The WTO and the Politics of India's Textile Sector: From Inefficient Redistribution to Industrial Upgradation♠

Errol D'Souza♦

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♦ Professor, Economics Area, Indian Institute of Management, Ahmedabad 380 015, India. Tel.:91-79-632-4947 (O). Email: errol@iimahd.ernet.in

Abstract: In political economy, the more specific a factor is to a sector, the greater the incentive in that sector to lobby the state for policies that discriminate in favour of them. In Indian textiles, however, segments like powerlooms that had more mobile factors were favoured with input subsidies and price supports - an inefficient redistribution (as opposed to an efficient one involving direct transfers) that promoted entry and the growth of the sector. This is partly due to the state's self-conscious use of economic policy to prevent the concentration of economic power in the private sector and to restrain the emergence of big capital. The mills where factors were more specific were instead targeted by the state with the imposition of duties on fabrics, high exit costs, etc. The growth of world trade in textiles and the movement up the buyer-driven supply chain from full package supply to original brand name manufacturing requires industrial upgradation and dereservation and as the gains from this begin to outweigh the benefits of inefficient transfers, better organized powerlooms have begun to align with organized mills and begun to lobby for a regime change. The potential obstacle to reform from the unorganized segments who have a poor capacity to flexibly respond to the changing economic system was overcome by framing complementary policies that supported their restructuring so as to take advantage of the new market opportunities. As textiles and garments are a leading sector in terms of employment and foreign exchange earnings the state's interest is in the promotion of this new alignment so that it does not suffer significant revenue losses and lose the ability to service its constituents. Interest groups that used to seek exemptions and concessions from the state and pursue strategies of shifting tax burdens down or up the value chain increasingly realize that the emerging competition is such that investing time and resources on multilateral negotiations at the WTO is meaningless unless priority is given to the restructuring of domestic industry so that they may benefit from the opening up of trade when the Agreement on Textiles and Clothing ceases to exist in end 2004.

The ATC, Market Access, and India

After decades of vigorously defending state-led development strategies governments in many developing countries including India have since the last decade undertaken liberal economic policy reforms. Programmes of economic reform have the strategic aim of integration of the national economy with the world economy and involve two types of changes - (1) institutional harmonization with regard to trade policy, legal codes, tax systems and other regulatory arrangements, and (2) increased market-based trade and financial flows. The Agreement on Textiles and Clothing (ATC) is a WTO agreement of the second type that makes it necessary for domestic reform due to the pressure of international competition that arises as trade liberalization links the domestic economy increasingly with the world trading system.

The Agreement on Textiles and Clothing (ATC) is an attempt to correct the violation of the GATT principles of non-discrimination and transparency in respect of the Multifibre Agreement (MFA) that governed textile trade from 1974 to 1994. Textiles, clothing, and agriculture were the only sectors that had a multilaterally negotiated independent agreement when the Marrakesh Agreement establishing the WTO was signed in April 1994. The ATC is a transitional agreement that regulates trade in textiles for 10 years after which trade in textiles and clothing is to be completely integrated into the GATT. The elimination of quantitative restrictions under the ATC is taking place through a stage-by-stage removal of existing quotas ('integration', as described by the agreement), and through accelerated expansion of the remaining nonintegrated quotas ('liberalization'). Integration has been scheduled to take place in four stages and by January 1, 2005, all imports are to be integrated[1]. Along with the process of integration products remaining under restriction are allowed an increase in growth rates in quotas above those agreed on under the MFA (liberalization). Currently it is clear that the ATC has resulted in the back-loading of

[1] The choice of products to be integrated is left to the importing country but must include at least one item from each of four major product groups – yarns and tops, fabrics, made-ups, and clothing.

integration and liberalization during the 10-year transition period[2] and this is creating problems of market access for developing countries[3].

India has been pressurizing the WTO for faster implementation of integration by large textile importers such as the US and EU. The Ministry of Commerce explicitly states that integration is a key issue for India in multilateral trade negotiations. Market access for Indian textiles has not increased significantly and compounding the problem is anti-dumping actions, transitional safeguards and rules of origin[4] that nullify the little market access resulting from implementation of the ATC (Ministry of Commerce, 1999). However, the pressure on the Indian government from the textile industry has been more to reorient domestic policy so as to enable domestic firms to restructure and face the emerging competitive market when the ATC ends in 2004. Textile industry associations in India realize that the attention at the WTO on the pace of integration of textiles into the multilateral trading system is low due to the growth of regional non-quota trade and the changing pattern of trade in textiles and garments in the last decade. First, there has been a growth of regional trade in clothing amongst developed countries such as the US and EU, most of it being free of quota restraints[5]. Exporters from developing countries such as India find that their export markets to the EU and US being subject to quotas are protected and isolated from these other non-quota suppliers who receive some form of preferential treatment. At the same time, these other non-quota

[2] Integration has been concentrated in low value-added products such as tops, yarns, and fabrics. Also, during negotiations many countries expanded the Annex to include many items never subject to the MFA (Bagchi, 1994).

[3] Not only is approximately one-half of the integration scheduled to occur at the end of the transition period, but, as the importing countries are to determine which items are to be integrated, their incentive is to delay the inclusion of high value added products as far as possible. Clothing which is a high value added product has not been integrated by major importers and the US has put this off to the end of the ten-year transition period.

[4] Under US rules of origin when textiles and apparel exported to the US from one country, the quota allocated to a second country would be deducted if the inputs from the exported product come from the second country. India contested this at the WTO arguing the quota of the second country should be deducted only if dyeing, printing and finishing are carried out in the second country. The Dispute Settlement Panel upheld the US rules stating that they have not discouraged exporters from shipping their products to the US. India is still to decide whether to appeal to the Appellate Body against this ruling.

[5] In the US, Mexico has been a source of rapid growth for apparel imports which has been subject to NAFTA rules of origin rather than quotas, and some imports have been sourced from Jamaica and the Dominican Republic under the Caribbean Basin Initiative (with transformation rules). In the EU there has been a growth in apparel import trade which is free of quota from the Central European countries such as Poland, Romania, Hungary, The Czech Republic and Slovakia.

country suppliers given their preferential access do not pay attention to the WTO and the pace of integration of textiles into the multilateral trading system.

Second, about twenty years ago Korea, Taiwan and Hong Kong were the major developing country exporters of textiles and garments who felt the restraints on their exports due to the MFA system and this motivated them to press for the reform of the quota system. By 1999, China was the dominant developing country exporter of textiles clothing besides being the dominant textile exporting country in the world[6]. For a large part of the decade China was outside the WTO and this reduced the pressure for rapid implementation in the spirit of the ATC. By 1999 Korea and Taiwan also had unfilled quotas for the export of their apparel, reducing their incentive to press for quota elimination or more meaningful integration of textiles into the WTO.

Both the industry associations and the government also see that the ATC has a commitment accepted by all WTO members to terminate the MFA in end 2004 and that a programme for integration and liberalization is in place in the intervening period. With this on the table they do not see much sense in doing anything beyond monitoring whether the follow up on integration and liberalization is going broadly according to plan even if it may meet the letter but not the spirit of the ATC as that in their view would entail an ineffective use of negotiating capital. As other issues come up on the negotiating agenda such as labour standards and trade and the environment, it makes more sense for the state to concentrate scarce negotiating resources in these areas rather than employ negotiating resources on fine tuning market access. Government and trade lobbies are of the view that negotiating resources are better utilized in grappling with the newer issues that are coming on the agenda and in keeping the already discussed and agreed on issues on the back burner. Accordingly even though India and other countries that are much affected by the way trade in textiles is actually being conducted make an issue out of implementation of the already negotiated agreement, there is the realization that such an approach can only be temporary and as a time buying measure is fruitful

[6] China accounted for 8.5 per cent of the world exports of textiles and 15.7 per cent of clothing in 1999.

only to the extent that it enables the development of a position on the newer issues that are increasingly taking up space on the agenda[7].

The ATC has thus resulted in a demand by interest groups for reforms in regulations governing the conduct of business in the textile sector with a view to enabling the industry to face the competition of a post-quota multilateral trading system. As these demands require the undoing of decades of prior policy and a decline in the returns to the historical beneficiaries of these policies they have been resisted and often delayed[8] as the distribution of benefits and burdens amongst interest groups is changed when policies change. Moreover the supply of these distributional gains comes from politicians and bureaucrats who are not a passive instrumentality but who would choose among demands that best advance their own interests. The ability of interest groups to attain their objectives in the shape of industrial policy is circumscribed because the services they seek are provided by the state and policy reforms that increase the role of markets weaken the state's discretionary authority over economic privileges. An account of how reform takes place thus needs to spell out the mechanism whereby the redistribution of benefits amongst interest groups occurs.

