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Industrialisation through regionalism? Policy space, industrial policy and upgrading in the textiles and apparel value chains of the East African Community

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**Industrialisation through regionalism?**

**Policy space, industrial policy and upgrading in the textiles and  
apparel value chains of the East African Community**

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**Thesis submitted for the degree of PhD**

**2022**

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## Abstract

Regional integration is increasingly viewed by policymakers as a key driver of industrial development, yet there is a lack of academic research on the key channels by which this is supposed to occur. This gap is addressed through examining firstly the impact of regional cooperation on policy space, secondly the potential for industrial upgrading in regional value chains, and thirdly how policy space and upgrading are linked through specific industrial policy rents at the national, regional and global levels. The research takes the East African Community (EAC) as a case study, with a particular focus on the textiles and apparel (T&A) subsectors. Fieldwork was carried out in Tanzania and Kenya consisting of a firm survey and semi-structured interviews with industry stakeholders.

Policy space is necessary to allow states to implement industrial policies, but there is little agreement about its definition or analysis. The thesis proposes a conceptual framework for industrial policy space, defined as the set of legally permitted, economically viable and politico-institutionally feasible policy options at the national, regional and global levels which can promote industrialisation of an economy. This framework is then used to analyse policy space in the EAC T&A sector. Contrary to the literature which sees regional cooperation between countries in the South as having a negligible or positive effect on policy space, we argue that the impact of the EAC on members' policy space in the T&A sector has been significant, and both positive and negative across different dimensions.

The purpose of industrial policy space, industrialisation, is increasingly understood by scholars as a process of industrial upgrading in value chains. With increased regionalisation of trade, regional value chains (RVCs) and national value chains (NVCs) have emerged as possible alternatives to global value chains (GVCs) for countries pursuing late industrialisation. In presenting the firm survey results we introduce the concept of *value chain directionality*, arguing that NVCs, RVCs and GVCs each offer distinct opportunities in terms of functional, product, process and end market upgrading. Explaining these results, we develop a multi-scalar approach to industrial policy analysis and argue that rents at the national, regional and global levels were critical to the investment and upgrading decisions of firms integrated into NVCs, RVCs and GVCs.

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## **Abbreviations**

AfCFTA - African Continental Free Trade Area  
AGOA - African Growth and Opportunity Act  
ASEAN - Association of Southeast Asian Nations  
BIT - Bilateral investment treaty  
BoP - Balance of Payments  
BTA - Bilateral trade agreement  
CCC - Circular and cumulative causation  
CET - Common External Tariff  
CIF - Cost, insurance and freight  
CMT - Cut, make and trim  
COMESA - Common Market for Eastern and Southern Africa  
CTA - Cotton, Textiles and Apparel  
CTH - Change in tariff heading  
CU - Customs Union  
DC - Developing Country  
DFID - Department for International Development  
DFQF - Duty-free and quota-free  
DR - Duty Remission  
DRC - Democratic Republic of the Congo  
EAC - East African Community  
EBA - Everything But Arms  
EFTA - European Free Trade Association  
EPA - Economic Partnership Agreement  
EPZ - Export Processing Zone  
EU - European Union  
FDI - Foreign Direct Investment  
FOB - Free on board  
FTA - Free Trade Agreement  
G77 - Group of 77 (coalition of developing countries at the United Nations)  
GATT - General Agreement on Trade and Tariffs  
GVC - Global Value Chain  
HIC - High Income Country

HS - Harmonized System (Commodity Description and Coding)  
IFI - International Financial Institution  
IIA - International investment agreement  
IMF - International Monetary Fund  
ISDS - Investor-State Dispute Settlement  
ISI - import-substitution industrialisation  
ITC - International Trade Centre  
K&K - Kanga and kitenge  
LDC - Least Developed Country  
LIC - Low Income Country  
LLMICs - Low and Lower-Middle Income Countries  
LMIC - Lower-Middle Income Country  
LPS - Local Production System  
MFN - Most-favoured nation  
NAFTA - North American Free Trade Agreement  
NGO - Non-governmental organization  
NIC - Newly industrialised country  
NIE - New Institutional Economics  
NTB - Non-tariff barrier  
NVC - National/Domestic Value Chain  
OBM - Own brand manufacturer  
ODM - Original design manufacturer  
OECD - Organisation for Economic Co-operation and Development  
OEM - Original equipment manufacturer  
PSA - Partial Scope Agreement  
PTA - Preferential Trade Arrangement  
REC - Regional Economic Community  
ROK - Republic of Kenya  
ROO - Rules of Origin  
RQ - Research Question  
RTA - Regional Trade Agreement  
RVC - Regional Value Chain  
SACU - Southern African Customs Union  
SADC - Southern African Development Community

SCM - Subsidies and Countervailing Measures (WTO)  
SDT - Special and differential treatment  
SEZ - Special Economic Zone  
SOA - Stay of Application  
SOE - State-owned enterprises  
SPS - Sanitary and Phytosanitary Measures  
SSA - Sub-Saharan Africa  
T&A - Textiles and Apparel  
TBT - Technical Barriers to Trade  
TCF - Third Country Fabric  
TDR - Trade and Development Report (by UNCTAD)  
TDU - Textile Development Unit of Tanzania  
TFTA - Tripartite Free Trade Area  
TNC - Transnational/multinational corporation  
TRIMS - Trade-Related Investment Measures (WTO)  
TRIPS - Trade-Related Aspects of Intellectual Property Rights (WTO)  
UN - United Nations  
UNCTAD - United Nations Conference on Trade and Development  
URT - United Republic of Tanzania  
USA - United States of America  
VC - Value Chain  
WITS - World Integrated Trade Solution  
WRAP - Worldwide Responsible Accredited Production  
WTO - World Trade Organization

# 1. Introduction

## 1.1. Context & motivation

Dramatic changes in the global economy, and the policy frameworks underpinning it, have resulted in a new context for industrial policymaking. The Covid-19 pandemic, escalating climate emergency and technological shifts linked to advanced robotics and artificial intelligence have captured recent media attention, but the underlying conditions of economic cooperation, trade and policy space affect how these factors will feed through to sustainable development outcomes. These longer term underlying trends include the crisis of multilateralism that has unfolded since the stalling of the Doha round of World Trade Organization (WTO) trade talks, the latest chapter of which included the trade wars between the USA and China in the Trump era as well as the neutering of dispute settlement mechanisms.

In lieu of deepening liberalisation under the auspices of the WTO, countries seeking closer ties have signed a mushrooming number of regional and bilateral free trade agreements (FTAs), hoping to foster greater levels of economic integration in participating regions (Ravenhill, 2014). The case of Brexit – the UK’s exit from the European Union – appears to be an outlier, with the remaining EU countries seeking deeper cooperation, while the rapid progress towards agreeing a pan-African Continental Free Trade Area (AfCFTA) exemplifies the priority placed on regional integration by many low and lower-middle income country (LLMIC) groupings. The AfCFTA will span a large number of overlapping regional economic communities (RECs) in Africa which tend to have relatively low levels of intra-regional trade and remain reliant on primary commodity exports to the global North (UNCTAD, 2007; UNECA, 2017).

These policy developments have coincided with a shift in demand dynamism from the global North to the South, as economic and demographic changes result in growing investment and trade opportunities between LLMICs (Horner and Nadvi, 2018). The reorganisation of capitalist production into global value chains (GVCs) has arguably peaked, and there is a growing focus on the role of regional value chains (RVCs) as vehicles for industrial innovation and development (World Bank, 2020). It is well established that intra-regional trade between LLMICs tends to be disproportionately composed of higher value products such as manufactures, but the implications of the intensification of South-South regional value chains remains under-explored in the literature and is a focus of this research.

In this evolving context, governments of LLMICs face many familiar policy challenges, particularly how to raise living standards and provide decent employment opportunities through structural transformation of their economies towards higher value activities. Industrial policy therefore remains at the heart of the contemporary global development landscape, as increasingly reflected by its

acceptance as a crucial topic in policy debates even among formerly sceptical international financial institutions (IFIs). Less attention has been paid to the key precondition for industrial policymaking – namely, adequate policy space – which is widely accepted to be increasingly constrained due to the advent of the WTO and various regional and bilateral agreements (UNCTAD, 2014).

In short, this thesis examines how a key component of the development strategies of LLMICs – regional integration – impacts industrial policy space and structural transformation. Regionalism is increasingly seen as offering improved prospects for industrialisation, with African policymakers in particular pushing an ambitious agenda to implement the AfCFTA. Yet there is little consideration of how such regional free trade agreements impact the policy space of countries to pursue the kinds of industrial policies necessary to promote industrial catch-up. It is often simply assumed that regional trade agreements and regional value chains offer enhanced prospects for technological upgrading and employment creation, without proper scrutiny of the potential for reproducing the uneven development outcomes which emerge from GVCs underpinned by international trade agreements.

