

Indonesian Textiles and Apparel: A New Dawn for a “Sunset Industry”?

Significance:

The Indonesian apparel industry has performed better than expected since the global system of quotas ended. Growth in shipments to the United States, the largest import market in the world, is higher than for any other non-preferential supplier except China since 2004. Underlying this performance has been a shift towards higher value products that do not necessarily compete with Chinese products. Another factor is the imposition of restrictions on China starting in late 2005 that has created space for Indonesian products that do compete with those of China.

Shipments to the EU picked up in 2005-6, leading to an increase in market share. Indonesia has benefited from safeguards on shipments from China that were imposed by both the US and EU. The safeguard quotas are progressively being loosened and will end this year in the EU and in 2008 in the US. In order to secure market access gains, Indonesia will need to implement trade and investment reforms to take advantage of competitive strengths in the Asian region, particularly by reducing or eliminating measures that restrict access to intermediate inputs and that inhibit development of regional production networks.

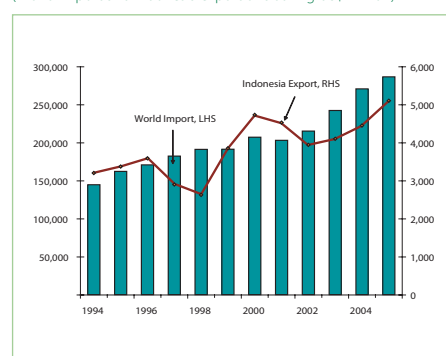
Analysis:

Conventional wisdom is that China will dominate global markets. Analysts often wrongly assume that suppliers from other countries are unable to compete on the basis of variety and quality of products. Access to quality inputs at world prices, particularly yarn, fabric and accessories is also a source of competitiveness in the Asian region. Gains for Asian suppliers also arise from increased productivity resulting from large investments in textile and apparel machinery and through development of efficient production networks capable of turning out a large variety of differentiated products that consumers demand on a timely basis. Losses are largely at the expense of preferential suppliers that are constrained by restrictive rules of origin requiring use of high-cost inputs and former large quota holders that are uncompetitive.

Increasing demand in major markets is creating opportunities for Indonesia.

World trade in clothing grew steadily by about 6% annually between 1995 and 2005, leading to a near doubling of the value of clothing trade over the period of 1994 to 2005 (Figure 1). This major structural development in the world market has been caused by the elimination of quotas, technical change and lower trading costs. This market access expansion has provided competitive suppliers of clothing with significant opportunities for growth and employment.

Figure 1. Indonesia clothing export growing (World Import and Indonesia export of clothing US\$ million)



Indonesian clothing exports had performed relatively poorly but began to recover in 2004 while growing rapidly since the abolition of quotas thereafter. Exports increased by 15% in 2005 and topped \$5 billion. Over 50% went to the US market alone. In 2006, Indonesian clothing shipments to the US reached \$3,670 million, an increase of almost 28% over those of 2005. Significantly, the growth in value terms has been more rapid than in volume terms, reflecting an increase in unit prices. Unit prices rose by 3.7% in 2006 and an estimated 6% in 2007. Indonesian firms have responded to the end of quotas by shifting production towards higher quality garments that fetch far higher prices per unit than do those of lower-cost producers such as China and Bangladesh. This reflects a supply response by Indonesian exporters and the product differentiation that characterizes consumer markets in the US and EU.

Trans-shipment concerns are overblown.

Press reports claim Indonesian shipments are inflated by the illegal transshipment of Chinese products using false certificates of origin. The economic logic of transshipment is rarely considered and evidence for widespread

transshipment is scant. Transshipment of products that are not under quantitative restriction would presumably be to evade tariffs and would therefore seek to enter the US market from a country that has preferential access. Indonesia has no such access and transshipment of non-restricted products can be ruled out on that basis. Transshipment would therefore be limited to the items on which China is restricted. Volumes of shipments to the US would be rising faster than values in the China restricted items, reflecting the decline in unit prices. However, data on China-restricted clothing products indicate that Indonesian unit prices have increased rather than decreased on average since the restrictions were imposed. In contrast, unit prices fell in Cambodia, Hong Kong, Malaysia, the Philippines and Thailand.

Trends in world wide investment in textile machinery are indicative of Asia's competitiveness.

Investment in yarn spinning and in fabric weaving and knitting machinery in anticipation of the removal of quotas has expanded within the Asian region—particularly in China. These investments have helped Asian suppliers to significantly increase their share of global yarn production capacity and of global fabric weaving capacity – the latter increased from 26% to nearly 50% over the period 2000 and 2005. Asian suppliers are dominant in knit fabric capacity as well.

Indonesian yarn spinners and fabric weavers have responded by reducing capacity in outmoded machinery (short staple spindles, shuttle looms, single-heater texturing machines) and have added capacity in new more technically advanced machinery such as open-end rotors, shuttle-less looms and double-heater texturing machines. In some particular types of advanced machinery growth has been even higher than in most Asian countries. As Table 1 shows, Indonesia's 61% growth in installed capacity of open-end rotors during 2000-5 is second only to China (86%) in the region. But in other investments in modern machinery, Indonesia is lagging behind: its 7% growth in shuttle-less looms over the period is significantly lower than that for the major Asian suppliers as a group (137%) and for China (279%). Indonesia has upgraded its technology in yarn spinning and weaving as well as in knitting although it has lagged somewhat in investment in filament fiber weaving used to produce synthetic fabrics.