In this paper we argue that sectoral characteristics and market conditions determine the balance of power between competing private sector claimants to government 's supply of policy. The incentive of an interest group to influence policy depends on the susceptibility of the assets of the interest group to policy. The less that policy can influence the return on an asset in a sector the less is the incentive for an interest group to attempt to affect policy. Moreover, the more that assets are specific (i.e., the harder it is for assets to be deployed to alternative uses) the greater would be the incentive for sectoral interests to demand policies favouring their activities due to the high costs of exit and adjustment. Existing theories suggest that

[7] India has consistently opposed the expansion of the WTO agenda to include new issues. As stated at the recent Cairo Ministerial meet, by S.N. Menon, Additional Secretary, Ministry of Commerce, "in view of the interest shown by some trading partners, (India) embarked on a clarification process, following the decision taken at Doha. This was subject to the condition that negotiations on modalities of these issues (such as investment, transparency in government procurement, competition policy, etc.) will proceed after Cancun only after an explicit consensus".
[8] Some of these delayed reforms as we shall see later have to do with the structure of taxation, labour laws, etc.

specificity of factors should make lobbying and rent seeking more prevalent (Brainard and Verdier, 1994, Alt et al, 1996, and Coate and Morris, 1999). Paradoxically as we show for segments of the textile sector in India the state may dominate such industrial interests and rather than defend these interests could instead target them as easy sources of revenue as it is difficult for these segments of the sector to avoid such an imposition by moving assets to other uses. In conjunction with the greater asset specificity and the incentive for sectors to demand favourable policies that secure their returns is the ability of the state to ignore these demands and to instead use the sector as a base to raise revenues for itself. High asset specificity is also usually associated with fewer firms and greater industrial concentration. Such sectors with high concentration should find it easier to undertake collective action (Olson, 1965). However, the state may find it easier to not accommodate interest groups in such sectors as with their assets limited to current uses, resistance to and escape from state appropriation of returns is difficult.

If the effectiveness of the lobbying of interest groups as we argue is a function of the specificity of the assets they own and the market conditions (about which more shortly), then, the state discriminates amongst interest groups and supplies policies with a view to the impact on revenue generation. Even though liberalization seeks to reduce the role of the state, it also requires a reduction in borrowings and the debt burden to improve fiscal solvency and this has made policies which adversely affect the buoyancy in tax revenues a low priority for the state. When a sector like textiles in India is a leading sector in terms of employment, foreign exchange, and revenues, the state responds to the new balance of power that materializes when the sector faces changed circumstances by reorienting policy so as to support the restructuring of the sector and to enable it to continue its leading sector status as well as its contribution to the fiscal resources of the state.

The political economic explanation in this paper is that though policy matters to outcomes, it is also very much the case that changes in the underlying market conditions that affect outcomes can trigger a change in the leverage interest groups have over policy makers for specific institutional arrangements. The source of the shift in policy regime is the ability of heterogeneous interest groups to influence the state in particular between those who own assets that are specific and those whose assets are more easily redeployable. Asset specificity increases an interest group's incentive for 'voice' as the 'exit' option is costly. However, as pointed out earlier, such groups pose less of threat of successfully executing an 'investment strike' and so politicians are often able to dominate such interests. The redistribution from organized interest groups that own specific assets to unorganized groups whose assets are more mobile was also historically influenced by the intellectual heritage that informed the choice of policy in India. For instance, Fabian socialists believed that a strict reliance on the market might yield rapid economic growth in the short run but an offshoot of that would be a highly unequal distribution of income that would undermine the political stability necessary to sustain such growth. To prevent such outcomes the Fabians recommended extensive government intervention to control the distributional side effects of the operation of markets and this set of ideas had a profound influence on leaders like Jawaharlal Nehru who were instrumental in designing the initial policy framework. The use of a redistributive policy in the textile sector was sound finance as well for the state as behind an import substituting policy regime it could raise the tax revenues required from the sector without bothering about the impact on the competitiveness of the sector.

The impending integration of textiles into the WTO in end 2004 which frees trade in textiles and garments requires industrial upgradation via technological upgradation and assembly-line automated production that generates scale economies along with flexibility as well as product quality and the compression of delivery lead times. The participation in such a changed market environment is easier for the organized segment of the industry than the unorganized who have a poorer capacity to make a rapid and flexible response to the changing economic situation and this was an obstacle for the organized segments to get policy changed in their favour. The inability of the unorganized segments to respond to the new opportunities provided by trade liberalization could very well reverse intended reforms such as dereservation for the small scale sector and the removal of distortions and rigidities since the costs in terms of increased competition and unemployment amongst the unorganized would be experienced prior to the benefits to the organized from the expansion of activities and markets. In the Indian context this resistance to reforms that would have adverse consequences on the unorganized was weakened through the introduction of complementary policies such as the Textile Upgradation Fund

Scheme that enable the unorganized to respond effectively to the new economic opportunities[9]. Such policies are framed to enable the unorganized segments to restructure and gain from the liberalization of trade rather than to have to take the exit option. The better managed amongst the unorganized realize the advantage of this gain vis-à-vis those from the redistributive policy regime and this helped build the support for a regime change. The state also realized that the inability to restructure now and take advantage of the emerging market would result in less revenues and foreign exchange earnings which makes it vulnerable as the textile sector is a leading sector of the economy. Policies that have the ability to raise the income potential of the various segments in the industry as well as of the state raises the payoff to these various interests in support of new policies. The better managed unorganized segment forms a coalition with the organized segment of the industry and this provides the necessary influence that backs the government's introduction of a liberalized policy environment.

The textile sector dominates the Indian economic landscape and on that basis it would be natural to expect that the interests that permeate this sector command a privileged status in the economic policy making process. The textile sector's contribution to the Indian economy can be seen in terms of its contribution to industrial production, employment generation and foreign exchange earnings. The textile industry contributes 4 per cent of GDP, and 14 per cent of the total industrial production. It employs around 30 million workers – the second largest component after the agricultural sector – and earns 35 per cent of the country's foreign exchange and 8 per cent of the total excise revenue. The textile sector thus has the status of a leading sector in the Indian economy[10]. As the Indian state derives significant revenues and export earnings from this sector which aids the state in funding itself as well as servicing its constituents, it gives attention in policy making to the fortunes of

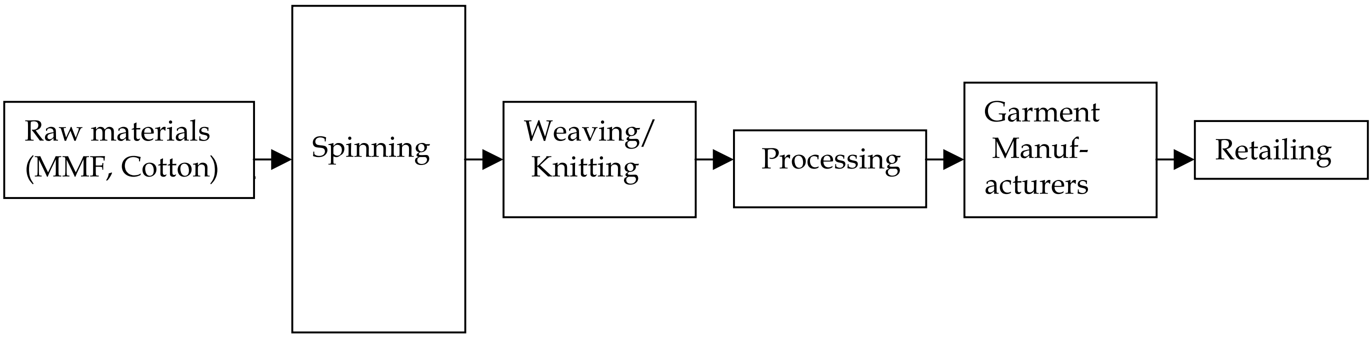
[9] The Textile Upgradation Fund Scheme was launched by the Ministry of Textiles in 1999 with a corpus of Rs. 25,000 crore and was initially focused on the weaving and processing sector though later the spinning industry was also included as the natural based fibre industry was losing out to the technology-based synthetic fibres in textile applications.