## **1.2. Research questions**

Informed by the context and literature, this thesis and its main chapters set out to answer a set of research questions (RQs) that are presented here. The overarching research question is:

*RQ: How does regional integration impact industrial policy space and prospects for industrial upgrading in LLMICs?*

To translate this broad enquiry into a tractable research project, a number of sub-research questions were identified. First, given the variety of ways to understand and analyse policy space in the literature, it was necessary to determine an approach that could guide this research. Chapter 4 therefore aims to answer the first sub-research question:

*Sub-RQ 1: How should policy space be conceptualised for the analysis of industrial policy?*

It was decided that in order to meaningfully study the impact of regional integration on industrial policy space, it would be necessary to focus on a case study. This reflects not only the context specificity of industrial policy analysis but also the wide range of approaches to regional integration observed worldwide. The East African Community (EAC) was chosen as the regional focus and its textiles and apparel (T&A) industry as the sector focus, as explained in section 3.2. Chapter 5 examines how regional integration affected industrial policy space in that case, answering the second sub-RQ:

*Sub-RQ 2: What is the impact of the East African Community (EAC) on policy space in the region's textiles and apparel (T&A) sector?*

The purpose of industrial policy space, industrialisation, is increasingly understood by scholars as various kinds of upgrading in value chains. In addition, the economic dimension of policy space – i.e. the set of industrial policies that are economically viable – is to a large extent conditioned by the nature of value chains present in a particular sector. It is often argued that regional integration fosters regional value chains that offer enhanced prospects for upgrading, which Chapter 6 explores in the chosen case study, answering the third sub-RQ:

*Sub-RQ 3: What prospects do regional value chains (RVCs) offer for industrial upgrading compared to national value chains (NVCs) and global value chains (GVCs) in the EAC T&A sector?*

Findings from Chapter 6 pointed to the importance of specific rents emerging from the policy space that drove outcomes at firm level. Chapter 7 explores how regional integration affects the landscape of policy rents in the case study, connecting the analysis of industrial policy space and observed firm upgrading outcomes. A multi-scalar approach to industrial policy analysis is developed to show that rents at the national, regional and global levels were critical to the investment and upgrading decisions of firms integrated into NVCs, RVCs and GVCs. This answers the final sub-RQ:

*Sub-RQ 4: How do multi-scalar industrial policy rents affect EAC T&A firm upgrading strategies and outcomes in RVCs, NVCs and GVCs?*

### **1.3. Thesis overview**

This research concerns the potential for policies and inter-firm dynamics at the regional (i.e. supra-national) level to drive contemporary structural economic transformation in the Global South. The choice of topic is motivated by changes in the global economy, especially increased uncertainty in international trade, the shift in demand dynamism from global North to South (especially for manufactured products), and increased efforts towards regional integration among LLMICs and African countries in particular. Policymakers and researchers often assume that regional cooperation will go hand in hand with expanded policy space, regional value chain development and industrialisation, but there is little evidence about whether and how this occurs. Chapter 2 reviews the literature in these areas and identifies several areas where the thesis aims to contribute. In line with the sub-research questions outlined, the empirical contributions of the thesis are organised as chapters on the impact of regional cooperation on policy space, the potential for industrial upgrading in regional value chains, and how policy space and upgrading are linked through specific industrial policy rents.

Chapter 3 presents the research methods used, centring on a case study of the East African Community (EAC), one of the most integrated trade blocs in Africa, with a particular focus on the textiles and apparel (T&A) subsectors. T&A is chosen because of its prominence in the development

strategies of earlier industrialisers, as well as the EAC policy focus on T&A and the presence of cotton production, a key input. Fieldwork was carried out in Tanzania and Kenya, the EAC countries where most T&A activity is located, consisting of a firm survey and semi-structured interviews with industry stakeholders. Unlike previous studies of T&A sectors in sub-Saharan Africa (SSA), the firm survey was designed to capture firm engagement with and upgrading in multiple value chains and end markets at the national, regional and global levels. Furthermore we ‘unbundle’ the usual packages of functions found in the T&A literature (CMT, FOB, OBM, etc.) to explore how firms perform different functions in different value chains.

The first main organising theme of the research is how regional cooperation affects policy space for structural transformation. Policy space is necessary to allow states to purposefully implement policies aimed at transforming their economies, e.g. through industrialisation (Reinert, 2007). The literature has focused on how multilateral rules at the global level impact the policy space of countries in the South, but the proliferation of regional trade agreements has altered the landscape and requires attention (Wade, 2003; UNCTAD, 2014). A contribution of the thesis (in Chapter 4) is to develop a conceptual framework for industrial policy space, defined as the set of legally permitted, economically viable and politico-institutionally feasible policy options at the national, regional and global levels which can promote industrialisation of an economy.

In Chapter 5, regional integration and policy space in the EAC T&A sector are analysed using the proposed conceptual framework, populated by drawing on data from policy official documents, statistics and semi-structured interviews. Academic and grey literature tend to see regional cooperation between countries in the South as having a negligible or positive effect on policy space (e.g. Thrasher and Gallagher, 2010), but we argue that the impact of the EAC on members policy space in the T&A sector has been significant, and both positive and negative across different dimensions. The expanded market access provided by duty-free trade within the EAC has expanded the set of economically viable industrial policies, but the EAC’s institutional framework – e.g. rules around duty remission and EPZs – place new constraints on national authorities’ ability to unilaterally grant rents to domestic firms.

The second overarching theme of the thesis is whether regional value chains (RVCs) and national value chains (NVCs) offer comparable opportunities for upgrading to global value chains (GVCs). In recent decades the organisation of the global economy has changed, with production dis-integrated across countries and firms, and upgrading in value chains has become the principal framework for understanding contemporary industrialisation processes (Milberg and Winkler, 2013). The literature has focused on GVCs, but with increased regionalisation of trade, RVCs have emerged as an alternative, with research needed on the distinct opportunities they offer for industrialisation.

This is explored in Chapter 6 through presenting and analysing results from the firm survey carried out for this research. We introduce the concept of *value chain directionality* – how orientation to NVCs, RVCs and GVCs has important implications for development – and show that each value chain type offers distinct opportunities in terms of functional, product, process and end market upgrading as well as other economic outcomes. Firms integrated into global value chains focus on a narrow range of lower-value functions (mostly garment assembly), while those oriented to national and regional value chains perform a wider range of functions including vertical integration to textile manufacture (spinning, weaving, knitting, etc.) and higher-value functions such as design, branding and distribution. Crucially, results in the area of end market upgrading confirmed the hypothesis that RVCs can serve as ‘learning grounds’, or ‘stepping stones’ to more demanding and potentially lucrative global markets.

The third theme of the thesis is around the mechanisms by which policy space translates into the upgrading outcomes observed. The framework of policy space captures the essential characteristics of the market and policy landscape, but upgrading outcomes are the result of the specific industrial policies which are chosen, how they are actually implemented and their interactions with firm strategies. We develop a multi-scalar approach to industrial policy analysis, examining how rents at the national, regional and global levels affect the investment and upgrading decisions of firms integrated into NVCs, RVCs and GVCs.

Chapter 7 applies this to the EAC T&A sector, analysing the industrial policy rents which bridge the gap between policy space and upgrading outcomes at the national level – with a particular focus on Tanzania and Kenya – and also at the regional and global levels. At each level we examine how particular upgrading outcomes are associated with rents generated by the implementation of policies. At the national level, public procurement contracts have enabled investment in functional and process upgrading by NVC-oriented firms in both Tanzania and Kenya. At the regional and global levels, duty-free market access arrangements under the EAC, SADC and AGOA combined with their particular rules of origin have delivered more or less targeted rents to RVC and GVC oriented firms. We find that rents have been critical to the upgrading outcomes observed in each value chain type, but that their design and implementation is conditioned by the policy space and also imposes limits to other kinds of upgrading.

Chapter 8 summarises conclusions from the research and draws out policy implications for the design of industrial policy and regional cooperation initiatives. These should be assessed across the various levels and dimensions of industrial policy space, explicitly taking into account the inevitable trade-offs between legal, political-institutional and economic dimensions. Policy rents should be designed to capitalise on the distinct benefits offered by NVCs, RVCs and GVCs for the development of productive capabilities rather than myopically focusing on a single value chain type.

## **2. Literature review: policy space, industrial upgrading and regionalism**

### **2.1. Introduction**

This literature review situates the present work at the nexus of three main strands of academic research. Firstly, policy space has been identified by industrial policy scholars as critical to allowing states to pursue strategies for rapid late industrialisation. The concept is traced from its origins in debates around national sovereignty, to more recent work distinguishing between *de facto* and *de jure* aspects of policy space, which we argue is helpful but has important limitations.

