy orders from buyers demanding full-package services (*ibid.*). These financial support mechanisms are only available to domestic firms.

Alongside the DBE, the Commercial Bank of Ethiopia has also begun to place greater emphasis on financing exports and manufacturing. This includes making finance available for working capital and loans at low interest rates for upgrading technology (Van der Pols, 2015).

2.3.2 Value addition and value chain development in the textile and garment sector in Ethiopia

Ethiopia has a long history of cotton farming. However, the existing level of cotton production remains well short of potential (with an estimated 3 million hectares potentially available for growing cotton). At present, only around 6% of the land designated by the government for cotton farming is used to grow cotton for downstream use in the textile industry, with the balance remaining uncultivated (Van der Pols, 2015). Turkish textile firms are said to source some cotton locally, but accessing it is reportedly challenging. Some textile firms have invested in ginneries to secure high-quality cotton fibres (Staritz and Whitfield, 2017). Tchibo, a German company, sources around 40% of the cotton it uses in its Ethiopian production domestically, but imports the remainder (mostly organic cotton) (de Haan and Theuws, 2018).

The poor quality of locally produced cotton supplied to ginneries is a major constraint

to boosting the use of Ethiopian cotton in downstream processing. Factors involved include a lack of support services for cotton farmers, low crop yields, poor quality inputs, low land utilisation rates and weak agricultural practices. These undermine the quality and quantity of cotton produced in the country (Berg et al., 2015; Ethiopian Herald, 2017). Hence, since 2005, the value of cotton (HS 52) imported by Ethiopia has increased steadily to meet the demands of textile and garment firms downstream. For example, Ethiopia imported nearly \$33 million worth of cotton in 2015 and close to \$18 million in 2016, versus just \$558,958 in 2005 (UN Comtrade data).

More generally, a shortage of locally available good-quality raw materials that meet export standards is a major deterrent to functional upgrading among garment suppliers (Mulubiran, 2016). This issue affects both textile and garment enterprises in Ethiopia (United Nations Development Programme, 2017). Shortages in the supply of local cotton prevent downstream firms from producing higher volumes and undermine productivity (Jemaneh, 2018). In turn, these firms suffer from a lack of management and technical experience (*ibid.*). This means they are ill-equipped to enhance productivity and improve product quality, both of which would make them more attractive as suppliers to garment firms. The local textile mills in Ethiopia are not competitive on price, quality or delivery lead times and, in many cases, do not produce the types or quality of fabric required for downstream apparel production. For some inputs, such as accessories, there are no local suppliers at all. The lack of local suppliers capable of providing fabrics, trims or accessories is a major constraint on the development of value chain linkages (Whitfield and Staritz, 2017).

Most textile and apparel exports from Ethiopia are concentrated in low-value products (Oqubay, 2018). In production, much of exporting firms' emphasis remains on a narrow range of products, in order to satisfy orders from global buyers and retain market access (Mulubiran, 2016). The Ethiopian Government has sought to encourage value addition within the sector and focused policies on developing the downstream elements of the textile and clothing value chain, such as through investment in

knitting and weaving capacity. Producers in the country are actively engaged in most areas of the value chain, from the production of yarns, fibres, threads and textiles right through to finished garments, carpets and home textiles. Many textile companies are vertically integrated, including two state-owned enterprises that produce woven fabric and made-up textiles. These are mostly produced for the domestic market but also increasingly for export (approximately 30% of production) (Staritz et al., 2016). Some international firms, such as Bangladesh's DBL Group, have also established vertically integrated garment factories. Given that Ethiopia is still at a very early stage of industrialisation, the presence of vertically integrated firms is a distinguishing feature compared with many other garment exporting countries in sub-Saharan Africa (Staritz et al., 2016).

Capacity utilisation rates in the apparel segment are generally quite low, ranging from 45% to 70%. Further upstream, the spinning and ginning industries are weak (Dinh et al., 2012). Despite the influx of FDI, certain areas of the value chain remain underdeveloped, particularly in the production of accessories, materials and textiles (ITC, 2015). Supply-side constraints, including skills gaps, a lack of modern IT systems and difficulty adhering to quality in international markets, are problematic at various levels of the textile and garment sector value chain.

Moreover, Ethiopia still imports significant volumes of yarns and fabrics. It is estimated that 90% of the fabric used by the garment sector is imported (ibid.). As the apparel export industry has expanded, this reliance on imported inputs has only increased. Oqubay (2018) reports that Ethiopia's imported input dependency ratio increased by 38.5% between 1994 and 2017. Overall, the reliance on foreign inputs for the garment sector has resulted in a rapidly expanding trade deficit, even as textile and apparel exports have grown significantly.

That said, the long history of textile production for manufacturing traditional wear in Ethiopia has supported some backward integration from garments to textiles. Drawing on historical expertise in textile production and machinery within the country, some domestic firms still opt to produce their own knit fabric rather than source

inputs internationally: an activity that requires a different set of capabilities (Whitfield and Staritz, 2017). As Whitfield and Staritz (2017: 32) explain: 'Because many Ethiopian-owned firms are producing basic products, the option of producing pure cotton products using their own textiles is feasible, particularly in the EU market where exports are concentrated in knit products.' This suggests there is a foundation on which to build a national value chain from cotton to textile and apparel production in Ethiopia, but also that value-chain integration remains at a very nascent stage.

2.3.3 The role of inward investment in the textile and garment sector in Ethiopia

The Ethiopian Government's explicit emphasis on attracting FDI has coincided with rapid growth in the volume of investment into the country since the early 2000s. That influx of FDI has been central to the swift growth of apparel exports. These inflows have come in three waves. FDI flows in the first wave in the early 2000s were mostly small-scale investments from individual entrepreneurs (primarily from India and Pakistan). This wave coincided with the government's overall policy focus on encouraging domestic investment. A second wave of investment from Turkish firms began in 2008, coinciding with the government's shift in policy emphasis towards attracting FDI. This included some investment into garment production, with a focus on exporting to gain access to incentives. The third wave since mid-2010 has involved significant investment from (mostly Asian) transnational garment producers, predominantly concentrated in industrial parks. This has been stimulated by the emphasis of government policy on channelling foreign investment into specialised industrial parks, and has seen several Western brands begin to source from Ethiopia. The second and third waves have been central to the acceleration of garment production and exports in Ethiopia (ITC, 2015; Staritz and Whitfield, 2017).

An important element of the government's desire to attract FDI is to use it as a tool to support the development of domestic capacity and facilitate strategic collaboration with foreign firms to ease technology and skills transfer (Staritz et al., 2016). To date, however, backward

linkages or subcontracting of local firms has been limited. There are, nevertheless, some cases of foreign investors working with locally owned factories. H&M, for instance, works with four or five locally owned factories and has invested in knowledge transfer and training.

Some foreign investors are locally embedded, meaning they are interested in locating higher value-added activities domestically and building linkages to local input providers (Staritz et al., 2016). However, backward linkages to apparel firms producing for export are still not widespread. In general, few foreign firms source from local textile mills, mostly because these mills are not competitive on price, quality or delivery lead times (ibid.). Improvements to the capacity of local upstream suppliers are necessary to integrate them more effectively into the supply chains of foreign firms (Yost and Shields, 2017; de Haan and Theuws, 2018).

2.3.4 Local ownership and backward linkages in the textile and garment sector in Ethiopia

Ownership across Ethiopia's textile and garment sector is more diversified than that of most other garment-exporting countries in sub-Saharan Africa (Staritz et al., 2016). Locally owned firms operate in both the textile and apparel segments. The presence of locally owned firms partly stems from the history of garment manufacturing in Ethiopia, which has supported the development of indigenous expertise (Yost and Shields, 2017).

Most locally owned firms focus on production for the domestic market. The participation of these firms in the export market has been constrained by a lack of access to long-term industrial financing (Oqubay, 2018). Nevertheless, some local firms have started to export (Staritz et al., 2016; Staritz and Whitfield, 2017). Local firms accounted for 18% of Ethiopia's total textile and apparel exports in the fiscal year 2014/15 (Staritz and Whitfield, 2017). In 2016, 14 out of 48 Ethiopian-owned firms operating in the textile and

garments sector were exporting either made-up textiles or apparel (Whitfield and Staritz, 2017). Some of these firms began exporting from their inception, whereas others initially produced only for the domestic market and started exporting at a later stage (ibid.).

The Ethiopian Government's export push and associated incentives played an important role in supporting local exports. Ethiopian-owned firms were required to export in order to qualify for government incentives, such as accessing finance from the DBE on preferential terms, for investment to support production. This would include the purchase of equipment, production materials and vehicles, as well as investment for working capital.⁴ The government also rewarded exporting firms by providing them with priority access to foreign currency (Staritz and Whitfield, 2017).

Access to foreign currency is very important for local firms relying on imported fabrics for apparel production (ibid.). Local exporting firms also benefit from an exemption from corporate tax for several years, as well as access to land provided by the government at favourable lease rates (including land in industrial villages located near Addis Ababa). Staritz and Whitfield (2017) report that as many as 15 export-oriented apparel firms have been established by Ethiopian investors on the back of these government incentives.

The government's privatisation programme also played an influential role in prompting domestically owned firms to enter the export market. As part of this programme, the government explicitly pushed private investors leasing or purchasing publicly owned textile and apparel enterprises to export. For example, privatisation contracts stipulated that a specified percentage of production be exported (Staritz and Whitfield, 2017). In some cases, this required investment from the new private owners to address technology gaps and boost productivity to attain the level of competitiveness necessary to export. For example, Yirgalem undertook renovations to its knitting and dyeing facilities

4 These loans cover up to 80% of an investment at an interest rate of 7.5% payable over eight years, with a two-year grace period. Should local firms that qualify for the loan stop exporting at any point, they are penalised with a higher interest rate of 12%. The interest rate is reduced as the share of production that is exported increases (e.g. a 2% reduction in the interest rate is applied if the firm exports 60% of production and this increases to a 4% reduction if 80% of production is exported) (Staritz and Whitfield, 2017).

and expanded its apparel factory to export-quality standards before gradually starting to export basic cotton knit products (ibid.).

In two cases, the Ethiopian Government also rehabilitated state-owned firms that were not privatised, with a view to pushing them to export. Both of these firms are vertically integrated textile mills and produce woven fabrics, as well as made-up textiles (Whitfield and Staritz, 2017).

The export participation of domestically owned firms in Ethiopia contrasts with most other sub-Saharan garment-exporting countries, where exporting tends to be the domain of foreign-owned firms. Even so, locally owned Ethiopian firms generally struggle to enter and remain competitive in GVCs. Some Ethiopian-owned firms that began exporting no longer do so, while others only export small volumes, and no previously state-owned apparel firms that were privatised are currently exporting (ibid.). According to Staritz and Whitfield (2017), just six of the 15 locally owned firms established as a direct result of the government incentives were still exporting by mid-2016, with just two of these exporting all their production. Successfully building and maintaining relationships with buyers has been a key factor for the locally owned firms that have managed to survive in the export market (Whitfield and Staritz, 2017).

Backward linkages in textile and apparel production in Ethiopia remain weak – and this is the case across the manufacturing sector. This is both created by a) constraints related to the availability and quality of local suppliers (discussed above) and b) the global production and sourcing networks operated by transnational firms, which are less conducive to the development of backward linkages (Whitfield and Staritz, 2017).