[10] In fact, the Ministry of Textiles that is responsible for policy formulation, planning, export promotion and trade regulation in the textile sector has 10 public sector undertakings, 8 textile research associations, 9 export promotion councils, 6 advisory bodies, 3 autonomous bodies, and 4 statutory bodies under its umbrella.

this sector and spends much time and resources in negotiating policy with the interests that constitute the sector.

The prospect promoted by the Agreement on Textiles and Clothing (ATC) agreement of making trade in textiles restriction-free by end 2004 calls for changes in domestic policy. Upto now the policy was supported by an administrative and incentive structure built around the internal allocation of quotas. All these arrangements which include special quotas for small/young firms, extra quotas for firms shipping to non-quota markets so as to encourage trade diversification, and secure long term access to existing firms so that they may grow, will go by end 2004 and firms will have to reorganize themselves from capturing quotas to capturing markets. Recognizing that this change is immanent there has been a renewal of claims made on the government by interest groups for changing regulatory and tax policies in order to enhance their ability to compete and give a fillip to exports when the textile and apparel market is freed in end 2004. The recognition is not just that nations have become interdependent through the flow of goods but that an important part of global trade is conducted through systems of governance that link firms together in a variety of sourcing and contracting arrangements as exemplified by the value chain of an industry. The shift of focus in the textile industry is accordingly from production alone to the whole range of activities from the raw material stage to design, marketing, and retailing. In the textile industry access to international markets is not achieved via designing and marketing new products but via gaining entry into international production, sourcing, and marketing networks that are set up by lead firms. Market access in a long term sense is participation in these sourcing and contracting networks and a prerequisite for that is industrial upgradation which the industry realizes is becoming more important than focusing on market access via multilateral forums such as the WTO. The exercise of influence by interest groups over the state and policy is thus better understood by examining the supply chain in the textile industry – the supply chain being the input-output structure of value-adding activities beginning with raw materials and ending with the finished product. The operation of the supply chain gives us insights into how industrial units influence the organization of production, logistics and marketing, and the options open for improving competitiveness such as moving into more sophisticated product lines (product upgrading), acquiring superior technologies or reorganizing production systems (process upgrading), or even acquiring new functions such as moving from production to design or marketing (functional upgrading) or backwards and forwards to different stages in the supply chain (vertical integration). The supply chain in the textile industry is as given in Figure I[11]:

Figure I: Supply Chain in Textiles



Each segment of the supply chain has a plethora of associations/interest groups that lobby with the government to get policies favouring their particular segment often without taking the common interest of the industry into consideration. Commenting on the number of councils and associations the Sathyam Committee set up by the government[12] had questioned the need for so many of them and recommended that representative bodies should be fibre driven rather than segment-wise focused. This requires that for say cotton, one association representing cotton fibre, yarn, fabric, made-ups and garments would be more rational than having different associations representing each of these segments. There has been no move in this direction and an indication of the state of affairs is that in the town of Bhiwandi which is a powerloom cluster there are a dozen associations, most of them having no permanent organizational set-up. Most associations came up in response to the policy regime that was marked by controls, licenses, and permits. Not only have associations been acting independently of one another within a segment of the

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[11] An alternative frame for identifying the various segments of the industry is to classify according to the technology used and the degree of integration achieved (Anubhai and Mote, 1994).

[12] To make recommendations for a new textile policy, the Government constituted a committee in July 1998 under the chairmanship of Mr.S.R.Satyam, a former Secretary in the Ministry of Textiles. The committee submitted its report to the Government in early 2002.

industry but there have been conflicts of interest between upstream and downstream producers.

Upstream producers in the spinning segment for instance were protected by trade barriers and the higher domestic prices relative to international prices for textile fibres resulted in higher cost burdens for downstream weavers and garment manufacturers and affected their unit costs and competitiveness. This created a distributional conflict between upstream and downstream producers. Upstream producers in the spinning segment require investments in facilities that are capital intensive and which have high sunk costs and are opposed to liberalization of their products as they stand to reap a much lower return. One such distributional conflict has been between the All India Texturisers' Association and the Association of Synthetic Fibre Industry. Separate taxes are levied on processes like drawing, twisting, texturising, dyeing, etc. and the texturiser association has been lobbying for the government to raise the revenue it gets from them by shifting the excise on to the partially oriented yarn (POY) instead of levying it on the subsequent processing like twisting and texturising that the yarn goes through before being used in the manufacture of fabrics. The collection costs they argue would be lower as there are around 35 producers of partially oriented yarn whereas now revenue has to be collected from about 2000 manufacturers in the post spinning phase.

The lobbying for redistribution of burdens between various segments of the supply chain has been the characteristic of associations in the industry. As the integration of the textile trade into the framework of the GATT approaches with the dismantling of the Agreement on Textiles and Clothing in end 2004, the realization is growing amongst associations that competing for rents in a controlled economy is now a thing of the past and competing for markets is the emerging order of the day. The Indian Cotton Mills Federation recently for example has been emphasizing the benefits of the work of strong international associations such as the American Textile Manufacturers Institute (ATMI) and the Taiwan Textile Federation (TTF) and advocating trying the same in India. The TTF for instance is an umbrella federation of the textile industry representing yarns, fabrics, finishings, technical textiles, etc. and the coordination amongst these segments it is claimed helped Taiwan to become a competitive global textile and clothing supplier[13]. The picture of industrial upgradation via product, process and functional upgradation is nascent and embedded in the strategies of leading firms in each segment but has not yet become central to the objectives of interest groups/associations. The transformation from redistributive to upgradation strategies is occurring in all segments of the supply chain and the emergence of this shift requires a focus on the situation in each segment to which we now turn.

Segment: Raw Materials and Spinning

The Cotton Farm and Ginning Sector is highly fragmented with a low infusion of technology. The cost advantage that India has in cotton is steadily being eroded due to high levels of contamination, poor quality of cottonseeds, and low productivity[14] - given that India ranks third in the world (China is the first) in production of raw cotton, with a 14.4% share of world production in 1998-99. The Man-Made Fibre(MMF) and Synthetic Fibre Filament industry is a capital-intensive sector dominated by few players – the Association of Synthetic Fibre Industry has just eleven members[15]. India ranks fifth in the world production of synthetic fibre (viscose, polyester, and acrylic staple fibres) and third in cellulosic fibre (again China ranks first in the production of both fibres). Initially the Man-made Fibre industry was uncompetitive due to the industrial licensing policy that did not allow the exploitation of scale economies and inter-fibre flexibility – this changed with the Textile Policy of 1985 which adopted a multi-fibre approach.

The fibre lobby has always been able to keep raw material prices high and favourable to suppliers and the government has till recently usually been reluctant to use the import window to redress the power balance between the fibre manufacturers and the industry (Anubhai and Mote, 1994). There is another policy bias that still prevails – Man-made fibres have always been subject to higher rates of indirect taxation vis-à-vis cotton[16] and polyester filament yarn has always attracted a higher incidence of duties as compared to other such yarns in its category. With

[13] Interview with Mr. M.P. Gajaria, former Secretary General, ICMF.
[14] Speech by T.Kannan, Chairman TEXPROCIL, at Annual GBM in September 2001.
[15] These include large corporates such as Century Enka Ltd, Indo Rama Synthetics (India) Ltd, JCT Ltd, and Reliance Industries Ltd.

regard to cotton a recent study for the Cotton Textiles Export Promotion Council (TEXPROCIL) done by the firm Gherzi Eastern argued that cotton prices need to reduce by at least 10 percent for the industry to become competitive. To this end it recommended strategies to reduce the cost of production such as mechanization of cotton farming, adoption of drip irrigation, and amendment of the Land Ceiling Act so that corporates can enter into cotton farming. TEXPROCIL is pursuing the implementation of these recommendations with the government.