Secondly we examine the purpose of policy space, namely industrialisation, which we argue to be most usefully conceptualised as industrial upgrading in value chains, given recent changes in the global economy. It is argued that increasing returns specific to manufacturing result in that sector having the potential to serve as an ‘engine of growth’ for the broader economy, and that the globalisation of production means that participating in cross-border manufacturing value chains is increasingly necessary for achieving broad-based development. The case of the textiles and apparel (T&A) sector is examined in depth, with a focus on the types of upgrading found, before several issues in previous T&A studies are identified which guide the present research.

Thirdly we introduce regionalism, increasingly seen as the defining feature of contemporary policy space, and argue that the type of regional integration pursued is critical for understanding its impact on industrial development. Open, closed and developmental regionalism are critically examined, and despite several shortcomings identified, the latter is presented as a useful model for policymakers seeking to employ regional economic cooperation to promote manufacturing-led structural economic transformation.

### **2.2. Policy space**

Economic convergence between rich and poor countries requires the latter to grow more quickly than the former, to “catch-up” in terms of industrial development. This is challenging because already industrialised countries have a head start, so latecomers must devise strategies and institutions to allow domestic productive organisations to rapidly increase their technological capabilities. Historically a wide range of industrial policy measures have been used to support ‘infant industries’, from Henry VII in 15th century England to the East Asian tigers and China in recent times (Chang, 2002). To prevent this, historical and contemporary colonial and imperial powers have sought to restrict policy space in territories under their control, for example by restricting higher value economic activities like manufacturing and through the imposition of ‘unequal treaties’.

### **2.2.1. Industrial policy and rents for late development**

From at least medieval times, political leaders have actively sought to promote the growth of manufacturing. For Chang (2002, p.19), Edward III (1327-77) was the first English monarch to deliberately promote manufacturing, using bans on woollen cloth imports and encouraging the immigration of skilled Flemish weavers to foster the manufacture of wool domestically. Reinert (2007) sees these efforts as motivated by the goal of revenue raising, and argues that the Tudor king Henry VII (1485-1509) was the first to deliberately use large-scale industrial policy, based on his observations as a child growing up in Burgundy of the wealth found in areas with woollen textile production.

The distinction between increasing and diminishing returns (further explored in section 2.3), and their respective association with manufacturing and agriculture, has important implications for economic development and has historically provided a strong rationale for industrial policy. It suggests that countries will have more potential to increase productivity, overall output and living standards if they specialise in manufacturing activities where increasing returns are pervasive. This justifies a role for the state in promoting the manufacturing sector and thus shifting the economy onto a trajectory of increasing rather than decreasing returns. When economic development is seen as a process of circular and cumulative causation rather than the competitive equilibrium of neoclassical economics, the multitude of factors pushing the economic system towards “disequilibrium” – pervasive and significant increasing returns, complementarities in investment and production, endogenous technological change, etc. – imply a wide-ranging role for the state to overcome coordination failures, particularly with regard to the timing, volume and industry composition of investments (Toner, 1999, p. 163; Richardson, 1990 [1960], p. 86).

Those that have successfully fulfilled these functions have been termed ‘developmental’ states, especially in Japan and East Asia (Johnson, 1982; White and Wade, 1988; Amsden, 1989; Wade, 1990). These kinds of states are the same ones promoted by Hamilton (1791) and List (1841) and later described by Gerschenkron (1962) as ‘latecomers’ who emulate the achievements of more ‘advanced’ countries by seeking to initiate processes of circular and cumulative causation through inducing investment in manufacturing activities where increasing returns are present.

The ‘infant industry’ argument, as set out first by Alexander Hamilton (1791) and subsequently by Friedrich List (1841) provides a clear rationale for industrial policy. In his ‘Report on the Subject of Manufactures’, Hamilton (1791) explicitly addresses the differences between types of economic activity and makes the case for the diversification of the United States’ economy away from a reliance on agriculture and towards manufacturing. The reasons for doing so include national autonomy and military self-reliance, but are closely linked to the presence of increase returns in manufacturing, principally the benefits arising from a greater division of labour, more extensive use of machinery,

increased employment generation and an expanded domestic market (Hamilton, 1791, p. 18). The core of Hamilton's argument is that in order for new ('infant') industrial sectors to be able to compete with imports produced by foreign firms – who have already mastered production techniques and may receive support from foreign governments – it is necessary to provide rents, i.e. subsidies and various forms of protection via industrial policy in order to incentivise investment, cover any initial losses, compensate for the risks and extra costs associated with entering a new sector, and – in contemporary parlance – buy the time necessary for the development of technological capabilities.<sup>1</sup> Unlike the static, two-stage analysis of comparative advantage theory, the infant industry argument takes a dynamic, long term perspective in recognition of the fact that areas of specialisation may change over time as new productive capabilities are developed.

Industrial policy is defined here as purposive state measures to restructure the economy away from low productivity, diminishing returns activities towards high productivity, increasing returns activities such as manufacturing (Dosi et al, 2009). The definition is not prescriptive about the sectors in each category because the transfer of organisational principles and technologies developed in manufacturing has led to significant productivity boosts in other sectors, even those traditionally viewed as characterised by diminishing returns. For instance Kay (2009) highlights the synergies between agriculture and industry, pointing to the cases of South Korea and Taiwan where the promotion of industrial sectors such as chemical fertilisers and farm machinery had spillover benefits for agricultural growth. Likewise the services sector depends on inputs from manufacturing, with information technologies based on microelectronics being critical drivers of structural change in services sectors such as telecommunications and finance (Park and Chan, 1989).

For the purposes of this research, the form of industrial policy is viewed in terms of the creation and modification of institutions in ways that foster the development of productive organisations (Khan, 2010, 2017). Since, as Hamilton (1791) identified, domestic firms in latecomer countries do not have the capabilities to compete on equal footing with “advanced” country firms due to the very fact of “economic backwardness”, industrial policy measures aim to provide “learning rents” in return for measurable improvements in productivity, allowing domestic firms to catch-up to the technological frontier (Khan, 2000; Gerschenkron, 1962).

Development economists writing in the post-war period were convinced of the special characteristics of manufacturing and actively promoted policy measures in developing countries to coordinate investment, promote complementarities and foster intra and inter-industry external economies. Albert Hirschman (1958, 1977) approached the topic through the concept of backward and forward “linkage

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<sup>1</sup> Hamilton recommended a wide range of trade and industrial policy measures in strategic sectors: import duties and restrictions, export bans on raw materials, tax exemptions, duty drawbacks, incentives for technological upgrading, upholding of standards, transport infrastructure provision and particularly direct subsidies (“pecuniary bounties”).

effects”, which refer to the investment inducements brought about by the inadequacy of input suppliers or output users respectively. Criticising the ‘balanced growth’ approach associated with Rosenstein-Rodan which advocated simultaneous large-scale investments in wage goods, Hirschman argued for an ‘unbalanced’ growth strategy based on sequential investments in capital and intermediate goods sectors with the greatest potential to maximise linkage effects, based on analysis of input-output tables. In the contemporary context, Hirschman’s insights have contributed to a view of development as the promotion of sets of backward and forward linkages of various kinds (technological, fiscal, consumption, vertical, horizontal, etc.) in a country’s input-output matrix (Andreoni, 2019).

Hirschman (1958) also argued for governments in “underdeveloped” countries to fulfil the “initiating function” through “active leadership in industrialisation”, with the objective of promoting virtuous circles of investment and growth in interdependent industrial activities exhibiting increasing returns. Likewise Richardson (1990) [1960] argued that because of the heightened complementarities between investments in manufacturing in developing countries, and the informational uncertainty facing individual private investors, there was a clear role for the state in coordinating investment decisions. Nicolas Kaldor (1975, 1979) also emphasised the importance of complementarity in the analysis of economic systems – for example between capital and labour in production, or between interdependent sectors of the economy – and noted how growth in one sector tends to stimulate expansion in others via demand effects such that development can be seen as a “chain reaction” (Kaldor, 1979, p. 280).

The different outcomes across countries of similar industrial policy measures in the post-war period have resulted in an increased focus on the political economy context, and whether industrial policy rents are aligned with the ‘political settlement’, i.e. the distribution of power across society (Behuria et al, 2017; Khan, 2017). A political settlements approach to industrial policy encourages analysis of the ‘holding power’ of key organizations such as firms and state agencies, i.e. their ability to hold out in and win prolonged conflicts based on their resources and power to mobilize support (Khan, 2013a). The relative power of different organizations determines the kinds of policy rents that can effectively incentivise firms to make effort in learning to develop productive capabilities and achieve competitiveness (see also section 4.2.2.3). For instance an *ex ante* rent (i.e. one given before productivity gains have been achieved) such as tariff protection offered by the state to firms in a sector is most likely to induce learning in a ‘developmental’ political settlement where implementation capabilities are high and the ruling coalition is stable with a long-term planning horizon, i.e. the distribution of power is such that a state agency can monitor and withdraw rents to discipline recipients if performance expectations are not met (Khan, 2013a). In successful East Asian late developers such as South Korea these conditions were met while in other countries (such as post-independence Nigeria and India) they were not, with the origins of the political settlement rooted in the form taken by colonisation in each country and the character of state formation generally (Kohli,

1994, 2004). Where the political settlement suggests state disciplining capabilities may be weak, an *ex post* rent (given after productivity gains are achieved, e.g. via an above market price linked to trade preferences) may be more effective at inducing learning, as in the garment sector in Bangladesh (Khan, 2013a).