Some large international buyers, such as H&M, have expressed a desire to source more from local firms, but are often unable to find suitable suppliers that meet their price and sourcing requirements, as well as their preference for full-package suppliers (Staritz and Whitfield, 2017). Whitfield and Staritz (2017) report that just two Ethiopian firms were supplying H&M in 2016 – one being an apparel factory that used imported fabric and the other producing

its own knit fabric (which had been approved by H&M). Other local enterprises are said to be keen to supply H&M, but are unable to meet the necessary quality standards or delivery deadlines (Whitfield and Staritz, 2017).

Certain US investors are better placed to source from local suppliers in Ethiopia, who have advantages over Asian suppliers when it comes to supplying synthetic apparel products thanks to Ethiopia's duty-free access under AGOA. For example, a few firms – such as Champro, Cintas and Superior Uniform – focus on workwear and production using polyester-cotton blends sourced from local Ethiopian suppliers (Staritz and Whitfield, 2017).

Further upstream, a national enterprise is reportedly being established with a mandate to purchase and sell Ethiopian cotton (ITC, 2015). This is expected to strengthen linkages between Ethiopian cotton producers and textile mills with a view to raising the level of domestic value addition (ibid.). However, it is too early to tell whether such an approach will be successful.

Building the capacity of local suppliers is seen as an important way to enhance local content and promote backward linkages in the sector. Ethiopia's current industrial policy emphasises the role industrial parks can play in enabling local firms to learn from their foreign counterparts, but it is not yet clear how many local firms will locate in these parks and how the linkages will develop (Staritz and Whitfield, 2017). Local firms are provided with support to purchase factory sheds in industrial parks, along with finance for investment and training; this support is tied to performance targets related to workplace training and hiring expatriate technical staff (ibid.).

Some attempts have been made by the government to encourage joint ventures between locally owned firms and foreign counterparts producing apparel. These are mostly focused on promoting vertical integration – from apparel into textiles and, occasionally, cotton production – with backward linkages to domestic suppliers of inputs (Staritz et al., 2016). For instance, performance-based incentives are offered for firms supporting domestic participation. In Hawassa Industrial Park, these incentives include access to working capital, investment capital

and foreign currency, cost sharing for training and skills development, and an expat managerial staff wage subsidy (Mihretu and Llobet, 2017). However, according to Oqubay (2018), learning outcomes from the attempts to promote production linkages and interaction between domestic and foreign firms in industrial parks have been slow to materialise and the various government support schemes and incentives have, to date, offered limited impact in practice.

2.3.5 Conclusion

The rapid growth of export-oriented garment manufacturing in Ethiopia owes much to a favourable mix of two things. The first is a proactive industrial policy that centres on an ambitious industrial park programme, strong incentives for investment and effective investment promotion, led at the senior levels of central government. The second is the presence of significant FDI inflows. The latter is at the core of the Ethiopian Government's industrialisation strategy and recognised as key to accelerating the development of manufacturing capacity. Foreign manufacturers, mostly in the form of Turkish and Asian firms (particularly in India, China and Bangladesh) have invested in production bases in Ethiopia to supply major brands and retailers that are predominantly headquartered in the US and Europe. Some of these firms – such as PVH and China's Jiangsu Sunshine Group – have also built their own factories in Ethiopia. These investments have facilitated rapid growth in the country's export-oriented production capacity.

While the government operates a two-pronged policy of import substitution and explicit export promotion, attracting FDI to higher value-added, export-oriented investment is given priority. The results of this prioritisation are clear. FDI has played a key role in spurring significant growth in Ethiopia's garment production and exports, with apparel exports expanding from less than \$250,000 in 2000 to nearly \$63 million in 2016.

Despite this impressive growth, backward linkages or subcontracting of local firms remains limited. The government is attempting to address this issue by offering performance-based incentives, such as working capital, access to foreign currency and cost sharing for training and skills development, in industrial parks. This approach is

taken to encourage backward linkages to domestic suppliers. Further upstream, despite Ethiopia's considerable potential for cotton production, locally produced cotton is currently of poor quality and relatively little is cultivated for downstream use. This results in limited vertical integration from cotton to textiles. Nevertheless, ownership in the sector in Ethiopia is relatively diversified compared with other garment-exporting countries in sub-Saharan Africa and includes different types of locally owned firms operating in both the textile and garment segments.

2.4 India

Historically, India has been a major producer of textiles and garments for its large domestic market, but it also produces for the export market. Data for 2011 show total production of the industry at \$55 billion, 64% of it going to the domestic market, while the remaining 36% was exported (Ray et al., 2016). Exports started booming in the mid-1980s (Chatterjee and Mohan, 1993). In 2017, India exported over \$22 billion worth of textile and garment products, which constituted around 8% of the country's total exports.

The total garment and textile exports are quite diversified, reflecting India's production structure:

- Knit and non-knit garments – 46%
- Cotton exports – 17%
- Other textile articles (HS code 63) – 14%
- Other fabric and fibre exports – 23%

The bulk of India's textile and clothing exports comprise cotton-based yarns, fabrics, clothing and household furnishings, whereas synthetic and blended products are relatively less common (Landes et al., 2005).

The country's export destinations are also diversified (see Figure 4). The majority of garments (HS 61-63) are exported to the US, United Arab Emirates and United Kingdom (UK), while the majority of cotton textile (HS 52) exports go to other garment producers such as Bangladesh, China, Viet Nam and Sri Lanka. India benefits from preferential access to a number of countries and blocs, including GSP access to the US and the EU.

The domestic textile and garment sector is very diverse, as it includes formal firms and a large number of informal enterprises of various sizes. It also includes handlooms and power looms, which are not included in the formal textile and garment sector statistics, although they constitute an important part of it. The Ministry of Textiles reports that as of October 2017, there were 2.7 million power looms, accounting for 57% of India's total cloth production (Ministry of Textiles, 2018). Less than 3 million handlooms produced 15% of the country's fabric (ibid.). It is estimated that the formal and informal textile and garment sector employs 45 million workers, with another 10 million employed directly and indirectly in the handloom (4 million) and power loom (6 million) sectors (Kane, 2015b).

2.4.1 Key factors shaping the development of the textile and garment sector in India

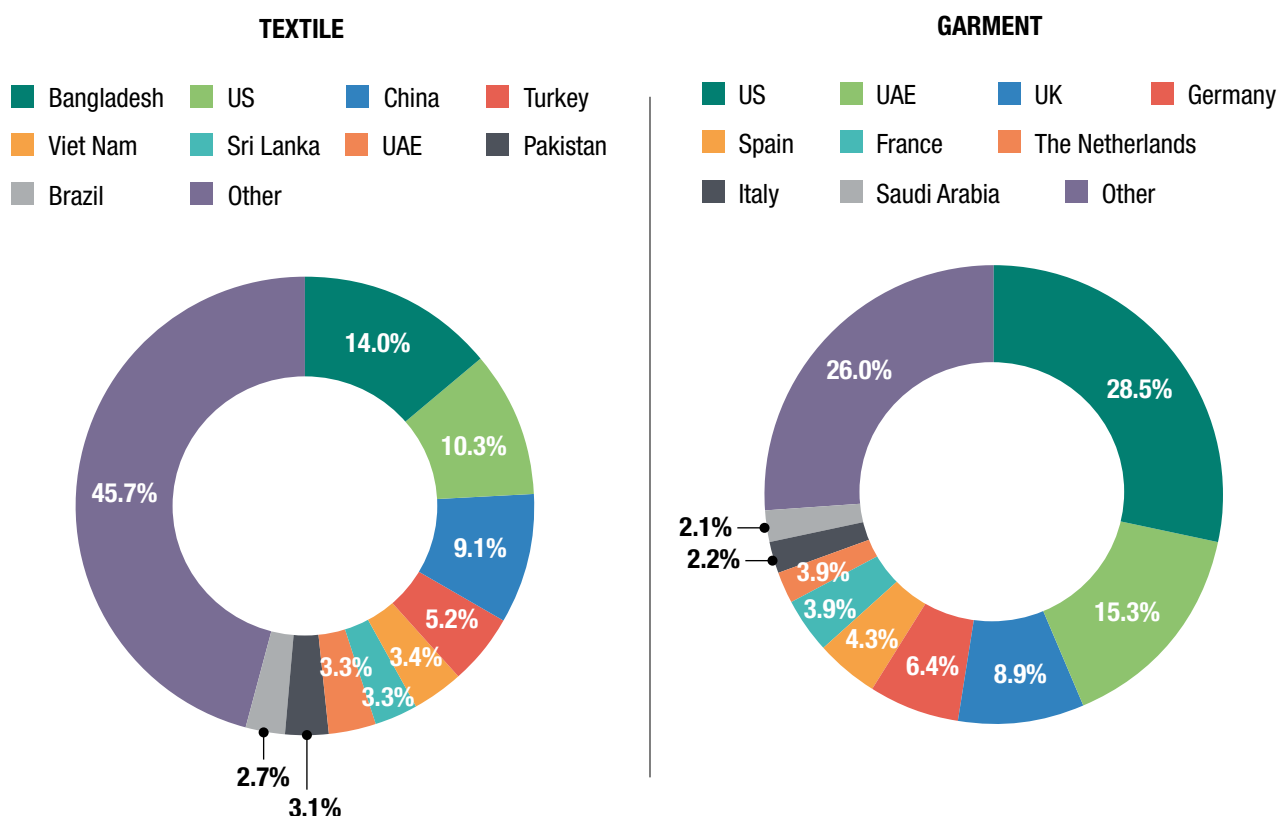
In India, textile and garment production has a long history. The sector is diverse, from small-scale producers to large industries led by the domestic elites. Until 2001, national legislation

reserved garment-making for small-scale production units (Bardhan, 2006).

This policy of 'reservation' was applied to many sectors of the Indian economy that were effectively ringfenced to only allow participation by small firms. Many companies circumvented this by setting up shop abroad and producing to export to India, or by breaking larger companies into smaller units (Srinivasan and Tendulkar, 2003).

The growth of India's modern RMG sector picked up following a series of reforms in the garment sector, marked by revisions to the country's textile policy in 1988, 1990, 2000 and 2003 (Tewari, 2006). From the mid-1980s, the newly created Ministry of Textiles loosened some regulations to allow the sector to grow and diversify domestically, while also supporting export growth. These policies promoted investment and technical upgrading, helped diversify the fibre base away from cotton and specifically promoted exports (ibid.). The country has several textile and garment clusters, with some specialising in the domestic market and others in the export market (Mezzadri and Srivastava, 2015).

Figure 4 India's textile and garment exports by destination, 2017



Source: UN Comtrade data.

Three salient features of the Indian garment sector stand out (Tewari, 2006):

- **Extensive textile base.** India is the world's second-largest producer of cotton and its domestic textile industry has been developed over a long period. This has been supported by government efforts to i) provide clothing for its citizens and ii) support employment creation. While India has diversified its products in recent years, the industry still produces large amounts of cotton-based textiles and clothing.
- **Strong domestic focus.** From the late 1960s to the mid-1980s, India's textile and garment industries had a strong domestic orientation. In this period, Indian political and economic policies were strongly inward-looking as a result of broader industrial policy choices, a severe foreign exchange crisis due to droughts and a forced devaluation of the rupee. This promoted a strong domestic focus in all industries, including textiles. The textile and garment sector was listed under the Essential Commodities Act and was subject to restrictions on both imports and exports. While far less pervasive, this domestic orientation still shapes the sector today, as more than 60% of output is sold on the domestic market.
- **Slow global integration.** This is strongly linked to the domestic focus discussed above. Because of domestic policies encouraging production for the local market and limiting imports and exports, India focused mostly on the domestic market from the late 1960s and started exporting garments relatively late (in the mid-1980s) compared with other countries in East Asia (Tewari, 2006).

