5.3.4 Financial Repression in Myanmar

Myanmar is a country characterized by what has become known as financial repression, which is equated with controls on interest rates, and particularly controls which result in negative real interest rates on deposits. In spite of negative real interest rates, deposits with the banks increased over the three years from 1999 to 2001. This is due to two major factors. One is that there are people who are afraid of lending to fund management companies or financing brokers because of high risks attached, since informal lending is not under legal control. They are content with low interest rates offered by the banks, though they are negative real interest rates. Second is that the majority of depositors with the banks deposits for transaction purpose rather than for interest income. Transactions by cash are becoming more and more difficult and transactions through banks by account transfers or by checks are more convenient.

The main instrument of repression is general interest rate controls, although exchange rate controls, high reserve requirements for commercial banks and institutional repression also play a significant role. Two main forms of administered interest rate controls may be identified as

- Ceilings on nominal deposit rates
- Ceilings on nominal loan rates

In Myanmar, both of these interest rate controls can be found. Interest rate controls generally seem to be imposed to encourage investment. If interest rates to borrowers are kept low, it is thought that this would increase the number of projects with positive net present value when discounted at borrowing rates, and would therefore increase the rate of investment. The ceilings on deposit rates are thought to produce the same effect indirectly, because if banks obtained funds cheaply, they will be able to lend to businesses at low interest rates.

But the ceilings and controls create distortion in the price of capital by producing below-equilibrium real interest rates which do not reflect the opportunity costs of capital. Inefficient investment allocation occurs because of that distortion, since investment is in low-return projects is promoted. Also, a shortage of credit supply means that banks tend to lend only to known borrowers. Small and unknown borrowers are denied credit in favor of known and large borrowers when credit is rationed. Hence, funds for investment are not only inefficiently allocated but smaller borrowers are subject to discrimination.

In order to increase the lending to SMEs, first of all, training should be provided to credit officers. Secondly, it is also important to establish business associations that can act as conduits between formal financial institutions and SMEs. Thirdly, the formation of insurance organizations that back SME financing through the banks is also important. But the formation of insurance organizations under the existing legal frameworks is not possible in the short time. Hence, the establishment of business associations that can help finance SMEs with bank credit should be encouraged. These business associations should be independent. Foreign experts should be able to

participate in the activities of these business associations for the transfer of technology necessary for evaluating and assessing the businesses of SMEs. Research on and analyses of SME activities should be constantly conducted. Fourthly proper training to SMEs to allow them to carry out business plans and feasibility studies should also be provided through these business associations. The support by these business associations regarding individual small and medium enterprises should be important for credit decision by bank, so that SME financing through the banks will be faster and more funds can be channeled to these enterprises.

5.3.5 Recommendations Regarding the Formal Financial Sector & SME Financing

(1) First of all, the financial authorities should direct the banks to categorize loans not only by sector but also by size of borrowing enterprises. There has been no intention on the part of the authorities so far to direct the banks to categorize loans by sector on a continuing basis. Such intention is important for the evaluation of not only the financial sector but also the financing situation of different economic sectors and different sizes of organizations. If this is done, a directive can be issued by the government to encourage financial institutions to channel more of loanable funds to key economic sectors and also to SMEs that play an important role in the economic development.

(2) Training programs to the bank officers should be provided to enhance efficiency in loan provision and in credit decision.

(3) Understanding between the banks and business associations (that should be acting as conduits between the banks and SMEs) should be built. It is also important to encourage the banks to adopt evaluation of business associations as one of major criteria in making credit decisions.

1) Proper training should also be provided to SMEs by business associations to constantly evaluate their business performances to make business plans to assess the profitability of their existing as well as potential future businesses. Further training and encouragement should be provided to SMEs to keep proper financial statements that reflect the actual business situation and to be able to take corrective actions if weaknesses are found.

2) Proper training should be provided to business associations so that they will be able to technically evaluate the potential of projects to be undertaken by SMEs and also to evaluate their business activities. These business associations should also be able to conduct necessary feasibility studies and set proper consultancy for potential SMEs, so that these firms may be able to have an easy access to debt financing through the formal financial sector.

3) Foreign assistance to provide technical training and share experiences with business associations and SMEs should be arranged by allowing the participation of foreign experts in the activities of business associations in conducting research, analyses and feasibility studies and in setting proper ratings for individual SMEs and giving technical training to SMEs.

(4) Banks should be allowed to raise lending rates say from 15% to 18~20% per annum on loan provisions to SMEs. This could encourage the banks in lending to SMEs. It would not discourage SMEs from borrowing from the banks since they would be able to have debt financing more easily from the banks at interest rates lower than those in the informal financial sector.

(5) Measures should be taken to develop the leasing industry, which can become one of major sources of SME financing. But repayment plans of leasing companies should be replaced by those that are more flexible and borrower-friendly. Banks should be encouraged to set up subsidiaries to undertake leasing activities for SMEs. Leasing periods should be extended to two to three years for SMEs in the industrial sector. The down-payment, which currently is 30%, should be reduced to for example 10%.

(6) Development of venture capital funds is also important, since they can become one of the major sources of long-term financing for SMEs in Myanmar before the development of the equity and bond markets. Long-term loans are rarely found in any of banks that currently exist in Myanmar. Short-term loans are not able to effectively help develop SMEs in the industrial sector: hence, the loan period should be based on the potential of the business and the sector in which the borrower is involved.

5.3.6 Recommendations Regarding Informal Financing

It was also found that although the informal financial sector is flourishing, it does not contribute towards the development of the nation because of high interest rates. Interest rates charged in the informal sector are normally higher than those in the credit-rationed formal sector. Financial liberalization with the removal of interest rate ceilings in the formal sector can reduce the interest rate differential between the informal and formal financial sectors. Since the interest rate in the formal sector is 15% per annum and interest rates in the informal sector vary from 36% to 72% per annum, the big gap is found between the prevailing interest rates in the two sectors. The15% interest rate in the formal sector is set as the ceiling by the financial authorities hence financial institutions in the formal financial sector cannot charge interest rates above 15%. Thus, financial

liberalization could help reduce the interest rate differential between the two sectors. The reasons for high interest rates in the informal sector are as follows.

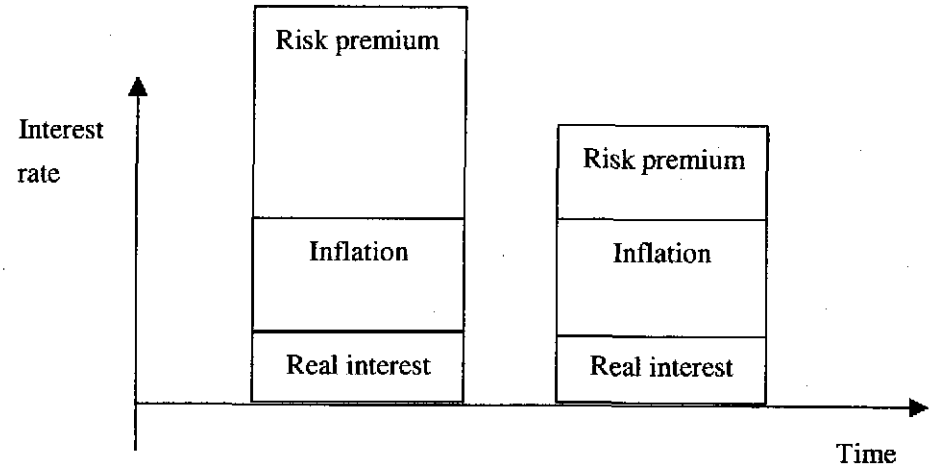
(1) High risk of default. (Loan provisions in the informal financial sector are believed to have higher risk attached. Personal loan provision in the informal sector requires land, properties, gold, etc. as collaterals. (If a borrower borrows money through the financing brokers in the informal sector, the borrower needs to collateralize land, properties, gold, vehicles, etc.) The borrowers are to leave the documents associated with their land or properties with the lenders, who need to thoroughly scrutinize to see if the documents are genuine. There are quite a few cases that borrowers come up with fake documents. Hence, due to a high risk of default, interest rates are set high.)

(2) Less willingness to pay back on the part of the borrowers (moral hazard problem). Since interest rates are high, the borrowers who are unable to pay back loans on time become completely unable or unwilling to pay interest which can then be two or three times the principal amount of loans.

(3) Not many people can act as financing brokers or informal lenders, since the ones who want to must have local knowledge and access to local situation. Consequently, a handful of people are monopolizing the informal financial market.

Most importantly, the authorities should take every possible measure to bring down the rate of inflation, since inflation and risk premium account for a large part of nominal interest rates. Inflation could be reduced by cutting government expenditure and through other fiscal measures as well as monetary policy. Since inflation cannot be reduced in a short period of time, policy interventions for transparency in the formal and informal financial sectors are necessary in order to help reduce the risk premium. One of the possible policies to reduce risk premium is to oversee, supervise and regulate informal lending activities. With the supervision by the financial authorities, the risk attached to the informal financial sector will be reduced to some extent. This is not usual in other countries and it can be one of financial innovations. There should also be supervision of commercial activities of fund management companies, which are actually small and medium enterprises seeking investment from members of the public by entering into bond-like loan contracts with them. They receive loans from the public and engage in other commercial businesses. If their activities are supervised efficiently, risks attached to loans provided to these fund management companies will be reduced. This can lead to reduction of risk premium. A possible result of the reduction of risk premium is shown as follows.

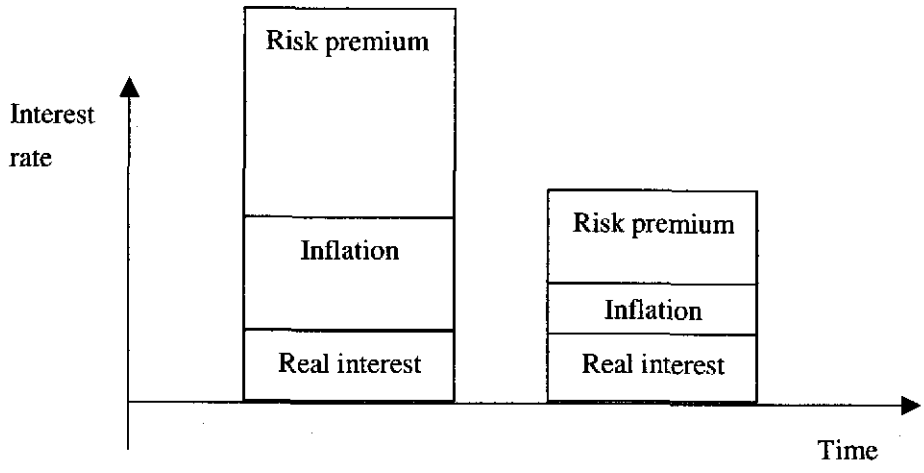
Figure 5- 38 Risk Premium



Source: JICA Study Team

Policies targeting the reduction of inflation can lead to the reduction of nominal interest rates as follows.

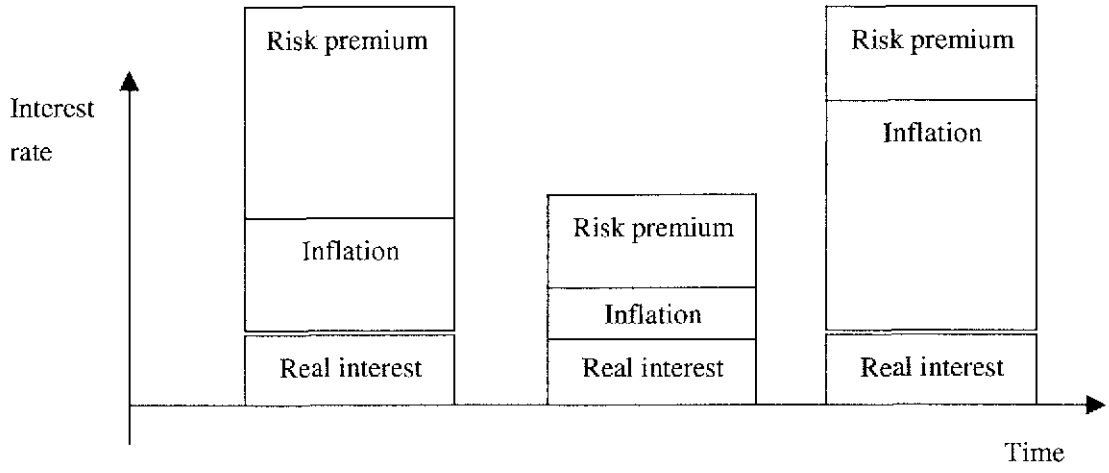
Figure 5- 39 Reduction of Risk Premium



Source: JICA Study Team

But, it should be noted that if policies and measures for reducing inflation are not taken, policies adopted for the reduction of risk premium may be in vain since a higher inflation can keep interest rates high as shown below.

Figure 5- 40 Not Reduction of Risk Premium



Source: JICA Study Team

Hence, policies for inflation reduction should be taken in line with policies for reduction of risk premium.

5.3.7 Roles of UMFCCI and Business Associations in SME Financing

UMFCCI and business associations could be taking the role of business association to help finance SMEs in Myanmar. The activities of UMFCCI have been limited to primarily the provision of technical training to different industries like timber, garment-manufacturing, etc. This is important, but focusing on assistance in debt financing to small and medium enterprises is also important. Benefits of this arrangement are as follows.

- SMEs wanting to get low-interest loans from the banks will definitely register at business associations under UMFCCI as members, since it is the good way they can get loans from the banks. Hence, an immediate benefit to UMFCCI is that its membership will be enlarged.
- Business associations will conduct surveys and feasibility studies of business activities of SMEs wishing to get financing from banks. Their business activities will be consulted by these business associations acting as financial intermediaries between SMEs and the banks. As SME's business activities will be constantly consulted, they will be more systematic, transparent and involve fewer risks.
- These business associations should evaluate SMEs and give recommendations to the banks if SMEs want, which will use them as one of major criteria in credit decision-making.
- These business associations under UMFCCI should provide financial management

training to SMEs, so that they will be able to draw up proper business plans, conduct feasibility studies and perform financial ratio analyses to assess their existing as well as future businesses. This can help them not only in obtaining bank loans but also in dealing with foreign partners when they grow and enter into partnerships or joint venture businesses with foreign companies.

In order to fulfill the above functions, business association and UMFCCI should have following teams.

- A research and analysis program which will conduct research on and analysis of the activities of small and medium enterprises on a continuing basis
- A training program which will provide sophisticated financial and management training to small and medium enterprises to enable them to draw up business plans and conduct feasibility studies on their existing as well as future potential businesses and also to enable them to perform efficient financial management by themselves
- A liaison program which will liaise small and medium enterprises with financial institutions in the formal financial sector.

Based on the findings of the research and analysis program, consultancy and recommendations will be made by the central board of respective business association. These consultancy and recommendations are to be conveyed to financial institutions through the liaison program. Financial institutions will take these consultancy and recommendations into consideration in the credit decision process.

5.3.8 A Proposed Action Plan for the Development of SME Financing in Myanmar

In-depth analyses of various problems faced by SMEs in Myanmar are made in the main body of this report. Based on the outcome of the analyses, the examples of proposals for an action plan for the development of SME financing in Myanmar is as follows.

Table 5- 31 A Proposed Action Plan for the Development of SME Financing in Myanmar

	Urgent target	Medium-term target	Long-term target
Directives or instructions by the Central Bank	Issue directives or instructions to private and semi-private banks to classify borrowers by industry and size and assign priorities.	Issue directives or instructions to private and semi-private banks to raise the ratio of SME lending and to governmental banks to expand lending to SMEs and not to focus so much on personal and housing loans.	Direct or instruct financial institutions to lend certain ratios of their loans to SMEs in priority industries, which are important for the development of the nation.
Flexible loan-to-		Although the Central Bank	

value ratios		instructs banks to lend 50% of collateral value, the loan-to-value ratio should not be fixed in such a manner. The amounts of loans should also be based on the future cash flows of the business.	
Enhancement of the functions of industrial associations that act as conduits between SMEs and banks	UMFCCI and industrial associations should enhance research/analysis, educational and liaison programs that will help business financing.	-Study SME business activities on a continuing basis. Offer consultancy and advice to the credit dept of banks. -Encourage banks to adopt industrial associations' assessments as a credit criterion.	
Educational programs	-Educate bank employees in loan application evaluation, credit screening criteria, etc. The focus is to educate that credit decision should be based also on future cash flows of the business as well as collateral value. -UMFCCI and industrial associations should train SMEs on how to evaluate the profitability of present and future businesses and to assess performance on a continuing basis. Training and support for SMEs to prepare accurate financial statements are also needed. -Training should be provided also to the industrial		

	associations so that they can make technical evaluation of the potentials of projects being planned by SMEs. UMFCCI and industrial associations should offer consultancy to SMEs so that they can conduct feasibility studies, etc. and can borrow from the formal financial sector.		
Leasing company(ies)	Allow borrowers to pay interest monthly and principal at the end of the contract period. The term of leasing for SMEs in manufacturing should be extended to two to three years. The down payment of 30% should be reduced to, for example, 10%.	Encourage the founding of more leasing companies.	
Venture funds		Venture funds should become major sources of long-term capital for SMEs. At present, none of the banks in Myanmar extends long-term loans.	
Insurer (credit guarantee institution)			Establish an insurer (a credit guarantee institution) that can absorb the risk of defaults.
Foreign assistance	Accept foreign assistance in education and training of industrial associations and SMEs.	Include foreign experts in the training of industrial associations and SMEs.	