#### 2.2.1.1. *Rents: definitions and debates*

Although critical to industrial policy analysis, the term ‘rent’ is rarely clearly defined in the literature, capturing a wide range of benefits above an ill-defined ‘normal’ level, from Schumpeterian returns to innovation, to purely politically allocated transfers to favoured groups. In classical political economy land was viewed as the primary source of rents, and the extent to which natural resource rents confer a ‘blessing’ or ‘curse’ on their owners has remained an ongoing focus in the study of political economy (Di John, 2009). Neoclassical economics considers rent to be any return above what could be achieved in competitive markets, such as the earnings of a patent holder or a monopolist who controls a market and can raise prices above the cost of production. From a New Institutional Economics (NIE) perspective, rents are defined as simply the income above a minimum which would have been accepted from the next-best activity (North et al, 2009). In different ways, both of these definitions are difficult to operationalise for research purposes. The absence of perfectly competitive markets in reality makes the neoclassical benchmark hypothetical, and the identification of the next-best activity is difficult or impossible in practice due to high information requirements about potential returns for particular actors across a range of sectors. It is notable that mainstream neoclassical economics tends to view most rents as an unproductive deviation from competitive equilibrium, and rent-seeking behaviour as detracting from overall economic welfare by causing a misallocation of resources (e.g. Krueger, 1974).

Within institutional political economy a definition has emerged which is more tractable for the study of industrial policy, with rents viewed as incremental changes in income created by particular institutions without being necessarily associated with particular value judgements (Khan, 2017). This approach to rents is particularly relevant for the purpose of analysing industrial policy which is itself characterised by changes in institutional structures and incentives, and alongside the problems identified with neoclassical and NIE definitions, justifies the choice to use it to guide this research. Industrial policies alter income flows which create rents for beneficiaries, who may invest in organisational learning to achieve competitiveness if political conditions and incentive structures are favourable. There are also losers from changes in income flows, which implies the idea of a ‘negative rent’ that is mentioned briefly by Khan (2013a) but remains an underexplored concept in the literature. Some of the key factors behind whether firms use (positive) rents productively include political economy factors discussed above such as the relative power and capabilities of rent governing agencies, but the market opportunities available to them in national, regional and global

value chains should also be considered, this latter area being a relatively new area for research, and a central focus of this thesis.

To conclude this section, an active state is necessary for late industrialisation, because through trade and industrial policy, learning rents can be created which compensate potentially productive organisations for the extra costs associated with economic ‘backwardness’, and give them space to gain competitiveness. However, it is crucial that trade and industrial policy instruments be compatible with the underlying political settlement so that that rent management systems can effectively discipline rent recipients to ensure effort in learning is made and productivity is improved.

### **2.2.2. From sovereignty to policy space**

LLMIC policymakers frequently call for policy space to allow the design and implementation of national development strategies. For instance the ministerial declaration following the forty-first annual meeting of ministers for foreign affairs of the member states of the Group of 77 in September 2017 “reiterated that each country has the sovereign right to decide its own development priorities and strategies” and in this regard “stressed the need for policy space and policy flexibility for developing countries” (G77, 2017).

#### *2.2.2.1. Sovereignty*

As the statement by the Group of 77 indicates, the concept of policy space is closely related to the idea of national sovereignty in international affairs. In Europe this can be traced back to the Peace of Westphalia treaty signed in 1648, which is supposed to have established the principle of Westphalian sovereignty, i.e. non-intervention in the internal affairs or authority structures of other states (Krasner, 1999). This was first formalized by the Swiss jurist Emer de Vattel in 1758, building on the work of German philosopher Christian Wolff, who considered the “law of nature” to extend to nation states, such that “no nation has a right to interfere in the government of another state” (Vattel, 1797 [1758]). For Emer de Vattel, the principle of state sovereignty was intimately connected to maximising the benefits of trade and the right of states to control and restrict the import of foreign goods as desired.

The principle of Westphalian sovereignty has arguably been honoured more in the breach than the observance. Krasner (1999) distinguishes international legal sovereignty from Westphalian sovereignty, and argues that while the former can only be violated by intervention (either through ‘imposition’ or ‘coercion’), the latter can also be violated by invitation (either through contracts or conventions) by “subjecting internal authority structures to external constraints” to gain certain benefits (Krasner, 1999, p. 22). Imposition and coercion, involving the use or threat of military force respectively to take control of domestic political structures, leave the weaker party worse off. Examples of imposition include colonialism, “gunboat diplomacy” and forcible regime change, while a common example of coercion is economic sanctions. Contracts and conventions involve voluntary

commitments which are either contingent or not, respectively, on the behaviour of other parties and (at least in theory) make no party worse off, but still open domestic authority structures to external influence. Conventions usually involve the ideational rather than security or economic interests of the rulers such that another party renegeing is not relevant, e.g. human right agreements. Examples of contracts include lending by international financial institutions and trade agreements, which may involve more or less demanding conditions depending on the degree of power asymmetry between parties. In reality the four types of sovereignty violation lie on a continuum, with for example elements of coercion sometimes entering into apparently voluntary contracting.

Historically, trade has been both a means and an end of sovereignty violation. As means, trade is a powerful tool for exercising coercion through the “influence effect”, i.e. the threat to cut off commercial relations and force a partner to find alternative markets, with a nation’s power greater the more indispensable it is to its trading partners (Hirschman, 1945). As end, extracting favourable trade arrangements through violation of sovereignty by imposition has been most obvious in direct colonialism, but was also commonly practiced through the “unequal treaties” forced on nominally independent countries in Latin America and Asia by Western powers in the nineteenth century (Craven, 2005; Andreoni et al, 2019). Colonisers routinely organised economic activity in their colonies to their own advantage, banning manufacturing and promoting raw material production for export, while unequal treaties provided for the opening of specified seaports to trade, insisted on most-favoured nation (MFN) status and fixed tariffs at low levels (Chang and Andreoni, 2020). Today, informal political pressure is also commonly used to achieve the ‘end’ of trade advantages (see also Amsden and Hikino, 2000). Of course, trade as means and end of sovereignty violation can be combined, as in the case of the World Trade Organization (WTO) where the threat to withdraw access to high-income country (HIC) markets is used to ensure compliance of LLMICs with rules around market liberalisation, foreign investment and intellectual property rights (Wade, 2003).

#### 2.2.2.2. *Contemporary policy space debates*

Despite its prominence in contemporary policy debates, the meaning of ‘policy space’ is rarely explicitly defined, allowing a degree of ambiguity and confusion to have built up around the concept. A review of one of the most cited sources on the subject of policy space, a collection of contributions edited by Kevin Gallagher (2005) remarks that: “The greatest weakness of the volume is that it does not define the concept of ‘policy space’” (Mayer, 2007, p. 362).

Another factor contributing to a lack of clarity around policy space is the wide range of applications of the term. For example, the International Monetary Fund (IMF) routinely refers to the concept of ‘macroeconomic policy space’, which also lacks a precise definition but appears to indicate a state’s room for manoeuvre regarding changes to fiscal and monetary policy, depending on the current policy stance (fiscal deficits, interest rates, reserve requirements etc.) and macroeconomic variables such as

inflation, economic growth, the output gap etc. (Gaspar et al, 2016). The IMF argues that its concessional program lending improves the macroeconomic policy space of recipient countries by easing balance-of-payments constraints (IMF, 2009), while critics frame policy space in terms of a country's ability to define its own economic policies, free from the conditions attached to IMF financing such as various types of "structural reforms" (Payer, 1975; Van Waeyenberge et al, 2010; Kentikelenis et al, 2016). In this sense the critics are asserting a violation of Westphalian sovereignty by invitation, through contracts which override domestic political decision making structures. In practice policymakers must manage both sides of the equation, i.e. the potential for external resources from IMF and other donors to increase the range of possible policy options, but also the fact that conditions attached to loans impose constraints on policy space. Efforts can be made to adjust the balance, for instance the 2009 Freetown Declaration by African finance ministers requested more policy space from the IMF to allow for countercyclical fiscal stimulus in the wake of the global financial crisis, including through additional lending and the elimination of the pro-cyclical conditionality (Weeks, 2010).