There has been a decline in policy bias in the last decade with the customs duties on synthetic fibres and the inputs going into the production of synthetic fibres declining over the years. This has resulted in the domestic synthetic industry becoming more competitive at the input stage and also in the output of fibres[17]. At the same time India's share in the world production of various fibres and yarns (except Nylon Filament Yarn) has significantly improved with the share for Polyester Staple Fibre doubling between 1995 and 2000. Despite industrial concentration this sector has not been able to elicit favourable treatment from the state. Indo-Rama Synthetics (India) Ltd and Reliance Industries Ltd account for approximately 70 per cent of the domestic production of PSF. In this case large interests have provided large targets for the state which is why the excise duty on cotton yarn is pegged at 8 per cent whereas on polyester filament yarns it is 24 per cent currently. Concentration in the industry as argued earlier may reduce the transactions costs of collective action, but the flip side is that the state finds the compliance costs of the burden of taxation to be lower and that makes it easier for it to impose burdens rather than grant concessions to such highly concentrated segments.

Segment: Fabric Production and Weaving

In fabric production there are two main segments – weaving and knitting. The weaving sector spans the handloom units producing around 5 metres a day to state of the art looms in mills producing 250-300 metres in an eight-hour shift. The non-mill sector is sometimes referred to as the Decentralized Sector and includes

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[16] The excise on cotton and man-made/blended fabrics, however, is at the same rate of 16 per cent.

[17] The Nominal Protection Coefficient (Basic Domestic Ex-Factory Price/International Price, CIF) has been declining in the latter half of the nineties though the coefficient

powerlooms, handlooms, and the knitting or hosiery sector. The decentralized sector produces around 95% of the total cloth in the country and is the major employer, income generator, as well as export earner for the weaving and knitting industry. From Table 1 we can see that the mills have a steadily declining share of cloth production during the nineties – in 1990-91 the mills produced 11.1% of the cloth but by the end of the decade this had more than halved to 4.2%. About 27 per cent of this declining contribution of the mills was compensated for by increased production by powerlooms (their share went up from 57.2 per cent to 59.1 per cent during this period) and the remaining 73 per cent by the hosiery sector (the sector's share increasing from 11.6 per cent to 16.6 per cent).

Table 1: Sector Wise Production of Cloth (percentages of Million Sq. Mtrs.)

Year	Mill	Handloom	Powerloom	Hosiery	Khadi, Wool & Silk	Total
1990-91	11.10	18.41	57.21	11.56	1.72	23330
1991-92	10.34	17.94	57.72	12.30	1.70	22978
1992-93	7.85	20.49	57.48	12.49	1.69	25475
1993-94	7.13	20.97	57.33	13.04	1.53	27898
1994-95	7.94	21.60	55.85	13.10	1.51	28606
1995-96	6.32	22.54	53.82	15.76	1.56	31958
1996-97	5.62	21.40	55.55	15.88	1.55	34838
1997-98	5.20	20.31	55.96	17.08	1.46	37441
1998-99	4.94	18.80	57.27	17.37	1.62	36127
1999-00	4.37	18.75	59.14	16.26	1.48	39208
2000-01	4.15	18.65	59.13	16.63	1.44	40256

Source: Compendium of Textile Statistics, Government of India.

The decline in the mill sector is very much related to government policy that has shaped the environment in textiles over the years. There was a freeze on looms in composite mills up till the New Textile Policy of 1985 and no increase in total width was allowed until 1978 so as to encourage the decentralized sector. To protect employment there were restrictions on the installation of automatic looms which were gradually relaxed from 1977 and even today though India ranks first in the total

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is still greater than one which means that domestic production is more expensive than the international benchmark.

number of looms in the world, it has the lowest share of shuttleless looms to total looms (excluding handlooms) installed of a mere 0.58 per cent. Also, up till the 1985 Textile Policy powerlooms were given favourable fiscal treatment compared to the composite mill sector. Excise duties were lower for powerloom cloth and powerlooms were allowed to grow unfettered. There have been large barriers to exit in the mill sector as well with government favouring organized labour and disallowing units from downsizing operations. If units were closed they were absorbed into the public sector where they continued as loss making units. In the public sector the National Textile Corporation's 119 mills are managed by 9 subsidiary companies. Eight of these subsidiaries are on the BIFR list[18]. The government has taken a decision that all viable public sector mills should be revived either by the public sector or private sector participation whereas non-viable units should be closed after giving workers a VRS option[19]. The utilization of looms in the textile mills has also been declining with the competition from the powerlooms. There has been a decline in the share of cotton cloth produced in the industry (by mills, powerlooms, handlooms, etc.) from 67.3 per cent in 1990-91 to 49.7 per cent in 2000-01. The mills have also responded to this shift in demand by increasing their production of synthetic cloth and reducing the production of cotton cloth, thereby exhibiting flexibility in the fibrewise production of cloth which has enabled them to put some brakes on their decelerating share of production. The decentralized sector contributes to 66.1 per cent of fabric exports in value terms[20] over the 1995-00 period and the mills thus contribute the remainder, but mainly in grey and dyed fabrics where they realize higher unit values per square metre[21].

Powerlooms have a large employment of 41,53,879 people – 5.8 times the employment in the mills[22]. The growth of powerlooms was not driven by only the policies such as freezes on looms in composite mills or exit barriers but also by the

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[18] When a business organization goes sick it is referred to the Bureau of Industrial and Financial Restructuring (BIFR) and in the Indian context is thus known as a BIFR case.

[19] The total revival package for the 8 subsidiaries including funding for VRS is estimated to be Rs 3,000 crore and government is looking at the sale of surplus mill land as providing resources for this purpose.

[20] This is computed by using the share of the decentralized sector in the production of synthetic fabric as the weight of this sector in synthetic fabric exports.

[21] Relative to mills powerlooms who have been able to emerge with a dominant position in printed fabrics.

backing of the middlemen in the textile fabric trade. The long chain of distribution intermediaries in textiles – the Wholesalers, Distributors, Agents, etc. – were the marketing arms of the mills and had the major contact with the final customer thereby making them powerful and relegating the mills to a pure manufacturing status. As the demand for made to order fabrics (especially in small batches from the export market) grew, these middlemen began preferring smaller independent units such as powerlooms which gave them a higher degree of flexibility.

The competitiveness of powerlooms is slowly eroding as the advantage that powerlooms had in terms of size is no longer as important as the technology used and the level of flexibility. The looms used in this sector are mainly discarded old looms from textile mills. It is estimated that of the 16.61 lakh looms in the powerloom sector, there are only 30,000 automatic looms (1.8 per cent) and around 5,000 shuttleless looms (0.3 per cent). There are nearly four lakh semi-automatic drop-box looms, but nearly half of these are obsolete. The remaining looms are conventional shuttle looms with virtually no process or quality control attachments. The average number of looms per unit is around four which is a tiny size that does not permit powerlooms to pursue economies of scale. Upto now they had the advantage of low wage cost, and they also indulged in excise duty evasion as they are decentralized and difficult to police.

Approximately 4.9-6.6 lakh powerlooms are inoperational and this is attributed to a tremendous over-capacity in weaving and the expectation is that larger units will increasingly lease or take over good powerloom units for production of certain lines with managerial control passing over to the big units. This vision of the integrated corporate entity making a comeback is based on the experience of units such as Siyaram's, S Kumars and LNJ Bhilwara which started off as small players in the powerloom sector and gradually with specialization and backward and forward integration emerged as significant corporate entities in the industry. Accordingly units with weaving/knitting and processing facilities or existing spinning mills will take over good powerloom units and set up a process house.

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[22] The dominant powerloom units are in Bhiwandi (near Mumbai), Surat (Gujarat) and Coimbatore (Tamil Nadu).

Those powerloom units that are unable to change will be forced to operate in the lowest rung of the market or shut down.

This shift towards larger integrated units is not a prospect all small units can look forward to and this is a speed breaker on the road to moving from a redistributive regime to a market based industrial upgradation one. To overcome this the Union Ministry of Textiles had initiated the Textile Upgradation Fund Scheme (TUFS) in 1999 which provides for a reimbursement of 5% point on the interest charged by a lending agency on a project of technology upgradation and the rate of depreciation allowance for machinery under this scheme has been raised to 50% to make modernization attractive[23]. With very few small units applying for assistance under the scheme the Textile Commissioner's Office changed its role from administrative functions to being a facilitator for the industry and has with the help of a consultancy firm, Gherzi Eastern, embarked on a training programme for its officers to enable them to provide comprehensive services to powerlooms. For the state, the powerlooms have been the goose that lays the golden eggs in terms of revenues earned as well as foreign exchange and a downturn in this sector has large consequences for the stability of the state which it is attempting to avert by initiating policies that impact positively on the return on assets in this sector.