Source: JICA Study Team

Appendix

Table 5-32 Questionnaires for SME Financing Research

1	Type of business	1	☐	Construction
		2	☐	Fishery
		3	☐	Agriculture
		4	☐	Mining
		5	☐	Petroleum
		6	☐	Timer
		7	☐	Foodstuff
		8	☐	Export/import
		9	☐	Brokerage
		10	☐	Hotel, tourism and ticketing
		11	☐	Advisory (Legal & Business)
		12	☐	Accountancy & auditing
		13	☐	Beauty parlor
		14	☐	Store
		15	☐	Restaurant
		16	☐	Foodstuff production
		17	☐	Production of construction related products
		18	☐	Production of chemical products
		19	☐	Electrical products production
		20	☐	Consumer products production
		21	☐	Production of timber related products
		22	☐	Production of foodstuff
		23	☐	Textile & garment production
		24	☐	Footwear & parts production
		25	☐	Others
2	Type of company	1	☐	Proprietorship
		2	☐	Partnership
		3	☐	Private limited
		4	☐	Public
3	Number of workers	1	☐	1 ~ 19
		2	☐	20 ~ 100
		3	☐	Above 100
4	Equity	1	☐	Less than 10%
		2	☐	10~ 19%
		3	☐	20~ 29%
		4	☐	30~ 39%
		5	☐	40~ 49%
		6	☐	50~ 59%
		7	☐	60~ 69%

		8	70~79%
		9	80~89%
		10	90~99%
		11	100%
5	Type of equity	1	Relatives' contribution
		2	Friends' contribution
		3	Contribution both from relatives & friends
		4	Own equity
6	Reason to borrow	1	To start new business
		2	To meet short-term financial needs for existing business
		3	To buy trade-related stocks
		4	Others ( )
7	Source of debt financing	1	From banks
		2	From relatives
		3	From friends
		4	From informal market
		5	Others ( )
8	Number of times loans acquired	1	1 time
		2	2 times
		3	3 times
		4	4 times and above
9	Source of highest amount of loan acquired at one time	1	From bank
		2	From somewhere other than bank
10	Name of bank from where loans are normally acquired	1	Myanmar citizens bank
		2	Cooperatives bank
		3	Yadanabon bank
		4	First private bank
		5	Myawaddy bank
		6	Yangon city bank
		7	Yoma bank
		8	Myanmar oriental bank
		9	Myanmar may flower bank
		10	Tun foundation bank
		11	Kanbawza bank
		12	Asia yangon bank
		13	Myanmar universal bank
		14	Asia wealth bank
		15	Myanma industrial development bank
		16	Myanma fisheries development bank
		17	SiPinTharYarYe bank

		18	Cooperatives promoter bank
		19	Cooperatives farmers bank
		20	Inwa bank
		21	MEB
		22	MICB
		23	Myanma agricultural development bank
11	Collateral given for loan	1	Gold
		2	Other jewelry
		3	Real estate
		4	Land and building
		5	Property
		6	Business
		7	Vehicle
		8	Trade-related stocks
		9	Machinery
		10	Others ( )
12	% of value of collateral as loan acquired	1	Less than 10%
		2	10~29%
		3	30~49%
		4	50~59%
		5	60~69%
		6	70~79%
		7	80~89%
		8	90~99%
13	Waiting period to get loan after application	1	Within 1 week
		2	1~2 weeks
		3	2~3 weeks
		4	3~4 weeks
		5	1~2 months
		6	2~3 months
		7	3~6 months
		8	Over 6 months
14	Reason to borrow from bank	1	Friends & connections exist at the bank
		2	Less paper works required
		3	Quick
		4	Good public relations
		5	Others ( )
15	Interest rate if borrowed from another source other than bank	1	1%
		2	2%
		3	3%
		4	4%

5 ☐ 5%
6 ☐ 6%
7 ☐ Above 6%

16 Collateral given if borrowed from other source

1 ☐ Gold
2 ☐ Other jewelry
3 ☐ Real estate
4 ☐ Land and building
5 ☐ Property
6 ☐ Business
7 ☐ Vehicle
8 ☐ Trade-related stocks
9 ☐ Machinery
10 ☐ Others ( )

17 % of value of collateral as loan acquired from other source

1 ☐ Less than 10%
2 ☐ 10~29%
3 ☐ 30~49%
4 ☐ 50~59%
5 ☐ 60~69%
6 ☐ 70~79%
7 ☐ 80~89%
8 ☐ 90~99%

18 Reason to acquire loan from another source other than bank

1 ☐ Difficult to borrow from banks
2 ☐ Do not have enough collaterals
3 ☐ Loan application rejected by banks

19 Maximum period of loan acquired at one time

1 ☐ Less than 1 year
2 ☐ 1 ~ 2 years
3 ☐ 2 ~ 3 years
4 ☐ Above 3 years

20 Business situation

1 ☐ Content only with existing business
2 ☐ Want to expand existing business
3 ☐ Want to do new business

21 To expand current business or do new business

1 ☐ Need additional funding either as equity or debt financing
2 ☐ Do not need funding since reserves and retained earnings are adequate

22 To raise required fund

1 ☐ Get funding from relatives
2 ☐ Get funding from friends
3 ☐ Borrow from relatives
4 ☐ Borrow from friends
5 ☐ Borrow from banks
6 ☐ Borrow from other informal sources

23 Reason not to borrow

- 1 ☐ Difficult to borrow from banks
- 2 ☐ Do not have enough collaterals
- 3 ☐ Do not want to pay interest
- 4 ☐ Have partners who want to invest
- 5 ☐ Others ( )

24 Type of new businesses interested to start

- 1 ☐ Construction
- 2 ☐ Fishery
- 3 ☐ Agriculture
- 4 ☐ Mining
- 5 ☐ Petroleum
- 6 ☐ Timer
- 7 ☐ Foodstuff
- 8 ☐ Export/import
- 9 ☐ Brokerage
- 10 ☐ Hotel, tourism and ticketing
- 11 ☐ Advisory (Legal & Business)
- 12 ☐ Accountancy & auditing
- 13 ☐ Beauty palor
- 14 ☐ Store
- 15 ☐ Restaurent
- 16 ☐ Foodstuff production
- 17 ☐ Production of construction related products
- 18 ☐ Production of chemical products
- 19 ☐ Electrical products production
- 20 ☐ Consumer products production
- 21 ☐ Production of timber related products
- 22 ☐ Production of foodstuff
- 23 ☐ Textile & garment production
- 24 ☐ Footwear & parts production
- 25 ☐ Others

25 Amount of funding required to start new business or to expand existing business

- 1 ☐ Less than Kyats 0.1 million
- 2 ☐ Kyats 0.1~0.4 million
- 3 ☐ Kyats 0.5~0.9 million
- 4 ☐ Kyats 1.0~2.9 million
- 5 ☐ Kyats 3.0~4.9 million
- 6 ☐ Kyats 5.0~9.9 million
- 7 ☐ Kyats 10.0~19.9 million
- 8 ☐ Kyats 20.0~49.9 million
- 9 ☐ Kyats 50.0~99.9 million
- 10 ☐ Kyats 100.0~200.0 million
- 11 ☐ Above Kyats 200.0 million

26 Preferred period for loan

- 1 ☐ Less than 1 year

	2 ☐	1~2 years
	3 ☐	2~3 years
	4 ☐	3~5 years
	5 ☐	5~10 years
	6 ☐	Above 10 years
27 For debt financing	1 ☐	It is the best to borrow from banks
	2 ☐	It is the best to borrow from relatives
	3 ☐	It is the best to borrow from friends
	4 ☐	Others ( )
28 Convenient period of loan	1 ☐	Less than 1 year
	2 ☐	1~2 years
	3 ☐	2~3 years
	4 ☐	3~5 years
	5 ☐	5~10 years
	6 ☐	Above 10 years

Source : JICA Study Team

5.4 A Master Plan for Development of Myanmar Garment Industry

5.4.1 Present Status of Myanmar's Garment Industry

(1) Garment manufacturers

Since the government statistics on garment-manufacturers are not made public, this study has based its estimates on data obtained from Myanmar Garment Manufacturers Association (MGMA). According to this source, there are an estimated approximately 400 garment-manufacturing plants that are incorporated as private-sector companies (excluding household businesses, including foreign investment). They are engaged primarily in CMP exports. An MGMA survey puts the ratio of small- and medium-sized enterprises with 300 or fewer employees at approximately 40%. The structure of the supply market of textiles and garments in Myanmar is as follows:

1) Foreign joint companies (which account for approximately 50% of exports) are the largest group of businesses engaged in the production of garments primarily for exports. They are followed by Myanmar businesses engaged in sewing on commission (approximately 40% of exports) and some SOEs (approximately 10% of exports). Since, the capability to develop materials and marketing and financial capabilities are not strong enough, 90~95% of exports are made under the CMP scheme at local factories. Only a handful of companies, including the Crocodile Group run by a Chinese Myanmar are engaged in FOB exports.
2) There are approximately 22,000 mostly household or very small tailors, who make longyi, Myanmar's traditional costume, with fabrics brought in by the customer. Longyi is a very simple cylinder-shaped skirt. Except for very large sizes, they usually come only in one size for men and one size for women. Because of the simplicity of longyi, garment-making skills in trousers have hardly developed in Myanmar. Such skills began to develop only during the first half of the 1990s, when CMP exports began.
3) Yarns and fabrics for longyi are made mostly by SOEs (approximately 35 companies) and some private enterprises. Production, however, has been declining as domestic demand is shifting toward low-priced imports. There are no full-scale investments by foreign companies in the yarn and fabric-making sector for the manufacture of materials for exports. According to Chinese data (Southeast and South Asia News, December 2001), one Chinese and one Myanmar private enterprises are operating two spinning (yarns) companies each, while three Chinese-affiliated spinning (yarns) companies are under construction. The output of these companies is and will be all

for domestic consumption. Although raw cotton grown in Myanmar is easier to break during spinning than imported Chinese raw cotton, it costs only one-third of the cost of Chinese raw cotton. By using inexpensive labor and blending inexpensive Myanmar raw cotton with Chinese cotton, it is possible to produce cotton yarns which are some five percent lower in price than Chinese yarns. At the same time, some private-sector spinning companies have begun to import weaving machines and technology from China to produce fabrics made of imported cotton yarns and synthetic fiber yarns. This is because while longyi made of domestic cotton is worn in the provinces, the preference of urban consumers is shifting to longyi made of imported raw cotton and synthetic fibers.

Table 5- 33 Businesses Engaged in Myanmar's Textile and Garment Enterprises

Characteristics	Spinning (yarn)	Weaving (fabric)	Garment-manufacturing (clothing)
Factor	Capital-intensive	Capital-intensive	Labor-intensive
Economies of scale	Large	Medium	Small
Businesses	SOEs (approx. 6), local firms (approx.80)	SOEs (approx. 17), local (approx. 300)	Foreign capital(approx. 60 including 8 Japanese and 40 S. Korean), local (230), SOEs (approx. 3)
Market	Approximately 100% domestic	Approximately 100% domestic	Approximately 90~95% CMP exports

Note: There are some 22,000 self-employed tailors (household or very small businesses) who serve the domestic market. When they are included, the total work force of the garment and textile industry is estimated at approximately 200,000 persons.

Source: Compiled by the JICA study team based on study in Myanmar.

(2) Structure of garment markets

1) Domestic market

Although statistics on the domestic garment market is not released, the amount of domestic production is estimated at approximately US$300 million. The total domestic production of cotton yarn is estimated at approximately US$10 million [12 rolls (50kg) /package x 150-200 packages /day x 300 days x 4,300 kyat /roll =approx. US$10 million]. As an estimated approximately US$20 million in cotton yarns are imported from China, the domestic cotton yarn market is estimated at approximately US$30 million. Assuming that the ratio of cotton yarn in the production cost of longyi and blankets is 30% and that the cost of a jacket is the same, domestic production of cotton products is estimated at approximately US$200 million. Assuming that the amount of synthetic

materials is half that of cotton materials, total domestic production of garments is estimated at approximately US$300 million.

In addition, there is a market for imports, which is estimated at approximately US$100 million. It is estimated that inexpensive fabrics and clothing imported through border trade or smuggling from China and Thailand account for approximately 80% of imports. These items are sold in very small retail shops or stalls. As these household businesses increasingly focus on items that sell well, their market share has been rising year after year. The remaining 20% is filled by defective items made by CMP plants which are not fit for exports to overseas and some products manufactured by CMP exporters to avoid idle times using materials imported for the production of garments for CMP exports. The latter are priced at the same levels as garments for domestic consumption, because the manufacturers are resigned to making losses. However, as MIC regulations cap the ratio of domestic sales to 10% of the total output of products made of materials imported tax-free for consignment basis trade, the market for the latter is not likely to expand. In fact, the more they sell to overseas buyers, the greater their profits, CMP exporters are hardly inclined to sell good merchandise in the domestic market. Even when they export less than 90% of the products made of materials they import tax-free, this is usually due to justifiable causes, such as defective fabrics or cancellation of orders. The problem is some fabric wholesalers who falsely claim that they have garment-manufacturing plants and import fabrics tax-free to sell in the domestic market. This is clearly illegal. Since such behaviors cause mistrust in the industry, it is suggested that the government examine the feasibility of adopting an import tax refund system on CMP, which is commonly adopted in other developing countries.

2) Export markets

Today, it is estimated that approximately 90~95% of Myanmar's exports are under the CMP scheme while the remaining five to ten percent are FOB export sold at souvenir or Asian goods stores under the manufacturers' own brand names.

Table 5- 34 Amount of Garment Exports from Myanmar (in millions of kyat, %)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Garment exports (a)	97	220	343	300	402	436	471	877
Total exports (b)	3,590	4,228	5,405	5,044	5,488	6,464	6,756	8,947
Ratio of garment exports [(a)/(b)]	2.7	5.2	6.3	6.0	7.3	6.7	7.0	9.8

Source: Selected Monthly Economic Indicators, January-February2002

Table 5- 35 Amount of Garment Exports from Myanmar to U.S. (US$ millions)

	1999	2000	2001
Knit exports	118.8	287.4	238.3
Woven exports	66.8	116.2	119.9
Total garment exports	185.6	403.6	358.2

Source: World Trade Atlas in U.S. (2002)

Table 5- 36 Amount of Garment Exports from Myanmar to Japan (US$ millions)

	1999	2000	2001
Knit exports	0.5	1.3	0.5
Woven exports	1.6	3.2	6.9
Total garment exports	2.1	4.5	7.4

Source: World Trade Atlas in U.S. (2002)

For Myanmar's garment-manufacturing industry to shift from CMP exports to FOB exports in the future, financing which makes it possible to shift to "develop and export" schemes (stop-gap loans to finance the purchasing of raw materials, inventory and sales until the money is collected from the customer) is as important as the capability to develop designs and domestically produced materials. FOB exports entail the following process: confirm the order from the buyer, order fabrics, pay to the fabric supplier, ship to the buyer and collect the money. Frequently, the interval from the payment for the fabric to the collection of the money from garment sales is more than six months, but in Myanmar this interval tends to be extended to one year. Consequently, unless banks in Myanmar adopt a system under which stop-gap loans are provided as is the case in Hong Kong, garment-manufacturers will find it very difficult financially to shift to FOB exports. It is estimated that as of 2000, 75% of exports were sold to buyers in Hong Kong, the Republic of Korea and Taiwan who export them to North America, 20% to EU and 5% to Asia, including Japan and the Republic of Korea.

Exports to the United States, however, peaked out in 2000 and have been declining since 2001. First, there has been a conspicuous unintended accumulation of inventories of cotton products in the United States due to the recession that began with a recession in the IT sector in 2000. Second, U.S. buyers have been refraining from placing orders because of the bill for a ban on imports of Myanmar products that came before U.S. Senate at early-2001 and afraid lobbying activity against Myanmar government (Made in Myanmar products). Third, since the terrorist attacks in the United States on September 11, 2001, consumer sentiments have cooled. Fourth, signing of a trade pact between the United States and Vietnam sharply reduced U.S. import tariffs on Vietnamese products, which has enhanced export competitiveness of Vietnamese garments. Fifth, since 2000 garment imports to the United States from South Africa have been both tariff- and

quota-free, provided that they are made of fabrics made in South Africa. As a result, large numbers of fabric-making and weaving plants have been built in South African by Hong Kong or Taiwanese capital, which has increased South African exports to the United States. Because of these factors, it is believed that approximately 50 private-sector garment-manufacturers, including those funded by Hong Kong concerns, were liquidated in 2001. There is also a substantial number of half idle plants, which operate only a few days a week. In 2002, however, some Western buyers have been reducing their orders to Islamic countries, such as Indonesia, Bangladesh, Malaysia and Pakistan, and taking their business to non-Islamic nations. Therefore, a further decline in Myanmar's exports is thought to be unlikely.

As Japanese firms started operations in Myanmar, orders from the Japanese market have been increasing since 1994. Exports to Japan are expected to increase in the future centering on inexpensive staple products, including men's suits, for which the adjustment of lead time is relatively easy. As a preferential tariff (zero tariff) on fabric products destined to Japan is applied to Myanmar, some Japanese buyers have been diverting some of their orders from China to Myanmar. Presently, S. Korean firms and Japanese firms are making production bases in Myanmar mainly for exporting to non-quarter markets such as Japan. Especially, a dozen of new S. Korean firms invested in Yangon areas past two years and amounted to over forty firms in accumulation. As another backgrounds of their preferential investing in Myanmar, there are two points indicated by them. The first is relocation of factories from Jakarta areas in Indonesia and shanghai areas in China due to increasing in wedge over US$100/month. The second is free duty for Myanmar made woven garments which issued new regulation. Before the amendment, the import duty was free only if garments made from woven fabric that made in third country. Recently, the regulation has changed to be able to apply duty free for garments made from woven fabric that made in Japan, as well. The third is the obedient attitude of Myanmar workers suitable to garment industry.

Regarding exports to the EU, Myanmar is cost competitive in inexpensive staple products in that market, as no quota is imposed on Bangladesh, Cambodia, Myanmar and other third world. Since the introduction of the OPT scheme, however, EU buyers have been increasing their orders to North Africa and former Eastern European nations. These countries have the advantages of low tariffs, low labor costs and quick delivery. In addition exports to the EU are not as profitable as those to the United States or Japan, because substantial discounts are required in the unit prices of CMP exports to that region. Therefore, further cost cuts and product differentiation are required for exports to this market.

At present, CMP exports from Myanmar consist primarily of such inexpensive

staple items as men's pants, shirts and uniforms with long lead time as well as men's formal wear. However, for a country like Myanmar where labor cost is low, the key to product differentiation and strengthening export competitiveness lies in specializing in products that require simple but manpower-consuming processes. In this respect, promising products include spangled, beaded or hand-embroidered garments, knitted products, clothes with many buttons, blousons and cargo pants that require intricate work and heavy-duty jeans. There are not many Japanese companies operating a knitted product plant for Japanese market in Myanmar. This is partly because knit-wears are excluded from the list of items subject to preferential tariff treatment and are not exempt from import tariffs. However, although there is a shortage of power supply in Myanmar, there is abundant inexpensive manpower. Therefore, as some of Hong Kong and Taiwan sweater factories are running quite well, we can introduce this advantage to Japanese government and reduce tariff or free quota for Kitted production also. Then, the country should be capable of producing intricate garments that have high value added. There is an idea to use non-electric sewing machines, but since there is a large difference in productivity and quality of the finished products between electric and non-electric sewing machines and also because foot-operated sewing machines are not capable of as many different stitches as electric sewing machines, few exporters are using them.

Items in which Myanmar is not competitive are pure white or light colored wedding gowns and luxury lingerie as well as fashion items with very short lead time. This is because it is necessary to air condition the shop where these items are made in order to avoid stains from perspiration and finger marks, which pushes up electricity charges substantially. Vietnamese, who are very patient, excel in this type of products. Therefore, in the near term, Myanmar should concentrate on the production of mass-produced, inexpensive staple items. As Myanmar has not shipped many garments to Japan, a word of caution is in order if it wants to get orders or continue to get orders from Japan. It has to do how products are handled. Even if a plant is brand new and the floor is cleaned spic-and-span, a Japanese buyer who comes to inspect the plant will never place an order if he finds fabrics and garments on the floor. As products are often put on the floor in Myanmar, comprehensive education of workers, including these fine points, is essential.

Although China and Vietnam are making products treated to keep their shapes, manufacturing of these products involves risk in Myanmar. A firm wholly owned by a Hong Kong concern brought in wrinkle free treatment machines to Myanmar in 1996 to process imported wrinkle free materials and exported the products to chiefly Europe. However, wrinkle free treatments were inadequate because of power outages during processing, which resulted in many returned goods. The items that are suited to today's Myanmar are those that are simple labor-intensive and power-saving. Also there were

difficulties to receive high price orders for Myanmar factory now, since the buyers are afraid of "Made in Myanmar" lobbying activities. Only the buyer who does not care about lobbying activities and just need lower price, accept made in Myanmar. Quota quantity to U.S.A. is still few quantity as well.

The Japanese markets increasingly call for items that satisfy sensitivity and functional needs as well as good design. Specifically, since the second half of the 1990s, consumer preferences have shifted to blends of natural fibers and synthetic fibers or those of staple fibers and long fibers. Nevertheless, at the moment Myanmar should concentrate on building an integrated production system that ranges from the development of cotton materials to garment-manufacturing, rather than being swayed by changes in consumer preferences in Japan.

3) Export competitiveness of Myanmar-made garments

The following table is a comparison of costs and prices of imported men's shirts in the U.S. market. In FOB price, Myanmar products appear to be more cost competitive than those of rivals thanks to low labor cost coming from wages that average approximately US$15 per month.