Turning to our policy area of interest, that of industrial and trade policy, we find a similar duality in debates around policy space, with participants putting differing emphasis on the enabling or constraining elements of the international policy landscape. While the WTO (2018a) heralds its own contribution to guaranteeing smooth and predictable international trade, concerns about policy space for development have found their most consistent and vocal expression in the work of UNCTAD (the United Nations Conference on Trade and Development), the UN intergovernmental body responsible for issues of trade, finance, investment and technology as they relate to development (UNCTAD, 2017a).

The establishment of UNCTAD in 1964 was primarily a means to address the specific problems of developing countries participating in the post-war international trading system, which later came to be seen in terms of 'policy space' (UNCTAD, 2004, p. 77). Changes to the international economic order from the 1980s, particularly the liberalisation of capital movements and floating of exchange rates, made the issue all the more pressing such that the second ever flagship Trade and Development Report (TDR) by UNCTAD in 1982, noted "the progressive alteration of the international environment in ways that narrow the range of feasible policies open to developing countries to promote their own development" (UNCTAD, 1982, p. 5; UNCTAD, 2012a). The actual term 'policy space' did not appear in a TDR until 1992, and by the early 2000s it had been taken up by developing country trade negotiators in the WTO and appeared routinely in WTO meeting minutes and ministerial statements (Hannah and Scott, 2017).

UNCTAD's pursuit of the policy space question, especially since the 2004 and 2006 TDRs, has proved controversial with HICs. The issue "nearly broke" the eleventh UNCTAD conference in 2004,

with “big countries... very upset about [UNCTAD’s] stance” (Hannah and Scott, 2017, p. 123). UNCTAD’s governance system involves ministers from its 194 member countries agreeing a quadrennial mandate for the organisation’s work, and at the ministerial meeting in 2012, “Western states... objected to any mention [of] “policy space” (Wade, 2012, p. 305). The same battle was fought at the next quadrennial meeting in Nairobi in 2016, with developing countries eventually managing to achieve the inclusion of a mild reference to “respecting each country’s policy space” (James, 2016; UNCTAD, 2016).

Among the principal features of the global industrial and trade policy landscape are multilateral, regional and bilateral trade agreements. The discussion of trade and industrial policy space initially centred on the multilateral arena, in particular the rules of the World Trade Organisation (WTO) and the significant differences from the prior General Agreement on Tariffs and Trade (GATT) regime. More recently, with the collapse of multilateral trade negotiations in the Doha round, regional and bilateral trade agreements have become the focus of discussions around industrial and trade policy space. This is all the more the case since so-called ‘trade agreements’ increasingly include cover areas beyond the realm of trade policy, with chapters on investment especially common, for instance prioritising the protection of foreign investors’ property rights (UNCTAD, 2014).

UNCTAD TDRs from 2006 and 2014, which include contributions from UNCTAD economists published separately such as Mayer (2009), define policy space as the combination of *de jure* policy sovereignty (“the formal authority of national policymakers over policy instruments”) and *de facto* control (“the ability of national policy-makers to effectively influence specific targets through the skilful use of policy instruments”) (UNCTAD, 2006, 2014; Mayer, 2009, p. 376). The approach of UNCTAD and Mayer is builds on prior work by Briant (1980) on how interdependence between countries affects national monetary policymaking and Tinbergen’s (1952, 1956) theory of economic policy.

Economists working in the ‘structuralist’ and ‘developmentalist’ traditions have long emphasised the interdependence between trade, macroeconomic and financial issues in processes of long term development and industrialisation (Hirschmann, 1958; UNCTAD, 1964; UNCTAD, 2004; Thirlwall, 2013). From this perspective it is essential to look beyond legal restrictions of trade policy autonomy to understand the policy space context in a holistic way. Specifically, late development today must be situated in the post-Bretton Woods era of liberalized international capital markets and floating exchange rate regimes which constrain the space for domestic economic policy by limiting national control over domestic interest rates and exchange rates (UNCTAD, 2004). Although recent research suggests that policy space has been created by the fact that there is no longer a consensus around the neoliberal paradigm in the sphere of international financial governance, with for example capital controls accepted at least in certain circumstances, in ‘normal’ times LLMICs must still make policy

in the context of capital mobility and floating exchange rates, which imposes clear constraints (Grabel, 2018).

When viewed this way, a country’s integration into the international trade, financial and macroeconomic order is likely to involve a multidimensional impact on policy space, with forces pulling in different directions (Mayer, 2009). This can be represented in the following table:

*Table 1: The impact of international integration on national policy space*

|          | De jure policy space   | De facto policy space  |
|----------|--|--|
| Positive | New policy instruments possible due to trade agreements, e.g. dispute settlement in WTO.   | (i) Multilateral disciplines prevent beggar-thy-neighbour policies by powerful countries<br><br>(ii) Increased market access increases scope for industrial policy in sectors with scale economies |
| Negative | Reduction in available policy instruments through commitments in trade agreements (WTO TRIMS, SCM, TRIPS etc.; RTAs, BTAs, BITs) | Reduced effectiveness of macroeconomic instruments   |

Source: own elaboration principally based on Mayer (2009)

### 2.2.2.3. Criticisms and gaps

While the UNCTAD/Mayer definition is helpful in suggesting multiple dimensions of policy space, the following issues remain underdeveloped in the policy space literature. First, Amsden and Hikino (2000) and Shadlen (2005) only briefly mention the informal geopolitical pressure placed on developing countries to “open up” their markets to foreign capital and goods, particularly by the “North Atlantic” economies. This could manifest in the use of coercion to induce the signature of contracts which violate Westphalian sovereignty and may result in net reductions in policy space. Alternatively it could involve implicit or explicit threats to remove preferential treatment or other advantages (e.g. development aid or military support) if certain policies are pursued (Oya, 2006, Wolff 2020). This shows the existence of a political dimension to policy space at the international level.

A second neglected issue for policy space scholars is how domestic political economy factors affect the set of policy options that can be feasibly implemented (Dagher, 2019). Mushtaq Khan’s (2010, 2013) political settlements approach provides a useful framework in this regard, suggesting that an analysis of the distribution of power across organisations in society can help explain why certain policy instruments can be effectively monitored and enforced, while others cannot. Recent research on the political dynamics of growth episodes has incorporated new elements alongside the political settlements framework, adding the ideas of a “deals space” and “rent space” which describe the nature

of interactions and the structure of economic opportunities respectively (Pritchett et al, 2018). The extent of ‘aid dependency’, i.e. fiscal autonomy is a key factor in the political settlement affecting policy space of LIC states (Whitfield and Fraser, 2010).

Third, analysis of legal policy space has largely taken for granted that LLMICs have the public sector governance capabilities to follow the procedural requirements laid out in trade agreements to take advantage of permissive clauses. Yet historical accounts of multilateral trade negotiations highlight how procedural requirements were often imposed by HICs as a compromise to limit the application of a principle held by LLMICs (e.g. special and differential treatment, SDT) that would otherwise justify an exception to the rules (Hudec, 1987). Imposing strict procedural requirements on states with weak governance capabilities amounts to slipping a *de facto* constraint alongside a *de jure* permission. It is often taken for granted by policy space scholars that, for instance, WTO provisions allowing for the imposition of safeguard measures, anti-dumping duties and quantitative restrictions for balance-of-payments purposes provide flexibility to LLMICs when in reality the associated procedural requirements may be hyper-constraining where state capacities were anyway weak and have been further eroded through aid conditionality and structural adjustment programmes (Amsden and Hikino, 2000; Chang et al, 2016; Oya and Pons-Vignon, 2010).

Fourth, another neglected area is how feasible policy options are affected by the existing productive capabilities of organisations (firms, SOEs etc.) and the structure of linkages in the Local Production System (LPS) (Andreoni, 2019). This can be approached in terms of the extent to which conditions for generating increasing returns are present in productive structures at the micro, meso and macro-levels. An in-depth understanding of the domestic economy is necessary for the formulation of industrial policies with the potential to be effective, and is therefore a critical element of policy space.

Fifth, international market conditions are an additional factor defining the set of feasible policy options and therefore policy space. As will be explored in the following sections of this literature review, the globalisation of production and in particular the growth of GVCs has important implications for LLMIC industrial development policy. These value chains are often dominated by transnational corporations (TNCs) who have significant power to determine value allocation between actors, while financialisation of the global economy affects TNC accumulation strategies and prospects for beneficial LLMIC insertion into production networks (Chang and Andreoni, 2020).

Sixth, non-tariff barriers (NTBs) are increasingly common as a means for governments to exercise control over trade policy in the face of constraints on the use of tariffs and restrictions from international trade agreements (Ederington and Ruta, 2016). These can consist of *de jure* and *de facto* elements due to their often non-transparent nature and intended purpose to evade existing trade rules.

