

Sri Lankan Apparel Industry in Post Quota World : Trends & Issues

Introduction

In the process of economic globalization, export is considered to play an important role in growth process, manufacturing exports in particular. With the emergence of terms of trade debate initiated by Prebisch (1949) and Singer (1950) and successful experience of Southeast Asian countries, many countries made an effort to change economic policies on international trade giving interest to the export manufacturing sector. In this background, textile and apparel industry was widely identified as potential sector by the most developing countries due to its labour intensive nature. Concerning this emerging trend in international trade, Sri Lanka changed its main economic policies introducing export oriented policies in 1977 and the textiles and garment sector was identified as one of potential sector in Sri Lankan development process. Over its 25 years of existence, it has played a prominent role in Sri Lankan national economy as a key driver. For instance, it represents approximately 62 percent of the industrial exports, 49 percent of the country's total exports earnings with value of US \$ 2809 million (Central Bank Report, 2004) and provides over two hundred and seventy five thousand direct and twice that number of indirect job opportunities as largest single employment provider in the industrial sector (Sri Lanka Labour Department, 2004).

However, the Sri Lanka apparel industry was expected to face for numerous challenges with phasing out of the multi Fibre Arrangement (MFA)¹ which was designed on world trade in textiles and clothing from 1974 through 1994 along with the Agreement on Textiles and Clothing (ATC)² at the end of 2004 (JAAP, 2003; Birnbarm, 2004; Richard, 2004; Oxfam, 2004; and Kalegama, 2005). In the controversial Uruguay Round negotiation of GATT, it was agreed to eliminate all restrictions applicable to the textile and garment industry within ten years under four phasing out stages beginning in January 1995 (see Table 1). Moreover, as observed by Rechard (2004), Sri Lanka is experiencing declining competitiveness due to its heavy reliance on quota categories, concentration on a few markets, lack of direct marketing links with major

purchases, and dependence on imported inputs. A number of countries fear that a new wave of cheap textile and clothing products will flood their markets and threaten their domestic industry whilst others hope for new export opportunities as a result of a quota-free trade environment (ILO, 2005). In view of this, this paper mainly attempts to examine the emerging trends and issues of Sri Lankan garment industry in the post quota world scenario.

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Table 1
The Ten Year Schedule for Integration

State	Starting date	Integration Share (based on 1990 import volume)	Expansion of growth rate for remaining quotas
Phase I	1/1/1995	16 (Total: 16)	16 (e.g. from 3% to 3.48%)
Phase II	1/1/1998	17 (Total: 33)	25 (e.g. from 3.48% to 4.35%)
Phase III	1/1/2002	18 (Total: 55)	27 (e.g. from 4.35% to 5.52%)
Final Phase	1/1/2005	All restrictions are eliminated	Full integration

Source: OTEXA/TDD-1995

2. Major export destinations of Sri Lankan garments

The United State is the world largest textiles and garments importer and it is the single largest buyer of Sri Lankan textiles and garments since the pre-quota period. Specially, 90 percent of textiles and garments exported to the US were based on quotas in the period during the MFA (Board of Investment, 2005). Hence it is good evidence that trends of the Sri Lankan apparel exports in US market gives real illustration on impact of MFA phase out. Moreover, 40 percent of Sri Lankan apparel is exported to the EU market and the UK is the second largest destination for Sri Lankan textiles and apparel exports. In 2006, 23.43 percent of total textiles and garments were exported to the UK market (Central Bank of Sri Lanka, 2006).

Table 2
Country classification of garment exports

Country	% of exports in terms of value			
	2000	2002	2004	2006
USA	62	63	58	56
European Union	33	31	37	40
Rest of the world	5	6	5	4
Total	100	100	100	100

Source: Central Bank of Sri Lanka, Annual Report, various issues

3. Export trends

US market

In the last four decades, world trade in textiles and clothing has increased by more than 50 times, from less than 6 \$ billion in 1962 to 300 billion in 1999 (Diao et al. 2001). By giving interest to the emerged trend in international trade and concerning the market opportunities due to existence of quota system, every Sri Lankan successful government made an effort to develop this significant sector. In the last two decades, it grew rapidly with the help of a guaranteed market due to the existence of the quota system. Low labour costs, liberal economic and trade policies and tax benefits and concessions granted to the industry are other critical contributory factors. However, during the period in which the Agreement on Textile and Clothing (ATC) was in place, most have demonstrated the competitive challenges of the Sri Lankan apparel industry. It was also predicted that the abolition of quota system will have an adverse impact on the Sri Lankan apparel exports in both US and EU market. In this circumstance, figure 1 shows the market integration of each selected Asian country in US market. The comparative behaviour of each country shows their competitive edge under the each phasing out stage and fully integrated period.³ It is clear that every country is improving their competitive edge in US market