Table 5- 37 Cost Competitiveness of Imported Men's Shirt in U.S. Market (US$/piece)

Exporting country	U.S.	U.S.-Mexico	India	Thailand	China	Vietnam	Myanmar
Raw materials	1.6	1.6	1.6	1.7	1.6	2.3	2.7
Labor cost	3.6	0.8	0.3	0.7	0.8	0.6	0.2
Power charges	0.3	0.6	0.8	0.5	0.4	0.5	0.7
Depreciation	0.6	0.8	0.6	0.6	0.7	0.5	0.5
Others	1.4	1.0	1.1	1.2	0.9	0.8	0.5
Total costs	7.5	4.8	4.4	4.7	4.4	4.7	4.6
Profits	1.2	0.8	0.7	0.7	0.7	0.4	0.3
FOB price	8.7	5.6	5.1	5.4	5.1	5.1	4.9
Shipping cost	0.0	0.5	2.1	2.0	2.1	2.2	2.4
Import tariff	0.0	0.0	0.4	0.4	0.4	0.4	0.4
Purchasing price	8.7	6.1	7.6	7.8	7.6	7.7	7.7
Sales price	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Profit on sales	6.3	8.9	7.4	7.2	7.4	7.3	7.3

Source: Compiled by the JICA study team from various sources (figures for 1998).

In terms of U.S. retailers' purchasing prices, however, Myanmar products are not very cost competitive. The reasons are as follows:

First, raw materials costs are high in Myanmar because of a high import dependency rate (approximately 90~95%) due to the underdevelopment of yarn- and

fabric-manufacturing sector. High costs of import and export resulting from inadequate port and harbor and transportation infrastructure are also responsible.

Second, electricity charges for private-sector exporters were raised ten-fold to 8 cents/kwh in early 1999.

Third, in terms of the quality of labor, although labor costs in Vietnam is three or four times higher than in Myanmar, Vietnamese workers are more eager to earn money. Consequently, it is said that they work harder and are more adaptable because they are eager to learn. Foreign companies operating in both Vietnam and Myanmar conclude that plants in Vietnam produce better quality products, have higher productivity and profit ratio than those in Myanmar. Foreign companies adopting the piece rate in both countries say, "Vietnamese workers come to the plant half an hour or more before the regular working hours giving one excuse or another and try to earn as much as possible. They want to keep working as long as possible, so they tend not to stop working immediately even when the lunch-hour bell rings. On the other hand, Myanmar workers are shuttled to and from work by a company bus due to poor public transportation (when the bus service is not provided, the separation rate jumps from approximately 5% to more than 20%). Even when the bus arrives at the plant 30 minutes before the regular working hours, workers take it easy by having breakfast, nibbling on snacks, combing their hair or just chatting. They start getting ready to stop working even before the bell rings announcing the lunch hour or the quitting time, and the minute the bell rings, they rush to the door. Because of this situation, piece rate is not very much effective in Myanmar at the moment, but still much better than daily paying system. Thus, the advantages coming from inexpensive labor are offset by these factors, and cost competitiveness of Myanmar-made garments is little different from that of products from other developing countries.

Table 5- 38 Labor Cost Performance Comparison of One-Piece Dress (2000)

	Myanmar	Vietnam	Thailand	China (Shanghai)
Production Pieces/ Per one person day (one day=9 hours)	6 pieces	11 pieces	12 pieces	14 pieces
Labor Cost/ Without fringe benefits (US$/month)	US$26	US$60	US$100	US$ 120
Labor Cost Performance (US$ one day labor cost/piece)	US$ 0.17	US$ 0.22	US$ 0.33	US$ 0.34

Source: Compiled by the JICA study team from data from various factories

Fourth, even if the kyat, which is overvalued at present, declines in its value in the future, the depreciation of the kyat will have the effect of cost push, even though there will be a slight improvement in the export competitiveness of Myanmar-made garments. This is because materials, sub-materials, spare parts, diesel oil for in-house power generation and fuel for transportation are bought from overseas and because payments for electricity and domestically procured materials (cartons and polyvinyl bags) have to be made in the dollar. The only advantage when costs are converted into the dollar is the labor cost. As such, the depreciation of the kyat may not lead to stronger export competitiveness of garments made in Myanmar.

4) Stages of development of garment industry and present status of Myanmar's garment industry

There are following stages of development of a garment-manufacturing company based on ITC definition. Since this is a theoretical process of development, in practice not all companies follow this pattern. This section will describe the stages of development in order to grasp the present status of garment manufacturers in Myanmar.

At the first stage (CM/CMP), since the garment manufacturer is unable to procure materials and equipment on its own, it receives the supply of these items from primary manufacturers or large retailers and is asked to perform the basic processes. It delivers the products to the primary manufacturers or large retailers. Most of garment manufacturers in Myanmar are at this stage.

At the second stage (CMT) since the garment manufacturer is unable to obtain materials on its own, it receives the supply of these items from the industry (converters), importers or large retailers. It performs the entire process of manufacturing. It delivers the products to the industry (converters), importers or large retailers. . Most of garment manufacturers in Vietnam are at this stage.

At the third stage (RTU), the garment manufacturer partly outgrows from processing on commission. It purchases materials from its own sources to fill orders from large customers and performs all production processes. Some firms in Vietnam are at this stage. Companies at this stage find customers, chiefly mass-merchandisers, on their own.

At the fourth stage (RTS), the garment manufacturer completely outgrows commissioned jobs, and plans and develops products to sell to large customers. It purchases materials from its own sources and conducts all manufacturing and marketing on its own. Some Chinese firms are at this stage.

At the fifth stage (Collection), the garment manufacturer develops sales channels

centering on specialty shops on its own. Korea, Taiwan, Hong Kong firms are at this stage.

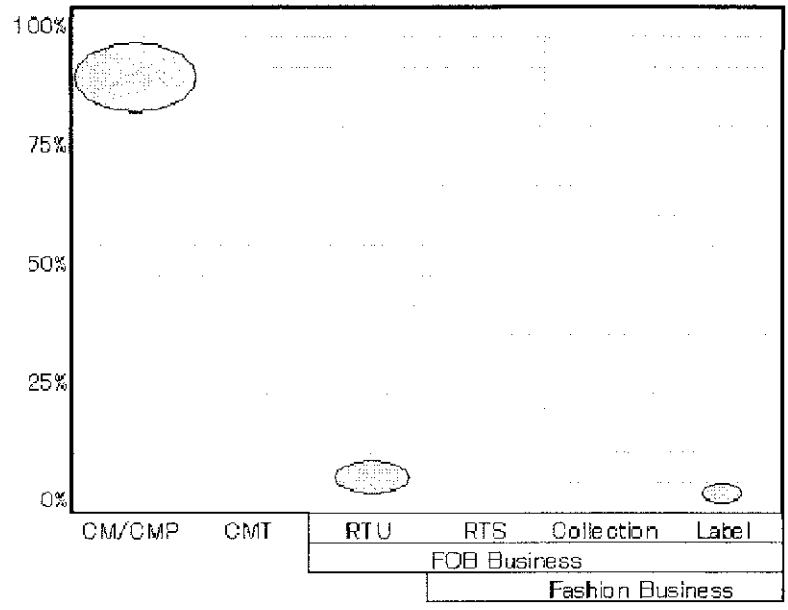
At the sixth stage (Label), the company goes one step further than the fifth stage and takes advantage of its strong brand name to sell through its own sales networks. Most of garment manufacturers in advanced countries are at this stage.

Table 5- 39 Business Development Steps of Garment Firms

Type of business	Products/Services offered by this type of business	Target Groups in Export Markets
Service		
A/ CM (cutting-making), CMP(cutting-making-packing)	-Production (cutting, sewing, packing, etc.)	-Industry (manufacturing /converters) -Large retailers (USA)
B/CMT(cutting-making-trimming)	-Production -Procurement of garment trims	-Industry (converters) -Importers -Large retailers (USA)
FOB Business		
C/ RTU(ready-to-use)	-Production -Procurement of fabrics and garment trims	-Industry (converters) -Importers -Large retailers
FOB Business & Fashion Business		
D/ RTS(ready-to-sell)	-Product R&D (basic product) -Production -Procurement	-Industry -Large retailers
E/ Collection	-Product R&D (product line) -Procurement -Product marketing	-Large retailers -Chain stores/clothing multiples -Specialist retailers
F/ Label	-Product R&D (product line) -Procurement -Product marketing -Strong brand	-Own sales networks

Source: Prepared by the JICA study team based on IFC definition

Figure 5- 41 Positioning of Exporting Garment Companies in Myanmar



Source: JICA Study Team

(3) Organizational format of garment manufacturers

In Myanmar, there is quite a number of firms whose registered owners are Myanmar nationals but are in practice wholly-owned subsidiaries of foreign companies or joint ventures with foreign companies. Of the approximately 400 companies registered with MGMA, 98 are wholly-owned subsidiaries of foreign companies and eight are joint ventures. In other words, nearly one-third of these firms are financed by foreign capital. Out of these companies 94 are registered as being run by Myanmar nationals, but in practice are run by foreign nationals who are given control of the company. This is attributed to the following factors:

First, under the law of Myanmar, joint venture factories incorporated under the Company Law are quite difficult to receive the approval from the government. On the other hand, joint ventures incorporated under Myanmar Investment committee or the Foreign Investment Law are classified as foreign-capital companies. In particular, joint ventures formed under the Foreign Investment Law are guaranteed control by foreign capital. Thus, joint ventures are classified as domestic companies or foreign-capital companies depending on the law under which they were incorporated rather than on the basis of the ratios of domestic and foreign capital.

Second, the reason that there are not many firms taking the form of joint ventures are that in a joint venture with a private-sector enterprise, the firm can lease land and buildings from the private sector, but since contracts of more than one year are not permitted, they have to be

renewed every year, which is quite cumbersome. On the other hand, joint ventures with SOEs must often lease land and buildings at high rents for a period of 10 to 30 years lease agreement.

Third, even businesses that are joint ventures with the government or foreign capital-companies that lease land and buildings from the government find that they are no longer in better positions to obtain quotas for exports to the United States. This is because approximately one-third of quotas are allocated to the private sector, another approximately one-third to enterprises affiliated to Myanmar Economic Holdings (MEH, government-affiliated veterans' public corporation),i.e., joint ventures with MEH or enterprises leasing land and buildings from MEH, and another approximately one-third to enterprises affiliated to MTI (Myanmar Textile Industry) ,i.e., joint ventures with MTI or enterprises leasing land and buildings from MTI. Since MTI-affiliated and MEH-affiliated firms obviously have fewer plants than private-sector enterprises do, it is more advantageous to be affiliated with them in obtaining quotas. However, a reform is now in progress to allocate quotas to the private sector depending on the firms' past export performances. At the same time, since the trade issue with the United States has yet to be unsolved, foreign buyers are reluctant to place orders with MEH-affiliated or MTI-affiliated enterprises. As a result, some of the quotas of government-affiliated firms remain unfilled and resold to private companies.

Fourth, generally speaking, joint ventures with SOEs are being shunned. When SOEs in Myanmar are compared with those in Vietnam, we find that equipment and technologies at SOEs in Myanmar are out-dated because of the shortage of government's investment and loan funds for SOEs. Other problems include a lack of information on overseas markets due to the economic sanctions imposed by the Western nations and slow decision-making that is a characteristic of SOEs. Foreign buyers cannot find much merit in placing orders with joint ventures with the government, which involves risks in terms of delivery, product quality and inventory management.

Fifth, some of the firms in Taiwan, Hong Kong, the Republic of Korea and Japan are reluctant to be seen to be operating wholly-owned subsidiaries or joint ventures in Myanmar because they are afraid of reactions from the Western nations. As a result, they often prefer to register their affiliates as domestic firms by incorporating them under the Company Law and engage in sewing on commission.

Sixth, some SOEs that are partners in joint ventures claim that foreign partners should bear a greater part of business costs because they have more money or that because Myanmar's economy has just opened itself to the external world, Myanmar enterprises are still infant who need to be protected according to the government. In fact, there are not many incentives to foreign capital-affiliated firms. Moreover, telephone and electricity charges and other costs are lower if a business is a domestic corporation. Until 1999, foreign capital-affiliated companies paid international telephone tolls and power charges that are several times higher

than those of domestic firms. Consequently, registering as a foreign capital-affiliated company worked against them.

(4) Problems in business environment

1) Quotas

In the past quotas for exports to North America were allocated only to SOEs. However, the allocation system was revised in 1998 so that private-sector companies can get quotas if they applied for them. At US$2.5/DZ, the cost of acquiring quotas is not very high. As it is officially banned to re-sell quotas, they are traded in the black market, where quotas cost US$3-18/DZ depending on the item. The most popular quotas are those for trousers to the United States. Although they are more expensive than other quotas in Myanmar, these quotas prices are still much cheaper than other counties like China and these quotas are almost completely filled every year. Even if a company purchases a quota in the black market, since exports and imports involved in CMP business must be carried out by the original assignee of the quota, outsourcing relationships have been formed. In 2000 in particular, when the U.S. economy was buoyant, quota prices in the black market reached record levels. The difference between the original cost of quotas and their sales price is pocketed by the original assignee of the quotas.

Nevertheless, the cost of quotas in Myanmar is only a fraction of what it is in China. In addition, even if quotas are expensive, their buyers can make profits because the items on which quotas are imposed are limited to some woven fabrics in the case of Myanmar and the number of items subject to quotas is much smaller compared with China or Vietnam. As quotas on international commerce will be abolished in 2005 when WTO's Agreement on Textiles and Clothing goes into effect, it is pointed out that exports of garments to the United States from China will increase and may diminish Myanmar's advantages. However, because the U.S. government retains the option of placing a safeguard against the imports of garments from China, Myanmar is not likely to lose its advantages to a great extent.

As a reference, this section will briefly examine the garment industry in Cambodia, which is seen as a rival of Myanmar. Before 1999, when Cambodia was free from quotas, foreign companies made direct investments in that nation one after another. In recent years, however, the investment environment in Cambodia has somewhat deteriorated for the following reasons. First, although there are no quotas for exports to Canada and the EU, Cambodia is subject to more stringent restrictions than those in

Myanmar as far as quotas to the United States are concerned. Second, as a result of the criticism from the International Labor Organization (ILO) and the U.S. government that the wages in Cambodia are too low, the government raised the minimum wage for workers of the garment industry in one stroke to minimum of US$40 a month. As a result, most Cambodian garment manufacturers are unable to make profits, because while production efficiency there is lower than that in Vietnam, the wage levels are close to those of Vietnam. In 2000, while a large number of foreign capital-affiliated garment plants were established, a larger number of garment plants was shuttered. Third, in Cambodia, laws, regulations and export taxes are revised quite often, forcing garment manufacturers to scramble each time.

2) Production cost

Because garment manufacturing is a typically labor-intensive industry, it is usual for foreign garment manufacturers to move their plants seeking inexpensive labor. At present, with average monthly incomes of US$45 to US$60, labor costs in inland regions of China and Vietnam are three to four times those in Myanmar. In the coastal urban areas of China, average monthly incomes are US$90 to US$150, and the labor costs in these areas are equal to those in the Philippines, which are six to ten times those of Myanmar. Myanmar's average monthly income of US$15 is the lowest in Asia and is at the same level as that of Madagascar (average monthly income of US$18) where is also lowest level of salary in Africa, which in recent years has been increasing garment exports to the United States.

Eighty percent of foreign capital-affiliated firms engaged in CMP exports in Myanmar were established in the last five years. This is because the government of Myanmar began to aggressively accept foreign firms at the mid-1990s. Foreign firms with their own sales channels found that it was possible to start a business with capital investment of around US$50,000 (for approximately 30 sewing machines and some 80 workers). In Myanmar, however, while labor cost is low, the costs of telephones, electric power, diesel oil for in-house power generation and other items are high. Consequently, it is difficult to register sales that are large enough to absorb the salaries of a few foreign technicians and the cost of overseas marketing, unless the firm employs at least 500 workers. As a result, very few companies are making good profits. The key to the development of the garment industry in Myanmar, therefore, lies in to what extent the country can reduce the costs of power, telephones, courier services (like DHL), sea and air freight, which are more expensive than in those in the neighboring countries, by improving efficiency. The country also has the problem of frequent labor strikes

because workers' right are protected by the Labor Bureau. Although the frequency of strikes in Myanmar is only a fraction of that in the Philippines, it is several times higher than that in Vietnam. Personnel management in Myanmar is a difficult job.

3) Inferior exchange rates applied to foreign exchange earnings from CMP exports

Since August 2001, an inferior exchange rate (of 450 kyat to a U.S. dollar <FEC>) is applied to foreign exchange earnings from CMP exports on the ground that CMP is no more than a service industry in that it has little spill-over effect on other industries. Compared with the market rate of approximately 740 kyat to a U.S. dollar, this means a discount of nearly 30-50% in sewing fees. Manufacturers wish to pass the difference with the market rate on to sale prices, but they are unable to do so because of keen competition to win orders, as most of the orders have been stopped due to the anti-Myanmar bill, which is now before U.S. Congress. The following three points are recommendations to solve this problem.

First, it is a mistake to regard CMP as a mere service industry on the ground that it has little spill-over effect on other industries. Since Myanmar still lacks materials for garments for exports, design capability, sewing machines, overseas marketing channels, etc., there is no way to export garments other than by CMP, utilizing the country's inexpensive labor. Even in China, Japanese companies began CMP on a trial basis in the early 1980s following the opening of China's economy to the outside world in 1979. CMP exports began to increase in earnest in the second half of the 1980s, and it was only in the second half of the 1990s that "develop and export" schemes were launched using local fabrics. During the 15 years from the early 1980s and the second half of the 1990s, China single-mindedly acquired technologies and skills, grasped the needs of the overseas markets, developed fabrics for export garments and improved design capability by engaging in CMP exports. CMP exports should be regarded as a process of the transfer of skills to Myanmar.

Second, the Myanmar's dependency rate on the United States is very high at more than 70%, because Myanmar's garment industry depends largely on Taiwan and Hon Kong dealers, whose principal sales channels are in the United States. The fact that Myanmar's garment exports depend largely on the country that is imposing economic sanctions on it in itself is a problem. Prior to the signing of a U.S.-Vietnamese Trade Pact in 2000, Vietnam's dependence rate on the United States was below 10% because that country applied the enemy country clause and high import tariffs on Vietnam. As a result, Vietnam successfully worked to increase the shares of the European and Japanese markets to 40% each of its total exports.

Myanmar should work to diversify its export markets by developing business with Korean, Hong Kong and Singaporean dealers, who are strong in the European market. At the same time, as more technologies are needed to improve the quality of products destined to the Japanese market, the government of Myanmar should create garment training centers and also introduce such measures as extending assistance to primary contractors. Training at the garment training centers should consist mostly of practices. In the future, they should offer sufficient programs to nurture trainees with areas of specialization. Judging from the present status of garment manufacturers in the country, courses needed in Myanmar are i) patterning, ii) cutting, iii) sewing, iv) quality control, v) finishing, vi) storage, vii) plant management, viii) marketing, ix) planning, x) printing, xi) embroidery, xii) CAD and CAM, xiii) designing, xiv) dyeing, xv) knitting, xvi) spinning, and xvii) weaving.

Third, raiding the coffers of private enterprises through exchange rate adjustments in order to solve the problem of the shortage of foreign exchanges is not desirable from the viewpoints of both the stability of government policies and the development of private enterprises. Therefore, the government should end adjustments via the exchange rate and examine the feasibility of introducing refunds of import taxes to CMP, a practice that is common among other developing nations. The scheme should also prevent illegal domestic sales of CMP materials, which are imported tax-free.