Seventh, there may be ideological factors which make it more difficult for certain policy options to gain traction, even though they are technically and politically feasible. The educational background of

the ruling elite is a key factor, for instance economic bureaucrats in South Korea in the 1960s took their inspiration from List, Schumpeter and Marx so were well disposed towards state intervention (Chang, 1996, p. 125). Assessing the “cognitive maps” of policymakers through the prevailing political discourse, particularly with regard to the role of the state, is an important aspect of understanding the range of policy options seen as legitimate (and therefore the policy space) even though perceptions change over time (Hall, 1993; Mehta and Walton, 2014).

Eighth, recent literature has acknowledged the need for policymakers in the global south to develop industrial strategies in a complex multi-scalar context (Behuria, 2019). This requires navigating policy space at the national, regional and global level simultaneously, and while policy space literatures acknowledge tensions between the national and the international level, a more nuanced understanding of interactions and trade-offs between policy arenas is necessary. The various gaps and underdeveloped areas identified in the policy space literature do not map neatly onto the *de jure* and *de facto* distinction presently in use. This points to the need for a more comprehensive framework that can accommodate the broad range of factors that affect the ability of a state to pursue industrial policy, which will be attempted in Chapter 4.

## **2.3. Industrial upgrading in value chains**

### **2.3.1. Industrialisation as upgrading in VCs**

The recognition of manufacturing in particular as the source of national wealth and power was widespread across Europe from the late sixteenth century, based on “common sense” and observation rather than any underlying theory (Reinert, 2007). Giovanni Botero (c. 1544-1617) sought to understand why cities were wealthy, and wrote in 1589 how Italy and France, despite their lack of access to gold mines (unlike Spain) were “rich in money and treasure” because of the “power of industry” (Reinert, 2007, p.86).

#### *2.3.1.1. Increasing returns in manufacturing*

Almost as far back as policymakers have sought to encourage manufacturing, theorists have worked to understand its special properties compared to other economic sectors. In his treatise of 1613, Antonio Serra was the first to theorise what we now call “increasing returns” as the source of manufacturing’s wealth-generating potential, building on previous more descriptive works by others like Giovanni Botero (Reinert, 2011). In one passage, Serra (2011 [1613], p. 121) wrote that:

*...in manufacturing activities it is possible to achieve a multiplication of products, and therefore of earnings. The same cannot be done with agricultural produce, which is not subject to multiplication. If a given piece of land is only large enough to sow a hundred tomoli of wheat, it is impossible to sow a hundred and fifty there. In manufacturing, by*

*contrast, production can be multiplied not merely twofold but a hundredfold, and at a proportionately lower cost.*

The concept of increasing returns has since had a chequered history in economic thought. Adam Smith (1904 [1776]) alluded to the concept of increasing returns in his discussion of specialisation and the productivity increases associated with a greater division of labour (Young, 1928; Buchanan and Yoon, 2000). Malthus and Ricardo did not recognise the importance of increasing returns but the idea was kept alive in mainstream economics by Alfred Marshall, before being effectively abandoned by subsequent neoclassical economists.

The standard definition of increasing returns to scale in contemporary economics follows Marshall (2013 [1920], p. 125), who suggested that increasing returns are present when an increased use of factor inputs in a production process results in an extra “return” (i.e. increment of output) larger in proportion than the increase in inputs. Marshall (2013 [1920], p. 221) identified greater mechanisation, specialisation and division of labour as sources of increasing returns, but fundamentally distinguished between those arising within a single organisation (internal economies) and those arising between such organisations in the same industry (external economies).

The prospect of pervasive increasing returns in the economy poses fundamental problems for neoclassical analysis because it implies a tendency towards oligopoly or monopoly rather than perfect competition (Toner, 1999, p. 8). While they accept the possibility of increasing returns, neoclassical economists adhere to the belief that diminishing returns will eventually take hold in manufacturing (Samuelson and Nordhaus, 2010, p. 117). This is not based on any empirical or theoretical reasoning, but an appeal to common sense and the inappropriate analogy of an empire “stretched too thin”. Instead of investigating the dynamics of the period during which increasing returns are acknowledged to apply, and when and why they might cease to operate, neoclassical economists assume constant returns to scale so that tractable but practically irrelevant models involving perfect competition and equilibrium can be refined. The belief that diminishing returns prevail in all sectors is partly behind the idea that development can be achieved by specialisation in any sector, yet (setting aside the strong evidence for increasing returns in manufacturing) this view fails to account for the dependence of high value services and agriculture on manufacturing in terms of demand, productive inputs (machinery, chemicals etc.) and organisational innovations (Andreoni and Chang, 2016).

A succinct expression of the link between manufacturing and increasing returns in a form that can be empirically tested is found in Kaldor’s three “Growth Laws”: (i) manufacturing is the engine of growth because (ii) static and dynamic returns to scale drive productivity growth in industry, and (iii) increases in productivity outside of manufacturing as resources are drawn from diminishing returns activities (Kaldor, 1967; Thirlwall 1983, 2015). A range of recent studies have found strong empirical evidence for the first proposition that the manufacturing sector drives broader economic growth, in

middle and high income countries (Marconi et al, 2016) as well as African countries (Wells and Thirlwall, 2003) and studies including countries across income groups (Szirmai and Verspagen, 2016). Studies also generally find support for the second proposition – that increasing returns in manufacturing are the main cause of the sector’s contribution to economic growth (also known as Verdoorn’s Law) – in samples of high income countries (Millemaci and Ofria, 2014), developing countries (Dasgupta and Singh, 2005), and African countries (Wells and Thirlwall, 2003).

#### 2.3.1.2. *Sources of increasing returns*

The potential for increasing returns in manufacturing is determined by the conditions of aggregate demand at the macroeconomic level. Charles Babbage (1832) and Allyn Young (1928) concurred with Adam Smith’s (1904 [1776]) assessment that an increasingly complex division of labour in an economy was the underlying factor making possible the phenomenon of sustained productivity growth in manufacturing, which came to be understood in terms of increasing returns (Vassilakis, 1987). Crucially, Smith (1904 [1776]) further identified that “the division of labour is limited by the extent of the market”, since increased specialisation in the economy is only viable insofar as there is (effective) demand for a greater array of goods and services.

Elaborating on Smith’s insight, Young (1928) added “but the extent of the market also depends upon the division of labour”, introducing an element of circularity into the argument. Based on this, the theory of circular and cumulative causation (CCC) illustrates how the presence of pervasive and significant increasing returns in the economy (especially manufacturing) drives productivity growth, which is linked in a circular and cumulative relationship with total output growth (Young, 1928; Myrdal, 1957; Kaldor, 1970; Ricoy, 1987; Toner, 1999). CCC theory has been chosen to underpin the research because it provides the most coherent theoretical account of the dynamics of long run economic development, engaging directly with the specificities of the manufacturing sector.

If demand conditions are propitious at the macroeconomic level, increasing returns may be realised at the meso and micro-level. Young (1928) illustrates this by accepting Marshall’s distinction between internal and external economies, and arguing for the primary importance of external economies as a source of increasing returns. Internal economies (such as scale economies) at the micro-level are seen as secondary in that they depend on external economies: “the scale of [firms’] operations... merely reflects the size of the market” (Young 1928, p. 539). Thus for Young, the higher productivity of American over British industry after the First World War could be best explained by its larger domestic market: “the most important single factor in determining the effectiveness of [a country’s] industry appears to be the size of the market”, with market size defined in terms of “buying power” (Young 1928, p. 533). The importance of market size for productivity outcomes highlights the potential for external demand, i.e. that of foreign markets accessed through trade, to contribute to the industrialisation process. The objective of multilateral and regional trade agreements between

countries is to enable domestic manufacturers to capitalise on the increasing returns offered by a wider market.

At the meso-level, sitting between the level of the overall economy and that of a single firm, increasing returns arise because of the specific characteristics of certain sectors – particularly manufacturing. In Marshall's parlance these are still external economies, but operate at the intra and inter-industry level, unlike the macroeconomic factors which operate at the aggregate level. In the case of agriculture, Marshall describes how a farmer applying increasing quantities of capital and labour to a fixed area of land will first see increasing returns up to a point, after which diminishing returns will kick in. This eventual inevitability of diminishing returns in agriculture underlies the view in CCC theory, following Serra, that increasing returns are largely restricted to the manufacturing sector (Toner, 1999, p. 11). The most straightforward reason for this is that in agriculture a key input is fixed by the land area available, while in manufacturing there is no reason in principle why any input should be fixed. The input of capital equipment in particular is a "produced means of production", so an increase in the output of the manufacturing sector is also an increase in available inputs, introducing further circularity into the system (Ricoy, 1987, p. 6). The resulting potential to increase the capital-labour ratio virtually without limit in manufacturing creates huge scope for productivity growth, and therefore also for growth in total output through the dynamics of circular and cumulative causation.