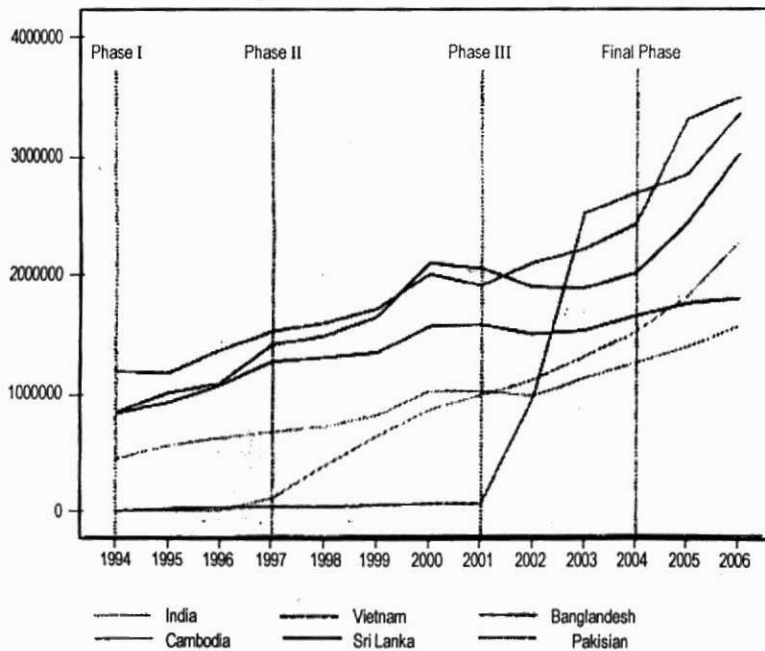
in each stage. However, Sri Lanka shows a fewer performance in US market achieving a marginal growth compared with other countries. Besides, China's involvement in world trade having a WTO membership in 2001 has resulted to further improve the competitiveness in the world trade in textiles and clothing. Especially, it should be noted that each competitive country is tremendously expanding their competence than that of Sri Lanka in the post quota world.

quota world. Especially every country shows a positive average growth in terms of value. Also, it is further highlighted that although Sri Lanka has shown a declining trend in average growth of first three phasing out stages, it has recorded a 4.25 average growth in terms of value at the fully integrated period. Conversely, it shows a continuous declining trend of average growth in terms of volume at the each stage even as recording a negative growth at post quota period.

a greater role during the entire quota-free period. On the other hand, exports of woven garments (HS 62)⁴ to the US market have declined by 11.41 percent while the export of knitted (HS 61) garments has increased by 55.94 percent in terms of value in the fully integrated period. The basic trend of Sri Lankan apparel exports in fully integrated period is value of exports has increased yet there has not been a simultaneous increase in the volume of exports (see Table 3). It indicates that Sri Lanka is accrediting its competitive edge giving an interest to high value products.

Figure 1

Market integration by selected Asian countries in US market



Source: United States Department of Commerce and International Trade Commission

Table 3
Average export growth in each phasing out stage

Country	Average growth rate (in value)				Average growth rate (in volume)			
	Phase I 95-97	Phase II 98-01	Phase III 02-04	Fully integ. 05-06	Phase I 95-97	Phase II 98-01	Phase III 02-04	Fully integ. 05-06
World	11.82	7.17	4.80	4.86	-	10.01	6.25	1.90
Sri Lanka	15.31	5.70	1.77	4.25	-	6.30	2.49	-0.59
Bangladesh	19.36	10.28	-0.46	22.47	-	11.42	4.28	27.89
Cambodia	1536.10	93.68	15.73	22.67	-	62.75	16.26	18.25
China	7.76	1.74	19.05	37.71	-	4.53	98.68	28.85
India	9.92	6.04	8.37	20.86	-	11.19	7.52	3.71
Pakistan	14.97	11.34	7.75	11.66	-	14.88	13.16	14.89
Vietnam	255.34	18.28	641.23	11.88	-	20.61	434.25	7.13