If traditionally the government was tacitly backing powerlooms and organized labour, the opening up of trade in textiles has pushed the government to siding with the organized sector. To enable the industry to face the global competition the government announced the New Textile Policy-2000 and a Textile Package in the 2001-02 Budget[24]. In the 2002-03 Budget the government has dereserved the knitting sector from the small scale sector which will result in large readymade garment manufacturers entering this sector and lead to modernization of this segment. In the subsequent Budget the organized textile mill sector got one of its major demands of restructuring the fiscal structure and introducing the payment of excise duty (Cenvat) by all by extending the Cenvat chain to fabrics and madeups from the yarn

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[23] Powerlooms with their low technology levels and low levels of productivity are the very weak link in the textile value chain and modernization has been low due to more than 80% of units in powerlooms being run by job workers who have poor financial conditions as they are squeezed by master weavers and merchant exporters.

stage. This will enable consolidation of the industry and encourage upstream and downstream linkages. Extending the Cenvat chain required that the excise duty on hank yarn be removed. Uptil this budget, policy stipulated that spinning mills should supply not less than 50 per cent of the yarn marketed by them in the form of hanks for use by the handloom sector. As hank yarn was exempted from excise and sales tax it opened up possibilities for corruption, misdeclaration, etc, resulting in a significant portion of the benefits of exemption flowing to unintended beneficiaries.[25] The powerloom sector used to consume cotton yarn in hank form for the manufacture of yarn dyed fabric and extending excise duty to hank yarn will push up fabric costs and reduce powerloom competitiveness.[26]

Not surprisingly the Powerloom Development and Export Council of India Limited (PDEXCIL) has petitioned the government for lowering the excise duty element in the cotton yarn it buys to help it reduce the cost of production. Many powerlooms downed their shutters when their representation to the government for not being included in the excise net was not heeded to. Spinning mills and units using powerloom products including warping and sizing mills were affected and with the support of the largest textile interest groups, the Indian Cotton Mills Federation (ICMF), the government response to this was to allow the payment of the excise by traders without them first registering their units with the authorities. The Chairman of the ICMF, Mr. Chintan Parikh, went on record as stating: "The Cenvat chain completion would bring the vested interests (traders - master weavers) under the tax net. That is why they are resisting compliance with the new excise framework, which is very simple and has little scope for harassment"[27]. This relaxation of the registration requirement was to assure the powerlooms that they would not be harassed or subject to complicated procedures by the regulatory authorities and that compliance costs would be low. The 24 day strike by the powerlooms in Malegaon (Maharashtra) and in Tamil Nadu were called off on this assurance and this helped the credibility of the reform process. Reforms are credible only if agents believe that the changes will occur and alter their expectations and actions accordingly. In this case the successful handling of the resistance to the

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[24] A listing of the important policy changes are in D'Souza (2003).

[25] To safeguard the interests of handloom weavers, however, a rebate scheme is being introduced to compensate them for such duty incidence.

[26] This view has been expressed by M.S. Mathivanan, Chairman, Confederation of Indian Weaving Industry.

announced policy has strengthened the foundation for future attempts at reform. The successful handling of the strike by the powerlooms has helped build the focus of the industry on its common interests in the emerging liberalized trade regime rather than on issues particular to one segment or the divide between the organized and unorganized components within segments of the industry.

The plea for withdrawing excise exemption to SSI spinners was also accepted in the Budget. Many of the big mills who had outsourced their spinning or set up a separate unit for this activity due to the exemption. This did not allow economies of scale to be reaped in addition to inefficiencies as inventories and stock outs had to be managed which affected delivery schedules and lead times. The withdrawal of this exemption is yet another example of the shift in policy to rationalization in the industry and towards improvement in the level of organization. The Indian Cotton Mills Federation (ICMF) which is the interest group of the organized mill sector has been lobbying hard for a level playing field between large and small units[28] and as part of this had made a representation to government against hand processors who pay no duty whilst composite mills pay 16 per cent duty on fabrics. This differential in excise duty structure between independent process houses and the composite mills was also removed by the government in the last Budget. The ICMF in its campaign had claimed that "In the textile industry it is the survival of the un-fittest" and the government is veering round to this view as well in its recent textile policy announcements. As a result the interests of organized mill owners are on the ascendancy in the thinking and formulation of textile policies by the state.

From a political economy perspective an explanation for this is in terms of a sector's degree of production and asset specificity as measured say in terms of the size of fixed costs, size of firms' investment in their workforce, and firms' sensitivity to work stoppages. Those sectors with high production and asset inflexibility would have greater incentives to lobby the state for their policy preferences. Upto quite recently, however, the organized mills had this incentive but did not have sufficient leverage with policy makers to realize their preferences. The supply of policy by the

[27] Press release by ICMF, April 2, 2003.

[28] Prior to the budget the ICMF had even put out full page advertisements in the print media stressing the absence of a level playing field between large and small units.

political elite (political parties) and policy elite (intellectuals and bureaucrats) was influenced by their belief that unfettered market competition whilst it might stimulate growth, would increase poverty due to structural rigidities (i.e. sluggish responsiveness to price signals) as a result of market fragmentation, lack of access to credit, etc. The Indian government took on the mantle of a benevolent social guardian with control of the "commanding heights" of the economy (capital intensive, formal industry) and was guided by the goal of a socialist and equitable society.

Over the 1980s and early 1990s the distribution agents who controlled the market for the produce of the mills subverted state policy through subcontracting to powerlooms or investing in powerlooms and spinning units which they then controlled. With the phasing out of quotas in end 2004 the option of pursuing profitable markets will increase for those countries whose firms exhibit cost competitiveness across products which requires amongst other things that their industries exhibit high productivity levels. In India policy makers see this emerging scenario and have initiated measures to address the disadvantages due to the fragmented nature of the industry and the technological obsolescence prevalent in it[29]. Moreover, the fiscal crunch that has engulfed the state has limited its ability to baptize more mills into the public sector and subsidize them so as to promote the interests of organized labour. With the threat of cheap imports from neighbouring countries such as Sri Lanka and Bangladesh round the corner as international trade in textiles is on the verge of entering a quota-free regime, promoting a fit for survival textile industry has become a prerogative the state must entertain or face losing even more revenues and reducing its fiscal sustainability. In the process the interests of organized capital in the mills have been receiving favourable attention from the state.

Segment: Processing

The processing sector is one of the weak links in the textile supply chain. The processing industry can be divided into Hand Processors and Power Processors. The Hand Processing segment constitutes 82.5 per cent of the total number of processing units. Power processing units can be segmented into Independent Process Houses that do job work and those belonging to composite mills that process their own fabric – some 89 per cent of power processing units are Independent Processing Houses[30]. Unless fabric processing is improved domestically, there is the increasing possibility of foreign suppliers entering en masse into the domestic market once the quota regime goes as the better finish of their cloth will attract customers.

The growth of modern processing units was hampered because of excise policies that sought to give encouragement to hand-processing units. Moreover, wide-width processing machines are hardly produced domestically and need to be imported and the import duties on the components for producing these machines is high. In the processing sector the need is for huge capacities under one roof to handle bulk volumes and to ensure colour harmony and quality. Upto now processing different lots of a single shade in two-three units has been a drawback for garment manufacturers. New units with modern processing technologies such as softflow, balloon padding and colour communication systems as well as those processes that can add value to garments such as anti-microbial and wrinkle free finishes are required to support operations in a competitive environment. Without these value added processes being introduced besides the flood of imports, exports will continue to be dominated by grey fabrics which are then processed abroad resulting in foregoing foreign exchange that is valuable to the economy. The Ministry of Textiles has been encouraging the setting up of state-of-the-art processing facilities with the use of eco-friendly dyes and chemicals and quality assurance systems (ISO-9000 and ISO-1400 standards). The Ministry aims to set up 400-500 modern process houses and revive 50 modern process houses with an annual capacity of 10-12 billion sq. metres so as to increase the export of processed fabrics from the existing 46 percent to about 90 percent[31]. Again the upgradation in this segment is intended to promote integrated large units with an improved quality and lower cost structure and to phase out previously favoured hand processors. The earlier policy objective of

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[29] Speech of Atul Chaturvedi, Joint Secretary, Ministry of Textiles, at Seminar organized by Nodal Centre for Upgradation of Textile Education, N. Delhi, on WTO and Indian Textile Industry, May 2002.