At the micro-level of an individual production unit such as a firm is where many of the external economies outlined are concretely realised. Increasing returns at the firm level largely correspond to Marshall's (2013 [1920]) concept of 'internal economies'. A crucial 'static' source of plant scale economies in manufacturing enterprises is the fact of indivisibilities in factors of production, such that the cost of "lumpy" investments (e.g. capital equipment) must be spread over a large number of units of output to be justified (Kaldor, 1934). Joan Robinson (1933) identifies indivisibilities as a principle source of increasing returns, since it is "impossible for an industry to equip itself to produce one unit of a commodity without immediately providing capacity to produce more than one unit" (Robinson, 1933, p.334). Clearly, indivisibilities in factor inputs can only be overcome if market demand for the output is sufficient, such that the realisation of internal economies is conditional on the presence of external economies, and the latter may be augmented by trade and particularly export markets.

Turning to dynamic sources of increasing returns at the micro-level, CCC theorists argue that the endogeneity of technological change is a special feature of manufacturing which explains its central position in the growth and development process. For Young there is a causal link in both directions between "scientific progress" and industrial growth, with changes in the organisation of production usually involving the application of new knowledge such that "change becomes progressive and propagates itself in a cumulative way" (Young, 1928, p. 533). While capital investment and increases

in the capital-labour ratio are seen as distinct from process of technological change by neoclassical economists, in CCC theory they are they are often a transmission mechanism for technological change (Toner, 1999, p. 12).

An important mechanism by which industrial production itself contributes to scientific progress is that of “learning by doing”. This leads to both a reduction in the time taken to do a particular task (Arrow, 1962) but also refinements to the production process itself and the advancement of knowledge (Kaldor, 1972). Learning by doing is seen as a “dynamic economy” rather than a “static economy” because once learning-by-doing has occurred at a certain level of output, reducing the output level does not result in the loss of what was learnt, unlike a physical plant economy which is reversible (Toner, 1999, p.12).

To conclude, we have argued that the special features of manufacturing, especially the prevalence of increasing returns, result in it being an “engine of development” for the overall economy. The sources of increasing returns are many, encompassing internal economies at the micro-level such as indivisibilities in capital equipment, and external economies at the meso and macro-levels, such as complementarities between firms and industries. Increasing returns lead to productivity growth, which is linked in a circular and cumulative causal relationship with overall output growth, i.e. the “extent of the market”. Productivity gains usually translate into wage increases and real price reductions for goods and capital equipment (a produced means of production), increasing demand for output further. On the other side, increases in the extent of the market permit greater specialisation and division of labour, allowing higher capital-labour ratios (embodying technical change), which together boost productivity growth. The desirability of triggering increasing returns dynamics, along with Young’s case for the primacy of external economies in driving the virtuous circle, provide a strong justification for LLMICs with small domestic markets to seek to increase the market access of their nascent capitalist sector through multilateral and regional trade agreements, thus overcoming indivisibilities in capital investment and capitalising on regional complementarities in production.

### 2.3.1.3. *Globalisation of production and GVC scepticism*

For most of the history of capitalism, manufacturing has been conceived of as taking place within factories and clusters of factories, geographically co-located inside the borders of particular nation states (List, 1909 [1841]; Gereffi, 1994). Successful catch-up development typically took the form of a national project, often in resistance to outside influence and based on an imperative to self-reliance and independence (Gerschenkron, 1962; Woo-Cumings, 1999). The focus on analysing national systems of production has become less relevant with the rise of manufacturing in globally interconnected networks whereby value addition takes place across multiple geographic locations, and the initial optimism about the resulting implications for industrialisation have given way to increasing scepticism.

The concept of a “new international division of labour” emerged in the late 1970s to describe the increasing tendency for manufacturing activities to be relocated from high to low-wage countries (Fröbel et al, 1977). The organisation of the resulting specialisation patterns came to be seen in terms of global commodity chains (GCCs) and later global value chains (GVCs) and global production networks (GPNs) which all analyse, with differing emphases, how the production of a single good is split into tasks carried out in multiple countries and as a corollary trade in intermediate inputs is increasingly important (Gereffi and Korzeniewicz, 1994; Gereffi et al, 2001; Henderson et al, 2002). Baldwin (2016) argues that the rising importance of GVCs represents a “new age of globalisation” driven by information technology, which has reduced international transaction costs and enabled the relocation of labour-intensive activities to LLMICs.

The increased importance of transnational production systems has major implications for industrialisation prospects in LLMICs. Baldwin (2016) and the World Bank (2017, 2020) generally see GVCs as positive for development, arguing that GVCs have made it easier for countries to enter into manufacturing activities, since they can specialise in one stage of production of a complex product, rather than having to master all stages. Instead of building complete domestic supply chains countries can join existing GVCs, especially through the development and promotion of Export Processing Zones (EPZs) and Special Economic Zones (SEZs) to local and foreign investors. It is argued that this way, local firms can rapidly build capabilities and upgrade, bringing broader development benefits through payment of wages to increasingly skilled workers and purchases of inputs from local suppliers (backward linkages). As a result the process of development as a whole has become ‘compressed’, i.e. happening more quickly than previously, with China’s experience from the 1990s being the archetypal example (Whittaker et al, 2020).

However, concerns have grown that integration into transnational production networks does not automatically bring wider development benefits, characterising the impact of FDI in EPZs as often creating “enclave economies” (Gallagher and Zarsky, 2007) and the overall result of GVC integration as “thin industrialization” (Whittaker et al, 2020). These outcomes are partly driven by the tendency for FDI rather than local investment to underpin LLMIC integration into GVCs, with the upskilling of local firms critical to the development of broad-based productive capabilities (Lall, 1992; Whitfield et al, 2020a). Foreign investors also often have their own sourcing strategies relying on imported inputs rather than developing linkages to local firms outside EPZs. Furthermore, the rising industrial concentration and power of lead firms headquartered in HICs contrasts with heightened competition among suppliers based in LLMICs, creating ‘endogenous asymmetries’ in GVCs which facilitate ‘supplier squeeze’ (Nolan et al, 2008; Milberg and Winkler, 2013; see also section 4.2.3.1). In this context the risks and costs for local firms of achieving global competitiveness are very high, increasing both the scale of learning rents required and the complexity of monitoring and enforcement by government agencies.

The policy challenge of industrialisation has come to be seen as one of not only joining but also upgrading in value chains, i.e. shifting gradually into higher value-added activities, which is seen as qualitatively different from previous conceptions of import substitution and export oriented industrialisation (Milberg et al, 2014). Yet even the more enthusiastic advocates of the changes wrought by GVCs acknowledge that the objectives and means of development are in many respects unchanged. Baldwin (2016) describes the objectives of upgrading in GVC in terms of building linkages in the domestic economy and developing domestic firm capabilities to supply FDI projects in EPZs, using similar language to that of classical development economists such as Hirschman (1958). Similarly, in their discussion of upgrading in GVCs, Taglioni and Winkler (2016) call for “densification”, i.e. increasing links between the local economy and GVCs, through such traditional instruments as local content policies, designing FDI policy to promote spillovers from EPZs, supply side capacity-building for local firms, supporting skills development programmes, etc. It is thus arguably more useful to consider industrial policy as not simply a question of integrating into GVCs, but developing Local Production Systems (LPSs), understood in a Hirschmanian ‘generalised linkage approach’ as sets of backward and forward linkages of various kinds (technological, fiscal, consumption, vertical, horizontal, etc.) in a country’s input-output matrix, where processes of learning and value-addition are promoted (Andreoni, 2019; Hirschman, 1977).

Governance is an organising concept in the GVC literature, with the types of upgrading opportunities available to firms seen as conditioned by governance arrangements in the value chain, particularly the relationships between lead firms and suppliers and the degree and nature of competition (discussed above). Building on institutional economic analyses of firms and markets (Richardson, 1972; Williamson, 1985), GVC researchers posited a spectrum of value chain governance from arm’s length market relations to the hierarchy of a vertically integrated firm, with various forms of quasi-hierarchies in between where lead firms have more or less power over suppliers (Humphrey and Schmitz, 2000; Gereffi et al, 2005). A lack of functional upgrading by LLMIC firms is usually explained by the hierarchical governance arrangements in GVCs, with buyers and lead firms having much more power relative to suppliers to determine value allocation within the chain and capture more value for themselves (Bazan and Navas-Alemán, 2004; Milberg and Winkler, 2013). For the purposes of this research, it will be essential to interrogate the specific governance arrangements in the value chains studied and the resulting opportunities and challenges for contemporary industrialisation.

#### 2.3.1.4. *Types of upgrading*

Upgrading is a central concept when manufacturing is viewed through the analytical framework of value chains. This section will explore the conceptual connections between industrial upgrading and

industrialisation more broadly, consider some of the levels at which upgrading can be seen to take place (firm, sector, nation or region) and the types of upgrading possible at each level.