Source: United States Department of Commerce and International Trade Commission

The Table 3 shows that world apparel exports to the US market have increased by average growth of 4.86 and 1.90 percent in terms of value and volume respectively during the post

In a regional perspective, this situation reflects the lower rates of competition of Sri Lankan apparel products although countries such as India, Bangladesh, Pakistan and Cambodia have played

Moreover, US imports, especially from main competitive Asian countries to rise, further expanding their role in the US market. The export levels of these countries increased significantly both in terms of value and volume thus indicating their relative competitiveness in free market era. It is worth note that the value of Indian exports rose by more than the volume of apparel exports to the US market during the post-MFA period. It is also witnessed that India also had the highest average value of garments in their export basket. On the other hand, China played a vital role in the US market at the beginning of 2005, yet this has drastically changed due to added restrictions by the USA and the EU on specific categories such as Chinese-made cotton trousers, cotton knit shirts and underwear.⁵ This put other developing countries producing such categories at an advantage. China had recorded a substantial growth by mid 2005 (64.76 & 68.49 per cent in terms of volume and value respectively), yet it declined dramatically due to new policy tools adopted by the USA and the EU. Sri Lanka has had little impact from such policies but not in significant level due to the lack of comparative advantages of those categories in comparison to countries such as India, Bangladesh, Vietnam, Cambodia, and Pakistan.

EU market

Although, Sri Lanka achieved substantial growth during transitional period, partly due to the GSP concessions, as predicted it recorded a 2.39 and 12.44 percent negative growth in terms of value and volume respectively in 2005. However, Sri Lankan market position was gradually improved as a result of the reimposition of safeguard measures on China by EU and strategic changes of Sri Lanka apparel export

basket regarding the EU market as proposed by JAAF in 2002. In this background, Sri Lanka achieved significant growth in EU market, UK market in particular in 2006 even though it recorded a negative growth in 2005 (see table 5). Bangladesh, Cambodia and Pakistan reflect the same trends during the post-MFA era.

China, Vietnam and India have tremendously expanded their exports both in terms of value and volume early after the MFA phase out indicating an edge in competitiveness in the EU market, UK market in particular. For example, China, India and Vietnam have achieved 46.62, 30.39 and 8.21 percent growth in terms of value respectively in EU market while recording a negative growth by other countries listed below (see table 4). The Sri Lankan exports of both woven (HS 61) and knitted (HS 62) garment to UK market have increased by 12.78 and 13.31 percent in terms of value and volume respectively in 2006. Specially, although Sri Lanka recorded a declining trend at the beginning of the quota-free era, it began to record significantly higher growth during the late 2005. This indicates that Sri Lanka is improving its position in the EU market UK market in particular. China has also recorded a significant growth throughout 2005 and 2006.

4. Market Share of the Selected Asian Countries in the US and UK Market

The market share of Sri Lankan apparel exports in the US market was 2.46 percent in terms of value in 2000. However, gradual reduction of market share in US market could be seen after the discontinuation of the ATC and during the post-MFA era while other competing countries, especially China, Bangladesh, India, Pakistan and Cambodia have expanded the market share. For instance, during the period of 2005-2006, Sri Lankan market share in US market has declined by 1.28 percent (see table 6). The main reason for this negative trend is the comparatively higher growth of other apparel exporting countries. As can be seen, the size of the Chinese market is

crucial. In 2000, China's market share was 10.48 percent in value term and it increased rapidly with the WTO membership reaching to a 27.27 percent in 2006. In the mean time, other Asian countries listed below expanded their market share significantly at the US market. However, this trend clearly shows that most of the other competing countries are expanding their market share creating a negative impact on Sri Lankan apparel exports in US market. Conversely, in the UK market, Sri Lankan share was 3.47 percent in terms of value in 2004 and it increased by 25.07 percent during 2004 to 2006. China, India, Bangladesh and Vietnam show positive and significant improvement in the UK market also.