[30] Independent processing houses primarily do job work with very few dedicated to a weaving and marketing set-up. They are mostly located in clusters and the labour is mainly contract labour and they use semi-continuous pre-dyeing processes or batch dyeing.

employment generation through discrimination in favour of hand processors is giving way to the favouring of skill intensive employment that accompanies modernization.

Segment: Garments and Retailing

Garments in India are typically manufactured in three stages[32] - (1) Cutting the fabric to patterns, usually by power-operated cutting machines, (2) making or Sewing the garment on sewing machines either foot operated or power operated. This is the most labour intensive part of the process and firms providing sewing services are called fabricators, (3) Finishing the garment by trimming, checking for dimensions, washing, ironing and packing. Khanna (1991) in his study had found that 89.7 per cent of the firms in his sample had resorted to subcontracting to fabricators and only 0.3 per cent did complete in-house production. Manufacturer-exporters subcontract to fabricators depending on the size of the order. The flexibility that subcontracting gives is at the same time an exclusion from the mass market for apparel exports which requires consistent quality across large volumes. In fact, successful garment exporting countries subcontract much less – Hong Kong apparel firms subcontract 11% of their output, in China it is 18%, 20% in Thailand, and 36% in Taiwan, compared to 74% in India. A requirement for meeting quality, consistency and tight delivery schedules is investment in assembly-line production and a focus away from reliance on independent fabricators.

A major reason for the non-occurrence of assembly-line manufacturing is the labour policy which is pro-organized labour. Retrenchment is not permitted and for an export oriented firm work stoppages or strikes can be disastrous. The Apparel and Handloom Exporters Association (AHEA) has for instance been arguing that the productivity of an Indian worker is amongst the lowest in the world.[33] A worker in an Indian factory typically makes 6 to 7 shirts per day whereas one in Sri Lanka, Nepal or Dubai makes 22 to 32 shirts a day. To remain competitive, the AHEA has been asking for disbanding the minimum wage culture and delinking wages from the consumer price index and the ushering in of labour reforms where wages are

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[31] See "Indian Textiles: An Overview", Compendium of Textile Statistics 2001, Office of the Textile Commissioner, Mumbai.

[32] See Khanna, S.R.(1991), Ch.7, and Kathuria, S. And A. Bhardwaj (1998) .

[33] This has been stated by Mr. Nariman F. Mogrelia, President, AHEA, on many occasions.

based on productivity. The Apparel Export Promotion Council has been arguing also that Indian garments are 20-30 per cent costlier than that of China and Bangladesh and as a result India is losing market share in the EU and Canada. The Confederation of Indian Industry's Textile Committee a couple of months ago has also argued for flexibility in labour laws[34]. The Government Exporters Association has also petitioned the National Labour Commission that work stoppages and strikes ought to be banned on the lines of similar provisions in Sri Lanka, Bangladesh, and some other Asian countries. Currently labour policy is the major claimed disincentive to operating in the factory mode according to major garment manufacturers as the other major disincentives such as reservations for small scale industry in the garment sector, inclusion of garment industry in the list of industries for automatic approval for FDI, removal of the 24 per cent cap on FDI, etc., have been addressed in the Textile Policy, 2000.

The dereservation of garments from the small scale industries (SSI) sector has been justified by the government on the grounds that "SSI reservation in India is handicapping the development of efficient economies of scale, while firms in countries such as China are able to compete effectively in the international and in the Indian market" (Government of India, 2003). The state thus posits the growth of the world market as increasingly penetrating and dominating the national economy and the only way the state can protect domestic agents against this is by reduced intervention and liberalization. Unlike in the past where the state actively promoted reservations in the small scale sector to prevent growing inequalities, "phasing out of SSI reservation in consultation with stake holders, would constitute an important element of policies that foster efficiency and productivity in India" (Government of India, 2003). If the prevention of the concentration of economic power and the promotion of a more equitable and socialist society was the major objective of economic policy making, the economic logic of productivity and efficiency has displaced that objective.

[34] Citing the Vietnam case, their Chairman, S.P. Oswal has argued for reformed labour laws in the garment sector which allow labour to work 12 hours depending on the need and an overtime to be calculated on a yearly basis, rather than on extra time after the completion of 8 hours on a daily basis.

The N.K. Singh Committee[35] whose report on the textile sector was accepted by the government argues that fiscal and other tax incentives given in the past to the SSI sector led to fragmentation of the textile sector and adversely affected modernization and the setting up of large scale production capacity so as to achieve economies of scale. Behind an import substituting industrialization strategy that enabled high tariff walls to be erected, reservations to small units and protection to segments of the industry was considered possible. As trade barriers crumble, financial capital mobility increases, and the internationalization of production proceeds, domestic industry can be swamped if policies do not enable competitiveness in the industry to be achieved. The integration of trade also means larger markets and firm size becomes important to establish a presence in such markets. As a result big organized firms are becoming more favoured by the state in economic policy making.

The garment sector is being visualized as playing a crucial role in sustaining employment in textiles due to its inherent labour-intensive nature. The Planning Commission envisages that the major contribution to increased employment will be in the Readymade Garment Sector with employment doubling in this sector between 2001 and 2006. Amongst the various sectors involved in cloth production the hosiery and mill sectors are expected to gain at the expense of the powerlooms. However, a central feature of the new automated lines in garmenting is the efficiency of the use of capital involved in machines and installations which has become more important than the cost advantage of sourcing labour[36]. With shorter product life cycles, it is more the difference in efficiency in the production cycle rather than wages that determines the cost of bringing products to the market. The focus of the industry is increasingly on inventory, stock outs and the compression of lead times which has merged the functions of manufacturing, garment sourcing, and retail space management. The future belongs to those firms that have not only an advantage in costs but also in quality, delivery and flexibility. It is those firms which not only

[35] See the "Report of the Steering Committee group on investment and growth, Chairman, Shri N.K. Singh, Member, Planning Commission", Ministry of Textiles, Government of India, 2003.

[36] In textiles the share of direct labour in production costs has fallen ten times in the last two decades as conventional product lines have given way to new automated lines according to comparisons made by the International Textile Manufacturers' Federation, Zurich.

modernize capital equipment but also induct managerial practices such as supply chain management that will reap the benefits of the liberalization of trade in textiles from end 2004. In fact, it is the specific nature of the supply chain in the textiles sector that determines the strategies for long-term competitiveness and the responses of firms and the state to the opening up of trade in textiles.

BUYER-DRIVEN SUPPLY CHAINS

In order to sustain existing markets the upgrading of local capabilities is important. However, in textiles the challenge really is not just in improving the capacity of firms to enable their access to new markets or maintain market share, but to spread the gains from this more widely to other especially non-exporting domestic firms. This is achieved through control over new activities at different levels in the supply chain (Gereffi, 1999) rather than the standard cost reductions or product differentiation strategies advocated for gaining competitiveness. There are broadly two different types of economic networks. Producer-driven commodity chains are those where large manufacturers play a central role in coordinating production networks. This is the case of capital and technology intensive industries such as heavy machinery, aircraft, automobiles, computers and semi-conductors. In buyer-driven commodity chains by contrast large retailers, branded marketers and manufacturers play a pivotal role in setting up decentralized production networks in a variety of exporting countries typically located in the developing world. This is usually the case with labour-intensive, consumer goods industries such as garments, footwear, toys, housewares, consumer electronics, and a variety of handicrafts. The main leverage in the buyer-driven chain is exercised by retailers, marketers and manufacturers through their ability to shape mass consumption via strong brand names and their reliance on global sourcing strategies to meet this demand.

In textiles the global retailing industry is dominated by big organizations[37] that are moving toward greater specialization by product (specialty stores that sell only one item such as clothes, shoes, or office supplies) and price (high-volume, low-

[37] The top 5 retailers in the US – Wal Mart, Sears, Kmart, Dayton Hudson, and JC Penney – account for 68 percent of all apparel sales in retail outlets. In the UK, Marks and Spencer and the Burton Group control over 25 percent of the UK market.

cost discount chains). The major impact of growing retailer concentration has been the tendency to augment global sourcing. In the 1970s and 1980s Hong Kong, Taiwan, and S. Korea were the major apparel producers that dominated global textile and clothing exports. In the late 1980s and 1990s mainland China and Sri Lanka began to be dominant and new suppliers emerged in Latin America, Bangladesh, Vietnam, etc. This was not so much a function of low wages as of industrial restructuring.