The Government of India played a key role in shaping the Indian textile and garment sector, in particular by: i) encouraging production for the domestic market, especially by reserving quotas for smaller-scale producers, and ii) maintaining employment in small-scale firms. The government established a licensing regime, whereby firms had to seek permission to establish new operations or expand capacity. To protect employment in small-scale industries, the government introduced strict labour laws and required all spinning

mills to produce 50% of their output in a form that could be used for handlooms and small power looms (the 'hank yarn obligation'). The government also used a system of taxation, licenses and subsidies to restrict imports and exports of textiles and clothing. This approach was taken to achieve the goals of self-reliance and employment generation (Tewari, 2006).

In the mid-1980s, in response to broader domestic and foreign circumstances, the Indian Government prioritised increasing foreign exchange earnings. Therefore, the textile and garment sector became more geared towards exports and set about achieving international competitiveness. The government was instrumental in this shift by setting up a Ministry of Textiles and other dedicated institutions, such as the Apparel Export Promotion Council and the Textile Export Promotion Council. These oversaw and supported India's textile and garment sector. The New Textile Policy (1985) relaxed some of the existing restrictions to allow the sector to diversify domestically and to increase exports (Tewari, 2006). The policy:

- reduced licensing requirements, allowing firms to expand and diversify production
- raised the maximum limits on allowable investment
- provided credit to modernise through the importation of capital goods and technology
- reduced import controls and tariffs
- used duty drawback programmes to promote exports.

These reforms were reinforced by additional export promotion efforts in the early 1990s and were very successful in boosting India's production (Tewari, 2006). In recent years, the Ministry of Textiles has continued to support the sector by pursuing increased market access through agreements with other countries and blocs (Kane, 2015c).

India's modern garment sector was initially built by protecting the large domestic market. By limiting the need to export to achieve economies of scale, it was possible for companies to adopt a more inward-looking approach in the early stages of the sector's development. When India later opened up to the global market, producers were supported with the tools to compete

internationally. This led to an explosive growth of exports throughout the late 1980s and early 1990s (Chatterjee and Mohan, 1993).

Chatterjee and Mohan (1993) identify two main ways in which production was organised in India: large integrated textile mills and a more fragmented process operated by subcontracting different tasks to many smaller units and firms. While the former mostly served the domestic market by producing traditional Indian attire, the latter dominated production for export. The model used by export firms allowed them more flexibility to reduce costs and adapt quickly to the fluctuations of the global market. This differentiation was particularly marked during the 1980s, but it became blurred in the following decades, as western-style garments became more popular in the domestic market.

One of the features of the textile and garment sector in India is the relatively limited penetration of foreign investment (Tewari, 2006). In other countries, foreign investors have promoted the international division of labour. Due to the history of the Indian garment sector, exports have grown without a large import content (Chatterjee and Mohan, 1993), limiting their participation in GVCs. Gereffi and Frederick (2010) identify Indian firms as full-package producers. Indian firms can undertake all stages of production including product design, but usually not branding.

2.4.2 Value addition and value chain development in the textile and garment sector in India

India covers the entire cotton-to-clothing value chain. It is one of the largest cotton producers in the world. A large share of the country's production goes into the domestic garment industry and it has been largely self-sufficient (Landes et al., 2005), while also trying to diversify its textile sector into other fibres.

The high level of domestic value chain integration is the result of the history of cotton production in the country as well as the government efforts. Policies like the 'hank yarn obligation' ensured the value chain remained active in India, as did the government's efforts to maintain employment in the small-scale textile and garment sector.

Policy objectives promoting self-reliance and employment creation ensured that production capacity was maintained and utilised across all segments of the value chain in India.

2.4.3 The role of inward investment in the textile and garment sector in India

FDI played a relatively limited role in the development of the Indian textile and garment sector (as well as in other sectors of the Indian economy). Until recently, the Indian market was protected from FDI (Tewari, 2006). Even when exports increased in the mid-1980s, this was mediated by Indian agents and brokers, rather than by foreign companies (ibid.).

While FDI did not play a critical role in the initial stages of the modern Indian garment sector, India now sees increased volumes of FDI, both in textile and garment production and in retail (Kane, 2015c). Since 2016, 100% foreign investment is allowed in the textile and garment industry under the automatic route, which reduces the number of permits and licences to be obtained. There are large global retailers and brands that currently source from India (ibid.). The government's 'Make in India' campaign encourages foreign investment in 25 industrial sectors, including textiles and garments.

2.4.4 Local ownership in the textile and garment sector in India

A natural consequence of the above state of affairs is that there is a high degree of local ownership in the Indian textile and garment sector. The limited foreign presence implies that many Indian entrepreneurs operate in the sector. This is a result of the history of the country's garment sector, as well as government policies that have encouraged the development and growth of domestic firms.

2.4.5 Conclusion

The textile and garment sector in India is rooted in the country's long history of cotton and textile production. The modern sector was developed through a combination of trade protection, which promoted the use of domestic inputs along the value chain, and supportive government measures that promoted production and encouraged exports. In recent times, the

sector has opened up to the international market and foreign investment, with the government maintaining its support to ensure competitiveness.

Due to its history of producing cotton and textiles, but also its large size, the Indian garment sector is well integrated along the value chain and there are high levels of domestic ownership. While FDI is increasingly present in both production and retail, these investments have not been catalytic in promoting the growth of the Indian textile and garment sector.

The current domestic focus was made possible by a large domestic market for textiles and garments. With a population now surpassing one billion, India has always been able to rely on a large domestic market. Tanzania, in contrast, needs to focus on the export market to achieve economies of scale.

Another interesting lesson for Tanzania is the role of the Indian Government, which very actively promotes the use of domestic textiles for garment production, while at the same time supporting exports through a series of targeted policies.

2.5 Lesotho

Lesotho's narrow economic base means it is heavily reliant on the textiles and apparel sector, which is a key element of the economy and the country's main manufacturing and export activity. It accounts for approximately one-third of national GDP and 60% of total exports (Morris et al., 2016). The sector is also a major generator of jobs, employing around 40,000 people, most of them women, making it Lesotho's largest source of private employment (Brown, 2016a). Nearly half of Lesotho's formally employed workforce are engaged in textile and garment production, with the textiles and apparel sector accounting for around 80% of employment in manufacturing (Morris and Staritz, 2016).

Lesotho has registered considerable recent growth in garment exports (see Figure 5), driven by an influx of FDI. It is widely regarded as an African success story in export-oriented

manufacturing on the back of preferential market access and foreign investment. Indeed, preferential trade and access to key markets have played important roles – together with FDI – in kick-starting industrialisation in Lesotho. Such access has been gained through the Lomé convention, AGOA and its third-country fabric derogation, MFA quota provisions, and duty- and quota-free access to the Southern African Customs Union (SACU).

Initially, foreign investment into the sector stemmed primarily from Taiwanese transnational producers with established links into GVCs supplying the US market. These Taiwanese investors came to Lesotho after relocating from South Africa, where they had been situated in decentralised areas to benefit from South African government incentives. Their move to Lesotho was initially prompted by sanctions imposed on the apartheid regime in South Africa (Salm et al., 2002). Similarly, South African regional investors relocated production to Lesotho in the 1980s in the wake of the sanctions. A second wave of relocation to Lesotho followed in the 1990s in response to lower tariffs on imports into South Africa, which made supplying the South African market less attractive. Much can be learned from the interplay between these different types of FDI (regional versus global) in Lesotho and their various implications for the development of backward linkages, local production and upgrading. We take a closer look at these implications later on.

While the take-off of Lesotho's textile and garment sector has been largely driven by FDI, it remains built around trade preferences. Preferential access to the US market is a major driver of competitiveness and this is reflected in the dominance of US exports in the overall export bundle. This was particularly the case in the early 2000s following the enactment of AGOA in 2000 (see Figure 6). In this sense, the sector in Lesotho remains heavily reliant on AGOA for its survival. Nevertheless, beyond supplying the US, exports to regional end markets have also increased in importance, especially since 2007; South Africa, in particular, has become a major destination for Lesotho's

apparel exports (Morris et al., 2014).⁵ However, the domestic sector is uncompetitive when it comes to a number of other dimensions unrelated to preferential market access. Lesotho's labour costs are relatively high compared with other sub-Saharan African countries. Productivity in the sector is generally low relative to major competitors (Edwards and Lawrence, 2010). Moreover, Lesotho is not competitive on manufacturing costs when compared with Ethiopia, Kenya, Madagascar or Mozambique (Shakya, 2011).

2.5.1 Key factors shaping the development of the textile and garment sector in Lesotho

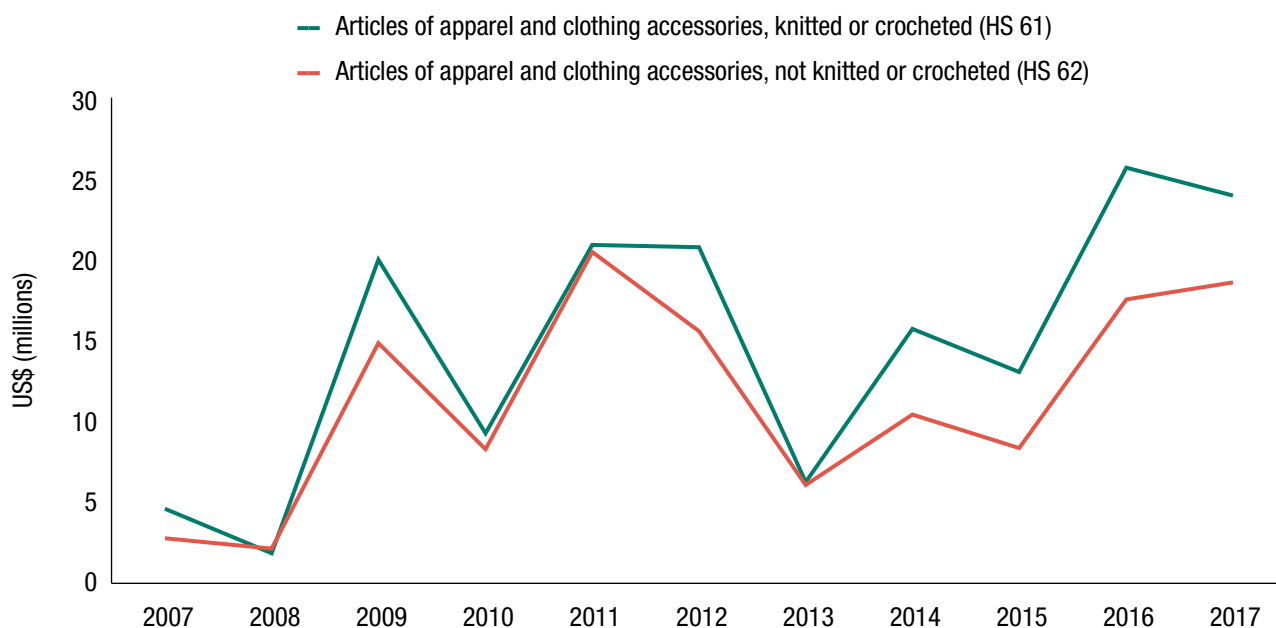
The foundation of the apparel exporting industry in Lesotho dates back to the 1980s. The various phases of the sector's growth are linked to different waves of foreign investment. This growth began at – and remains focused on – the garment stage of the value chain. Historical links with both Taiwan and South Africa have helped to provide a platform for the first wave of foreign investment. In the early 1980s, a number of Taiwanese-owned firms based in South Africa initially relocated plants to Lesotho. This was motivated by a desire

to capitalise on the cost advantages associated with Lesotho's low-cost labour and duty-free access to Europe under the Lomé Convention (which included special rules of origin allowing single transformation) and also to avoid Apartheid-related sanctions (Salm et al., 2002; Staritz and Morris, 2013; Morris and Staritz, 2016). Later in the 1980s, there was a further influx of investment from Taiwanese firms (most of which were based in South Africa) looking to capitalise on Lesotho's underutilised MFA quotas and take advantage of the country's various FDI incentives (Morris and Staritz, 2016).