4) Unclear labor rules

The foremost problem is the very strong protection given to workers by the government. The Labor Bureau requires an employment agreement that stipulates that the employer will pay a generous separation allowance when an employee is terminated by a private firm. For example a separation allowance equivalent to at least one month's pay or one month advance notice is mandatory even when an employee is still in a trial period or when he or she is paid by the day. If an employee is terminated after the trial period and before the first anniversary of the employment, a separation allowance equivalent to at least two months' pay or one month advance notice plus one month pay is mandatory. This is probably because the concept of a trial period or payment by day does not exist in Myanmar. Moreover, we have to give 10 days continuous earned leave after one-year service, six days casual leave after provisional period, and medical leave and maternity leave after certain period as well.

Furthermore, it is impossible to secure workers without a bus service to shuttle workers to and from the plant, unless it is located near a bus stop served by a large number of public buses. This is more so when one is dealing with clerical workers who

are mostly from middle class backgrounds. One cannot expect workers to commute to work on their own using public buses, bicycles, or motorcycles as they do in China or Vietnam. Consequently, the cost of purchasing or leasing a bus and buying gas comes to an equivalent of approximately 30% of monthly salaries. The bus service is a fringe benefit. The employment contract with the worker stipulated that a special bonus would be paid if the employee did not use paid holidays. The governing body of the relevant industrial zone had claimed that since the worker who employed under monthly salary pay system was entitled to four paid holidays a month, even if he or she took four days off, he or she was still entitled to a special bonus. This means that although labor is inexpensive in Myanmar, employers often have to pay unplanned labor costs.

Second, the Labor Bureau of the Ministry of Labor has a very strong discretionary power. The labor law in Myanmar follows the British tradition of common law and stipulates that the labor contract between the employer and employee takes precedence. This results in the Labor Bureau of the Ministry of Labor having very strong discretionary power. For example, even though a labor contract on the right to have demand of strike was protected by the Labor Bureau, when the employer terminated employees on the ground of going on a strike or other factors, the employees brought the case to the Labor Bureau, which ordered the employer to pay a compensation equal to several months' average pay for the sole reason of terminating the employees. This means that although labor unions are banned in Myanmar, the Labor Bureau, which may be called the "Ministry of Labor Unions" although establishment of union is not allowed by the law, often stands on the side of workers to rule against the employer. The discretionary power of the Labor Bureau of the Ministry of Labor can prevent businesses in Myanmar from establishing large-scale garment plants like those which exist in China and Vietnam. It should also be noted that there are only a handful of large-scale garment plants in the Philippines, where labor unions are powerful and the unions tend to go on strikes due to the national temper. There, garment manufacturing is divided into several processes and each process is assigned to a separate plant. Most garment manufacturers are small to medium in size with 100 to 300 workers. This is an obstacle in the development of the garment industry.

5) Improvements and deterioration in business environment since 1996

(Improvements)

i) The requirement that an import license must be obtained prior to the issuance of the bill of lading (B/L) has been amended so that the import license can be obtained as

long as it is before ETA Yangon.

ii) The number of shipping companies has increased from three to six, and there are more frequent services to Singapore. The Five Star Line (whose agent in Singapore is Jardine Matheson), the operator of the fastest vessels between Yangon and Singapore, now uses five vessels (three of which can be used as liners) instead of two.

iii) The roads in industrial zones have been widened and improved, and the number and area of industrial zones have increased several-fold.

iv) There are no problems with export and import procedures thanks to the increases in the numbers of freight forwarder and shipping company offices and workers versed in customs clearance procedures.

v) In the past, the government was quite sensitive about foreigners living in the same house or same apartment buildings with Myanmar nationals, but now such arrangements are not strictly restricted if they are reported to the township immigration.

vi) There are e-mail providers and CDMA mobile phones s well as GSM mobile phone have also been introduced. The introduction of CDMA has made it possible in some areas to obtain permits within a few days after applying for telephone lines if that local phone office has line stocks. In contrast, in the past there were waiting periods of from six months to several years, and one had to buy permits in the black market if one was not willing to wait that long. Telephone services have improved: in the past it was necessary to dial several or sometimes even dozen times before the connection was made and there were frequent crossing of wires. Now, connection can be made after several dialing and the quality of telephone lines has improved.

(Deterioration)

i) Now, bribes are demanded practically on many occasion when an application is made or for custom clearance. Besides, the amount of bribes has increased.

ii) Now, it takes many more days to clear customs or file applications than in the past because the numbers of processes of authorization and inspection have been increased on the ground that some Taiwanese or Chinese have violated the law.

iii) It is no longer possible to go freely into MTI offices to follow up on applications.

iv) As the government of Myanmar has ignored a U.S. request to write "Myanmar (Burma) or Burma (Myanmar)" instead of "Myanmar" in certificates of origin, clearance of the country's products at U.S. customs now takes more time.

v) Due to ILO's criticisms of child labor and enforced labor, since the end of 2000 the government has been guiding the industry to write labor contracts that provide

excessive protection to the rights of workers and to receive worker's agreement on each it and submit to labor office to endorsement. Moreover, labor offices instructed factories establish "supervising committee" which include labor officers, chief township management as well as representatives of employee and employers.

vi) Deterioration of power supply and difficulties in purchasing diesel oil for in-house power generation. The supply of gasoline for automobiles at the government price has been limited to three gallons per day.

5.4.2 Policy Recommendations for Development of Garment Industry

(1) Strengthening of functions of Myanmar Garment Manufacturing Association (MGMA)

There are approximately 400 private enterprises in the association. However, the association has not been officially approved, because foreign capital-affiliated firms have also been given membership because it was felt that the association is not meaningful unless it includes foreign capital companies, which place CMP orders and provide manufacturing technologies. The association is very active. Members exchange views frequently centering on the firms that serve as directors of the association. It joins forces with UMFCCI to make recommendations to the government. When a bill to boycott Myanmar products was before U.S. Congress, the association sent petitions to the United Nations and the U.S. government. It is also working very hard to correct the government's misunderstanding about the private-sector garment manufacturers. For example, materials used for CMP are imported tax free, because they are exported after they are made into garments. The government points out that in some cases a considerable portion of such raw materials is sold in the domestic market. Specifically, there are some instances in which nearly half of 10,000 yards of fabrics imported tax free were sold in the domestic market. This is tax evasion on imports and is a violation of the law. Export licenses for CMP exports are issued within three to nine business days, but it takes longer for other types of exports. The example cited above is an abuse of the preferential treatment in the issuance of licenses. Since there is no system of checks to prevent such illegal behavior, the association is proposing to the government that it can donate approximately 15 computers (including approximately three each to the customs, the Ministry of Trade and the Ministry of Industry No.1) so that the government can check the volumes (in yard) of exports and imports. The association says that it is making this proposal in order to dissolve the misunderstanding on the part of the government.

The association's articles of association state that it is a nationwide, non-governmental and non-profit organization and is open to both Myanmar and foreign nationals and to all businesses regardless of their business format. The objectives of the association are to conduct

market research overseas, offer information, improve product quality, provide skill training to garment workers and participate in trade fairs and shows. Membership fees are collected from 400 companies at the rate of 30 kyat per month for each sewing machine they own. This means that a member with 100 sewing machines pays 36,000 kyat a year (30 kyat x 12 months x 100 sewing machines). If a member is also a member of UMFCCI, it pays additional 3,000 kyat a year to UMFCCI. MGMA does not pay membership fees to UMFCCI. When the association makes petitions to the government it involves UMFCCI as well. The president of MGMA is also a member of the CEC of UMFCCI.

To officially recognize MGMA as an organization and give it a voice is very important for the development of the garment industry in Myanmar. Therefore, the provision that "organizational activities of groups whose membership includes foreign nationals are not approved" should be changed to "organizational activities of groups that include foreign nationals in their membership are permitted, provided the majority of the membership is Myanmar nationals (corporations) and that the president and secretary general of the association are Myanmar nationals," so that information and technologies held by foreign capital companies are utilized aggressively. At the same time, the association should be made responsible for the solution of business disputes among its membership. The association should have offices with full-time staff members at least in Yangon and Mandalay, and offer and receive information regularly through a home page on the Internet or an Intranet. It should send people to Taiwan, Seoul, Hong Kong and Shanghai in the near future, and in a longer time span to the Embassies of Myanmar or a trade promotion organizations (which are to be established in the future) in Tokyo, New York, Hamburg, and Paris to collect information on materials, marketing and technologies. Unless such efforts are made, Myanmar will not be able to promote the shift away from CM/CMP exports to CMT/FOB exports as the government hopes to do.

(2) Development of supporting industries

At present, CMP exports play the central role in Myanmar's garment industry. If industry can get accessories and sub-materials domestically, it will be able to access FOB exports, which will increase the value added in the garment-manufacturing process and make companies more profitable. At present, no or very few factory in Myanmar makes yarns, interlining or lining materials, zippers, buttons, labels and tags that meet the quality required for exports. The only items that are available locally are cotton padding used in jackets, carton boxes and polyvinyl bags. The development of supporting industries for sub-materials is essential to switch to CMT/FOB exports in the future. It is essential to include Japanese experts on production technology of sub-materials among the instructors at the garment training center, which is to be created with Japanese assistance. Japanese experts should also be sent to

Myanmar to transfer dyeing, embroidery and printing technology and skills to the nation with the aim of developing the early processes in fabric-making.

In the longer term, the development of the upstream (yarn-making and fabric-making) sector to supply raw materials for garments for exports is a key in strengthening Myanmar's competitiveness in export markets. However, since this sector is capital and technology intensive, the introduction of foreign direct investments is a prerequisite. Moreover, the yarn and fabric making sector in Myanmar should be differentiated from that in China. If we are just looking at cost competitiveness, Chinese cotton yarns are not necessarily competitive in international markets. This is because of the following factors: i) The cost of raw cotton is approximately 10% (US$1,500/ton) above the international price because of the government support price; ii) high cost of the textile-making process due to the existence of a large number of workers; iii) the depreciation period in China is more than 10 years, while the international standard is eight years; and iv) small amounts of depreciation resulting from the use of out-dated equipment. Thus, China has many problems in terms of international competitiveness of its textile industry. An outlook for China after its accession to the WTO suggests that there are many factors which will further weaken the competitiveness of its cotton products in the long run. They include i) competition with Central and South Asia, which produce better-quality raw cotton at lower prices; and ii) competition in the U.S. market against garments made in the Caribbean nations after the signing of NAFTA using cotton fabrics made in the United States with high production technology, including the use of jet spinning machines, and imported to the United States tariff-free or at low tariffs. The government of China is now working hard to switch from shuttle spinning machines to jet spinning machines, eliminate redundant workers and abolish the government's support price for raw cotton to make domestic purchases at the international price. It has recently decided to shift to the exports of synthetic fiber textiles and their products from those of cotton and cotton products.

Table 5- 40 International Comparison of Cost of No.30 Count Cotton Yarn (1997) (US$/kg.)

	Brazil	India	U.S.	S. Korea	China	Vietnam	Myanmar
Raw material cost (including losses)	2.17	1.73	1.91	2.15	2.62	2.43	1.25
Labor cost	0.22	0.06	0.52	0.25	0.24	0.10	0.04
Power cost	0.19	0.33	0.17	0.18	0.13	0.20	0.24
Depreciation	1.02	1.01	0.88	0.95	0.30	0.50	0.50
Others	0.12	0.11	0.12	0.13	0.18	0.12	0.10
Total	3.73	3.24	3.60	3.65	3.47	3.35	2.13

Source: Compiled by the JICA study team from data from various countries.

In developing supporting industries in Myanmar from now on, an essential strategy is how to differentiate its products from those of China in terms of materials. As China's

strategy regarding materials is to export chemical and synthetic fiber textiles and their products, Myanmar should focus on the exports of cotton and cotton products. It should first improve the quality of raw cotton to meet domestic demand, then produce high-quality cotton yarns and fabrics and to improve the dyeing process to produce goods for exports. Myanmar can expect to export cotton fabrics for shirts to Europe, the United States and Japan in the future. However, it must improve the investment environment to bring foreign fabric makers to Myanmar. Integrated product development starting from the production of raw cotton will be effective in enhancing competitiveness in the export markets in the long run. At present, though domestic cotton costs only about one-third of Chinese raw cotton, its quality is said to be only about half that of the latter because it lacks resiliency and breaks easily. As a result, 50% of raw cotton and 50% of cotton yarns consumed in Myanmar are imported from China and other countries. Therefore, measures to be taken include the improvement of cotton strains by importing seeds of Indian and Egyptian cotton, which are of high grade, increasing domestic acreage of cotton production and promoting joint ventures in these areas. Vietnam is also aware that integrated product development starting from the production of raw cotton in the medium to long term will be effective in enhancing the competitiveness of the nation's products in export markets in the long run. As a results, competition against cotton products from Vietnam in the export markets will intensify. The following is a comparison of the productivity of raw cotton and production plans of Myanmar and Vietnam. Myanmar is more ambitious to cultivate cotton trees than Vietnam is.

Table 5- 41 Comparison of Vietnam and Myanmar in Cotton Cultivation

	Raw Cotton Productivity	Cotton tree cultivation area	
Myanmar	600kg/ha (1999/2000)	32,300ha (2001/2002)	389,400ha (2005/2006)
Vietnam	680kg/ha (2000)	22,600ha (2001)	60,000ha (2005)

Source: Vietnam; "Development Strategy of Vietnam Textile and Garment Industry up to 2010"(Ministry of Industry), Myanmar; New Light of Myanmar

On the other hand, the construction of a large number of chemical and synthetic fiber yarn plants in China will increase the exports of chemical and synthetic fiber yarns from China to Myanmar and constrain the building of such plants in Myanmar. Therefore, Myanmar should choose to improve land transport infrastructure and build a deep-water port toward Andaman Sea, then it has the potential of importing Chinese synthetic yarns by land transport and growing into a base from where finished products are shipped by sea. As China needs Myanmar and vice versa in the long-term economic relations, industrial adjustments or harmonization between the two nations in the synthetic textile sector is a possibility.

Table 5- 42 China's Synthetic Textile Development Strategy and Its Impact on Myanmar

	Exports from China	Imports to China	Capital investment in China	Impact on Myanmar
2001-2005	Focus on exports of medium- and high-grade garments to the U.S. to differentiate China from other developing nations	Increase in the import of dyed, printed fabrics	Promotion of joint ventures for dyeing and printing (for export purposes)	Exports of inexpensive staple products to the U.S. may increase (advantage)
2006-2010	Increase in exports of dyed printed fabrics	Increase in imports of medium- and high-grade synthetic textiles (blended yarns)	Focus on the import of blended yarn plants (for import substitution)	Increase in imports of dyed printed fabrics from China (disadvantage)
2010-2020	Exports of high-grade garments using blended yarns	Progress in domestic production of synthetic textiles for medium- and high-grade garments	Focus on the import of blended yarn plants (for import substitution)	Increase in imports of blended yarns from China (disadvantage)

Sources: Data on exports from and imports to China and capital investment are compiled by the Textile Industry Bureau, China National Economic and Trade Commission (August 2000). Other data compiled by the JICA study team.

(3) Creation of market for transactions in quotas

As black market transactions in quotas are raising the cost of garment manufacturing, foreign companies and overseas buyers frequently ask for the creation of a market for transactions in quotas. Such a market will allow factories that are producing high-quality garments as outsourcing because they are unable to get quota allocations to get orders for items subject to quotas and engage in export activities that are commensurate with their capability. This will be a temporary measure, because quotas will be abolished when WTO's Agreement on Textiles and Clothing goes into effect in January 2005.

(4) Explicit statement of labor rules

As mentioned earlier, employers must pay a separation allowance equivalent to at least one month's pay or advance notice even when the employee is in a trial period or are paid by the day. The separation allowance is equivalent to at least two months' pay or one month advance notice plus one month pay when an employee is terminated after the end of the trial period and before the first anniversary of the commencement of the employment. Moreover,

even when an employment contract banning strikes is approved by the Labor Bureau, if the employer terminates an employee for going on a soft strike or for theft without police evidence and if the employee takes the case to the Labor Bureau, the employer is ordered to pay a separation allowance equivalent to a few months' average pay simply because it terminated the employee. These labor rules must be explicitly stated to the employers before the Labor Bureau receives labor contracts from them. Since there is no adequate system to defend the employers in these cases, an environment in which foreign capital firms can operate without undue fears should be provided. This can be done by, for example, MIC mediating on behalf of the foreign capital company in its dealings with the Labor Bureau when it is an MIC-authorized business.

(5) Improvement of infrastructure

The infrastructures required for the garment industry are power supply, repairs of paved roads, enhancement of container trailers, the introduction of high-speed telephone lines, cell phones and e-mail at lower charges, and the permission for the fee use of the Internet. Regarding the electric power supply, in particular, the Ministry of Electric Power issued an administrative guidance in the early of 2001, banning the use of industrial electricity by plants other than those affiliated to the government at night time (between 5:00pm and 9:00pm). The Chinese government is planning to extend cooperation for the improvement of power infrastructure centering on hydropower.

(6) Support for formation of outsourcing relations

Since contracts for sewing on commission are signed after foreign buyers have carefully examined the export quotas and production capacity as well as quality of the plant concerned, the plants that are chosen are in principle not allowed to subcontract work to other plants. In practice, however, outsourcing is being carried out in various forms. When a foreign parent company has a strong marketing capability and its subsidiary and the primary contractor in Myanmar is capable of placing enough orders to its primary and secondary outsourcing contractors, a pyramid-shaped structure of primary contractor and outsourcing contractors is formed. The primary contractor supplies the materials and samples provided by foreign buyers and, in some cases lends sewing machines, to outsourcing contractors. In the future, as materials manufacturers start operations in Myanmar and as the right to procure materials is given to CMP companies, linkages with forward sectors will be formed.

In the long term, as a level playing field is created, the division between SOEs and private manufacturing enterprises will become increasingly blurred. Some private enterprises that

have attained strong competitiveness in international markets through technological and marketing tie-ups with foreign companies may gradually shift from CMP exports to FOB exports. On the other hand, SOEs which lag behind in technological and marketing capability because they do not have tie-ups with foreign companies may find themselves unable to outgrow CMP exports. Not only that, they may find themselves in the position of a second-tier outsourcing contractor. Therefore, in order to guarantee the stability of business operations of garment-manufacturing outsourcing contractors, in the long term the government should extend support through the following policy options: The government will create a garment-manufacturing outsourcing contractor development association under MGMA's umbrella and open its offices in Mandalay, Yangon and border regions where plants are clustered. These offices will provide consulting and guidance on business management to the outsourcing contractors and solve claims and disputes concerning outsourcing contract transactions. A business matching center for outsourcing will be established within the new association to gather outsourcing contracting information offered by primary contractors and offer it to outsourcing contractors on a continuing basis. In the future, the Internet will be used to offer information.