Table 6
Market share of the selected Asian countries

Country	US market				UK market			
	In terms of value			% Change	In terms of value			% Change
	2004	2005	2006	2004-2006	2004	2005	2006	2004-2006
Sri Lanka	2.35	2.36	2.32	-1.28	3.47	4.22	4.34	25.07
Bangladesh	2.87	3.27	3.91	36.24	4.84	5.58	6.57	35.74
Cambodia	2.16	2.44	2.95	36.57	0.99	0.85	0.83	-16.16
China	16.14	23.99	27.27	68.96	8.58	18.35	17.56	104.66
India	3.45	4.44	4.51	30.72	3.97	7.11	6.91	74.06
Pakistan	1.78	1.86	2.02	13.48	1.6	1.69	1.73	8.12
Vietnam	3.83	3.82	4.34	13.32	0.61	1.11	1.51	147.54

Source: Authors calculation from USITC and UKtradeinfo.Data

Table 4
EU imports of textiles and clothing from Sri Lanka

Country	Value (1000 Euro)			Volume (1000kg)		
	2004	2005	% change 2004-2005	2004	2005	% change 2004-2005
Sri Lanka	813837	794355	-2.39	58863	51543	-12.44
Bangladesh	3719267	3524505	-5.24	456064	453898	-0.47
Cambodia	519065	474968	-8.50	38820	35679	-8.09
China	11483056	16836514	46.62	1110115	1602767	44.38
India	2478253	3231364	30.39	178054	212151	19.15
Pakistan	916801	788007	-14.05	116298	105606	-9.19
Vietnam	630224	681993	8.21	53112	60202	13.35

Source: Eurostat trade data

Table 5
Percentage change of apparel exports to the UK market

Country	Change (in Volume)			Change (in value)		
	2000-2004	2005	2006	2000-2004	2005	2006
Sri Lanka	15.61	-17.04	16.5	13.65	-3.65	13.04
Bangladesh	-9.4	-7.39	24.9	81.12	-8.6	29.05
Cambodia	69.11	-31.74	10.35	113.88	-32.47	8.22
China	7.55	73	1.06	50.66	69.53	5.25
India	78.64	39.62	-8.2	98.77	41.72	6.94
Pakistan	-15.58	-11.16	26.14	107.49	-15.48	12.37
Vietnam	17.75	53.84	57.74	39.05	44.95	49.2

Source: UKtradeinfo.data

5. Major issues faced by the industry

Lack of vertically integrated production system

The lack of vertically integrated production structure is the main constraint faced by Sri Lankan apparel industry in the post quota world. Although the industry has grown rapidly over the last two decades, achieving international statuses, the industry supply chain for raw materials required like fabric and trims have not developed at the same pace. The industry is heavily dependent on imported fabrics and other accessories. Over 80 percent of the fabric requirements of the apparel industry are met by imports (Sri Lanka Garment Buying Office Association, 2005). This has constricted the competitiveness of the Sri Lankan apparel industry in the global market. The countries which are more competitive in the post quote world

such as China, India, and Pakistan etc have well established vertically integrated production systems and their lead time is also becoming shorter. Specially, the components contained in the apparel industry of China and India are vertically integrated from raw material to the finished product – including fabric production, spinning, knitting and weaving, and apparel manufacture. Furthermore raw materials such as cotton, silk, wool, linen and manmade fibres which are required by the industry are produced in these countries. It is apparent that countries that would emerge as globally competitive would have to establish a significantly consolidated supply chain. However, Sri Lanka is primarily concentrated in the production stage which leads to an increase in the cost of production and reduction in its competitiveness in the global market.

working period. Approximately, 70 percent of workers have less than five years working experience. The reasons of such short terms of service are the poor wages, hard working conditions, marriage and its consequence i.e. lack of employment opportunities for spouse, lack of affordable accommodation for a family unit in close proximity to the work place, long hours of work which are not conducive to mothers with young children and lack of social recognition for the apparel industry workers (Oxfam Community Aid Abroad, 2004). However, all the labour relative issues affect to reduce the efficiency and productivity of the industry while reducing the industry competitiveness in the free market.

trained towards more sub contracting. Further it revealed that 45 factories have closed down with approximately 10000 workers in early after the MFA phase out. The majority of them are small and medium scale factories located in rural areas. The crucial problem is that workers who lost their jobs do not have alternatives, especially for women to continue their livelihood.

Long lead time

The long lead time is another issue which has had an adverse impact on competitiveness in the world market. The average lead time for Sri Lanka is eight weeks (Department of Labour, 2004) and this situation deteriorates even more due to the high dependency on imported fabrics. For instance, the average lead time in receiving raw materials is 33 days (Sri Lanka Labour Department, 2004). Especially, the heavy reliance of the garment industry on imported raw materials, significant distance of the Sri Lanka from its major markets, long-lasting custom clearances, and poor infrastructure network have contributed to long lead time.