Lesotho's AGOA eligibility (and the third-country fabric derogation), combined with MFA quota provisions, sparked a second wave of foreign investment after 2000. This led to significant growth in apparel exports to the US, spearheaded predominantly by Taiwanese investment. Taiwanese transnational producers investing in Lesotho were able to draw on their global networks to link into GVCs supplying retail chains in the US (Morris et al., 2016).

A third wave of investment from South African garment manufacturers followed. These firms relocated to Lesotho in order to benefit from

Figure 5 Lesotho's apparel exports to the world, 2007–2017



Source: ITC Trade Map data.

⁵ See UNCTADStat data for 2016. Some 21.4% of Lesotho's exports of textile fibres, yarn, fabrics and clothing (SITC 26, 65 and 84) go to (South Africa.)

lower costs in terms of both labour and overheads, greater labour market flexibility and duty-free access to SACU (Morris and Staritz, 2016). The lower-cost operating environment in Lesotho was crucial for these South African firms because they were not able to compete with imports into sub-Saharan Africa, owing to the high cost of labour in South Africa. Many of the South African firms that set up operations in Lesotho produced complex, high-value garments for both regional markets and exporting overseas.

In addition to Lesotho's cost advantages and preferential access to major markets for apparel exports, the Government of Lesotho also played a proactive role in supporting investment attraction through several explicit interventions. The government actively coordinated the delivery of certain public goods to overcome market failures, improve Lesotho's investment climate and trigger private sector investment inflows. This included interventions to improve transport infrastructure and customs and logistics systems.

The government also offered a series of early-stage special FDI incentives to attract investors. These included:

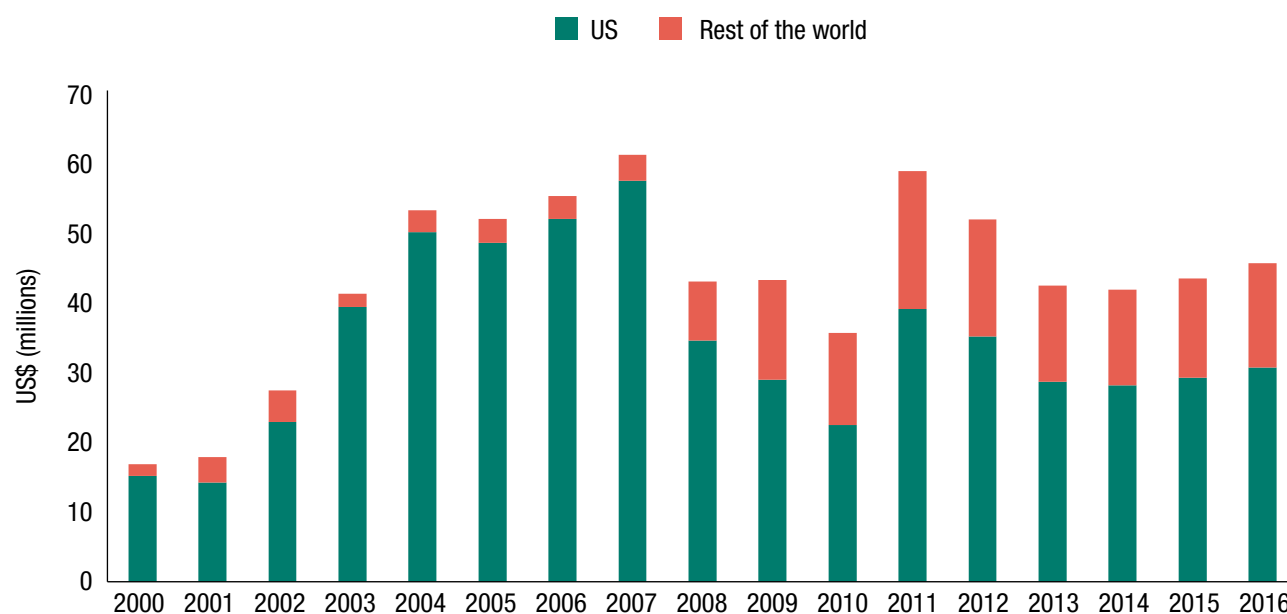
- a reduced corporate tax rate for exporting manufacturers (down from 15% to 0% for

those exporting outside of SACU and 10% for intra-SACU exporters)

- free repatriation of profits, tax exemptions on machinery and equipment imports
- rebates on imported inputs for exports (Bennet, 2006; Morris and Staritz, 2016; Morris et al., 2016).

Similarly, the government's provision of industrial zones and serviced factory shells (with subsidised rent for investors) was important to Lesotho's success in attracting foreign investors (Shakya, 2011). The government made a conscious decision to locate zones close to the infrastructure necessary for industrialisation. These locations were selected to capitalise on South Africa's good quality road network to transport textiles and apparel to ports in Durban and East London. The timing of zone development was also important – Lesotho was among the few countries to already have well-equipped industrial zones when AGOA became effective and offered to subsidise the rent for garment firms for at least the first five years of their operations. These zones offered fully serviced industrial plots that were serviced with electricity, telephone, water and sewerage connections, and customised factory

Figure 6 Lesotho's exports of textile fibres, yarn, fabrics and clothing, 2000–2016



Source: UNCTADStat data.

buildings. Locating within the zones also helped firms to overcome high land costs and certain bureaucratic inefficiencies related to the local land market (Shakya, 2011).

Finally, the Lesotho National Development Corporation (LNDC), a parastatal serves an important function as a de facto garment investment promotion agency (Shakya, 2011). The LNDC's role is multi-faceted and includes facilitating investments, brokering and managing investment incentive offerings, as well as developing real estate. It also provides one-stop support to investors, including for firm registration, site selection and expedited processing of trading and manufacturing licences. The LNDC's active engagement in targeted investment solicitation has proved an important element of Lesotho's success in export and investment promotion (*ibid.*).

The government, however, has been less proactive in other areas. It has had little active engagement with foreign lead firms to try to drive Lesotho's participation in regional or GVCs (Morris et al., 2016). The government's support for training and interventions to improve productivity in factories has also been limited, and where there have been public-sector interventions to develop skills, they have proved ineffective. For example, the Lesotho Garment Centre had little success in supporting the emergence of local entrepreneurs in the formal garment sector and was closed down in 2003 (Shakya, 2011). Training completion rates at Skills Development Centres in Maseru and Maputsoe have generally been underwhelming (Morris et al., 2016).

2.5.2 Value addition and value chain development in the textile and garment sector in Lesotho

The historical development of Lesotho's garment industry demonstrates both the power and limitations of trade preferences. The industry's reliance on preferences means the sole purpose of firms' market entry has been to export. This is evident, for example, in Figure 5, which shows the large increase in exports in the early 2000s after AGOA was introduced. This reliance has also disincentivised diversification into high-value products or investment in

quality upgrading (Edwards and Lawrence, 2010). This indicates limited vertical integration and has resulted in little progress in developing domestic value addition.

The industry in Lesotho comprises only foreign firms that have located one part of one segment of their value chain in the country to make use of trade preferences and to diversify their production locations. Hence, the premise of the local industry when it emerged was that it would be restricted to that segment of the value chain. The firms entering Lesotho continued to operate their fabric and input sourcing, along with their distribution functions, from China and the rest of Asia. Over time, this dynamic has changed somewhat – one of the largest spinning and denim manufacturers in Africa is now based in Lesotho (discussed further below) and many firms source fabric from Africa, particularly from other SACU and Southern African Development Community (SADC) countries.

Historically, the combination of MFA quotas on imports by the US and preferences offered through AGOA generated a favourable environment for Asian firms constrained by quotas to move their low value-added, fabric-intensive and low-priced clothing production for export to countries like Lesotho that benefited from unused quotas. In turn, these quota-constrained countries re-directed production towards higher-quality products (*ibid.*). At the same time, AGOA's third-country fabric provision offered an implicit effective subsidy for clothing exports from Lesotho (and other LDCs) to the US. It also enabled firms based in Lesotho to import fabrics and engage only in the final stages of production for export and thus failed to facilitate the development of integrated value chains or encourage upgrading (Edwards and Lawrence, 2010; Rotunno et al., 2013). The broader implication, as Morris et al. (2016: 6) explain, is that: 'the functional upgrading challenge is hence much more complicated than simply creating broader capabilities. It requires fundamentally challenging the *raison d'être* for the establishment of production facilities in Lesotho, which is marketing and extracting rents from disembedded production units based on preferential market access.'

Today, there is a barely-functioning domestic textile industry in Lesotho and the country

produces little fabric, due to a lack of local fabric mills. The Formosa Textile Mill (discussed further below) is an important exception, producing denim textiles. But sector's main focus is on the downstream assembly of textile and garment products (mostly CMT), using imported raw materials, with very limited integration upstream and little value addition. Moreover, production is highly routine and mostly concentrated in a narrow range of low-unit-value products in large volumes (Edwards and Lawrence, 2010). That said, after 40 years of apparel production in Lesotho, some upgrading of production skills has occurred and more complex garments are now being produced.

2.5.3 The role of inward investment in the textile and garment sector in Lesotho

As alluded to, inward investment has been central to the development of the garment industry in Lesotho, particularly since 2000. FDI inflows have gone to export-oriented manufacturing, primarily for the production of textiles and clothing (Setipa, 2016). However, different types of FDI firms linked to distinct value chains have had varied impacts on local upgrading, depending on the rationale for – and nature of – their investments. The different motivations of Taiwanese and South African investors have been central in determining their impacts on functional and process upgrading. The ownership and governance structures of these investors, along with their targeted end markets and varying levels of local embeddedness, have also played a part (Morris and Staritz, 2016).

Taiwanese investors in Lesotho, who accounted for the majority of FDI inflows in the early 2000s, are mostly affiliates of Taiwanese transnational firms linked to Chinese (mainland) production networks and generally supply the US market. These firms are structured so that key decision-making and higher-value functions, such as input sourcing and product development, are centralised at their head offices. In turn, they operate a global strategy hinging on long-run production of a narrow range of basic products for export, drawing from a worldwide sourcing network (Staritz and Morris, 2013). In keeping with this model, investment from

Asian transnationals in Lesotho since 2000 has been concentrated primarily in production units focusing on CMT activities, with the aim of capitalising on AGOA trade rents generated by Lesotho's preferential access to the US market. These firms are generally not locally embedded, instead using foreign networks for input suppliers and agents working with sourcing and buying offices (Morris et al., 2014).

These firms have brought knowledge and capabilities related to production set-up and processes through their initial investments. Crucially, they have also helped to link the sector in Lesotho to GVCs. However, they have not generated many major process innovations or investments to improve technology, capital or skills (Staritz and Morris, 2013). This is because there is a focus on securing AGOA trade rents as part of an overriding strategy of cost containment for exporting globally, rather than other strategic reasons for locating in Lesotho. This stifles the need/scope for investment in upgrading and skills development (Staritz and Morris, 2013; Morris et al., 2016; Staritz and Frederick, 2016). There is a very real threat that Taiwanese investors will leave Lesotho if AGOA benefits are withdrawn. The uncertainties around the continuation of preferential market access further disincentivise these firms from investing in upgrading plants based in Lesotho (Morris and Staritz, 2016).