(7) Support measures for development of domestic market for clothing

The "import substitution effects of export industries" will become increasingly important to save foreign exchanges and to capture the domestic market. Such effects are necessary, because approximately 80% of the domestic market at present is filled by low-priced garments imported mainly from China and Thailand. These imported garments cost only one-quarter to one-third of the garments made on commission for exports (which cost at least US$5 per piece). Another reason for the inflow of low-priced Chinese garments is the absence of large distributors who handle high-quality garments. When a medium- or small-sized enterprises engaged in CMP exports wish to enter the domestic market, they have to either open their own outlets or sell on consignment or through agents who are not obligated to purchase the products. It is not easy to enter the domestic market not only because of the flooding of the market by smuggled items, fake brands, and cheap, second-class products from factories but also because of the heavy financial burden of inventories and building sales channels. Therefore, support measures aimed at the development of the domestic distribution market are needed to build solid foundations for domestic distribution by small and medium-sized garment manufacturers. The following are some of the policy options:

1) Promotion of the opening of large mass-merchandisers selling high-quality products in large cities
2) Assistance to the entry of garment manufacturers-exporters into the domestic

distribution market (low-interest loans to help open outlets)

3) Support to increase the efficiency of physical distribution (creation of shared delivery facilities and low-interest loans to the building of a physical distribution system)
4) Support measures, including subsidies, to participation in domestic trade fairs and shows so that most garment manufacturers will be able to share information on materials and sub-materials and to feedback garment-manufacturing firms' needs for materials to domestic materials manufacturers
5) Support to market research and advertising and publicity (make these expenses deductible expenses under the tax law)
6) For the development of domestic market for clothing, garment manufacturers should make efforts to introduce more beautiful and fashionable items to the consumer. The fashion sense and ideas, like arts, are polished and refined as one is exposed to beautiful things. Attraction to Japanese fashions, as seen among some people in Hong Kong and China, helps the understanding of Japanese culture. Some of policy options are:
   a) Publication of the Myanmar editions of Japanese fashion magazines
   b) As the people of Myanmar are very fond of fashion shows, regular fashion shows by Japanese designers should be held (no admission charges) and these should be broadcast live on television. Newspaper and magazine articles about them should also help.
   c) Introduce more modern Japanese TV programs and movies.

(8) Faster and more simplified customs clearance for exports and imports

1) Explicit statement of customs clearance rules

   As the interpretation of customs clearance rules should not be left to the discretion of individual customs officers, customs clearance rules should be disclosed. At the same time, such unusual rules as "in principle, import licenses are not issued for the imports of fabrics unless their prices are higher than US$1.5/yard," which do not meet international practices, should be abolished.
2) Simplifying procedures for obtaining import licenses

   Obtaining an import license for materials for export garments now takes ten days to thirty working days. The approval procedures should be simplified so that this period can be shortened to half a day or one day.
3) Abolishing import bills of remittance

   Although an import bill of remittance is required for customs clearance of imports, this has become just a formality. In the case of CMP, the import bill of remittance

can be obtained within a few hours if the application is made. Since the usual procedure is to make advance payments for the import of materials, requiring CMP exporters to file a report on the balance of their bank account to make sure they can pay for the imports is just cumbersome and should be abolished.

4) Streamlining of cargo inspection

At present, detailed inspections of cargoes are made for customs clearance of imports and to release the cargo to the factory warehouse, totally, it takes four to eight business days. This procedure should be simplified into sampling inspections, and the time required for customs clearance should be shortened to two to three days for items which do not require inspection and to three to four days for those requiring inspection. At the same time, a simplified customs clearance system should be introduced and items which are found to have no problems in prior inspections should be released within two days of ETA Yangon, even if the fees for this procedure are double or triple usual charges.

5) Streamlining of export license issuance procedures

At present, it takes a total of three to nine business days to obtain an export license (1.5 to four days at the MTI and an additional 1.5 to five days at the Ministry of Commerce). The procedure at the Ministry of Commerce should be scrapped, while MTI should shortened the period between the license application and issuance to half a day.

6) Omitting the requirement for cargo acceptance at the time of exports

It is not necessary for the government to confirm the shipping company's release orders. The government requirement that a container which is taken out of the container yard should be exported or used as a warehouse without fail and cannot be returned to the garment manufacturer is a burden to garment manufacturers. For example, often a garment manufacturer is asked to ship just one 20 feet container when it has planned to ship a 40-foot container. In the worst case, the garment manufacturer is required to pay the freight for a 40-foot container and that for a 20-foot container or the difference between the freight for two 20-foot containers and that for a 40-foot container or keep 40 feet container to use as warehouse for a while with pay, until next 40 feet shipment.

7) On-site customs clearance

In the medium term, it is hoped that the government will make on-site customs clearance at the plant as it is done in China, so that cargoes can be loaded to the ship immediately after they are shipped from the plant.

8) Application and issuance of certificates of origin prior to export

In case of air shipments, the application for and issuance of certificates of origin prior

to export are authorized as long as air way bill (AWB) has been issued. The same system should be adopted for shipments by sea. Depend on the forwarder system, a freight forwarder is designated as the consignee in a bill of lading issued in Yangon because the cargo makes a transit in Singapore. The companies have to wait to be issued CO until they submit mother B/L from Singapore to final destination. A certificate of origin should also be issued in these cases. At present, MTI issues certificates of origin for clothing, but this function and responsibility should be assigned to UMFCCI, as is done in Japan, or other bodies to spread responsibility and shorten the time required. The present system of requiring the approval of MTI or the Ministry of Commerce for everything should be changed.

9) Advance issuance of GSP Form A

Like the certificates of origin mentioned in the previous paragraph, this form should be issued by the UMFCCI or other organizations based on prior applications.

(9) Marketing

Since most private garment firms identified marketing and sales as a major difficulty for their firms, "marketing performance" has been highlighted as one of the key issues and analyzed accordingly. The price-value ratio of Myanmar garments is good compared to international competitors. This situation is confirmed by foreign buyers through interviews survey in Myanmar. Private garment firms have no access to market information, trend research, and customer data. This is mainly due to the fact that there are no export promotion institutions, private sector institutions or other organizations which can supply firms with this important data. All firms stated that access to information like potential buyers and agents, data about the export potential of other countries, and all other necessary information is of high importance.

Garment firms do not have access to market information, fashion news, new fashion trends, etc. Furthermore, firms lack know-how in terms of sizing tables, grading lists, and technical data for product development. Also, personnel in charge of product development and design are very weak and inexperienced in using modern methods for product development like CAD/CAM or other more advanced technologies. This is important since international firms communicate product development data via the Internet to the outsourcing manufacturer. These new technologies will be of future importance in helping Myanmar firms become FOB exporters or ready-to-sell/collection businesses. Locally produced fashion designs and products are usually not saleable in international export markets like Japan and the EU. Designers who participate in local fashion shows and exhibitions cannot really compete in export markets, only in domestic market. SMEs confirmed that their promotion activities are weak and need to be improved in order to compete in international markets. Therefore,

business associations should help most firms to have company profiles, and information about their products or services in a readily available form for international buyers. Business associations should help firms to participate in international and local trade fairs through annual members' fee and subsidies provided by government finance in the future.

(10) Fund-raising

Even in Myanmar, many financial institutions have not changed their stance on making lending based on collateral, and they are still reluctant to lend to SMEs, which are seen as high-risks. However, financial institutions should recognize the intermediate function of business associations. As business associations are in existence nearer SMEs rather than financial institutions, business associations have various kinds of information useful to screening credit quality of SMEs. Under such situation as the screening capability of banks for lending to SMEs is not well-established, the bank's effective using the information on SMEs which business associations have accumulated, becomes an important step turned to the lending expansion to SMEs.

Therefore, the enhancement of business associations for supporting fund-raising for SMEs is of great importance even as seen in Japan after the World War II. Business associations should strengthen a leadership role to guide SMEs how to make a feasibility study and how to make a business plan for new business for project necessary to obtain a loan. And, business associations should carry out a capacity building for staff working for financial institutions and SMEs on risk analysis, cash flow analysis, collateral evaluation and lending on benchmarks, etc. Many staff for financial institutions does not have a skill to judge whether or not SMEs or projects are good. As one of the important reforms requested to financial institutions is to shift from collateral-based-lending to spread-based-lending which takes preferential/risks premium interest rates into account, human resource development for staff of financial institutions and SMEs is of urgent importance.

(11) Another Points to be stated in A Master plan for Myanmar Garment Industry

1) Objective:
   - Develop textile and garment industry into a major export sector; satisfy increasing domestic consumption demand; create more jobs for employees; improve export competitiveness; firmly integrate into regional and global economies.
   - It is necessary to organize in harmony for acquiring of synthetic fibers in the required raw materials by joining with the Petroleum and Chemical Works so as to be able to implement works as expected, chemical dyes from local chemical works,

the products of help such as sewing thread and button from the local market, machine parts and tools from the local market. It is necessary to lead to acquisition of fashion designs locally.

2) Speed-up Development Strategy of Myanmar Textile and Garment Industry up to 2005

A/ Textile: production of material for weaving, spinning, printing, dyeing and finishing.

- Investment should go along with environmental protection; spinning, weaving, printing, dyeing and finishing enterprises should be located in a sufficiently long distance from big urban centers.
- Investment in equipment of modern technology and of high specialization; Focus on designing new textile products in order to step by step assure credibility of Myanmar made textile products in the international market
- Re-organize quality management system accordance with international standard, increase output, made textile products to meet export garment and domestic demand.

B/ Garment:

- Promote fashion and garment designing activity. Improve production, quality management system. Apply all economical measures to increase productivity, decrease costs and enhance competitiveness of Myanmar garment products in the international market.

C/ Develop zones for cotton trees growing, silkworm raising, production of material and accessories, chemical stuff, dyeing stuff to serve textile and garment industry to gradually self-provide a majority of material and accessories to replace imported ones.

D/ Encourage all forms of investment, especially FDI in order to enable the textile and garment mechanical sector to produce part, assemble and fabricate textile and garment equipment.

3) Targets (Example):

A/ Production output:

- By the year 2005/2006 production output is to reach 230 –250 tones (Estimated at 190 tones in 2000/2001) of raw cotton, 320 – 350 million pieces (Estimated at 200 million pieces in 2000)

B/ Export turnover:

- By 2005/2006: US$ 1200 to 1500 million pieces

- (Estimated at 200 million pieces in 2000)

C/ Employment:

- By 2005/2006: 150 to 200 thousand workers
- (Estimated at 120 thousand workers in 2000)

D/ Equipment

- By 2005/2006: 110 to 150 thousand machines (Estimated at 80 thousand workers in 2000)

E/ Ratio of home-made material and accessories used for export garment production

- By 2005/2006: over 30% (estimated at 5% in 2000)

4) Main Measures

A/ Financial and capital solution:

- It is encouraged and enabled to call for investment within the country and from abroad in order to be able to mobilize all capital sources from all economic sectors.
- The government is requested to establish favorable mechanism and policies for the garment and textile sector (for both domestic and foreign investment) so that the development speed-up program can be implemented.

B/ Investment solution:

- The garment and textile sector should carry out the planning of the material development areas, positioning textile industry complexes at provinces' industrial zone as well as co-operating with the provinces so that to produce the planning to develop garment factories at different localities in the provinces.

C/ Market solution:

- A trade promotion system for key markets such as EU, Japan, the U. S etc. must be created. The trade system network must be closely integrated, which mean attention must be paid to the establishment of several agents in one market.
- Each garment and textile firms or trading and services or companies operating in garment and textile sector must pay attention to product designing with appropriate model. It is necessary for each firm to establish a long lasting style and brand as well as seasonal fashion collection following the business methods of the big garment and textile distributors in the world.
- It is required to pay attention to building and registering commercial brands. Firm names, brands and traditions should be publicized not only at home market but also at target markets.
- The leading firms should establish its world-wide trade promotion network. That will be a reliable source of information for another firms when entering such

markets as well as re-enforcing and widening their market shared.

D/ Human resource management and development solution:

- It is required to study and apply an advance management method that can improve management efficiency in garment and textile firms. Firms must find out measures to improve the efficiency complying with ISO-9000 management standard under TQM (Total Quality Management) system.
- The director is wholly responsible for all activities so he/ she must be granted all needed rights to legally carry out his/ her duty.
- All garment and textile firms need to make a plan build up a management information network for improving the efficiency of management and control (an advance management method).
- In order to receive suitable technology and import compatible equipment, the re-enforcement of research institutes and employment of specialized experts is necessary. It may also be necessary to hire foreign experts for the efficient implementation of investment projects.
- Foreign and technical expert can be hired to solve problems of some firms or management of new investment projects.
- New treatment mechanism (actually an enterprise culture) both mentally and materially can be established to attract all sources of intellectuals for the development of the garment and textile sector.
- Vocational training schools and enters must be improved (including employment of foreign expert) to improve training efficiency that will meet the booming requirement for management and technical staff in the time to come.

E/ Some Petition about Policy and Mechanism

- The Government is requested to distribute capital from the state budget to support the projects of planning for development of material areas for cotton growing and silkworm raising, waste water treatment plants, textile industry complex planning, infrastructure construction for new textile complexes and training and research carried out by institutes, schools and research centers specialized in garment and textile.
- The Government is requested to allow the firms to keep quota fees and quota bidding fees as budget for opening export market, paying international garment and textile associations membership fees, spending on trade promotion and human resources training for the sector.
- The Government is requested to encourage garment and textile firms to speed up export to the U. S. market. Myanmar financial authorities must shortly issue guide to applying the support some ratio of the foreign currency generated from

export to U.S. until they can enjoy normal trade policy.

- Foreign investment in the fields of production of material and accessories for the garment and textile sector should be encouraged. Especially for export textile and garment sub-sector, it is necessary to put high priority to establishment of production firms or export garment joint-venture firms for export to the U.S. market and award quota (if any) equivalent to the exact export amount in the non-quota years.
- The Government is requested to assign business associations to consider and decide direct purchase of used machinery and equipment as guided by Ministry of Trade.
- The Government is requested to make and release an action plan to clear all impediments as pointed in this reports and to improve business environment of private garment firms.

5.4.3 Proposed Development Strategies for the Development of Myanmar Garment Industry

Under these circumstances, it is essential for Myanmar to reform its systems and improve its products more aggressively than its neighboring countries do as it competes with China, Vietnam and other countries in the field of garment-manufacturing. Particularly in Myanmar there are a number of problems both in its export system and product costs (raw materials and electric power costs, etc.). If Myanmar fails to take actions, we cannot say that there is no likelihood of Myanmar's market shares in the United States and Europe declining in the medium-term as well. It will also be unlikely that its exports to Japan will increase. The main body of this report makes in-depth analyses of various problems faced by private enterprises and foreign companies in their operations in Myanmar. Based on the outcome of the analyses, we summarize the examples of our proposals for development strategies for the development of the garment-manufacturing industry as follows.

Table 5- 43 Development Strategies for the Garment-Manufacturing Industry

	Urgent Target	Medium-term Target	Long-term Target
Reduction of business costs		In Myanmar, while labor cost is low, the costs of telephones, electric power, diesel oil for in-house power generation and other items are high for foreign investors. One of the key to the development of the garment industry lies in to what extent the country can reduce the business costs.	

Improvement of exchange rates from CMP exports		Since August 2001, an inferior exchange rate is applied to foreign exchange earnings from CMP exports. The government should end adjustments via the exchange rate and examine the feasibility of introducing refunds of import taxes to CMP, a practice that is common among other developing nations.	
Explicit statement of labor rules		The foremost problem is the very strong protection given to workers by the government. Labor rules must be explicitly stated to the employers before the Labor Bureau receives labor contracts from them. Since there is no adequate system to defend the employers, an environment in which foreign capital firms can operate without undue fears should be provided.	
Speedy custom clearance	It takes many days to clear customs or file applications than in the past. The faster and more simplified customs clearance for exports and imports are needed as suggested in this report.		
Strengthening of functions of Myanmar Garment Manufacturing Association	To officially recognize MGMA as an organization and give it a voice for policy recommendations is very important for the development of this industry in Myanmar.		
Development of supporting industries		The development of supporting industries for sub-materials is essential to switch to CMT/FOB exports in the future. It is essential to include Japanese experts on production technology of sub-materials	The development of the upstream (yarn-making and fabric-making) sector to supply raw materials for garments for exports is a key in strengthening Myanmar's competitiveness.

			However, since this sector is capital and technology intensive, the introduction of foreign direct investments is a prerequisite.
Expansion of export markets	As the Myanmar's dependency rate on the United States is very high, Myanmar should work to diversify its export markets by developing business with Korean, Hong Kong and Singaporean dealers, who are strong in the European market.		
Creation of garment training centers	Introducing more technologies in order to improve the quality of products destined to the Japanese market, the Myanmar should create garment training centers. Judging from the present status of garment manufacturers, courses needed in Myanmar are patterning, cutting, sewing, quality control, finishing, storage, plant management, marketing, planning, printing, embroidery, CAD and CAM, designing, dyeing, knitting, spinning, and weaving.		
Improvement of infrastructure			The infrastructures required for the garment industry are power supply, repairs of paved roads, enhancement of container trailers, the introduction of high-speed telephone lines, cell phones and e-mail at lower charges, and the permission

			for the fee use of the Internet.
Support for Marketing by MGMA	SMEs confirmed that their sales promotion activities are weak and need to be improved in order to compete in international markets. Therefore, business associations should help firms to have information about their quality of products or services in a readily available form for international buyers.	MGMA should help firms to participate in international and local trade fairs through annual members' fee and subsidies provided by government finance.	
Consultancy for Fund-raising by UMFCCI		Even in Myanmar, many financial institutions have their stance on making lending based on collateral, and they are still reluctant to lend to SMEs. As UMFCCI have various kinds of information useful to screening credit quality of SMEs, the enhancement of business associations for supporting fund-raising for SMEs is of great importance	

Source: JICA study team

(Annex)

Changes in International Environment surrounding Textiles and Garments

(1) Currents in international trade and investments in textile and garment- manufacturing sector

In the global structure of trade in textiles and garments, the EU, North America and Japan are major importers, while China and the rest of Asia are the exporters of inexpensive staple products and the EU is the major exporter of high-grade garments. On the other hand, the production of textiles and garments is being carried out by three poles: i) the NAFTA regime [the Caribbean Basin Trade Partnership Act (CBTPA)], under which textiles from the United States are made into garments in the Caribbean nations; ii) the OPT regime (Outward Processing Tariff or Trade), under which EU textiles, such as those from France, Germany and Italy, are made into garments in North Africa or the former Eastern Europe and iii) the third regime under which textiles from Japan, the Republic of Korea (South Korea) or Taiwan are made into garments in China, Southeast Asia, Indochina and South Asia for exports to Europe and the United States.

Since the first two poles are quota-free, non-tariff alliances, investments in garment-making from the advanced, industrialized nations to the developing nations in the same regime and circle trade in which textiles from the advanced, industrialized nations are made into garments in the developing countries in the same regime for re-exports to the countries from which the textiles originated have increased. As a result, in the United States and the EU, which are both major markets, the ratio of intra-regional trade has been increasing.

Between 1990 and 2000, garment exports from the Caribbean nations to North America increased at an average annual rate of 23%, while those from the Central Europe, Eastern Europe and Russia to Western Europe increased at an average annual rate of 15%. These figures are much higher than the average annual rates of increase in exports from the Asian nations to North America and in exports from the Asian nations to Western Europe, which stood at five percent and four percent, respectively.

The movement of textile trade between 1990 and 2000 within a regime shows that while textile exports from North America to the Caribbean nations increased at an average annual rate of 16%, those from Western Europe to the Central Europe, Eastern Europe and Russia increased at an average annual rate of 12%. However, since textiles from Japan (including those manufactured by Japanese affiliates in Thailand, Indonesia and other countries), the Republic of Korea and Taiwan are made into garments in China, Indochina, South Asia and other places for exports, the increase in textile exports from the Asian countries to North America or to Western

Europe was very small.