Initially counties like Hong Kong and S. Korea typically used export processing zones located near major ports that were involved in low wage assembly line production such as the assembly of cut parts into finished garments which required a low level of expertise. Slowly they moved up the chain to becoming full range package suppliers for foreign buyers. Whereas in assembly production there is industrial subcontracting where manufacturers provide the parts for simple assembly to garment sewing plants, in full package supply there is commercial subcontracting where the buyer-seller linkage between foreign merchants and domestic manufacturers allows for a greater degree of local learning about the upstream and downstream segments of the apparel chain. In full-package supply the supplying firm makes a product according to the design specified by the buyer, the product is sold under the buyer's brand name, and the supplier lacks control over distribution. The full package supply manufacturer learns much about the downstream (marketing side) and upstream (subcontracting parts of orders to others, logistical know-how required in finding parts (thread, buttons, etc) needed in final product) segments of the apparel commodity chain from the buyer and their expertise extends over the coordination of production, trade and financial networks that adds substantially to their ability to compete.

As these full package supply producers in Taiwan, S. Korea, Hong Kong and Singapore faced competition from lower cost exporters in S. Asia and the Caribbean and Latin America as well as suffered low realizations on their exports due to currency appreciation, they moved up the value chain to original brand name manufacturing (OBM) by integrating manufacturing expertise with the design and sale of their own branded merchandise. Hong Kong has been the most successful in shifting from full package supply manufacturing to original brand name manufacturing (Gereffi, 1999).

From this exposition of the commodity chain emerges the necessity for industrial upgradation which contrasts with the conventional wisdom that informs policy which is that "India's strengths lie basically in natural resources and factor endowments" (Kathuria and Bhardwaj, 1998, p. 24), which emphasizes the advantage of cheap labour that can be utilized in accessing the mass market for clothing through the advantages of an assembly-line, factory-type system of production. Hence, the focus of policy has been on issues such as dereservation of the garment sector and technological upgradation through installation of shuttleless looms and modern garment precutting and processing machines. This formulation of policy takes a narrow view of competitiveness when the industry is part of a buyer driven commodity chain – where the learning potential of moving beyond being pure suppliers of garments to organizing various elements of the chain through the construction of strategic alliances for the organization of production, logistics, etc (full package supply) to eventually taking over the distribution and retailing and marketing activities where the real value in the apparel chain lies (original brand name manufacturing) – is overlooked. As a result, the impact on labour absorption can only be transitory as the expansion of trade can only serve to augment incomes according to factor abundance – and as wages in labour intensive garmenting increase apparel production will shift to locations where labour is cheaper.

The history of the industry has been that migration of production took place from North America and Western Europe to Japan in the 1950s and 1960s, to Hong Kong, Taiwan and S. Korea in the 1970s and 1980s, and to S. Asia, Latin America and the Caribbean in the 1990s. As production has migrated to least cost locations, the only means of survival has been to move up the value chain into retailing and marketing whilst using manufacturing expertise gained to outsourcing production to least cost locations. In this way the industry moves from labour intensive production and export of dyeing assembly, or sewing standard garments to the information and technology intensive activities of design, retailing, marketing and logistics which contributes to a division of labour incorporating all phases of the commodity chain from raw material supply, through production, distribution and consumption.

INDUSTRIAL UPGRADATION IN INDIA

Of course, some textile firms in India are upgrading capability by not only diversifying product portfolios by moving into high value added clothing such as technical textiles (heat resistant, acid resistant, textiles) but also moving into new functional areas by expanding backward and forward linkages in the chain[38]. India has for some time been a destination for global retailers and Fortune 500 companies like Walmart Ikea, JC Penny, Nike, Reebok, Marks & Spencer to outsource their requirements. In the recent past joint ventures are also emerging in the textile and garment sector[39]. The emergence of branding is also taking place in the Indian market[40]. The major Indian brand is Park Avenue – a Rs. 100 crore brand. Raymond is in fact looking to acquire a European garment manufacturing unit along with its brand rights so as to export semi-processed fabric from India which could then be processed further in Europe and sold under a "Made in Europe" label. Branding which began in the menswear segment is slowly moving into the women's wear[41] and sportswear segments and the semi-formal and casual wear segments. The turnovers of most brands has remained stagnant at around Rs. 60 crore and consolidation in the branded apparel sector is on[42].

Price limitation has meant concentration of brands in the top 20 cities of the country and they have been unable to move into smaller cities and unleash a ready-to-wear culture there. The only group to break this trend has been Siyaram's whose brand Oxemberg began by targeting smaller cities and is only now moving to bigger cities and will be venturing for the first time into the Western region. The strong

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[38] Super Spinning Mills, a major cotton manufacturer has announced plans to forward integrate into knitting, processing, and garmenting, as well as backward integrating in its quest for high quality yarn. Prem Exports, a major garment exporter is venturing into spinning to source quality yarn and control costs.

[39] The Singapore based Crocodile International has set up a joint venture with Shivram Associates and Lee (of V.F. Corp. in the US) has a licensee agreement with Arvind Mills and is looking at the possibility of a joint venture.

[40] Marks & Spencer is the first global retail giant to open two stores in India.

[41] TCNS Clothing Company Pvt. Ltd from Bangalore for instance recently launched 'W', a workwear brand for women which is not a premium brand but focuses on the 'salwar suits' category. It has planned 4 stores in the capital city and plans to generate revenues of Rs. 100 crore by the end of the third year.

[42] Raymond Ltd is set to acquire Color Plus a top garment exporter from the country to Gap, Banana Republic, etc. and Reliance Industries Ltd. has entered into an alliance with Indus League for manufacture of its branded garments line Reance Likewise.

brands like Madura Garments and Raymond with a national presence will be able to withstand competition from imports with the opening up of trade but the high productivity-low price garments manufactured in countries like Sri Lanka (where a shirt can cost just $3) will make it difficult for Indian brands to move out from existing price segments into lower ones. To survive brands in India may have to join hands or move into newer areas such as ladies' wear or sportswear. This is a prime area of concern for India because if the textile industry is not able to move up the value chain to branding, then, it might end up a step ahead of just processing to becoming full-package suppliers. The impact of this development would be lower long-term employment, incomes, and foreign exchange earnings.

Some Indian firms have turned to shifting their production facilities to offshore factories which has resulted in triangle-type manufacturing. In this system of manufacturing US and EU buyers place their orders with Indian firms who in turn shift some of the production required to meet that order to an offshore factory. The shipping of the finished good directly to the foreign buyers from the offshore location completes the triangle. Raymond and Indian Rayon are setting up manufacturing facilities in China for instance and Grasim Industries of the Aditya Birla Group is exploring the possibility of following suit. In addition companies depending heavily on the US market are exploring the option of setting up manufacturing bases in the Caribbean countries to take advantage of the Caribbean Basin Initiative. Recently Mr. Kanshiram Rana, the Union Textile Minister, visited Mauritius to explore the possibility of using Mauritius as a gateway to potential African markets once the MFA is dismantled in 2004. Similarly, the Powerloom Development and Export Promotion Council is exploring West African countries such as the Ivory Coast, Benin, Togo and Senegal so as to sustain markets for powerloom fabrics. Mozambique recently invited Indian textile and garment manufacturers to take advantage of its duty and quota free access to the US market under the Africa Growth and Opportunity Act for exports. The shift of the manufacturing of fabric and garments offshore has the potential of reducing the employment generation capacity of the textile sector and will deepen the poverty that the labour force may experience.

A fall out of this triangulation process is that eventually negotiations at the WTO on services and on textiles will become more interlinked. The Cabinet

Committee on the WTO had as recently as the beginning of June, 2003, put on place a roadmap for services negotiations and mandated the Commerce Ministry to open up nine services[43], but this list did not include retail trading[44]. This is expected as the ruling BJP is considered a party of the trading community which considers liberalization of this sector as resulting in an end to neighbourhood stores as large retail chains will offer products at lower prices and under one roof. As a result Arvind Mills Ltd. which has decided to adopt the Mauritius route in a joint venture[45] plans to undertake cash and carry to institutional buyers both in India and abroad but cannot undertake retail trading in India due to policy restrictions on retailing by foreign joint venture companies. The company is at the moment seeking export markets but as trade liberalizes there will be pressure on government domestically to liberalize retail trade services as well. Unlike in the past when the US was pressurizing for the inclusion of services in the Uruguay Round and India had pressed for concessions in the GATS and TRIPs which were linked to the developed country concessions in agriculture and textiles, it is more likely that domestic interest groups will begin to pressurize the government for favourable negotiations that cut across sectors.