Cost and policy factors (e.g. availability of underutilised quotas, AGOA eligibility, the third-country fabric derogation and special FDI incentives) are the central motivations for Taiwanese investment in Lesotho (Bennet, 2006). Consequently, their emphasis is on reducing worker costs and raising worker efficiency to drive competitiveness in CMT activities to support higher value-adding facilities located elsewhere, rather than through improvements to technology or production processes (Morris and Staritz, 2016). Taiwanese assistance in advancing local skills has mostly been focused on basic production (e.g. on-the-job training for handling sewing machines). The mode of investment from Taiwanese transnational producers has thus had little impact on functional upgrading in the domestic garment industry. As Morris and Staritz (2016: 10) explain:

The very reason why Taiwanese firms set up operations in Lesotho, and which provides them with a competitive advantage, makes it difficult for them to upgrade [...] The integration of Taiwanese firms in their parent companies' triangular manufacturing networks limits their taking over higher value-added functions (product development, design, fabric management and merchandising), which are conducted by the head offices. Their primary exporting strategy is to utilise their Taiwanese head offices to market their Lesotho capacities, which remain focused simply on manufacturing.

In contrast, South African firms investing in Lesotho operate a different production model to the Asian transnational firms and are generally more locally embedded within a regional production network, because they have networks in South Africa and direct relationships with South African retailers. These firms have recently been driving some upgrading to focus on producing more complicated products with higher fashion content within Lesotho. The South African firms that invested in Lesotho in the 1970s and 1980s brought with them the skills and capabilities to produce high-value garments and these skills have been retained in Lesotho.

Rather than looking to access the US market through AGOA, the South African firms have focused on establishing a regional value chain involving Lesotho in order to capitalise on lower labour costs and duty-free access to SACU markets (Kao, 2016). This is motivated by a regional displacement strategy that hinges on relocating more functions to Lesotho (Morris et al., 2011; Morris and Staritz, 2016). The South African-owned firms produce smaller-run, higher-fashion products for South African retailers. This is in contrast to the long runs of basic or semi-basic items produced by Taiwanese firms for the US market in simple assembly facilities in Lesotho (Morris and Reed, 2009; Morris and Staritz, 2016). Close geographical proximity enables more interaction and greater fluidity in the division of labour between head offices

in South Africa and Lesotho-based production plants (Morris et al., 2016). Moreover, in certain cases, the manufacturing plants based in Lesotho enjoy greater influence over decision-making than their Taiwanese-owned counterparts because the plants themselves cannot be as easily substituted for others in different production locations (Staritz and Morris, 2013).

2.5.4 Local ownership and backward linkages in the textile and garment sector in Lesotho

The challenges discussed above relate to the extent to which FDI is locally embedded. They are also reflected in a very limited level of local ownership and backward linkages in the sector. The garment industry is almost entirely foreign owned and there are virtually no locally owned garment factories operating in Lesotho (Brown, 2016b). Indigenisation of the sector remains a major challenge, in stark contrast to the experience of Bangladesh.

In the past, distortions created by the interaction of trade preferences and the third-country fabric provision under AGOA meant there were reduced incentives to source locally and made it less likely that backward linkages into domestic textiles industries would be developed (Edwards and Lawrence, 2010). The third-country fabric provision meant firms could import fabric and only undertake the final stage of production in Lesotho. As explained, the Asian transnational producers in Lesotho form a part of wider global production networks and concentrate solely on CMT activities in Lesotho, meaning they have few incentives to develop backward linkages and source inputs locally. This is exacerbated by their need to conform to the requirements of overseas buyers, which limits the scope for subcontracting and utilising local suppliers.

This is also the case for many South African investors in Lesotho, whose input sourcing decisions are made at head offices in South Africa. These are generally guided by global or regional sourcing strategies. However, the closer proximity of manufacturing plants in Lesotho to head offices in South Africa does allow for more interaction on decision-making, including sourcing decisions. This increases the scope for moving some higher-value functions to local

production plants or to experiment with using local suppliers of particular inputs (Staritz and Frederick, 2016).

Nevertheless, progress in developing backward linkages in the sector is generally constrained by the limited availability of local input suppliers. At a fundamental level, there are very few locally owned firms engaged in manufacturing export-oriented apparel or inputs (Staritz and Frederick, 2016). Moreover, capacity and competitiveness limitations among the existing local supplier base still represent a major constraint for investors (particularly South African firms) looking to source locally (Morris and Staritz, 2016). As a result, the majority of inputs used in garment production are imported. The Taiwanese firms operating in Lesotho, for example, source as much as 93% of the material they use for production from their Asian sourcing networks (de Voest, 2012). Aside from the constraints of local input supply, this is also very much a function of these firms' global sourcing strategies, which dictate that the inputs for all their production plans are generally sourced globally from nominated fabric and input suppliers (Morris et al., 2011).

Only a small number of Taiwanese-owned firms have invested in more capital-intensive finishing operations (e.g. laundry, embroidery, screen printing and dyeing) and the majority of the foreign-owned garment firms operating in Lesotho have not built local fabric mills (Staritz and Morris, 2013; Morris et al., 2016). Just one Taiwanese-owned firm, the Nien Hsing Textile Company, has integrated backwards into fabric and yarn production by investing \$100 million in a vertically integrated denim fabric mill (Formosa). The Formosa Textile Mill was established primarily as a result of concerns that the AGOA third-country fabric provision would not be extended and that two-stage processing would be required as standard in rules of origin. With this in mind, there were also plans to establish a large-scale knitting mill in Lesotho. However, the third-country fabric provision was eventually extended after considerable lobbying to retain it for LDCs. Consequently, these plans were shelved.

Even so, the Formosa Textile Mill plays a prominent role in the sector in Lesotho

– employing 400 people and boasting capacity to produce 1.6 million yards of denim fabric per month (USAID, undated). The mill's presence has helped to direct some sourcing locally. The bulk (between 70% and 80%) of the mill's fabric production is sold to three export-focused denim manufacturing operations in Lesotho (Nien Hsing Industrial, C & Y Garments and Global Garments) (ibid.).

Attempts to localise skills have also had mixed results. Some localisation has been achieved at the level of supervisory, line and production managers, as well as those maintaining machines (Staritz and Frederick, 2016). In this respect, there has generally been more progress with the localisation of skills for these roles in South African-owned firms, owing in part to their embeddedness in a regional production network (Morris and Staritz, 2016). However, overall progress in developing a local skills base at higher levels has been limited. Most technical, managerial and supervisory roles are still filled by expatriates, particularly in Taiwanese-owned firms (ibid.).

2.5.5 Conclusion

The development of Lesotho's garment industry is a much-publicised example of how preferential trade and FDI can interact to kick-start industrialisation around export-oriented garment production. The take-off in the sector, particularly since 2000, has been largely driven by FDI from Taiwanese and South African firms. The Lesotho case demonstrates both the power and limitations of trade preferences and the varied implications that foreign investment can have for the development of backward linkages and the localisation of manufacturing.

Although, Lesotho has been producing garments for more than 40 years and has a state-of-the-art spinning and fabric-producing factory, the sector remains highly reliant on AGOA for its survival. Very little progress has been made in developing locally owned garment factories and indigenisation of the sector remains a major challenge. Most manufacturing is confined to CMT activities and there has been little vertical integration or progress in enhancing domestic value addition. That said, there are contrasting impacts of Taiwanese and South African

investment in terms of backward integration, local embeddedness and upgrading. These offer insights into the role that foreign investment can play in supporting the domestic development of the sector.

The potential for further growth of the sector in Lesotho is capped by the country's small population and (landlocked) geographic location. The industry is too small to justify significant expansion into other value chain segments such as inputs (e.g. trim, buttons). However, a very large denim mill was set up in 2004 and supplies three related manufacturing operations in Lesotho. Furthermore, Lesotho's proximity to South Africa has made it difficult to retain entrepreneurial activity. The ease of migration to South Africa is constraining the emergence of a local business class. In contrast, these constraints are not present in Tanzania, which – like Bangladesh – has scope for a larger and stronger business class to become interested in a domestic and export-oriented garment sector.

2.6 Madagascar

This case study examines how preferential market access and foreign investment have stimulated the growth of a highly export-oriented garment manufacturing industry in Madagascar. We particularly highlight the nuanced role of different types of inward investment in driving the development of the sector.

Madagascar's economy is heavily dependent on the textiles and garment sector. For at least two decades, garment production has served as the economy's principal driver of growth in exports and formal employment (Morris and Staritz, 2014). The garment industry alone contributes around one quarter of manufacturing value added (Kaplinsky and Wamae, 2010).

Garment-based industrialisation in Madagascar, largely stimulated by an export-oriented model, with foreign investment playing an important role, has impacted positively on job creation and poverty reduction (Morris and Sedowski, 2006). As a result, Madagascar is widely regarded as a successful example of industrialisation among those African countries with high levels of dependence on

exports of primary commodities (Fukunishi and Ramiarison, 2012).

In a similar manner to many other sub-Saharan African countries, preferential access to key export markets in the EU and the US has been key to stimulating export-oriented garment production. These market-access advantages combine with low labour costs and relatively high productivity (and thus competitive unit production costs) to provide a compelling case for foreign investment in the sector. Madagascar's EPZ model has provided further motivation for foreign investors and helped to grow exports substantially. These factors have attracted varied investments into the textile and garment sector, with different implications for the development of backward linkages, value chain integration and upgrading in the domestic industry.

As Figure 7 shows, textile and garment exports have accounted for large shares of Madagascar's total goods exports since 2000, especially in the years to 2008. The majority of these exports go to the EU (mostly from European diaspora investors, along with Mauritian and locally owned firms) and the US (mostly from predominantly Asian-owned firms). In 2016, following steady growth since 2000, Madagascar's apparel exports to the EU totalled more than \$373 million (see Figure 8). Exports to the US are also substantial and have grown considerably following the introduction of AGOA. However, Madagascar's exports to the US did fall significantly after 2008, and particularly from 2010, after the country's loss of AGOA eligibility (discussed further below).

2.6.1 Key factors shaping the development of the textile and garment sector in Madagascar

A 'single factory EPZ' model has been the central pillar of the Madagascan Government's industrial policy support for the textile and garment sector. This has served as a key tool in shifting the focus of the sector towards greater outward-orientation. Single factory EPZ models provide greater flexibility while also avoiding the possibility of workers being poached by adjacent factories. The enactment of an EPZ law and the provision of incentives over the past 30 years

have played a central role in promoting export-oriented FDI in combination with preferential market access to the EU and later to the US (Fukunishi and Ramiarison, 2012). This, in turn, has been an important driver of Madagascar's boom in garment exports (Andersson, 2009).

The EPZ concept was introduced in Madagascar in the late 1980s as part of the country's structural adjustment programme (Andersson, 2009; Kaplinsky and Wamae, 2010). The ensuing structural reforms, which were supported by the International Monetary Fund and World Bank, saw a shift in focus from import substitution towards a more outward-looking, export-oriented approach (Andersson, 2009). To participate in the EPZ, firms in Madagascar are required to export at least 95% of their production or, alternatively, provide services and inputs to EPZ exporters. The imposition of VAT on imported inputs since 1997 has provided further stimulus for firms to export their output. This is because VAT payments on inputs are refunded if a firm can present proof that the final good was exported (*ibid.*).