The passage of the African Growth and Opportunity Act (AGDA) in U.S. Congress in May 2000 has made it possible for African nations to export garments to the United States (direct exports) at a tariff rate of zero percent through 2008, provided the exporting nation i) introduces a market economy and a multiple political party system, ii) removes barriers to imports and investments from the United States, and iii) guarantees the protection of intellectual property rights in line with the provisions of the World Trade Organization (WTO). AGDA stipulates that clothing manufactured in Africa using made-in-Africa fabrics and yarns will be subject to the zero tariff rate and will be free from import quotas, as long as it does not exceed 1.5-3.5% of the U.S. market for imported clothing, which is estimated at US$66 billion a year. Since exports of clothing from Africa under AGDA in 2000 were only about one percent of the U.S. market for imported clothing, African exports to the United States are expected to increase and work against exports from Asia to the United States.

Table 5- 44 Matrix of World Garment Trade (US$ billion)

			Importer								
			World	EU	Russia	China /Asia	Africa	Latin America	Japan	U.S.	Canada
Exporter	World	1990	114	60	3	10	1	2	8	24	2
		1994	148	65	3	18	1	6	14	32	2
		1998	190	88	4	21	2	10	14	44	3
	EU	1990	39	33	1	1	0	0	2	1	0
		1994	41	30	1	2	0	0	2	1	0
		1998	51	41	2	3	0	0	2	2	0
	Russia	1990	3	1	0	0	0	0	0	0	0
		1994	5	2	0	0	0	0	0	0	0
		1998	7	7	0	0	0	0	0	0	0
	China /Asia	1990	59	22	1	8	0	0	6	18	2
		1994	82	24	1	15	0	1	12	24	2
		1998	102	34	1	17	0	2	12	29	2
	Africa	1990	2	2	0	0	0	0	0	0	0
		1994	3	3	0	0	0	0	0	0	0
		1998	4	4	0	0	0	0	0	0	0
	Latin America	1990	2	0	0	0	0	0	0	2	0
		1994	4	0	0	0	0	0	0	3	0
		1998	8	0	0	0	0	0	0	7	0
	Japan	1990	0	0	0	0	0	0	0	0	0
		1994	0	0	0	0	0	0	0	0	0
		1998	0	0	0	0	0	0	0	0	0
	U.S.	1990	2	0		0	0	1	0	0	0
		1994	5	0	0	0	0	3	1	0	0
		1998	9	0	0	0	0	7	0	0	0
	Canada	1990	0	0	0	0	0	0	0	0	0
		1994	0	0	0	0	0	0	0	0	0
		1998	2	0	0	0	0	0	0	2	0

Source: Compiled by the JICA study team from data from various countries.

Under NAFTA, which came into effect on January 1, 1994, imports of products, especially from Mexico, produced of raw materials made in the United States are tariff-free and exempt from quotas. As a result, the U.S. textile industry has reaped great benefits from sewing on commission in Mexico. Because of zero tariff, inexpensive labor (approximately US$10/hour in the U.S. vs. approximately US$2/hour in the maquiladora zones in Mexico) and the fact that Mexico borders the United States, some 80 to 90% of garments imported from Mexico are made of U.S. fabrics. It is safe to say that the textile industry in the United States has successfully built vertical production alliance with the garment-manufacturing industry in Mexico.

In addition, under the so-called "807 scheme", U.S. import tariff is levied only on the value added created abroad (i.e. cost of sewing) when fabrics cut in the United States are made into garments in a NAFTA member country other than Mexico for re-exports to the United States. Regarding the Caribbean nations, in addition to the existing preferential tariff treatment, the so-called "807A scheme" allows separate less stringent quotas in addition to the quotas fixed in bilateral agreements. Since this scheme came into force, there have been large volumes of imports from these nations using materials made in the United States. Consequently, the share of the Latin American countries in garment exports to the United States has been increasing and has depressed that of the Asian countries.

Table 5- 45 Breakdown of U.S. Garment Imports by Region (%)

	1995	1996	1997	1998	1999	2000
Asia	63.8	61.0	58.7	56.9	55.8	55.0
Latin America	22.4	24.9	27.7	28.9	30.3	30.2
Western Europe	6.8	6.9	6.4	6.4	6.0	5.9
North America	2.2	2.5	2.7	2.8	3.0	3.0
Middle East	2.1	2.0	1.8	1.9	2.1	2.2
Africa	1.8	1.6	1.7	1.9	1.8	2.0
Central and Eastern Europe, Russia	1.0	1.0	1.0	1.1	1.0	1.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: *WTO International* Statistics 2001

As in the Americas, EU also has a preferential arrangement for the use of textiles made in the region. The Outward Processing Tariff or Trade (OPT) originally began by levying tariffs only on the value added created in other countries when semi-finished EU products (woven fabrics and knitted fabrics for garments and yarns in case of sweaters) are made into garments outside of the EU for re-exports to the EU. Today, the scheme has expanded to include the six countries of Central and Eastern Europe (Czech, Slovakia, Hungary, Poland, Romania and Bulgaria) and two North African nations (Tunisia and Morocco). Imports of garments made

under this arrangement from these eight countries are quota-free and tariff-free, and the preferential treatment is as significant as that in the United States. As a result, the share of these nations in garment imports to the United States and the EU has been increasing. The reason that OPT has not hampered the increase in garment exports from Asian nations to the EU is that the EU has been increasing quotas for them. However, when the Agreement on Textiles and Clothing (ATC) of the WTO goes into effect on December 31, 2004, abolishing quotas in international trade on January 1, 2005, Asian countries are to face a head-on competition with the Central and Eastern European and African nations in garment exports to the EU market.

Table 5- 46 Breakdown of Garment Imports to EU by Region (%)

	1995	1996	1997	1998	1999	2000
Western Europe	51.7	53.1	50.4	51.1	50.0	47.4
Asia	30.1	27.6	29.6	28.4	29.3	32.4
Central and Eastern Europe, Russia	8.3	8.9	9.7	10.4	10.6	10.3
Africa	6.9	7.5	7.4	7.7	7.8	7.7
Middle East	1.2	1.1	1.2	0.9	1.0	0.9
North America	1.1	1.1	1.0	0.9	0.8	0.7
Latin America	0.5	0.4	0.5	0.4	0.4	0.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

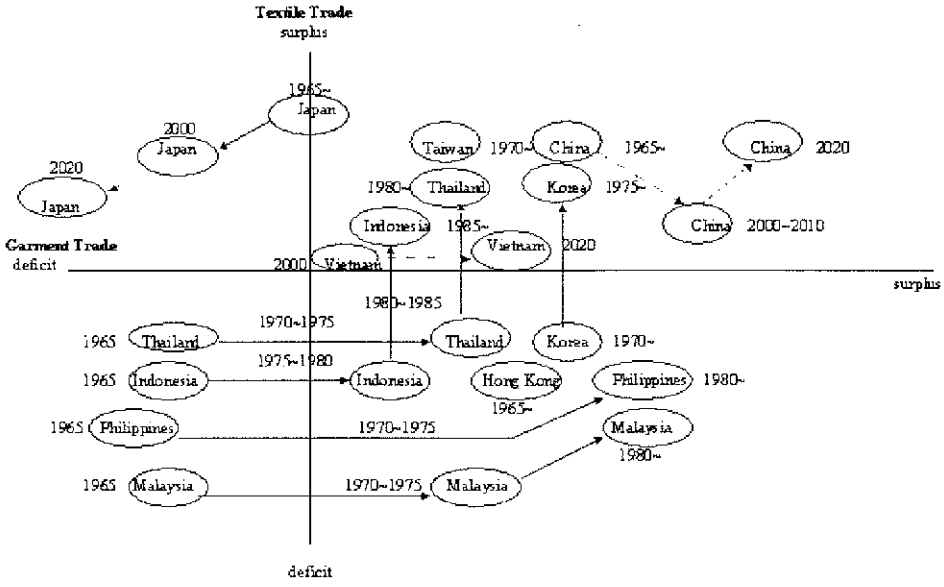
Source: WTO International Statistics 2001

Meanwhile, the ratio of intra-regional trade in Asia is not so high, because Japan, the Republic of Korea and Taiwan focus on investments in China, Southeast Asia and Indochina and export finished garments to the North American, EU or Japanese markets from these countries. Particularly in China, investments in upstream sectors, such as yarns and fabrics, from Japan, the Republic of Korea and Taiwan are accelerating as China becomes an important production base for chemical fibers, which require the economies of scale, and as a base for exports to the United States of garments made of such materials. The Republic of Korea and Taiwan are also making investments in upstream sectors in Vietnam, the former to make the country into a base for knitting and weaving cotton fabrics and the latter to build a base for knitting and weaving chemical fibers and to spread the investment risks from China. Under these circumstances, Myanmar needs to improve both government systems and policies, and product strategies in order to strengthen the competitiveness of its garment-making industry.

(2) Long-term strategies of Thailand, China, Japan and Vietnam for garment and textile trade and hints for Myanmar

1) Outlook for and long-term strategies of Thailand

Figure 5- 42 Long Term Trend of Garment & Textile Trade



Source: JICA study team

The development pattern of garment and textile trade in Asian countries has been as follows: i) At the initial stage, both garment and textile trade is in the red; ii) in the next stage, the garment trade shifts to black-ink figures helped by low wages; iii) foreign direct investments in the textile sector promote import substitution and iv) finally, like the Republic of Korea and Taiwan today, the nation becomes a textile exporter.

First, we would like to examine the development pattern of the garment and textile industry in Thailand, which is Myanmar's neighbor. Although the export competitiveness of Thailand's textile and garment industry has been eroded somewhat since the second half of the 1990s, the industry is still the nation's largest employer and the earner of foreign exchanges.

Table 5- 47 Weight of the Textile and Garment Industry in Thai Economy (1999)

	GDP	Exports	Trade balance	No. of employees
Textile & garment industry	143.2 billion baht	5.16 billion dollar	3.22 billion dollar	1.09 million person
As % of all industries	14.5%	8.8%	25.9%	24.7%

Source: Thai Textile Statistics 2000, Department of Industrial Promotion in Thailand.

Table 5- 48 Share of Textile and Garment Industry in Thailand (%)

	1996	1997	1998	1999
Amount of garment exports/Amount of total exports of goods	9.8%	9.5%	9.4%	8.8%
No.of textile and garment industry workers / No. of industrial workers	25.9%	25.9%	26.2%	24.7%

Source: Thai Textile Statistics 2000, Department of Industrial Promotion in Thailand

Amount of garment exports/Amount of total exports of goods

The garment-manufacturing industry in Thailand began to receive orders for sewing on commission from Taiwanese firms in the 1950s and developed with the creation of joint ventures with Japanese and other foreign companies in the 1960s. The Japanese and other foreign firms began to launch joint ventures for garment-manufacturing because of tax incentives extended under the Investment Promotion Act of 1959 and the Thai government's intensive efforts to improve communication, ports and harbors and other infrastructure.

Although the textile industry in Thailand started with cotton spinning, massive imports of cheap cotton yarn from Pakistan in the 1950s forced many Thai cotton spinners to go out of business. The Thai government, therefore, adopted an import substitution policy for cotton spinning. It enacted Restriction Act on Cotton Yarn in 1955 and in 1957 extended the scope of restriction to include cotton fabrics. As a result, tariff rates of up to 100 percent were imposed on cotton yarn and fabric imports from Pakistan. The Investment Promotion Act of 1959 was instrumental in bringing cotton spinning companies from Japan and elsewhere and Thailand launched on the domestic production of cotton yarn and fabrics. In 1964, the country was able to bring a Japanese synthetic textile maker into the country to start domestic production of synthetic textiles for import substitution.

A revision of the Investment Promotion Act in 1972 shifted the priority in the nation's textile industry policy from import substitution to export promotion. This was implemented through the strengthening of the power of the Board of Investment (BOI), tax incentives, the reduction in import tariff rates, and the development of industrial zones and export processing zones.

Table 5- 49 Decreasing of Import Tariffs for Textiles and Clothing in Thailand (%)

	1974	1978	1982	1992	1995	1997
Synthetic Fiber	20 (30)a	20 (30)a	20 (15)a	30b	20	10
Yarns	20	20	22	30	20	10
Cotton Yarns	25	25	27	30	20	10
Fabrics	60	80	60	60	40	20
Clothing	60	100	66	60	45	30

Note: Import surcharge as a percentage of CIF import price, a:1975, b: Import surcharge was abandoned.

Source: Textile Intelligent Unit, 1998, Textile Industry Division of Thailand

As a result of these measures, the garment-manufacturing industry became a net exporter during the first half of the 1970s and the textile industry in the second half of the 1970s. Even after Thailand became a signatory to MFA in 1976 and quotas on garment exports to the United States and Europe were imposed, the country continued to expand textile and garment exports to non-quota countries. Aided by generous government measures under the Fifth Five-year Economic Development Plan (1982-1986), the increase in textile and garment exports accelerated further. From the 1980s and onward, garment exports, mainly to North America and the European Community, accounted for slightly more than 70% of total exports. In 1995, garment exports and textile exports reached record figures of US$4.8 billion and US$1.9 billion, respectively.

However, since the second half of the 1990s, exports of both textiles and garments have somewhat slowed. This is because of i) the decline in export competitiveness of garments due to the pressure from the average monthly wage of US$150; ii) the decline in export competitiveness of textiles due to stagnant investments in the dyeing sector resulting from more rigorous domestic environmental regulations; iii) a sharp increase in the imports of foreign textiles as textile production technologies and equipment in the country became out-dated; iv) the decline in competitiveness vis-à-vis Chinese products because of geography, as the Japanese market called for ever quicker responses; and v) stagnant exports to the United States and Europe because of the growth of circle trade under NAFTA and OPT. Furthermore, the decline in the competitiveness of Thai textiles and garments themselves is a serious problem. Major export destinations of more labor-intensive garments are the United States, Europe and Japan. Thai products compete with garments from China, Indonesia, Mexico and Vietnam in these markets, but Thai competitiveness has been declining. As of 1998, Thailand was the world's eighth largest exporter of knitted garments and the 11th largest exporter of garments made of woven fabrics. A table below shows a list of competing exporters. In the garment-manufacturing sector, in particular, the Japanese garment makers who started operations in Thailand one after another in the 1960s and 1970s have begun to pull out of the country in increasing numbers since the 1990s. Many Japanese companies that export to Japan are moving their production bases to China, which can make quick responses to the changing Japanese preferences. As a result, exports to Japan have been on a downward trend.

Major destinations of exports of relatively more labor-intensive fabrics are the United States, UEA (United Arab Emirates) and the United Kingdom, while major competitors in this sector are China and Indonesia. Thailand's competitiveness vis-à-vis these nations has declined markedly, because it still uses out-dated shuttle spinning machines, which results in lower productivity and higher costs. While the majority of the world spinners are switching from shuttle spinning machines to jet spinning machines, 70% of the weaving industry in

Thailand still uses shuttle spinning machines. With regard to more capital-intensive yarns, major destinations of cotton yarn exports are China, Malaysia and Japan, while those of synthetic yarns are the United States, the Republic of Korea and Hong Kong. Major competitors in cotton yarn exports are India and Pakistan, while the major competitor in synthetic yarn exports is Indonesia. So far, the export competitiveness of Thailand has been strengthened by modernization investments by foreign companies. Because of these factors, at present Thailand is a net exporter of garments and yarns but is a net importer of fabrics.

Table 5- 50 Competitiveness of Thailand's Textiles and Garments (Ex-Im/Ex+Im)

	1985	1990	1991	1992	1993	1994	1995	1996	1997
Yarns	0.40	0.03	0.17	0.19	0.22	0.39	0.32	0.41	0.42
Fabrics	0.09	0.12	0.13	0.00	-0.04	-0.18	-0.01	-0.11	-0.16
Garments	1.02	1.00	1.01	1.00	0.99	0.97	0.95	0.91	0.88

Source: Textile Industry in Thailand, Nov.1998, APEC Secretariat (Singapore)

Table 5- 51 Major Export Markets for Thailand's Textiles and Garments (Top 5 markets)

(US$100 million, %)

	1997	1998	1999	2000
U.S.	16.3(29.7)	18.4(36.0)	18.6(36.1)	21.0(37.7)
EU	11.5(21.0)	10.9(21.3)	10.8(20.9)	10.8(19.4)
ASEAN	4.1(7.5)	3.4(6.7)	4.1(7.9)	4.6(8.2)
East Asia	4.8(8.8)	3.7(7.3)	3.8(7.3)	4.2(7.5)
Japan	5.0(9.2)	3.6(7.0)	3.7(7.2)	3.7(6.6)
Textile and Garment Exports	54.8(100.0)	51.1(100.0)	51.6(100.0)	55.7(100.0)

Source: Thai Textile Statistics 2000

Table 5- 52 Major Export Markets for Thailand's Garments (Top 5 markets)

(US$100 million, %)

	1997	1998	1999	2000
U.S.	13.7(42.97)	15.5(50.6)	15.6(51.7)	17.6(54.2)
EU	7.1(22.4)	6.7(21.9)	7.1(23.5)	7.3(22.4)
Japan	3.2(10.2)	2.3(7.6)	2.2(7.3)	2.0(6.3)
Middle East	2.7(8.4)	2.0(6.5)	1.7(5.5)	1.6(4.9)
Africa	1.0(3.3)	0.8(2.7)	0.8(2.3)	0.6(2.0)
Garment Exports	31.8(100.0)	30.7(100.0)	30.3(100.0)	32.5(100.0)

Source: Thai Textile Statistics 2000

Table 5- 53 Exporting Nations of Knitted Products and Their Markets (Top 10 countries in 1999)

(US$ million)

	World	EU	NAFTA	Japan
China	8,376	1,888	2,192	4,296
Mexico	3,334	8	3,309	17
Hong Kong	3,256	833	2,381	42
Korea (the Republic)	2,058	302	1,064	692
U.S.	1,929	190	1,474	265
Bangladesh	1,860	653	1,203	4
Taiwan	1,525	256	1,232	37
Thailand	1,335	323	860	152
India	1,100	540	547	13
Indonesia	988	460	454	74

Source: Cost Structure of Major Thai Industries, October 2000, WS Atkins, NESDB, World Bank

Table 5- 54 Exporting Nations of Woven Products and Their Markets (Top 15 countries in 1999)

(US$ million)

	World	EU	NAFTA	Japan
China	12,817	2672	4,165	5,980
Mexico	4,508	14	4,488	6
Hong Kong	3,648	1,399	2,209	40
Bangladesh	2,713	740	1,962	11
India	2,116	801	1,242	73
Indonesia	2,096	647	1,325	124
U.S.	1,825	216	1,450	159
Korea (the Republic)	1,589	192	1,221	176
Sri Lanka	1,285	264	1,014	7
Philippines	1,254	92	1,089	73
Thailand	1,071	207	756	108
Taiwan	826	87	718	21
Vietnam	716	378	44	294
Cambodia	635	37	597	1
Macau	601	216	379	6

Source: Cost Structure of Major Thai Industries, October 2000, WS Atkins, NESDB, World Bank

Thailand has been a member of the MFN since its inception in 1975. In early years, the MFN did not have negative effects on Thai exports. Indeed, it provided export markets for Thailand by curtailing the exports of the three major exporting economies; Hong Kong, the Republic of Korea, and Chinese Taipei. Like other MFN members, bilateral agreements have been negotiated between Thailand and individual importing economies.

