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Catalysing industrialisation? The role of the apparel export industry

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Introduction

Northeast Asian countries in the first wave of apparel supplier countries (Japan and then South Korea, Taiwan and Hong Kong) in the 1950s and 1960s used the apparel export sector to build local firms, accumulate capital and create broader linkages in the economy, particularly through textile production. In the context of small domestic markets, these countries used exports to drive demand, especially for intermediate goods such as textiles, and later quota restrictions on apparel exports drove innovations in man-made textiles that had linkages to other industrial sectors in their domestic economies. Furthermore, apparel firms in these countries internationalised rather quickly, taking on new economic activities such as coordinating global supply chains and managing design, while offshoring production to lower-income countries through their own factories or local firms in these countries. Industrial policies played an important role, as did the specific global context in which US apparel buyers supported learning, linkages and internationalisation.

Other countries followed the development path of these Northeast Asian countries in

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what we refer to as the second and third wave of apparel suppliers since the 1980s. However, there is a fallacy-of-composition aspect to national economic development in a global context. Participation in the apparel global value chain (GVC) contributed to industrialisation in the early supplier countries in Northeast Asia through increasing returns, cumulative capabilities and domestic economy linkages, but this is not a strategy that other countries can simply replicate. As competition increased for both buyers and suppliers, apparel GVCs evolved in ways that changed the opportunities for future apparel supplier countries. Increasing competition in the manufacture of clothes drove down profits, leading companies in the Global North, as well as in Northeast Asia, to retreat to economic activities in which high entry barriers could be created such as design and retailing, and to outsource and offshore labour-intensive manufacturing to countries with lower wages. As new waves of apparel supplier countries emerged, especially China, competition increased further. Innovations in global transport allowed fabrics and other inputs to be shipped around the world at low costs and with short lead times, changing the incentives away from the localisation of intermediate input production, which is the key driver of linkages, to sourcing inputs from the cheapest suppliers on a global scale.

Changing global political economy dynamics linked to structural adjustment led low-income countries to liberalise their economies and trade, initially often with export-processing zones that operated under different, more liberalised policies than the rest of the economy. These special liberalised zones were meant to attract foreign direct investment (FDI), increase exports and thus foreign exchange, and balance trade accounts, with generally limited strategic industrial policy to support localisation. Hence, they easily led to apparel export sectors becoming mere assembly platforms, where predominantly foreign firms imported all inputs and exported finished products, with little benefit to the domestic economy except for low-wage employment (often with problematic working conditions) and generating some foreign exchange. In Central America, it was largely driven by US manufacturing firms; in North Africa and the Middle East by European firms; and in Asia by Northeast Asian firms, which also increasingly invested in and sourced from other regions. However, apparel suppliers in the second and third wave differed in the degree of localisation, with countries such as China and India using industrial policy to support local firms to increase their capabilities, to modernise and expand textile production, and to create industrial clusters.

Low-income countries today also face more unfavourable dynamics in the global economy than countries in the first wave of apparel exporters. Increased concentration among apparel retailers and brand marketers in the US and Europe has resulted in the global fashion industry being dominated by a smaller number of very large buyers. This dynamic combined with the increase in the number of apparel exporting countries resulted in significant market power asymmetries. As a result, global apparel buyers have driven down prices paid to apparel manufacturing firms and demanded that firms accept short delivery deadlines, changes to orders, irregularity of orders and other sourcing practices that increase the costs and risks borne by supplier firms. These buyer strategies reduce profit margins (and create poor working conditions) and thus the scope for capital accumulation among local firms and reinvestment in domestic economies. Large-scale production and vertical integration increasingly became a survival strategy among local apparel suppliers.

Can countries, especially in sub-Saharan Africa, still use the sector to catalyse their industrialisation process?

As a manufacturing sector, the ability of apparel export to drive industrialisation is limited by its mature technology and few intermediate inputs that create intra- and inter-sector linkages. The main potential of apparel and textile production for export is in developing basic firm- and industry-level technological capabilities, managers and an industrial workforce, as well as more specific capabilities in capital-intensive machinery linked to textile. For late industrialisers, this learning requires engagement with foreign technology and production systems, making engagement with GVCs and foreign firms a necessary (but not sufficient) condition for technology transfer.

There is still potential within the apparel and textile industry to drive industrialisation if it involves substantial localisation through the presence of local firms and intra- and inter-sectoral linkages.

- Local firms are critical for cumulative capability building and developing a local supply chain in textiles.
- An extensive and diversified textile base is key for industry-level upgrading beyond competing based on labour costs and preferential market access.
- Industrial clusters play an important role in capability building and local supply chain development.
- Synergies between domestic and export markets are important, as they help local firms and industries grow and build a broad set of capabilities.

What does this mean for government policies?

Export-processing zones and financial and fiscal incentives for foreign apparel firms to set up factories will not, on their own, stimulate localisation and thus drive industrialisation processes. Industrial policy is key to developing an extensive and diversified textile base and supporting small- and medium-sized local firms to create dynamic industrial clusters, as well as to create synergies between domestic and export markets.