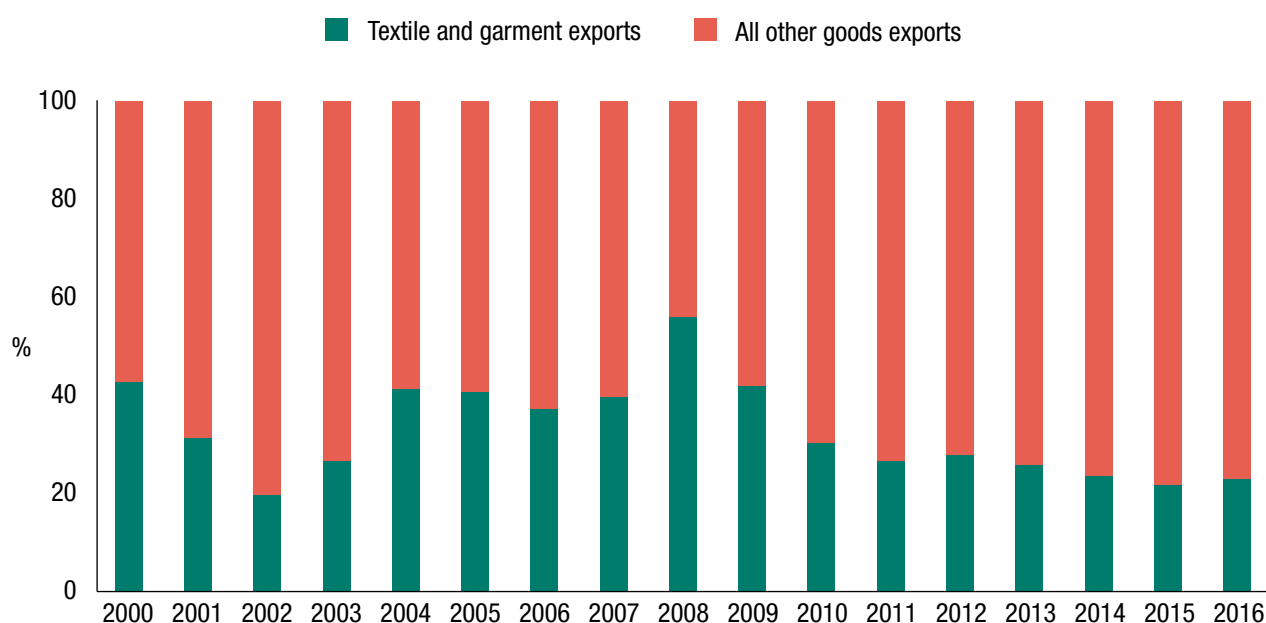
EPZ firms in Madagascar benefit from a number of incentives. These include:

- exemption from all duties on exports and imports
- accelerated depreciation allowances
- special access to foreign currency and unrestricted foreign currency controls, capital transfers and a range of tax concessions, including exemption from tax on profits for the first four years, followed by a lower fixed rate than non-EPZ firms thereafter (Andersson, 2009; Kaplinsky and Wamae, 2010; Morris and Staritz, 2014).

EPZ firms can be 100% foreign owned and are accorded free repatriation of profits. These incentives are available to all firms registered for EPZ status, regardless of where they are located, meaning they are not required to locate their factories within a designated area (Chen and Landry, 2016).

The enactment of EPZ legislation in the late 1980s not only helped to attract FDI and boost garment exports, but also facilitated diversification away from dependence on agricultural products. The bulk of EPZ-related investments from here – when measured in terms of the number of firms, employment or the size

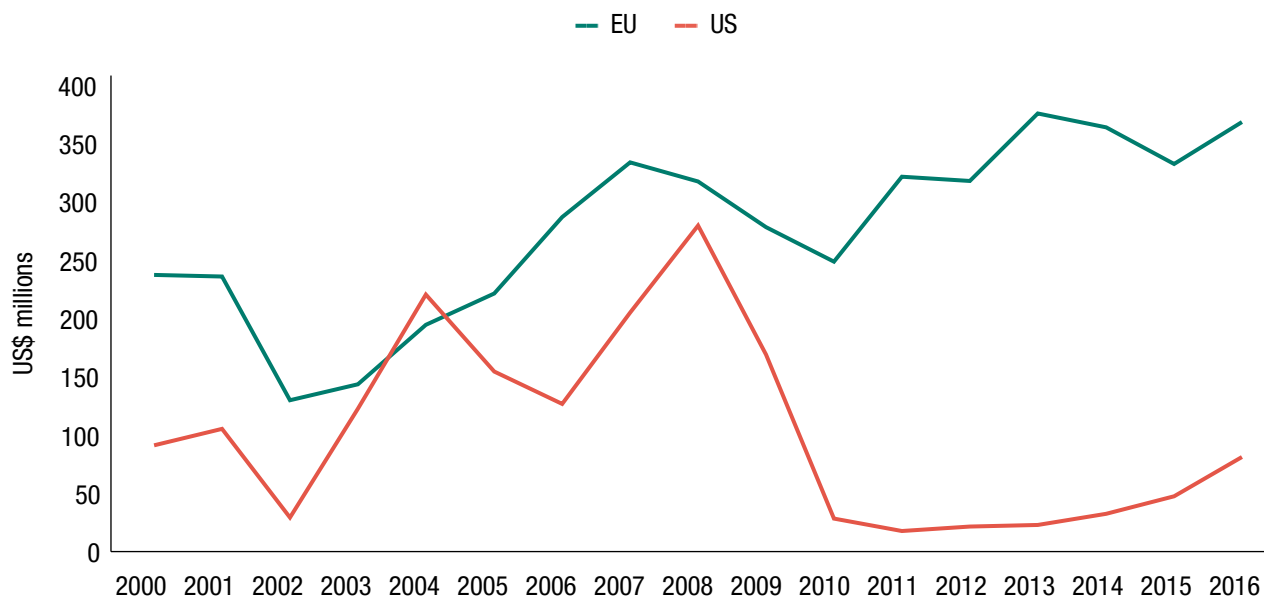
Figure 7 Share of textile and garment exports in Madagascar's total goods exports, 2000–2016



Source: Authors' own calculation, using UN Comtrade data.

Note: The value of textile and garment exports used to calculate the shares is the sum of goods exports under HS chapters 51–62.

Figure 8 Madagascar's apparel exports (HS61 and 62) to the EU and US, 2000–2016



Source: UN Comtrade data.

of the investment – were directed into textiles and garment production (Maminirinarivo, 2006). As a result, there was significant growth in the number of garment-producing firms in Madagascar, increasing from just 10 in 1990 to 120 in 2007 (Andersson, 2009). Many of these firms were foreign owned – the number of overseas companies receiving EPZ status increased around 26 times within just 10 years (Fukunishi and Ramiarison, 2012). This was accompanied by rapid growth in manufacturing activity within the EPZ, as well as productivity growth, as EPZ manufacturers boasted the highest productivity levels within Madagascar's manufacturing sector. These productivity benefits were generated by the greater exposure to trade and export dynamism of EPZ firms (*ibid.*).

Alongside the EPZ incentives on offer, preferential access to key markets (the EU, US and SADC) also served as an important motivation for locating production in Madagascar. The country's apparel exports to the US, for example, were boosted considerably by the introduction of AGOA. The market access afforded by AGOA, enhanced by generous rules of origin, spearheaded a boom in garment exports from Madagascar to the US from 2000 (Andriamananjara and Amadou, 2015). Similarly, the AGOA preferences had a major impact on industry expansion and boosting employment in

the early 2000s (Morris and Sedowski, 2006). Consequently, AGOA is widely regarded as the principal mechanism for stimulating growth in garment production in Madagascar since 2000 (*ibid.*). It was against this backdrop that Madagascar lost its AGOA benefits between 2010 and 2014, hot on the heels of the 2009 political crisis, in which President Marc Ravalomanana was overthrown after overseeing a period of economic reform and liberalisation. This had a major impact on Madagascar's garment production and exports and has been a major cause of the decline in textile and garment exports as a share of Madagascar's total goods exports ever since (as evident in Figure 8).

Coming after an earlier crisis in 2002, which lasted six months and resulted in the loss of up to 40,000 jobs in the sector (approximately one-third of total employment in EPZ clothing firms), these 2009 events stifled progress in developing the sector in Madagascar. Many firms had already been prompted to restructure or close down entirely – around one quarter of the textile and garment firms operating under Madagascar's EPZ framework closed in the wake of the earlier crisis (Morris and Sedowski, 2006). Similarly, the political crisis in 2009 had a major impact on Madagascar's wider industrial sector. Exports from Madagascar fell by 30.7%, while nearly 20% of the jobs in the textile and garment sector

were lost and real wages for low-skilled workers declined by 12.7% (Fukunishi and Ramiarison, 2012). The loss of Madagascar's AGOA status in 2010 prompted a large-scale exodus of foreign capital, dealing a major blow to private investment flows into the country (Chen and Landry, 2016). Most of the Asian-owned firms that had focused on supplying the US market relocated their operations away from Madagascar.

At the same time, however, the presence of more locally embedded investors targeting different end markets helped to shield the sector, at least to a certain extent, from the impact of losing AGOA eligibility in 2010, until it was reinstated in 2014. This was spearheaded by Madagascar's substantial exports to the EU. These were not significantly affected by the elimination of MFA quotas. Growing exports to South Africa in the period following the removal of MFA quotas on garments also helped to safeguard the sector (Kaplinsky and Wamae, 2010). Locating production in Madagascar to supply the South African market provided cost advantages over Lesotho, because Madagascan producers were better suited to manufacturing smaller production volumes.

2.6.2 Value addition and value chain development in the textile and garment sector in Madagascar

Madagascar has a history of textile manufacturing, with particular strength in textile, knitwear and woven cotton production. However, the domestic textile industry has been in decline for a number of years, exacerbated by the aforementioned political crises in 2002 and 2009, together with the subsequent loss of Madagascar's AGOA status (Chen and Landry, 2016). Consequently, most activity in the sector is focused on downstream CMT activities, producing cotton apparel (both knitted and woven).

The growth of Madagascar's apparel industry coincided with a decline in cotton and textile production in the 1990s and early 2000s. Local textile mills were uncompetitive. Imported textiles (from Mauritius or Asian countries) were increasingly used for export-oriented production. Consequently, linkages to the textiles segment of the value chain have declined (Staritz and Morris, 2013).

Today, there are long production lead times in the apparel segment of the value chain. These stem from Madagascar's relative isolation from raw material suppliers and export markets, alongside inefficiencies in logistics and transport infrastructure. They make it difficult for producers to move into higher value-added garments with more fashion content, because these types of items require rapid delivery to market (Morris and Sedowski, 2006). Nevertheless, Madagascar still generally exports higher-value garments than other sub-Saharan African exporting countries (Morris and Staritz, 2014). This is partly due to investment in upgrading by diaspora and Mauritian investors supplying regional markets (discussed further in the following sections).

There is generally a low level of vertical integration in the sector, with limited use of domestic inputs in production (Andersson, 2009). In the past, firms operating in Madagascar sourced fabric and accessories from other countries; their desire to source more locally was stymied by concerns about the quality and price competitiveness of locally produced fabric (Morris and Sedowski, 2006).

The regionally embedded production networks of Mauritian firms investing in Madagascar has facilitated some integration, although this still tends to occur on a regional scale rather than within Madagascar itself. For instance, some large Mauritian firms source from their own textile mills in Mauritius to supply apparel production facilities located in Madagascar (Staritz and Morris, 2013).