CONCLUSION: INTERESTS, POLICY, AND CHANGE

As trade liberalization proceeds the state is not in retreat but is pro-actively involved in restructuring to make the industry more competitive. This is not only in terms of tax structure and integration, technology upgradation, negotiating market access, etc. but also in terms of nudging the various textile and garment associations to change. Recently for instance the Union Textiles Ministry has written to the Indian Cotton Mills' Federation (ICMF) to take the initiative and form a representative body

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[43] These included financial services, construction and engineering, computer and related services, architecture, telecommunications, health, accounting, tourism, and maritime services.

[44] Other services not included are audit, legal, postal and courier services, commission agent services, and franchising activities.

[45] The Lalbhai group's Arvind Mills Ltd. (with a turnover of Rs. 1,479 crore in 2002-03) has announced the setting up of a joint venture with the Mauritius based Ganesha Ltd. an overseas corporate body. The joint venture is to be based in Mauritius and will undertake export and import of readymade garments in segments such as sports wear, jeans wear, and formal wear. The Lalbhai's have committed to an annual export turnover of $5 million to the government while seeking permission from it to adopt the Mauritius route for the joint venture company.

of all sub-segments within the textile industry. The prompt for this comes from the WTO requirement that any anti-dumping inquiry can be contested by only those bodies which represent 25 percent of a particular industry. As only a bigger industry association will have the mandate to fight WTO complaints the Ministry has taken the first step in moving towards the formation of an umbrella body. There is also the expectation that multinational garment sourcing companies will extend the insistence on the adoption of fair labour standards and environmental standards upstream to those industries supplying raw materials to garmenting units[46]. Government intervention in the recent past has attempted to modify and create institutions that will enable industrial growth and development in the textiles and apparel sector[47].

Whilst the state has been reaching out to collaborate with the industry, industrial associations that thrived by manipulating the system to gain access to quotas or to shift the tax burden down or up the value chain are slowly realizing the benefits of industrial upgradation and the need for domestic policy changes such as dereservation, etc. On trade issues, the various associations are also moving away from adopting a segmented approach which was a function of the market orientation of the producers. For instance, with the decline in global tariffs there is a counter pressure to reduce India's textile tariffs and only recently is there some agreement in the industry as to what it is willing to offer given the opposing interests of the exporters and those who cater to the domestic market and face the increased import competition. In March 2001 the EU had removed quotas on imports from Sri Lanka in return for it bringing down a range of tariffs and binding all its tariffs for textiles and clothing. The bilateral pact gave Sri Lanka an early advantage in the lucrative EU market that Indian companies are trying to enter and was seen in India as a signal by the EU that it should lower its tariffs if it wants better access to the EU market. This event followed incessant initiation of anti-dumping investigations by the EU against

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[46] The International Textile Garment and Leather Workers' Federation (ITGLWF) recently visited Tirupur and Coimbatore to study the operation of the code of conduct in labour practices being adopted by global garment sourcing companies.

[47] The Ministry of Textiles after consulting with various textile associations is setting up a National Institute of Textile Management in Coimbatore to train professional managers to meet the challenges of industry in a changed scenario. This will have an intake of 60 students per year and tie-ups with the College of Textiles, University of Manchester, and the North Carolina College of Textiles and Sciences, USA, are being explored.

Indian textiles that the industry viewed as arm-twisting by the EU to reduce its tariff levels on textiles. After comprehensive meetings the Clothing Manufacturers Association of India was able to eventually suggest reduced tariffs to match the Sri Lankan tariff rates[48]. That success in trade is linked to domestic bottlenecks is also increasingly voiced in negotiations between associations and the government. The Chamber of Textile Trade and Industry has been emphasizing with the government that even a decade after the initiation of reforms procedural issues in respect of movement of goods from one place to another and their supervision by the Central Excise authorities continues to cause delay and pushes up transactions costs which they estimate at 15 percent of manufacturing costs for exporters[49].

There is a break from the past when industrial associations thrived by manipulating the system segment wise and the state allowed the growth of an inefficient industry due to an overriding concern for protectionism so as to mitigate inequality. In the tussle between powerlooms and the mills for instance, the state favoured powerlooms by input subsidies of various kinds such as low wages (no firing costs) and power tariffs and gave price supports by ensuring the sector was by and large out of the excise net. This is partly due to the state's self-conscious use of economic policy to prevent the concentration of economic power in the private sector and to restrain the emergence of big capital. This inefficient redistribution – inefficient because it discouraged the relocation of productive resources to sectors like the mill sector where they could be utilized more productively – had the impact of encouraging entry into powerlooms and contributing to the growth of the sector in a way that more efficient redistribution such as lump-sum transfers would not be able to do as they would create a competition for these transfers. As the size of the powerlooms in the textile sector expanded the influence of this sector on policy

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[48] Sri Lanka had notified the WTO of bound rates of duty of 0% for raw materials, 5% for fibre and yarn, 10% for fabrics, and 17.5% for clothing products, except for a limited range. The Clothing Manufacturers Association of India has suggested import tariffs of 5% for fibres, 10% for yarns and fabrics, 15% for made-ups, and 20% for garments and has specified that this should be accompanied with a commensurate reduction in the specific rates of duty. The Association has also asked for a reduction of 50% in the tariff levels of the US and the EU which would bring down tariffs on textiles in the EU to around 8% and in the US to around 15%.

[49] The Cotton Textile Export Promotion Council (TEXPROCIL) has been arguing that the unfavourable exchange rate of the Indian rupee vis-à-vis competing countries like Pakistan, Sri Lanka and Indonesia where the disparity was around 5-6% in the past is over 20% currently and this adversely affects exports.

gained ground and it was able to keep policy focussed more on redistributions. In political economy it is standard to argue that the more specific factors are to a sector, the more we should see lobbying and rent-seeking. By contrast in the case of powerlooms, factors are less specific and more mobile and it is precisely to prevent the relocation and migration of such factors that the redistributive policy was inefficient – it is to motivate potential entrants to stay that the policy needs to be an inefficient redistributive one. The more organized mill sector where factors were more specific instead became a target for raiding by the state which imposed onerous laws with high firing costs on it as well as duties on fabrics.

However, incomes earned by powerlooms are constrained due to their inability to capitalize on scale economies due to policy restrictions. As markets grow and the export market becomes more lucrative, powerlooms who benefit from these inefficient transfers begin to trade this off with the gains from relatively higher incomes if dereservation takes place. Of course, there is a lottery to participating on more equal terms with the organized mills in a liberalized environment – either the powerlooms are able to restructure and obtain those higher incomes or they may have to shut down. It is the better organized and more innovative powerlooms whose expected gain from liberalization is larger, who are gradually becoming more in favour of the competition that comes with liberalization and are willing to take on the loss of inefficient transfers. The interests of these better organized powerlooms have begin to align more with the interests of the organized mills and a loose coalition between them is sufficient to pressurize policy makers for a regime change. The National Textile Policy, 2000, and the recent budgetary statements with reference to the textile and garment sector may be viewed in this light. The preferences of agents in the textile sector for certain institutional regulations and the associated transfers can therefore change as the income earning potential of the activity changes. Institutions are important to mediate outcomes but in this case it is the underlying change in expected income earning that generates a shift in preferences for institutional change. The state is not autonomous from this – given that textiles is a leading sector in the economy it realizes that the inability to restructure now and take advantage of the emerging market could only mean less revenues and foreign exchange earnings for it. Due to its overwhelming economic importance the economic policy interests of the state and the dominant actors in this leading sector are more or less coincident. Unless there is a revival of the leading sector the state loses the ability to fund itself and service its constituents. The message of liberalization is that there is no point in killing the goose that lays the golden eggs. It is by now quite clear to interests groups and policy makers in India that the world of textile trade in 2005 will be a much changed one and that to reap the benefits from participating in that world the priority is a restructuring and upgradation of domestic industry and that investing time and resources on multilateral negotiations will only be meaningful if that is accomplished successfully.

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