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Economies:	Installed Capacity in Textile Spinning Machinery: Open-End Rotors		Installed Capacity in Textile Weaving Equipment: Shuttleless Looms			
	Change in installed capacity 2000-5 (%)	% Share of World Total		Change in installed capacity 2000-5 (%)	% Share of World Total	
		2000	2005		2000	2005
China	86.0	7.5	14.5	278.9	9.6	29.0
Indonesia	60.7	0.7	1.1	7.4	4.3	3.6
India	10.6	5.5	6.2	28.5	1.2	1.2
Pakistan	0.8	1.8	1.9	50.0	2.5	3.0
Bangladesh	0.0	0.7	0.7	0.0	0.5	0.4
Thailand	-11.1	0.7	0.6	161.4	3.3	6.9
Taipei, China	-15.3	1.0	0.9	50.9	3.3	4.0
Asian Major Suppliers	39.1*	18.5*	26.6*	137.2**	26.0**	49.2**

Source: Anson and Brocklehurst (2006a & 2006b); USITC (2004) and author's compilations.

Notes: * Asian Major Suppliers in the case of open-end rotors: China, India, Pakistan, Indonesia, Taipei (China), Bangladesh, Thailand and Philippines.

** Asian Major Suppliers in the case of shuttleless looms: China, Thailand, Taipei (China), Indonesia, Pakistan, India, Hong Kong, Malaysia and Bangladesh.

Understanding the performance in the US market is of crucial importance for Indonesia to secure gains in world markets.

The share of Indonesian clothing products in the US import market has continued to expand since 2004 in value and volume terms (Figures 2 & 3). These gains in market share in clothing are explained by:

- Availability of textile and sewing machinery at competitive prices;
- Domestic capacity to produce yarns and fabrics at competitive prices responding to the competition from imports of yarns and fabrics from low-cost suppliers within the region;
- Shifting product mix into higher value products such as women's intimate wear, blouses and slacks, which means Indonesian products do not have to compete directly with Chinese products that are aimed at the low-end of the market;
- Being able to expand shipments in items that China faces restrictions;
- Allowing clothing exporters to import fabrics and accessories that are exempt from duty and VAT for firms in bonded and other designated zones;
- Shifting production to locations in Central and East Java with lower labor costs than in West Java;
- Improvements in telecommunications and information technologies that enable

firms to respond rapidly to buyer's orders and to trends in consumer markets. This has also allowed Indonesian firms to attract outward processing arrangements from garment companies in Malaysia and Singapore.

Indonesia faces several threats that could make it lose its market access gains:

- The phasing out of US and EU restrictions on China will lead to intensive competition and may reverse gains in unit prices;
- Some otherwise uncompetitive suppliers may benefit from duty-free access to the US market with new free trade agreements;
- The appreciation of the rupiah relative to the dollar and other currencies could undermine competitiveness;
- Poor infrastructure, port and customs procedures, including high incidence of illicit payments;
- Indonesia's non-tariff measures undermine the ability of firms to improve productivity through development of production networks.

The Road Ahead: Regional Integration in Textiles and Apparel

Indonesia can prepare itself for future competition by unilaterally adopting reforms.

It can also champion regional integration within Asia through trade facilitation and the removal of remaining tariff and non-tariff measures which inhibit ASEAN integration in textiles and apparel, particularly through outward-processing arrangements (OPA). The development of Asian-wide production networks will go a long way to helping Asian suppliers, including in Indonesia, to secure market access gains in major world markets.

To remain competitive, Indonesia needs to complement these measures with policies that improve its firms' productivity and that reduce their trade costs. Possible policies are those that promote investments in machinery, reduce high transactions costs and lower currently high transportation costs. One way of promoting the upgrade of Indonesia's aging fabric weaving machinery is to permit accelerated depreciation allowances for investments in textile and sewing machinery that reduce tax burdens and help cash flows to producers as recommended by FIAS (2006). Indonesia also needs to reduce its production and distribution costs by strengthening its weak legal system and by improving credit market conditions through reduced inflation, thus stimulating the supply of credit to the industry. Additional ways to reduce transaction costs in the textile sector should also be considered, like permitting cotton quarantine to take place at the factory.

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Figure 2. Value Share of Indonesia Clothing Product to US Import

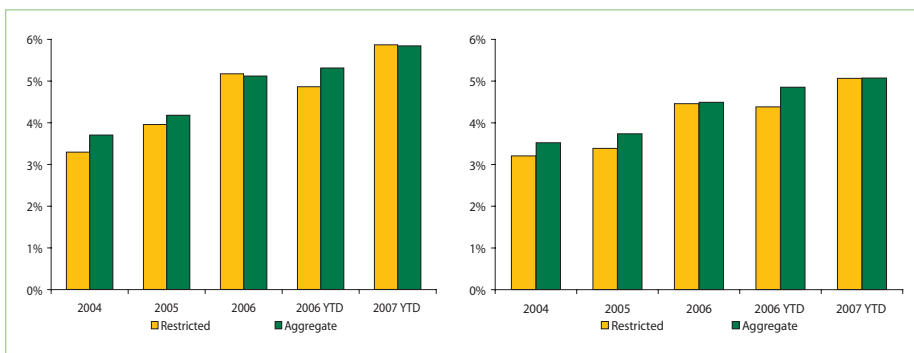
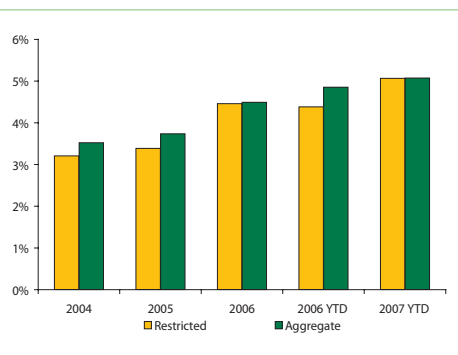


Figure 3. Volume Share of Indonesia Clothing Product to US Import



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