Nevertheless, there is evidence to suggest that some firms based in Madagascar are starting to vertically integrate upstream to produce cotton in-country for their textile needs. A number of Chinese-owned firms produce and process cotton in the southwestern part of the country around Toliara (Chen and Landry, 2016). This is undertaken primarily through contract farming arrangements, whereby the Chinese firms supply seeds and inputs to local farmers and then purchase the cotton they produce. A large investment made by Tianli Agri, totalling \$60 million in cotton and spanning 40,000 hectares of planted cotton fields (managed by contracted local farmers), supplies a cotton

spinning factory in Mauritius and meets up to 30-40% of its cotton demand (*ibid.*); it is thus a promising example of an emerging regional value chain in SADC. The SOCOTA Group, formerly state-owned but now jointly held by Sri Lankan residents in Madagascar, sources up to 60 different fabrics from its local cotton textile mill (Kaplinsky and Wamae, 2010). An interesting similar example of both backward and forward linkages can be seen in Cotton-Line, a Pakistani firm previously known as Cotona. This company has begun to vertically integrate cotton to supply its own needs in the downstream textile and garment segments (Chen and Landry, 2016).

More generally, the clustering of firms has also been an important factor driving greater vertical integration in the sector. The presence of three textile mills, together with more than 30 firms producing inputs, has facilitated the emergence of a sort of proto-industrial district in Madagascar (Kaplinsky and Wamae, 2010).

2.6.3 The role of inward investment in the textile and garment sector in Madagascar

FDI from Asian, European diaspora and Mauritian regional investors has been a key driver of growth in Madagascar's highly export-oriented garment industry. While the country has traditionally received relatively little investment in manufacturing, the textile and garment sector has been a significant exception and the core beneficiary of inward investment. This has been primarily due to the motivations of investors themselves, rather than any explicit government policy to attract investment. Most early investors in the sector were of French origin, until a raft of new investment from Mauritius and Asia followed from the mid-1990s. Mauritian investors, for instance, were motivated primarily by a desire to shift factories to Madagascar in order to capitalise on the country's low-cost labour, underutilised quotas and proximity to plants in Mauritius (Joomun, 2006; Gibbon, 2008).

Different types of inward investor have made varied contributions to upgrading, facilitating market access and developing domestic capacity. Much of this is due to the differentiated nature of their GVC relationships and their level of local embeddedness (Staritz and Morris, 2013). On the one hand, Asian investment on the

back of AGOA was mostly for CMT activities. The Asian-owned firms, many of whom exited Madagascar after the loss of AGOA eligibility in 2010, tended to source fabric and other inputs from their own mills in Asia. This was made possible because the AGOA eligibility requirements allowed for single transformation. Thus, while the involvement of these firms has helped link Madagascar-based production into GVCs, it has generally resulted in little local or regional supply chain upgrading.

On the other hand, export-oriented European diaspora investors (primarily French) and Mauritian investors with established regional production networks and sourcing strategies are generally more locally embedded in Madagascar, with greater spillover effects for local firms, primarily through subcontracting relationships (Staritz and Frederick, 2016). This is a product of their sourcing strategies and the way in which they are integrated into regional and global value chains.

The European diaspora investors have tended to locate head offices and decision-making functions in Madagascar. These firms have historically embedded roots in the country. When this is combined with access to their European networks, buyers and markets, it provides powerful linkages to end markets, sales networks and buyers (Morris et al., 2014). This level of embeddedness is in stark contrast to the Asian firms in Madagascar and to those in Lesotho, who use their own global networks to supply inputs, as well as their own agents and sourcing or buying offices.

The investment of Mauritian firms in Madagascar is a product of their regional sourcing strategies. Access to cheaper labour motivated these firms to relocate basic production to Madagascar in the 1990s, while production in Mauritius shifted to higher-value products and value chain segments (Morris et al., 2014). In this sense, these firms have followed a process of supply chain upgrading that is regional rather than local in scope (Morris and Staritz, 2014). Nonetheless, the Mauritian investors, operating a regionally embedded production network, have generally had a higher propensity to upgrade processes and products than other foreign-owned firms (Staritz and Morris, 2013).

Variation in the end markets targeted by different types of inward investors in Madagascar has influenced upgrading. The Asian-owned firms operating in Madagascar export mainly to the US. European (mostly French diaspora) and Mauritian investors, as well as some local Malagasy firms, export predominantly to the EU and, more recently, to South Africa. Buyers in the EU typically place greater emphasis on versatility and flexibility and often expect producers to make some contribution to design and product development, whereas US-based buyers usually provide strict specifications for producers to follow (Gibbon, 2008; Staritz and Morris, 2013).

Mauritian investors in Madagascar, along with their European diaspora counterparts, have played an influential role in regionalising exports towards South Africa and/or boosting production for the European market. This diversification of exports has supported the upgrading of both processes and products in Madagascar. The loss of Madagascar's AGOA eligibility in 2010 facilitated important changes in these firms' product mixes, forcing them to shift market channels and upgrade their products. Specifically, they shifted focus to shorter-run, smaller-batch, higher-quality and more complex products to supply regional markets (especially the South African market) and Europe. For Mauritian investors, this shift was possible because they had a regionally embedded production network and were able to utilise management capabilities in a flexible manner (Morris and Staritz, 2014). The EU and South African markets, which demand smaller batches of differentiated products with higher unit values, are more demanding in terms of processes and production capabilities (Kaplinsky and Wamae, 2010). The shift to producing these types of product in Madagascar has had positive impacts on upgrading, product quality and local skills (Kaplinsky and Wamae, 2010; Morris et al., 2014; Morris and Staritz, 2014).

In contrast, the primary focus of the Asian-owned firms has been to undertake simple CMT activities in Madagascar as part of a strategy to assume relatively basic long-run production for the US market. The focus of these firms is on efficiency in high-volume production to meet the specifications dictated by US buyers, meaning

they have prioritised improvements to processes rather than product or functional upgrading (Staritz and Morris, 2013).

In these ways, the Madagascar case illustrates the significant role that locally embedded, export-oriented entrepreneurs can play in driving the development of a domestic textile and garment sector, in different ways to transnational investors operating within a global sourcing framework. As Staritz and Frederick (2016: 22) contend: 'this shows that understanding the dynamics of distinct GVCs and foreign investor strategies is critical in identifying the possibilities for FDI-related spillovers and broader local industrial development.'

2.6.4 Local ownership and backward linkages in the textile and garment sector in Madagascar

Most locally-owned firms in Madagascar started operating as CMT sub-contractors for foreign-owned firms (mostly European or French diaspora investors, but also some Mauritian firms) keen to offset the seasonality of orders (Staritz and Morris, 2013). In some cases, these subcontracting arrangements included provision for upgrading support (e.g. to improve processes and product quality), for example, by sending quality control staff to advise local subcontractors on processes and quality. Backward linkages to local firms remain quite limited, notwithstanding the examples of vertical integration and local sourcing discussed in previous sections.

Some indigenous Malagasy firms have managed to go beyond these subcontracting arrangements to develop direct contacts with buyers in key overseas markets. However, many struggle to nurture and maintain these relationships and face significant variation in the complexity of product orders from buyers over time, with adverse effects on upgrading. As Staritz and Morris (2013: 18) explain: 'One year they can be producing complex products such as down jackets and seem to be on an upgrading trajectory; the next year, buyers may be demanding simple apparel products, which means they have effectively downgraded.'

The number of locally owned firms has declined since the early 2000s, partly due to an

absence of government support and an inability to build or consolidate buyer linkages (Morris et al., 2014). There were estimated to be just 12 small indigenous Malagasy firms operating in the sector in 2012 (ibid.), although more recent numbers are difficult to verify. The country of ownership of firms investing in Madagascar is an important determinant of backward linkages. Such linkages are particularly limited in the case of Asian-owned firms investing in textile or garment production. These firms generally have weak ties to the local economy and tend not to draw on local suppliers or source domestically produced raw materials, instead obtaining fabric and other inputs from their own mills abroad (Chen and Landry, 2016). Their engagements in Madagascar are typically structured around a ‘both ends overseas’ model, where raw materials are imported, mostly from Asia. Meanwhile, finished products are exported, primarily to the US and the EU. This takes advantage of Madagascar’s low-cost labour, investor incentives and preferential access to key markets (ibid.). There are few incentives to build domestic supply chains or backward linkages when operating this model.

In contrast, European (mostly French) diaspora investors tend to have their headquarters in Madagascar and generally do not have factories located in other countries. These investors typically source some inputs locally and often localise certain design and product development functions (Staritz and Morris, 2013).

2.6.5 Conclusion

FDI from Asian, European diaspora and Mauritian regional investors, combined with preferential access to major export markets, has been a key driver of growth in Madagascar’s highly export-oriented garment industry. But while the industry owes much of its recent success to the availability of trade preferences, the recent development of the sector also highlights the vulnerabilities that arise when a sector is built around preferential market access benefits that attract relatively footloose investors.

Political stability is often a key factor in supporting sectoral development and the loss of Madagascar’s AGOA eligibility in 2010 after a political crisis had a major impact on the country’s textile and garment sector. However, the overall effects have been varied, particularly as different investors have adapted in different ways to external developments, including by shifting end markets and altering their product mix. While most Asian-owned firms exited Madagascar after 2010, innovative entrepreneurs in the form of locally embedded diaspora investors and regionally embedded Mauritian-owned firms shifted market channels and upgraded, with positive impacts on process, quality, skills and product upgrading. More recently, Mauritian firms producing for regional markets have focused on shorter-run, more complex products. This offers interesting insights into how textile and garment production can adapt to external shocks and still experience important upgrading.

3 Conclusions

In this paper we have considered experiences in the development of textile and garment sectors in six countries, with the aim of identifying potential interventions to support the growth of Tanzania's textile and garment sector. The varied experiences in Bangladesh, Cambodia, Ethiopia, India, Lesotho and Madagascar show that no single model can be isolated as a definitive route to success.

Bangladesh has managed to create many jobs in garment production, while also achieving some upgrading after catalytic initial foreign investment, and there is now a high level of domestic ownership in the sector. India has benefited from its enormous domestic market, which has helped to achieve economies of scale while protecting local producers. This has provided a strong base for a later push into exports. Lesotho has managed to create a large number of jobs by focusing on exports, but the garment sector remains vulnerable to external shocks and there has been limited upgrading and little development of backward linkages or local ownership in the sector. Meanwhile, a diverse industry serving a range of end markets has developed in Madagascar, supported by locally embedded regional and diaspora investors, though political instability and external developments have hampered further growth. In Ethiopia, a proactive government has targeted FDI to kick-start rapid growth in export-oriented garment manufacturing off a low base.

Across these varied and nuanced experiences, important lessons can be drawn for Tanzania.

The development of the sector in most of the country cases considered in this study began with garment production or assembly, with subsequent phases of growth closely linked to various waves of predominantly foreign investment in export-oriented garment production. India, which has a long history of both textile and garment production is the clear exception. Bangladesh has managed to work its way backwards along

the value chain from basic garment production as part of a process of upgrading, but countries like Cambodia, Ethiopia and Lesotho remain largely stuck in the initial stages of producing basic, low value-added apparel products, albeit with some notable exceptions based on the type of investment and the end markets served by exporters. This indicates that the processes of upgrading and building backward linkages are not automatic.

The majority of the cases show that openness – both to trade and foreign investment – and export orientation are important drivers of growth across the cotton-to-textiles value chain. Bangladesh, Cambodia, Ethiopia, Lesotho and Madagascar have all capitalised on the benefits of preferential access for exports to key markets; in some cases, such as Ethiopia, this has been facilitated through a very strong export push. India's sector was more inward looking during its early stages of development, but this was made possible by access to an enormous domestic market, which limited the need to export to achieve economies of scale. The Indian state has proactively supported domestic producers as the country has opened up.