The emergence of local apparel export firms is more challenging today due to changes in the business strategies and imperatives of global buyers and foreign firms, which in the past more actively supported local firms in their learning processes. Therefore, government industrial policy to support local firms is even more important now. At a minimum, this requires access to at least the same, but preferably higher, incentives for local investment (compared to foreign). Based on Ethiopia's experience, access to investment and expansion financing is necessary but not sufficient. Firms must be supported and compelled to build capabilities related to knowledge of production systems and factory management, as well as networking with buyers and intermediate and capital good suppliers. Government agencies lack this knowledge and these networks, so they cannot by themselves support local firms.

Rather than focusing exclusively on either foreign investment or local firms, governments should devise industrial policies that support technology transfer by leveraging foreign expertise. This can include demanding that foreign factories support local firms in return for fiscal and financial benefits, using specific indicators of knowledge transfer and performance criteria to monitor and evaluate. Industrial policies can also facilitate joint ventures and other forms of local-foreign partnerships from which local investors and managers can learn. For such partnerships to work, however, there have to be incentives and compulsions for the owners of local firms to learn rather than to become silent partners, and for foreign partners to share knowledge.

Furthermore, government-financed industrial parks that lower production costs and improve lead times in particular locations are important, but need to include and benefit local firms. Local firms co-locating near foreign firms is essential for the direct and indirect spillovers that occur in industrial clusters. When local firms prove their capabilities to foreign firms, they can be given sub-contracting orders, which in turn will help prove their capabilities to buyers. Although local firms often start with basic, low-value apparel production in the early learning phase, government industrial policy can support local firms to shift into more complex products by encouraging foreign firms in those products to set up factories, along with foreign textile firms that produce the export-quality fabric required for particular product groups. This brings us to the issue of developing a textile base.

The emergence of a textile sector was always dependent on government industrial policy and the presence of local firms. Textile requires considerable financing and environmental compliance for its effluent-treatment systems. In sub-Saharan Africa, a regional strategy for a textile base would be key and should include capacities in dyeing and finishing. Neighbouring countries could develop specialised textile sectors around specific product categories and then source from each other, which would increase the overall variety of fabric available at minimal time and cost. This approach allows each country to have some textile production, which comes with greater linkages than apparel assembly, rather than some countries remaining only assembly platforms. The regional textile base would provide the opportunity for local firms to produce a range of products of higher value and offer the possibility of moving into design, which includes creativity with fabrics, and into technical textiles, which have more innovative potential and can be used in other industries. This approach would require a joint regional industrial policy strategy that reduces intra-regional tariffs and non-tariff barriers, as well as a focus on developmental objectives in the textile and apparel sector. For example, textile production requires access to stable, low cost electricity, water treatment facilities and other infrastructure.

Global buyers increasingly prefer one-stop shopping locations where they can source a variety of textile and apparel products.

They also have become aware of the need to align value chains regionally due to rising production costs in Asia, their increasing need for flexible manufacturing, and potential disruptions in global supply chains. Thus, global buyers may encourage textile manufacturers to create mills in new regions to be closer to final assembly, and governments can use their regional textile base policy to attract strategic foreign investments in certain fabrics, as well as to encourage joint ventures with local investors and the upgrading of existing textile mills.

While export sectors drive learning and technology transfer, the domestic market is equally important, especially after local firms have built production capabilities and seek to move into higher-value activities of design, branding, marketing and retail. The domestic market in many sub-Saharan African countries is dominated by apparel imports, including secondhand clothing. Once local firms have built minimal capabilities and achieved economies of scale through exporting, they can produce apparel at comparatively low prices and compete in the domestic market. However, firms still need to develop capabilities in design and branding, and also in retailing if there are no domestic retailers to which products can be supplied. Furthermore, this shift requires an increase in purchasing power within the domestic population, driven by inclusive growth processes in the country that lead to rising incomes.

Rather than pursue national policies of import substitution that include high protection of textiles and apparel, governments should reduce high tariffs gradually and strategically (but not completely), alongside support to domestic market-oriented local textile and apparel firms to build their capabilities, which would then allow them to compete with imports. Retaining high tariff walls, on its own, does not encourage domestic market-oriented firms to invest in building their capabilities.

Looking forward: A new textile economy

Beyond textiles, localisation of raw material production was also important for industrialisation through apparel exports in the past. A history of cotton production was a major asset, and the development of man-made fibres linked to petrochemical industries was an important driver of industrialisation processes. More recent developments include the production of cellulose fibres, which are man-made fibres developed from plants that are biodegradable. The next wave in raw materials is recycled fibres, linked to a sustainability shift in the global fashion industry.

This sustainability shift may offer new opportunities for countries in sub-Saharan Africa to use apparel exports to drive wider industrialisation and value-capturing processes by shifting from a linear production system to a more circular economy system. Such a system would be characterised by apparel inputs produced from recycled resources; closed-loop textile and apparel production systems; the use of renewable energy; and the development of inter-sectoral linkages through waste management services and industrial symbiosis.

Creating circular industrial economies requires accessing and learning how to use equipment at the technological frontier, but this is not impossible. The diffusion of new green technologies could provide the potential for countries in sub-Saharan Africa to skip linear, fossil fuel-driven industrialisation and move to building industries based on circular economy initiatives and renewable energy.

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