The utilization of the Thai exports quotas has been high. Utilization rates of quotas to the two principal markets, the EU and the US, were 90-100% in some categories in the first half of the 1990s. In others, flexible provisions led to utilization rates in excess of 100%. Thailand

has a discriminatory system for export quota allocation that favors large exporting firms. The Department of Foreign Trade is responsible for quota allocations. Two systems are used: one for yarns and fabrics and another for clothing. In each case the available quota is divided into two parts: the principal or basic quota, and a residual quota. The principal quota (usually 70 to 80 % of the export quota available) is distributed free of charge annually to exporting firms on the basis of past export performance. The residual quota, this is, the quota left over after principal quota, or about 20% of total export quota available, is allocated on a monthly basis. 20% of the residual quota is reserved for trading companies which are mainly exporting for large firms. These quotas can be sought by any exporting firm, including new ones as well as those already holding principal quotas. If a new exporting company can obtain part of the residual quota in one year, it will be entitled to an export quota allocation from the principal quota the next year.

Although the criteria for obtaining the residual quota appear to represent an open system for newcomers, in practical terms it is difficult for new firms to obtain quotas. The first and the second criteria are very difficult for small firms to meet. Large exporting firms are at an advantage because they usually have integrated spinning and weaving plants or even synthetic fiber, spinning and weaving production system. Their domestic input content is accordingly high. New exporting firms find it difficult to compete in terms of the third criterion because it is difficult for them to produce high value added products or high quality products.

The allocated quotas cannot, legally, be bought, sold or transferred to other firms. In addition, exporters are penalized if they fail to export less than 90% of their own quota. The quota allocation system allocates most of the rents arising from the MFA to large exporting firms. The export quota allocation system has, thus far, been efficient in the sense that available quotas have been highly utilized. Existing exporters, moreover, can monopolize the rents because of their historical performance. New exporting firms with less marketing experience have difficulty in obtaining a quota.

The process of managing the export quota system has diminished the incentives for exports in this sector. The well established firms have less incentive to expand their exports outside MFA markets while they enjoy rents from the quota restricted markets. Consequently, small, medium and new firms concentrate on non-quota markets.

In Thailand, there are more than 2,000 garment manufacturers of various sizes, ranging from those with less than ten sewing machines to those with more than 1,000 sewing machines. However, since those with less than 30 sewing machines are not required to register as businesses, it is impossible to accurately grasp the number of very small garment manufacturers. Many of the small garment manufacturers are household businesses that are not incorporated and work as subcontractors to large garment makers. Weaving firms also vary greatly in size. There are some 250 small weaving firms, which export their products to Myanmar, Laos,

Cambodia, Malaysia, Vietnam and other countries through border trade in addition to supplying their products to the domestic market. The textiles and garment industry in Thailand is increasingly shifting to yarn manufacturing. Large-scale spinning firms with modern equipment have been formed through joint ventures with foreign firms. They produce and export high-quality chemical and synthetic textiles.

The following is a SWOT (strengths, weaknesses, opportunity and threats) analysis made by the association of garment manufacturers in Thailand.

a. Strengths

- Suitable geographic location of Thailand in the Asian Pacific region
- Abundant supply of skilled labor
- Wages are not excessively high whilst skill content is good.
- High degree of vertical integration
- Good collaboration amongst companies and between the private and public sectors.
- Purchasers trust the quality and timely delivery of Thai products.

b. Weaknesses

- Lack of information especially on the rivals' cost and products and of export possibilities for SMEs
- Lack of high skill in production and marketing
- No multi-shilling
- Lack of information and networking in souring materials and products from overseas
- Poor R&D in the designing stage of production
- Use of outdated equipment and technologies
- High tariffs for raw materials and machinery lead to prices marginally higher than those of competitors.
- No strong world-wide brand names

c. Opportunities

- Exports of high-end products where the cost of production is relatively higher elsewhere.
- Many quota categories are under-utilized due to small quantity.
- Exploit the short-term benefits of currency devaluation by looking at medium and long- term benefits of creating brand names in the export markets.
- Use of direct marketing channels to enhance the earnings accrued to producers

d. Threats

- Quota allocation under the MFA which sometimes limits the ability to expand the exports volume.
- The manufacturers' lack of awareness on code of conduct of major brands buyers

- Additional products certification including EN ISO 9000 and EN ISO 14000
- Fast track tariff reduction (to 0% and 5% by the year 2000) industry within ASEAN. Low-end garments will face stiffer competition from Indonesian and China.
- There is now a greater awareness and perception of environmental issues and these will continue to strengthen over the next few years. Most of the major European and American retailers are using the environment as selling mechanism by promoting environmentally friendly processing. Each buyer has their own "factory compliance" standard and all of contracted factories must be complied to receive orders.

  In Europe where legislation will soon be passed banning the use of certain processes in the production of fabric, particularly dyeing and finishing. The standard that will be imposed is Oeko-Tex, and currently is only a voluntary scheme. It has however been adopted by major European retailers, and all their swing tickets and product labels now state that they conform to this standards.

It is expected that Chinese firms will be the main competitor to Thai firms in the future due to: 1) the larger capacity of their textile production; 2)lower wages among Chinese workers; and 3) the lower level of traffic protection on inputs such as textile and petrochemical products. These factors provide Chinese firms with some advantages over Thai firms. This is particularly true in the lower end of the product range where competition with small scale Thai textile factories is more direct.

Challenges and opportunities exist in the international environment. Although the MFA is being phased out, Thailand will confront many issues in the process. The benefits remain either uncertain or delayed. On the other hand, the industry now is looking to the regional market. Production adjustment among ASEAN economies become more specialized in production products which suit their skills and resource endowment. Export expansion could take place on intermediate inputs and final products ranging from synthetic fiber to clothing. In the case of Thailand, where labor costs have become more expensive, adjustment could be made to produced more sophisticated products or upgrade the products at labor intensive end of the industry.

2) Outlook for and long-term strategies of China

China is the world's largest textile exporter. In 1999, its textile exports totaled US$13 billion, or 8.8% of the world textile exports. Hong Kong is the world's second largest textile exporter with textile exports in 1999 standing at US$12.3 billion, or 8.3% of the world textile exports. China and Hong Kong combined account for 17% of the world textile exports. China also has the distinction of being the world's largest garment exporter, with its garment

exports in 1999 standing at US$30.1 billion, or 16.2% of the total world garment exports. It is followed by Hong Kong, which exported US$22.3 billion worth of garments in 1999 and accounted for 12.0% of the world total. China and Hong Kong combined account for 28% of the world total. In 2000, China's textile and garment industry had a trade surplus of US$36.0 billion, which was larger than the nation's total trade surplus, which stood at US$24.0 billion. In 1999, China's textile imports stood at US$12.0 billion, and garment imports at US$2.0 billion. This means that in 1999 China's balance of textile trade was slightly in the black, while the balance of garment trade was a big surplus.

Table 5- 55 Garment and Textile Exports from China and Hong Kong (US$ billion)

	1996	1997	1998	1999
(Textile exports)				
China	12.1 (8.0%)	13.8 (8.8%)	12.8 (8.5%)	13.0 (8.8%)
Hong Kong	14.1 (9.4%)	14.6 (9.3%)	13.0 (8.6%)	12.3 (8.3%)
(Garment exports)				
China	25.0 (15.3%)	31.8 (17.4%)	30.0 (16.4%)	30.1 (16.2%)
Hong Kong	22.0 (13.4%)	23.1 (12.7%)	22.2 (12.1%)	22.4 (12.0%)

Source: WTO Statistics, 2001

China has maintained high levels of exports thanks to its low wages and high productivity. However, China's advantage in terms of wage levels vis-à-vis other developing nations is relative rather than absolute. The weighted average of monthly wages of female factory workers in China is US$90, although wages vary greatly from region to region: US$60 in Sichuan Province (Chengdu City), US$80 in Hubei Province (Wuhan City) and US$150 in Shanghai. The average monthly wage of female factory workers in Vietnam (Ho Chi Minh City and Hanoi City) is US$60. Therefore, it is likely that in the long-term China's garment industry will migrate from the coastal regions to inland regions to take advantage of lower wages.

Table 5- 56 International Comparison of Average Wages of Female Factory Workers (1998)

	U.S.	Mexico	France	Poland	China	India	Pakistan
US$/hour	12.97	2.23	14.16	3.15	0.62	0.24	0.40
U.S.=100%	100%	17%	109%	24%	5%	2%	3%

Source: Compiled by the Textile Industry Bureau, China National Economic and Trade Commission, August 2000.

The textile and garment industry is a key industry in China. Its weight in the Chinese economy is large in terms of the amount of production, pre-tax profits, the amounts of exports and imports, the number of employees and the number of firms. In 1999, there were 3,119 state-owned enterprises (SOEs) and approximately 20,000 private enterprises in this sector.

There were 80 garment manufacturers that exported more than US$50 million annually and 159 garment makers that exported more than US$30 million annually.

Table 5- 57 Weight of Textile and Garment Industry in China's Economy (2000)

	Production	Pre-tax profits	Exports	Imports	No. of employees	No. of enterprises
Textiles and garment industry	880.6 billion yuan	29.0 billion yuan	US$53.3 billion	US$ 16.9. billion	7.63 million persons	18,862
Share in all industries	11.5%	6.0%	22.6%	8.5%	13.4%	11.7%

Source: Compiled by the Textile Industry Bureau, China National Economic and Trade Commission, August 2000.

Although China's textile and garment industry will continue to grow in terms of absolute amounts of production and exports, its share in the total amounts of industrial production and exports will continue to decline. Its share in the total amount of industrial output peaked out in 1985 and that in exports and the number of employees peaked out in 1990. Its share in total world garment exports peaked out in 1997. This is attributable to the following facts: i) the slight decline in competitiveness in the export market due to cost push arising from increases in wages in the garment industry; ii) sharp increases in the amounts of output and exports of electrical machinery and electronics industry in China; iii) competition from Central and South Asia, which produce high-quality raw cotton which is priced below the international price, since China became a member of the WTO [In China, the cost of raw materials is approximately 10% higher than the international price (US$1,500/ton) due to the government's support price for raw cotton]; and iv) NAFTA members are gaining competitive advantages in the U.S. market because of the development of a circle trade within the region, in which cotton yarns made in the United States, which has high levels of production technology and which uses jet spinning machines, are made into garments in the Caribbean nations.

Table 5- 58 Share of Textile and Garment Industry in China's Economy

	1978	1980	1985	1990	1995	1998
Output of the textile and garment industry /Total industrial production in China	14.7%	17.4%	17.9% (peak)	16.5%	14.6%	10.8%
Amount of garment exports /Amount of total product exports from China	24.9%	24.1%	23.5%	27.0% (peak)	25.5%	23.3%
No. of textile and garment industry workers /No. of industrial workers in China	10.5%	11.4%	12.7%	14.8% (peak)	14.2%	13.8%

Source: Compiled by the Textile Industry Bureau, China National Economic and Trade Commission, August 2000.

Table 5- 59 Share of China in Total World Garment Exports

	1990	1995	1996	1997	1998
Amount of China's garment exports/Amount of world garment exports	7.9%	12.3%	11.7%	13.7% (peak)	13.0%

Source: Compiled by the Textile Industry Bureau, China National Economic and Trade Commission, August 2000.

The following are the impacts of China's membership in the WTO on its textiles and garment industry.

a) Impacts on the state-owned textile and garment makers

As China is required to end preferential treatments such as quota allocation and subsidies, etc. for state-owned enterprises, the government plans to restructure 960 loss-making textile makers (SOEs).

b) Impacts on the garment-manufacturing industry

Exports are expected to continue to increase against the backdrops of the easing of the export quotas to the United States and reductions in import tariffs. However, the People's Government's External Economy and Trade Commission of the City of Shanghai is not optimistic about the competitiveness of Shanghai, which today is China's largest base for garment exports. This is due to the following factors: i) Nominal volume of garment exports will increase by 25-27% between 2001 and 2005 as quotas for exports to the United States will gradually be removed. However, as quotas will be abolished starting with those for products which are least likely to sell, it may not have significant export promotion effects; ii) even though the quota system will be abolished, the United States is likely to take protectionist measures in such areas as anti-dumping measures and environmental protection; iii) as Japan's textile and garment industry experienced in the 1970s, labor costs will rise while it will become increasingly difficult to secure manpower because of the industry's 3-D image (dirty, dangerous and demanding); iv) keener competition with the countries benefiting from tariff-free status or preferential tariffs extended under NAFTA and by EU; v) competition from Vietnam and other countries where wages are lower but labor productivity is high; and vi) the increase in imports of high-quality textiles and garments from the United States for consumption by high income-earners. The Commission's view is that there will be more challenges than chances for Shanghai. As such, migration of garment manufacturing bases from coastal regions to inland regions should accelerate.

c) Impacts on the cotton textile industry

Although half of China's textile output in terms of value is cotton spinning, large garment

manufacturers plan to expand the imports of cotton yarns and fabrics from abroad as overseas products are superior both in terms of quality and prices. As the Chinese government has supported farmers through a system of purchasing raw cotton at high support prices for many years, producers' prices in China are as much as 10% higher than the international price. As a result, the Shanghai Textile and Garment Group, which is China's largest garment manufacturer with annual sales of 4 billion yuan (equivalent to US$280 million) and which employs 100,000 workers uses cotton imported from the United States, Egypt or other countries for all of its production of high-grade garments. It is also switching to overseas cotton even for a large part of medium-grade garments.

d) Impacts on the chemical fiber industry

It is reported that in 1998 the labor productivity at state-owned chemical fiber plants was 10% of that of Japan, the Republic of Korea and Taiwan, 25% of that of Germany and 14% of that of the United States. The industry is focusing on the introduction of technology and foreign direct investments from other countries. During the second half of the 1990s, Japan's Toray Industries, Inc. and Teijin Ltd. started operations in Nantong City, Jiangsu Province. They are expected to expand their capacity in the future as well, in addition to them, investments from the Republic of Korea and Taiwan are also expected to increase. China is expected to make great progress in import substitution in the chemical fiber sector in and after 2010.

e) Impacts on the printing industry

While China's printed cotton fabrics are competitive enough to mark net exports, printed chemical fiber textiles are not competitive with the volume of imports exceeding that of exports. This is attributable to i) the fact that approximately 90% of chemical fiber textile printing equipment at state-owned enterprises are out-dated; ii) shortages of electronic inspection machines and electronically controlled production machinery; and iii) a lack of designing capability. One of the top priorities in the textile and garment industry for the Chinese government is the enhancement of the printing technology. However, China's accession to the WTO entails a reduction in import tariffs, which in turn is expected to increase the imports of medium- and high-grade printed fabrics from Japan and elsewhere. The Chinese government, therefore, plans to strengthen the introduction of technology through FDI, including joint ventures in printing business.

Under these circumstances, China plans to increasingly shift to the production of medium- and high-grade garments between 2000 and around 2005 in order to differentiate its products from low-grade garments of other developing nations. However, as chemical fiber textiles for upscale garments are in short supply and because of the reduction in import tariffs resulting from the accession to the WTO, textile imports have been on the increase. This means that although the surplus in the garment trade balance

is expected to increase, there will be occasions when the balance in textile trade will be slightly in the red. From around 2005 and onward, when the domestic as well as export markets for garments will expand further, moves to produce medium- and high-grade chemical fiber textiles domestically will strengthen. The expansion of production by existing foreign companies and the creation of new joint ventures with foreign firms should push import substitution of medium- and high-grade chemical fiber textiles for better garments and the surplus in the balance of textile trade should increase from around 2010. The Chinese government plans to raise the ratio of domestic procurement of chemical fiber textiles from 45% in 1999 to 80% in 2005 and to nearly 100% in 2010. It plans to make China a net exporter of chemical fiber textiles by 2015.

Table 5- 60 Actual and Planned Figures for China's Textile and Garment Output (%)

	1980	1985	1995	2000	2005 (f)	2010 (f)
Cotton yarns & fabrics	59.7	49.2	32.9	30	25	20
Woolen yarns & fabrics	5.5	8.4	8.2	6	5	3
Linen yarns & fabrics	1.4	2.2	1.2	1	1	1
Silk yarns & fabrics	7.1	9.7	10.8	10	12	14
Chemical fiber textiles	4.2	6.6	10.1	14	21	27
Embroidery	8.6	9.1	7.4	8	7	8
Garment-manufacturing	11.0	11.5	21.4	25	25	25
Others	2.5	3.3	8.0	6	4	2
Total	100.0	100.0	100.0	100	100	100

Source: Compiled by the Textile Industry Bureau, China National Economic and Trade Commission, August 2000.

Table 5- 61 International Competitiveness of China's Materials and Garments (Ex-Im/Ex+Im)

	Woolen yarns & fabrics	Cotton yarns & fabrics	Linen yarns & fabrics	Silk	Garment-manufacturing	Chemical fiber textiles
1990	0.08	0.68	0.65	0.70	0.99	−0.67
1991	0.24	0.62	0.73	0.69	0.99	−0.72
1992	−0.05	0.28	0.65	0.59	0.95	−0.77
1993	−0.19	0.36	0.40	0.50	0.94	−0.82
1994	−0.12	0.31	0.52	0.64	0.95	−0.65
1995	−0.12	0.27	0.50	0.68	0.92	−0.68
1996	−0.12	0.12	0.47	0.58	0.92	−0.74
1997	−0.06	0.14	0.37	0.61	0.93	−0.63
1998	−0.04	0.03	0.31	0.60	0.91	−0.66
1999	−0.02	−0.01	0.29	0.58	0.99	−0.62
2000	−0.11	−0.05	0.34	0.65	1.01	−0.55

Source: Compiled by the Textile Industry Bureau, China National Economic and Trade Commission, August 2000.

Table 5- 62 International Comparison of Competitiveness in Materials (Ex-Im/Ex+Im)

	1990	1995	1997	1999
France	−0.11	−0.01	0.02	0.04
Germany	0.08	0.07	0.11	0.15
Italy	0.22	0.33	0.34	0.37
Hong Kong	−0.11	−0.10	−0.05	−0.15
Japan	0.18	0.09	0.08	0.05
Republic of Korea	0.51	0.51	0.58	0.67
Thailand	0.02	0.12	0.21	0.23
China	0.15	0.12	0.06	−0.02

Source: Compiled by the JICA study team from trade statistics of various countries.

Table 5- 63 International Comparison of Competitiveness in Garment-Manufacturing (Ex-Im/Ex+Im)

	1990	1995	1997	1999
France	-0.28	-0.29	-0.34	-0.45
Germany	-0.44	-0.53	-0.51	-0.57
Italy	0.64	0.50	0.47	0.42
Hong Kong	0.38	0.25	0.21	0.19
Republic of Korea	0.96	0.64	0.50	0.48
China	0.99	0.92	0.93	0.99

Source: Compiled by the JICA study team from trade statistics of various countries.

China's garment exports to the United States are expected to increase further after 2005. First, the Agreement on Textiles and Clothing of the WTO will come into force on December 31, 2004, abolishing the export quotas in international commerce, which have constrained China's exports to the United States for the past two decades, on January 1, 2005. Accordingly, China will abolish its quota auctions and therefore, the companies which now have to pay for quotas will no longer have to bear this cost. This will enhance price competitiveness of China's garment exporters to the United States. Second, with China's accession to the WTO, the United States will reduce its import tariffs to 10-13% by around 2005 and permanently extend the most favored nation status to China. The Development Research Center of China's State Council forecasts that China's garment exports will increase from US$30 billion in 1999 to US$60 billion in 2005 and that the total employment in the garment industry will increase from 5 million persons in 1999 to 7.6 million persons in 2005.