The nature of the end markets served by exporting firms can impact on value chain integration. The cases of Cambodia, Lesotho and Madagascar show how serving more demanding markets or buyers seeking smaller-run, more complex and higher-value products can facilitate value chain upgrading. Meanwhile, focusing on supplying basic items on long production runs (primarily to the US) has had the opposite effect. This has important implications for the textile and garment sector in Tanzania, as firms in the country look to diversify their export markets.

Openness to inward investment has been particularly important. Export-oriented FDI has played a central role in growing garment production and exports in most of the cases in this report. This has helped to enable access

to GVCs and global production networks, particularly in Bangladesh, Cambodia, Ethiopia and Lesotho, but also in Madagascar. It has also facilitated the upgrading of technology, machinery and equipment in some cases, but prevented it in others. In the case of Bangladesh, inward investment has been central to skills development and knowledge transfer and has helped drive the development of a local cadre of garment experts who have eventually gone on to set up domestic garment firms of their own. Inward investment has provided the necessary ‘demonstration effect’ to encourage domestic investment in the garment sector in Bangladesh. The presence of a domestic entrepreneurial class that is financially resourced, technically competent and internationally connected is key to establishing an embedded domestic industry that serves the export market.

Notwithstanding the importance of FDI to the development of textile and, in particular, garment production in these countries, the varied experiences of the six cases show that the precise nature of the inward investment has important implications for backward integration and the development of domestic productive capabilities. FDI is pivotal to kick-starting the process, as it brings knowledge of the sector, as well as networks of suppliers and customers. However, foreign investors seem more likely to develop CMT-type operations. In most settings, the investment of Asian transnational firms with disembodied production units has been motivated primarily by a desire to access the rents on offer from preferential market access. This investment has generally brought little backward integration or supply-chain upgrading. Hence, in settings such as Cambodia and Lesotho, the prevalence of foreign investors seems to be a deterrent to value-chain integration, as these investors often find it easier to rely on existing sourcing networks outside the country.

The case of Bangladesh, where the domestic private sector entered the area of textiles and garments as second-generation firms, provides further evidence of the importance of involving the local private sector early on. Bangladeshi firms learned from the first-generation foreign investors, using the labour and managers trained

by foreign firms, as well as the reputation they built for Bangladesh, to establish their own production networks. These firms helped develop the sector, moving away from simple CMT operations via diversification and upgrading.

In contrast, regional investors with regional production networks and diaspora investors have been more locally embedded. In Madagascar, for example, these investors have helped to drive the upgrading and diversification of end markets and have tended to source more locally than transnational investors, who have sourced from offshore suppliers in their global sourcing networks.

Aligned to this, the case of Bangladesh shows how inward investment can be used strategically to develop domestic textile and garment production capabilities that are lacking. The spillover effects of inward investment into garment production in Bangladesh have also been also amplified by the focus on building production and management skills domestically.

Bangladesh has seen an open investment regime, along with industrial parks, SEZs and EPZs. These have often been combined with early-stage incentives for investors, serving as effective tools for proactively attracting and channelling domestic and foreign investment into textile and garment production, particularly in Ethiopia, Lesotho and Madagascar. The development of industrial zones was often accompanied by proactive government efforts to attract investment. For example, the Ethiopian government has elevated investment promotion to the centre of government: senior officials and ministers are actively involved in engaging with investors and solving their problems. There are stark contrasts between Ethiopia’s and Tanzania’s progress in developing industrial zones and in attitudes towards attracting foreign investment. Ethiopia, for example, has some ready-built factories within zones that help investors to become operational and provide access to ‘plug-and-play’ facilities.

Tangible infrastructure aside, preferential access to key markets through trade agreements is also a compelling platform for attracting investment to export-oriented textile and garment production. However, in cases such as Lesotho, the future of the sector remains heavily

dependent on access to these preferences. Building a textile and garment sector on the basis of trade preferences can, in certain instances, reduce incentives for diversification into higher value products or investment in skills development and upgrading. As a result, the focus in many of the case study countries remains on basic downstream CMT and apparel assembly activities, with little local supply chain upgrading, value chain integration or backward linkages. This suggests that preferential market access is important in the initial stages of textile and garment sector development. However, after the sector is established, active steps need to be taken to promote upgrading.

Textile and garment producers in certain countries have also been able to adjust more effectively to external shocks, particularly in the cases of Madagascar in the late 1980s (and with the suspension of AGOA eligibility in 2010) and India in the 1990s. Producers of textiles and garments in these countries were able to adjust their output mixes and divert to other markets due to supportive government policies and entrepreneurial innovation.

Lastly, the case studies show that governments have a part to play in shaping these factors. In specific cases, the government has played a central and proactive role in supporting the development of the textile and garment sector. In Ethiopia, for example, there is evolving industrial policy that includes an ambitious industrial park programme and a proactive approach to attracting FDI with a view to accelerating the development of manufacturing capacity. This has helped drive growth in garment production and exports. In Lesotho, a parastatal actively promotes the garment industry, as well as the government's early provision of well-equipped industrial zones and serviced factory shells to overcome investment climate challenges and attract investment. This aided the rapid growth of garment production and exports in the early 2000s. In Cambodia, an investor-friendly FDI regime has been central to attracting the inward investment that has driven the growth of the export-oriented garment industry. In Bangladesh, the government has financed innovation and provided infrastructure and instruments to support the expanding domestic private sector.

4 Recommendations

When assessed against the current context within the cotton-to-clothing value chain in Tanzania, the evidence presented in this study suggests the long-term development of the country's textile and garment sector could be supported through the following actions:

Promote an export-oriented textile and garment production model, focusing on high value markets

India has been able to follow a more inward-looking approach, favouring import substitution and the protection of domestic producers in the early stages of developing its textile and garment sector. This has been because of the country's huge domestic market. However, the much smaller domestic market in Tanzania makes it more difficult to follow such an approach and still achieve economies of scale. The other case studies we have considered show how export orientation has been instrumental in kick-starting growth in the sector and supporting wider industrialisation. They also show how export-led growth in textiles and garments can be a major source of job creation. Focusing on high-value markets for exports has been a successful strategy in Bangladesh, Cambodia, Lesotho, Madagascar and, increasingly, Ethiopia.

In Tanzania, some garment firms are already exporting successfully and looking to grow their exports further. Tooku, for example, produces jeans for the US market, while Mazava is producing low-cost sportswear for the US and Canada. This means Tanzania already has a base of exporting firms upon which it can build. To expand this base, more needs to be done to ensure Tanzania capitalises

on its comparative advantages in export-oriented production. Actions could include access to high-value markets (e.g. the US through AGOA), utilising a large workforce and improving infrastructure with access to port facilities. There is also a need to convert these advantages into competitive investment conditions.

Importantly, Tanzania needs to look beyond AGOA and establish how to boost competitiveness in a post-AGOA environment. Key factors to focus on to improve competitiveness include:

- productivity
- efficiency
- speed to market
- the ease and cost of doing business
- the quality of key supporting services, such as information and communications technology.

Improve the business environment and offer better investment promotion, attraction and aftercare

The cases we have examined show how an export push can be driven effectively by FDI, particularly through the presence of foreign lead firms and buyers. FDI in Cambodia, Ethiopia and Lesotho, for example, has enabled access to GVCs and global production networks, helping establish these countries as important sourcing markets. Attracting FDI and foreign lead firms to Tanzania will require proactive efforts from the URT and key investment-related agencies to improve the business environment, engage with investors and solve investor problems.

Target the right types of investor, focusing on those willing to make long-term investment commitments, help build local capabilities and develop backward linkages

Inward investment can be used strategically to develop domestic textile and garment production capabilities that are lacking (as in Bangladesh). Such investment can play a key role in transferring skills and technology, thereby facilitating domestic upgrades and diversification. This has been completed successfully in Bangladesh and, to some extent, by locally embedded regional investors in Madagascar and Lesotho. This success highlights the importance of ensuring that inward investments help build capacity domestically, for example, by developing the skills of local workers, entrepreneurs and managers. This can be facilitated through a supportive investment framework that encourages and incentivises strategic collaboration, skills and technology transfer, partnerships and joint ventures between inward investors and domestic firms within the value chain.

Actively support backward linkages into yarn, fabric and other intermediate inputs, as they may not simply follow from growth in garment exports

This is clear from the experiences of Cambodia and Lesotho. Focusing on the final stages of the value chain can be effective in kick-starting a domestic garment sector, but targeted policies are required to support the development of backward linkages along the value chain. As mentioned, attracting the right types of investors can play a key role in supporting backward linkages. In addition, it is necessary to **help domestic firms further up the value chain to grow**. Such support could include assistance to improve production and managerial skills or the provision of supporting infrastructure and services. These sorts of intervention can help

to boost the competitiveness of domestic firms, thereby making local sourcing more attractive.

It is necessary to target improvements in both the upstream and downstream segments of Tanzania's cotton-to-clothing value chain to pave the way for full value chain integration. For example, improved upstream access to agricultural inputs and farm credit, together with better-quality raw cotton would help to produce higher-quality cotton lint at competitive prices. In segments further downstream, interventions are necessary to enhance competitiveness in textile production (e.g. through greater use of modern equipment and machinery) and improve efficiency in garment manufacturing.

Speed up progress in developing industrial parks and SEZs in Tanzania

The presence of competitively priced and fully serviced industrial zones is key to attracting investors. Lesotho and Ethiopia are both good examples of where this has been done successfully. In turn, these zones can be important for creating manufacturing jobs and driving exports. There is a clear need to boost capabilities in Tanzania to design, finance and operationalise textile and apparel industrial zones. Once established, it will be equally important to provide an adequate incentive regime to entice firms to locate to these zones – as, for example, in Hawassa Industrial Park in Ethiopia or the EPZ in Madagascar. The cases we have examined show that an open investment regime – along with industrial parks, SEZs and EPZs – has often been combined with early-stage incentives for investors. These have served as effective tools for proactively attracting and channelling domestic and foreign investment into textile and garment production.

The ongoing development of zones in Kigoma, Kibaha and elsewhere can have important demonstrational effects; lessons from developing these zones could help to inform a more structured programme for financing and operationalising industrial parks and SEZs in Tanzania.

Improve coordination around the implementation of policies designed to aid the development of the textile and garment sector

The varied country experiences we have examined show how governments have positively impacted the development of textile and garment sectors in diverse ways, from following a detailed industrial policy with specific industry support interventions to creating a welcoming environment and institutional framework for investment (domestic and foreign) or supporting firms to upgrade technology. The URT already has a Cotton-to-Clothing Strategy as well as an Action Plan for the implementation of its FYDP II, which includes the textile and clothing industry among a list of priority manufacturing sectors. However, the URT has struggled to effectively implement policies and plans in the

past, suggesting better coordination in relation to the implementation of sector-specific support interventions is necessary.

Promote trust and mutually beneficial dialogue between the URT and the Tanzanian private sector

In Bangladesh, the government has been highly responsive to the needs of the private sector and receptive to suggestions. This has been an important element in creating an environment in which Bangladeshi garment firms can thrive. Similarly, a shared vision between the government and a foreign lead firm in Ethiopia was central to the successful development of the Hawassa Industrial Park in July 2016. Similar gains could be made in Tanzania with better dialogue between the public and private sectors to agree a set of interventions and support policies for driving the development of the cotton-to-clothing value chain.

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