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Export economics beyond the ‘white underwear’

Exports from Sri Lanka are thrice cursed. They are declining as a share of global exports, as a percentage of Sri Lankan gross domestic product (GDP) and also in absolute value. It’s timely to evaluate the reasons and consider solutions.

For over two decades now, the bulk of Sri Lanka’s exports have been apparel and tea. They still account for 52 percent of the total export value. But they have been gradually losing steam and nothing else is emerging to fill the gap. This ‘Insight’ examines the apparel sector, its trajectory and implications.

Losing steam in new millennium

The Multi Fibre Agreement (MFA), which guaranteed an export quota for Sri Lanka and other developing countries, ended in 2005. Nevertheless, the Sri Lankan apparel sector has stayed in the game. However, it is no longer playing in the forward offensive position as it did in the 1980s and 90s; but there is no shame in that.

For a long time now, ‘apparel’ has been the feather-in-the-cap of Sri Lanka’s export growth story. In the 1980s, it was apparel that shifted the balance of Sri Lankan exports from being agriculture based to being industrial based. With apparel overtaking tea as the leading export in the 1980s, the balance of export markets also shifted. The USA replaced the UK as the leading destination of Sri Lankan exports.

Apparel exports as a share of GDP peaked in 2000 at 49 percent. Then with the end of the MFA looming in the horizon, it began a long slow dip. In 2012, it was at 39 percent, around the same as where it was in 1991 (Exhibit 1).

This is not an indictment; in fact, the industry has done well to survive. And there are two strategies that have underscored that survival: (1) increasing product specialization, (2) increasing value.

Consolidation through specialisation

Half of all the apparel exports from Sri Lanka are to the USA. The top 15 products accounted for only one third of the USA exports in 2002, whereas in 2012 they accounted for almost three fifths (Exhibit 2). This suggests that apparel exports are consolidating around a smaller and more specialized range of products.

Driven by value, not volume

Since the turn of the century, Sri Lanka has been adjusting to the close of MFA. Consider just the top five products exported to the USA. While still under the protection of the MFA, there is a huge surge in the quantity of the top five products since 2000. But the momentum runs out in 2007, the loss of the MFA kicks in and the quantities start to decline drastically: from 7.3 million units in 2007 to 5.6 million units in 2012 (Exhibit 3).

But the drop in volume in these top five products was not mirrored in the drop of their export value. After free falling with volume for about two years, the value of the exports began picking up in 2010 (perhaps also benefiting from the war's end) and has been surging upwards despite volumes continuing to fall. In 2012, at US \$ 568 million, the value of apparel exports of the top five products is almost back at what it was at its high point of US \$ 575 million in 2007 (Exhibit 3).

Therefore, the increasing share of the top five products from 18 percent to 31 percent between 2002 and 2012 (Exhibit 2) is not based on increasing quantities in the remarkable increase in the value of these products such that the total export value increased despite volumes declining by 25 percent.

Value through ideas, not just products

The chain of value addition is often discussed as the physical transformation of raw materials to products that are retailed. The value addition in Sri Lankan apparel, however, has gone beyond physical transformation. This is mainly by competing in the space of ideas and image, through the creation of designs and brands.



The top apparel firms in Sri Lanka now compete for manufacture on the basis of owning attractive designs, rather than competing to manufacture on the designs of the buyer. In addition, Sri Lankan firms have also produced clothing ranges with their unique brand images such as ‘Amanté’ and ‘Avirate’. The trend in current investments suggests that Sri Lankan apparel firms will also compete in the future through the creation of specialised materials through nanotechnology methods.

Positive story is a limited story

Firms not sector: The positives highlighted above, have limited implications. The story of apparel firms weathering the storm of post MFA competition and surviving with specialisation and higher valued products is a story of particularly well managed firms and cannot be generalised to the whole sector. The best evidence of this is the rapid decline in the number of firms. Just between 2007 and 2010 the number of apparel establishments declined by 30 percent from around 2,900 to just above 2,000.

Falling employment: Employment figures make it clear that the decline in establishments is not reflecting a consolidation but an actual decline. During the same period, the number employed in the sector has also fallen by 30 percent from about 780,000 to about 550, 000. Therefore, the apparel sector is indeed struggling as reflected in the total export growth and performance of the sector.

From driving to lagging export growth: From 1992-2001 apparel exports was the driving force behind export growth recording an annual average growth of 13 percent while other exports growth was only 7 percent. In contrast, during 2002-2012, the annual average growth in apparel declined to 5 percent while other exports grew by 9 percent (Exhibit 4).

Beyond the ‘white underwear’

In the apparel sector, the ‘white underwear’ represents the low-end, highly labour-cost sensitive, resource-based product. While Sri Lanka has produced some remarkable firms that have got well beyond the ‘white underwear’, the sector as a whole has not shown the same potency and economists cannot expect it to be the future driver export growth in Sri Lanka.

The more pertinent issue, however, is that Sri Lankan exports as a whole, not just weaker apparel firms, have not been able to get beyond the proverbial ‘white underwear’. While post-77 Sri Lanka upgraded its export base from agriculture to industry, it seems to have managed only one-step up that industrial ladder into the apparel sector. Since apparel hit the inevitable snag, there has been nothing to take its place. Apparel, tea, spices, rubber products and precious stones account for over 70 percent of exports.

Many other countries, including South Korea, began their industrialisation climb with apparel but quickly moved up the ladder and diversified their industrial export base into other products and markets. But this is not yet the story of Sri Lanka.

Therefore, Sri Lanka's economic future rests significantly on two transitions that are yet to take place - first, the diversification and growth of industrial exports - second, development of industrial products beyond the 'white-underwear'.

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