Regarding the domestic market for garments, generally speaking domestic consumption of textile equivalent increases sharply when per capita real GDP exceeds US$1,000. The consumption of textile equivalent increases by 1kg. for every US$100 increase in per capita real GDP. China's per capita real GDP was US$855 in 2000 and per capita consumption of textile equivalent 6.0kg. Assuming that per capita real GDP will grow at an annual rate of 7% through 2005 and that the rate of increase in per capita consumption of textile equivalent will increase at an annual rate of 3.5%, the same as in the past, until per capita real GDP reaches

US$1,000, in 2003 when per capita real GDP is expected to reach US$1,047, per capita consumption of textile equivalent will reach 6.6kg. By applying the above-mentioned rule, it is forecast that in 2005, when per capita real GDP reaches US$1,198, per capita consumption of textile equivalent will reach 8.1kg. Thus, domestic consumption of textile equivalent is expected to increase from 7.5 million tons in 1999 to at least 10.10 million tons in 2005.

Furthermore, as China reduces import tariffs as a result of its accession to the WTO, there will be substantial increases in import activities by foreign mass-merchandisers who aim to enter the domestic consumer markets as well as direct investments by foreign basic material producers. The inflow of fashion apparels from the West will expand domestic markets for garments. The Development Research Center of China's State Council forecasts the domestic market for garments will expand from US$52 billion in 2000 to US$100 billion in 2005. As the U.S. market for garments is expected to reach an estimated US$130 billion in 2005, the garment market in China will become the second largest market in the world. It will be followed by Japan, whose market is expected to reach an estimated US$90 billion. An estimate by the Economic Intelligence Unit, a U.K. company, shows that the ratio of expenditure on clothing to total household consumption in China will be high, as demonstrated in the following table.

Table 5- 64 International Comparison of Ratios of Spending on Clothing to Total Household Consumption (%)

Higher 10			Lower 10		
	1992	2005(f)		1992	2005(f)
China	12.8	11.1	South Korea	4.3	3.2
Poland	10.9	9.2	Taiwan	4.7	5.7
Russia	9.9	9.8	Brazil	4.9	4.5
Italy	9.8	9.4	Canada	5.0	4.5
Czech	9.4	8.2	Argentina	5.3	5.2
Slovakia	9.4	8.5	Japan	5.5	4.5
Spain	9.0	8.3	Australia	5.7	5.0
Hungary	8.8	8.6	Denmark	5.9	5.5
Sweden	8.1	7.8	France	5.9	4.9
Mexico	8.0	7.0	UK	6.3	6.6

Source: Economic Intelligence Unit, 1995

All of these factors suggest that China's domestic market for garments will grow in depth against the background of a high propensity to consume, while exports continue to expand. By 2010, China could become an international capital of a new fashion by fusing the fashion of the East and the West. The following table shows the goals of China's Tenth Five-Year Plan (2001-2005).

Table 5- 65 Goals of China's Tenth Five-Year Plan (2001-2005) for Textile and Garment Industry

	2000	2005
Textile & garment production	800 billion yuan	1.1 trillion yuan
Total textile processing	12.1 million tons	14.25 million tons
Domestic textile consumption	7 million tons	8.6 million tons
Per capita consumption	6.0kg	8.1kg
Textile & garment exports	US$50 billion	US$65 billion
Foreign currency earnings/ton	US$12,000	US$16,000
Ratio of Kohma yarns	16%	35%
Ratio of knotless yarns	28%	50%
Local procurement of fabrics	35%	35%
Local procurement of chemical fiber textiles	47%	60%

Source: The Textile Industry Bureau, November 2000.

Some comments on these goals:

- The goal of increasing the ratio of Kohma yarns from 16% to 35% is intended to increase the ratio of No.40 count or higher counts, but it will be very difficult to increase the counts by using domestically produced raw cotton.
- The increase in the ratio of knotless yarns from 28% to 50% will upgrade China's fabrics, but it is assumed that this is based on the premise of using air-splicers, including Mach Corner, rather than domestically-built machines.

The government plans to restructure approximately 3,000 state-owned textile firms during the Five-Year Plan.

3) Outlook for Japan

The amount of garment imports to Japan increased sharply after the appreciation of the yen in 1987, and by 2000 imports accounted for approximately 50% of domestic consumption of garments. Among imports, Chinese products increased conspicuously, rising to slightly more than 70% of all imports. The improvement of garment-manufacturing technologies in China, ease with which materials can be procured, success in quick responses to Japanese consumer preferences, and the establishment of own brands all contributed to China's success in developing the Japanese markets. Japanese trends in the composition of garment imports by exporting country since 1990 show a sharp increase in imports from China, entry by Vietnamese products, a sharp decline in imports from other Asian countries and waning popularity of garments from the United States and Europe. This is attributable to the growth of the market for inexpensive staple products in Japan and shrinking of luxury markets. It is also said that the quality of products from the Republic of Korea, Taiwan, Hong Kong and Thailand has not improved significantly despite the increases in labor costs in these countries. These trends in

Japan will remain unchanged in the future, and deficits in Japan's balance of garment trade are on the increase.

Table 5- 66 Composition of Japan's Garment Imports by Exporting Country (%)

	1990	1994	1995	1996	1997	1998	1999	2000
Republic of Korea	28.2	13.1	9.9	7.0	5.2	6.2	6.3	4.8
China	27.4	54.0	56.5	59.4	62.8	65.1	70.1	74.7
Italy	13.7	7.9	8.4	8.0	8.1	7.9	6.2	4.9
Taiwan	5.1	1.7	1.4	1.2	0	0	0	0
Hong Kong	6.4	2.3	2.0	2.0	0	0	0	0
U.S.	3.6	5.9	5.9	5.4	4.5	3.4	2.9	2.4
France	2.9	1.8	2.1	2.1	0	2.2	1.7	1.3
Thailand	2.5	2.7	2.7	2.2	2.5	2.2	1.8	1.5
Vietnam	0	0.0	0	0	0	3.0	3.0	3.0
Others	10.2	10.6	11.1	12.7	16.9	10.0	8.2	7.4
								(US$ million)
Amount of Imports	8,704	15,248	18,540	19,567	16,638	14,566	16,438	19,633

Source: Japan Monthly Trade Statistics.

The history of Japanese textile and garment manufacturers' foreign operations can be divided into three periods: i) During the first half of the 1980s Japanese firms started operations in Europe and the United States to supply the domestic market of the host countries; ii) during the second half of the 1980s Japanese companies began operations in Malaysia, Indonesia and Thailand to produce synthetic fibers; and iii) during the first half of the 1990s they invested in other Asian countries to make garments for exports to Japan, Europe and the United States utilizing inexpensive local labor. In the future, Japanese companies are likely to invest in the upstream (yarn and fabric manufacturing) sectors in China to meet the needs of China's domestic markets, which are expected to grow significantly after the nation's accession to the WTO. As a result of the transplanting of yarn and fabric manufacturing sectors overseas, imports will account for most of low-grade synthetic textiles consumed in Japan. Therefore, the surplus in Japan's balance of textile trade will shrink at an accelerating rate. Japan's surplus in textile trade is bound to diminish toward 2010.

4) Outlook for and long-term strategies of Vietnam

Statistical data on entities in the garment industry are not complete disclosed. However, if data from MOI (Ministry of Industry) should be used for classification purpose, it may be estimated that there are approximately 600 private-sector garment firms and 200 private-sector textile firms. In addition, there are approximately 117 states owned garment firms and 70 states owned textile firms.

According to the 1995 census of business establishments (the Number of Economic, Administrative Enterprises and its number of laborers up to July 1, 1995), there were 82,876 offices of corporations and un-incorporated businesses, including main and branch offices, in the garment industry, indicating that there is a vast foothill of households (cottage industries and Pop-and-Mom shops) in this sector.

Table 5- 67 Entities in Textile and Garment Industry as of 2000 in Vietnam

	Number of garment firms	Number of textile firms	Number of employees	% of Total industrial output value	% of Total export turnover
Private firms	600	200	n.a.	n.a.	n.a.
SOEs	117	70 (32 central SOEs, 38 local SOEs)	100,000 persons in central SOEs (6.3%of garment & textile employees)	n.a.	US$560 million (28%of garment & textile export turnover)
JVs, 100% foreign investors	178 (total registered capital US$1,804million)		n.a.	n.a.	n.a.
Total	817 firms	348 firms	1,600,000 persons (25%of total industrial employees)	8.6%	US$2,000 million (15%of total export turnover)

Source: Estimates based on data Ministry of Industry

In order to understand the present situation of Vietnamese garment industry, SWOT analysis should be indicated, which was conducted by the Mekong Project Development Facilities as follows.

a. Strengths

(On country/industry wide)

- High quality labor force
- Low Labor costs for employers
- Competitive pricing of export
- EU quota allocation
- Relatively efficient transports & shipping facilities
- Workable system of export processing
- Some factories are well-equipped & have well trained workers.

(On SMEs)

- Larger companies have skilled workers & relatively modern equipment.
- Managers are keen to upgrade their skills.
- Limited investment is necessary due to widespread use of used equipment

b. Weaknesses

(On country/industry wide)

- Local value addition is small.
- Over dependence on foreign agents: little contact with final customers
- Shortage of skilled technologists, supervisors, quality controllers etc
- Low labor productivity
- Limited training given, especially for middle management
- Limited experience in generating own designs &limited products range

(On SMEs)

- No access to advantages enjoyed by SOEs: bank loan, ODA, EU quota allocation, participation in trade fair etc.
- Lack of know-how in design & production techniques, procurement, management, marketing & sales
- Production dominated by CMT (75% of garment export turnover)-therefore low value added.
- Factories are cramped & lack modern equipment.
- Managers wary of investing in staff training due to high staff turnover
- Strategic planning impossible due to ad hoc nature of orders

c. Opportunities

(On country/industry wide)

- Trade agreement with USA opens new markets.
- More local suppliers of fabrics and accessories are establishing.
- Increasing to improve efficiency in CMT and move up value chain into FOB
- Local design capacity increasing
- Opportunity to produce FOB for domestic market

d. Threats

- China's entry into WTO increases advantage over Vietnam.
- Ending of quota system under Multi-Fiber agreement in 2005 will lead to intensified global competition.
- NAFTA/AFTA will open up trade barrier in Asia & stimulate regional competition.

Based on the above circumstances, we will proceed to the following forecasting.

Table 5- 68 Changing International Environment for Vietnam's Textile and Garment Industry and Its Impacts

Turning point	Item	Contents	Impacts on Vietnam's textile & garment industry
2001	Vietnam-U.S. Trade Pact to come into effect	*Reductions in U.S. import tariffs **Application of U.S. Anti-dumping law ***Stricter enforcement of the certificate of origin requirements in the U.S.	*Big Advantage **Slight Disadvantage ***Neutral
2005	WTO's ATC to come into effect	The end of quotas in international trade could remove import guarantee from Europe. Competition will intensify in the European market, etc.	Disadvantage
2006	CEPT provisions under AFTA	Competition with imported textiles and garments will intensify in the domestic market, as Vietnam ends non-tariff barriers and reduce import tariffs to less than 5%.	Disadvantage
2005 -2010	Accession to WTO	To meet WTO membership requirements, Vietnam will have to end export subsidies, tariff and non-tariff barriers, bring transparency to trade measures, end export requirements imposed on foreign companies and protect intellectual property rights.	Advantage (for foreign companies) Disadvantage (for state-owned textile and garment makers, (i.e.VINATEX)

Source: Compiled by the JICA study team based on study in Vietnam, November 2000.

Export environment for Vietnam has improved with the ratification of the U.S.-Vietnam Trade Pact (2001) and will improve further with the end of export quotas (2005). Surpluses in the balance of garment trade will expand between now and 2005. However, growth in garment exports is expected to decelerate somewhat from 2005 and onward due to the following factor: as the Agreement on Textiles and Clothing of the WTO comes into effect in 2005, export competition in the staple products in the same price range will intensify vis-à-vis Bangladesh, Cambodia, Myanmar and inland regions of China.

Between 2005 and 2010, Vietnam will face an environment conducive to an increase in imports due to i) the reduction in import tariffs under AFTA (2006); ii) accession to the WTO (2005-2010) that will require that Vietnam end tariff and non-tariff barriers as well as export requirements imposed on foreign companies; and iii) imports of equipment through 2010 to promote import substitution of dyed and printed fabrics. However, before 2010 or thereabout, unlike China, Vietnam will not follow a policy that will make the nation dependent on imported synthetic yarns and fabrics. This is because of the following factors: i) The upgrading from

exports under CMP schemes (sewing on commission) to those under FOB schemes (develop and export) will take a long time; ii) VINATEX (which could become a non-state owned enterprise) and other SOEs will continue to be the producers of fabrics used for some garments for exports under FOB schemes; and iii) the five-year plan to 2005 calls for an equilibrium in trade, and Vietnam also plans to maintain balanced trade on a longer term. The share of CMP exports in total garment exports in 2000 is estimated to have been 80% and the share is expected to decline to around 70% by 2010 as the nation slowly shifts to FOB exports. As a result, though Vietnam's surplus in the balance of garment trade is expected to increase centering on CMP exports, the improvement of the balance of textile trade through FOB exports using domestic fabrics will take 10 years.

Table 5- 69 Demand-Supply Forecast in Vietnam

	2000	2005 (F)	2010 (f)	2020 (f)
Amount of exports				
Garments	US$2 billion	US$4 billion (annual rate +15%)	US$6.5 billion (annual rate +10%)	US$14.0 billion (annual rate +8%)
Amount of imports				
Textile raw material	US$1.5 billion	US$3 billion (annual rate +15%)	US$5 billion (annual rate +10%)	US$7 billion (annual rate +7%)
Textile plants	US$500 million	Annual average US$700 million	Annual average US$500 million	Annual average US$500 million
Domestic sales	US$2 billion	US$3.2 billion (annual rate +10%)	US$5.2 billion (annual rate +10%)	US$13.5 billion (annual rate +10%)
Textile production	150,000 tons	243,000 tons	360,000 tons	800,000 tons
(Breakdown)				
Cotton yarn	51%	50%	48%	48%
Cotton-chemical blend yarn	24%	24%	25%	25%
Chemical fiber yarn	25%	26%	27%	27%
(Breakdown)				
Knitted	18%	19%	19%	22%
Woven	60%	63%	66%	68%
Others	22%	18%	15%	10%

Notes: The draft plan for textile production was obtained from the government of Vietnam. Other figures are estimates by the JICA study team.

Source: Compiled by the JICA study team based on surveys in Vietnam, June 2002

Between 2010 and 2020, garment markets both at home and abroad are expected to grow further. Exports of garments made in Vietnam are forecast to increase from US$2 billion in

2000 to approximately US$4 billion in 2005, approximately US$6.5 billion in 2010 and approximately US$14.0 billion in 2020. The domestic market is forecast to grow from US$2 billion in 2000 to approximately US$13.5 billion in 2020. As markets expand both at home and abroad, Vietnam will first introduce preferential measures to South Korean and Taiwanese firms that are already engaged in cotton fabric production or chemical fiber textile production in Vietnam to enable them to expand cotton yarn production or increase production in the chemical fiber textile sector. Specifically, the government, after realizing a level playing field between Vietnamese firms (SOEs and private enterprises) and foreign firms, may introduce tax cuts on investments, special depreciation for machinery and equipment, tax deduction for test and research expenditures, a reduction or waiver of corporate taxes, and refunds in full of the value added tax on indirect exports. However, given the excess capacity of synthetic fiber plants operated in Vietnam by South Korean or Taiwanese firms that started operations in the country in or before 2000, the introduction of massive investments in new chemical fiber plants from Japan will not come true because such investments, which entail imports of equipment and raw materials, will push Vietnam's trade balance into the red. [In terms of profitability, a massive investment from Japan means a new plant of approximately US$1.5 billion (Production cost: US$1,000/ton x optimum annual output of 100,000 tons x 15 years required for the recovery of investment).] One should note that when large Japanese synthetic textile makers made investments in China between 1997 and 1998, China's garment exports stood at US$30 billion and that there were no other foreign direct investments in the nation's synthetic textile sector. However, with respect to investments in Vietnam, the introduction of relatively inexpensive small unused old plants from Japan can take place in order to upgrade chemical fiber yarns made in Vietnam.

Between 2010 and 2020, Vietnam will have to upgrade dyeing and printing processes of chemical fiber yarns in order to differentiate its products in export markets and also to meet the demand for high-grade garments in the domestic market. By 2010, joint ventures engaged in dyeing and printing in China will be on a steady track. After meeting domestic demand, China is expected to become a net exporter of printed fabrics from 2010 and onward. On the other hand, profits of Japanese synthetic textile makers in Japan will begin to decline sharply after 2010 due to foreign competition, forcing an increasing number of these companies to move their production overseas at an accelerating rate. As China upgrade its products to medium- and high-grade clothing, Vietnam can expect to increase exports of inexpensive staple garments. Thus, the share of the textile and garment industry in Vietnam's total industrial production and total exports of industrial goods will continue to rise.

Table 5- 70 Priorities in Development of Vietnam's Textile Industry

	Priorities	1996-2000	2001-2005	2006-2010	2011-2020
Exports	Factors in strengthening export competitiveness	Domestic production of cotton fabrics	Domestic production of high-count cotton yarns	Upgrading of dyeing	Domestic production of cotton-synthetic fiber blend yarns
Domestic sales	Factors in promoting import substitution	Synthetic fiber fabrics	-	Synthetic fiber yarns	-
Equipment investment	Updating of equipment	Replacement and renewal investment	Plus cotton spinning plants	Dyeing plants and medium-sized synthetic textile plants	Medium-sized synthetic textile plants

Source: Compiled by the JICA study team, November 2000.

5) Long-term strategies for textile and garment trade of Thailand, China, Japan and Vietnam and Hints for Myanmar

China's accession to the WTO means that the nation can no longer carry out the administration of the textile and garment industry that is lacking in transparency or impose discriminatory rules to foreign companies. Therefore, SOEs, private enterprises and foreign enterprises will have to compete under universal rules. China will continue to press ahead with institutional reforms that will guarantee a level playing field for all parties and strengthen the export competitiveness of its garments made of synthetic textiles, the production of which can benefit from the economies of scale. Vietnam is also moving to take further measures for the development of private enterprises and SMEs on the basis of its trade pact with the United States which was signed in 2001 and also to join the WTO sometime between 2005 and 2010. Under these circumstances, Myanmar, which plans to compete with China and Vietnam in garment-manufacturing, should implement more aggressive institutional reforms and improve product quality than these countries are doing. There is no other way to win in the export competition. The following is a list of hints Myanmar can get from the examples of other countries.

An evaluation of the export competitiveness of Myanmar-made garments in the U.S. market shows that there are many problems both in the export system and product costs as will be discussed later. If Myanmar takes no measures, its market in the U.S. could shrink in relative terms. The reasons that foreign companies select Myanmar as a production base for garments are as follows: i) Low labor costs; ii) at present, North American (the U.S. and Canada) export quotas imposed on Myanmar are conspicuously fewer than those imposed on its

rivals by the advanced, industrialized nations. Myanmar has the advantage that there are no quotas on exports to the United States of knitted products made in Myanmar. Some Hong Kong enterprises that are operating in Myanmar because there are fewer quotas there have suggested that they would pull out of the country when the system of export quotas to the United States is abolished in 2005. Withdrawal of quota shoppers has already been observed in Cambodia, to which the quota system for exports to the United States was increased in 2000.

In order to secure competitiveness of its garments in exports to the United States, Myanmar should place top priority to the launching of negotiations with that country to gain the most-favored nation status. Normally, the United States does not impose quotas on imports from a developing country during the first two years after the extension of a most-favored nation status to that country. Therefore, if Myanmar concludes a most-favored nation treatment with the United States before January 2003 (which is two years before the termination of the quota system in international commerce), it can lead to the promotion of exports to that country.