Table 7
Value addition and imports of raw materials

Item	Value in US Dollars Million					
	2000	2001	2002	2003	2004	2005
Value addition as % of total production *	32.20	31.69	32.00	32.30	32.1	32.3
Imports of Cotton Yarn & Textile (Value in US\$ Million)	1421	1320	1321	1372	1514	1531

Note* Textile, wearing apparel and leather products
Source: Central Bank of Sri Lanka, Annual Report (2005)

Labour related issues

Sri Lanka enjoys relatively low labour costs. Bangladesh, Indonesia and Pakistan in comparison show even lower labour costs and their real wages are higher than Sri Lanka (ICFTU, 2005). As observed by Sri Lankan Garment Buying Office Association(2005), Sri Lankan labour productivity is lower and goes hand in hand with lower capacity utilization, high labour turnover, absenteeism and under-trained employees. These factors have caused an increase in the unit cost of production relative to that of other countries. On the other hand, since most of the workers are young female workers in the age group of 18 – 25, many of them leave employment within very short

Table 8
Labour cost selected countries in apparel industry

Country	Labour cost (US\$ per hour)
Bangladesh	0.25
Indonesia	0.27
Pakistan	0.34
Sri Lanka	0.46
China	0.48
India	0.57
Thailand	1.24

Source: Sri Lanka Garment Buying Office Association : 2005

Besides, the other critical issue is the lack of safeguarded measures on labour issues raised due to the MFA phase out. As observed by Oxfam (2005), the industry is restructuring with closures, sale of factories, mergers with other factories and

Table 9
Average lead time to US and EU market

Market	verage lead time (days)
US market	65.24
EU market	61.65

Source: Sri Lanka Labour Department, 2004

Lack of market diversification

The lack of diversified market system is another critical issue faced by the industry. The major destinations for the Sri Lankan apparel exports are USA and UK which covered over 90 percent. It does not cater other potential countries such as Japan, Canada, and some EU countries adequately. Hence, signing of Trade Agreements and establishing market relationship with potential countries are crucial in protecting the Sri Lankan market share. Specially, continuous trade negotiations with potential countries which mostly depend on imported textile and apparel will be very helpful

to minimize the adverse effects of the MFA phase out.

Poor infrastructure facilities

Poor domestic infrastructure facilities are the other crucial problem faced by the industry. It increased the cost of production. Countries like China and India spend enormous amounts on infrastructure development, not only focusing on the MFA threat but also focusing on the overall development of the economy. Moreover, India has established several industrial parks with all facilities including the provision of utilities at very low prices. Transport and communication systems are the key areas that need to be developed by Sri Lanka in order to reduce the cost of production, lead time and to improve the information flows.

6. Conclusion

As predicted, the Sri Lankan apparel industry faces fierce competition within the region and the global market. The statistics clearly show that Sri Lanka has been able to maintain the edge during the quota-free era in both US and EU market retaining a modest growth. The export statistics show that Sri Lanka has been unable to achieve an impressive growth in USA compared with other main Asian countries. However, it shows a potential growth in EU market, UK in particular. On the other hand, the Sri Lankan market share has marginally declined in US market while improving its position in EU market mainly due to the GSP+ system and added restriction on China's apparel exports to the EU. Moreover, the lack of vertically integrated production system is main issue faced by the industry. Also long lead time, lack of market diversification, poor infrastructure facilities and labour issues etc., are other challenging issues faced by the industry in the quota free world.

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Footnotes

¹ MFA was designed as a short term protectionist measure to allow industrialized countries mainly USA, European Union and Canada to restructure and adjust to competition from less expensive imports from developing countries.

² The controversial Uruguay Round negotiations of General Agreement on Tariff and Trade (GATT) in 1995 decided to eliminate the trade restrictions via the implementation of the Agreement of the Textiles and Clothing (ATC)

³ China the world biggest textiles and clothing exporter to the US market was not included to the figure due to the huge data gap between China and other selected countries. But China was included in the Table 3.

⁴ The special feature of the woven garments is it requires more labour especially unskilled labour. So, most of the studies have shown that changes of production of woven garments directly affect to employment of each country.

⁵ New quota system was placed on China's some exported categories which recorded a highest growth by US and EU.