In the best known early analyses of capitalism, what is now commonly referred to as upgrading was recognised as a means or strategy by which capitalists could increase productivity and so maintain or increase their profitability, competitiveness and market share. Adam Smith (1904 [1776]) observed how improvements in the pin-making production process caused an explosion in productivity, and Marx (1990 [1876]) showed how competition between capitalists creates incentives to innovate improved methods of production to generate more (relative) surplus value, compelling rivals to adopt the same methods or be forced out of business.

Upgrading has been a prominent concept in more recent writing on industrialisation and economic development, and is closely linked to improvements in the technological capabilities of firms. Technological capability is usually defined as the ability to make effective use of technological knowledge, or the capacity to generate and manage technical change in specific functional areas such as production, investment and innovation (Lall, 1987, 1992; Bell, 1984). In his research on technological capabilities, Lall (1987) refers to upgrading as improvements with regard to products, technologies, processes, plants, knowledge and skills. In research on business strategy, Porter (1990, p.6) uses similar language, seeing upgrading as the principal requirement for sustained productivity growth and defined broadly as “raising product quality, adding desirable features, improving product technology, or boosting production efficiency”. More recent work has integrated the concepts of upgrading and technological capabilities in a coherent framework for analysing specific manufacturing sectors (Whitfield et al, 2020b).

As value chain analysis has developed over time, various definitions of upgrading have been used. In the early ‘commodity chain’ literature, industrial upgrading is identified in a simplistic way with increases in the unit value of products (Gereffi and Korzeniewicz, 1990). In subsequent work Gereffi (1994) did not define upgrading explicitly, simply referring to the work of Porter (1990) mentioned previously. In a 1999 journal article Gereffi does provide a definition of upgrading, though not in terms of value/commodity chains, as “a process of improving the ability of a firm or an economy to move to more profitable and/or technologically sophisticated capital- and skill-intensive economic niches” (Gereffi, 1999, pp. 51-52).

From 2000, a number of prominent value chain researchers consciously coalesced around a shared framework and terminology for analysing upgrading in value chains, presented in Humphrey and Schmitz (2000, 2002), which largely still prevails in the literature. Like Marx (1990 [1876]), Humphrey and Schmitz (2000) view upgrading as a strategic response to competitive pressure, and falling into two broad categories: perform the same activities more efficiently, or change the activities undertaken. Four types of upgrading are identified: *process* upgrading involves increasing the

efficiency of productive processes (e.g. with improved technologies or skills), *product* upgrading involves moving into higher value products, *functional* or *intra-chain* upgrading is the performance of new functions requiring more skills in the same value chain (e.g. design or marketing), and *inter-sectoral* or *inter-chain* upgrading involves applying capabilities gained to move into a new sector or value chain altogether (Humphrey and Schmitz, 2000, 2002; Gereffi et al, 2001). More recent GVC literature has added end market or ‘channel’ upgrading, i.e. reaching new higher value geographic markets, and supply chain upgrading, i.e. the creation of backward or forward linkages within supply chains, for example vertical integration to manufacture previously bought-in inputs (Staritz et al. 2017; Frederick and Staritz 2012).

Social upgrading is an increasing concern in value chain research, building on critiques of the GVC literature that it implicitly assumes economic upgrading will be accompanied by improvements in a broad range of social and labour outcomes. Although studies tend to find that economic upgrading is to a large extent necessary for ‘social upgrading’, the latter does not automatically follow from the former (Bernhardt and Pollak, 2016). This suggests a need for value chain studies to not focus exclusively on measuring economic upgrading, but also look at broader societal impacts.

### **2.3.2. Upgrading in textiles and apparel value chains**

This section reviews analytical issues arising in literatures covering the sector case study selected in this research, textiles and apparel (T&A), particularly in the context of LLMICs in Sub-Saharan Africa (SSA). International trade in inputs and outputs has long been a key aspect of national strategies for industrial competitiveness in T&A, from the sourcing of inputs from slave plantations to supply British factories, and the export orientation of the East Asian textiles industry (Bailey, 1994; Chang, 1994). In the contemporary era of globalisation the stages of transformation of fibre to clothing have remained fragmented internationally, and early case studies in the ‘global commodity chain’ and ‘global value chain’ (GVC) literatures often focused on T&A (Gereffi 1994, 1999). These studies of the interconnected capital-intensive textiles and labour-intensive apparel sectors produced organising GVC concepts like value chain governance and trajectories of upgrading (Gereffi, 1999).

In the apparel industry the ideal-type functional upgrading trajectory (based on experience in East Asia) is where a firm enters a GVC by carrying out basic assembly operations on a ‘cut, make and trim’ (CMT) basis as a contractor for a lead firm or first tier supplier, through which they develop greater capabilities for related activities such as input sourcing until they are able to provide a ‘full package’ service (aka FOB or OEM) to buyers, after which they may develop higher capabilities in design, becoming an ‘own design manufacturer’ (ODM), with further potential to market own-branded products as an ‘own brand manufacturer’ (OBM) (Gereffi 1999; Bair and Gereffi 2003). This trajectory builds on earlier accounts in the business studies literature of the ‘stages of exporting’

through which LLMIC firms may pass from assembly operations only to eventually own-brand manufacture (Wortzel and Wortzel, 1982).

Early studies of LLMIC firms participating in T&A and related GVCs cast doubt on the applicability of the above ideal-type upgrading trajectory, with evidence suggesting that while buyers support product and process upgrading by suppliers, functional upgrading is prevented since control of marketing, branding and often design is central to the business models of buyers (Schmitz and Knorringa, 2000; Bair and Gereffi, 2001; Bazan and Navas-Alemán, 2004). More recent studies of firms in low-income countries (LICs) participating in T&A GVCs corroborate these findings, with most firms focusing on garment assembly on a CMT basis and little or no involvement in design, marketing or branding for global markets (Phelps et al, 2009; Staritz, 2011; Morris et al, 2016; Staritz and Whitfield, 2018).

We identify several further criticisms of T&A value chain studies which guide the present research. First, studies tend to assume that firms operate in a single value chain serving a single end market, neglecting the potential for firms to engage simultaneously with multiple value chains and serve different end markets across regions (Navas-Alemán, 2011). Second, the study of global value chains has resulted in an overriding preoccupation with exporting firms, yet there is evidence that firms carry out higher value functions in NVCs serving domestic markets (Bazan and Navas-Alemán, 2004). Third, measuring firm performance using upgrading outcomes is problematic because upgrading need not be accompanied by greater surplus generation or capture, with strategic downgrading sometimes preferred by profit-seeking firms (Tokatli 2013). Finally there is increased recognition that a myopic focus on economic upgrading neglects important societal outcomes, with recent studies giving more attention to indicators of ‘social upgrading’ such as working conditions and wages (Milberg and Winkler, 2011).

Recent research on T&A value chains in the global South has addressed some but not all elements of these critiques. Staritz and Whitfield (2018) go beyond upgrading as a measure of economic performance to develop a matrix of sector-specific technological capabilities, yet they focus exclusively on GVC exporters despite acknowledging the numerous Ethiopian firms integrated into NVCs serving the lucrative domestic market. Likewise, Phelps et al (2009) focus on the FDI-driven, GVC-oriented segment of the Kenyan apparel industry, neglecting the domestically owned firms in NVCs serving local markets. Morris and co-authors examine the different upgrading potential for firms in SSA of value chains governed by regional and global investors, but with ownership characteristics their central analytical focus rather than a comparison of outcomes across different value chains per se (Morris et al, 2011, 2016). Section 3.4 below outlines how these insights from the T&A upgrading literature inform the design of the firm survey.

## 2.4. Regionalism

This section aims to highlight the competing conceptions of regionalism and argues that approaches which actively prioritise industrialisation over simply increasing trade volumes are more likely to contribute to structural economic transformation.

### 2.4.1. 'Open' and 'closed' regionalism

Debates around *regional* trade policy reflect broader debates in trade policy. For neoclassical and neoliberal economists, regional trade agreements are admissible as an exception to the most favoured nation (MFN) principle in multilateral trade arrangements only insofar as they are “building blocs” on the path to an international order of free trade (Bhagwati, 1993; Baldwin, 2006). This approach has been termed “open regionalism”, because while it allows for an element of preferential treatment for regional neighbours, it occurs “in a context of liberalisation and deregulation” which is thought to enhance competitiveness (ECLAC, 1994). In essence it is a strategic, step-wise approach to liberalisation, involving an initial ‘opening up’ to the region allowing domestic firms to adjust to increased competition at that level before full liberalisation and exposure to global competition (Bowles, 2000). In Balassa’s (1961) distinction between the “liberalist” and “dirigist” ideal types of economic integration, open regionalism corresponds more closely to the “liberalist” ideal based on “free markets” and the removal of internal barriers to trade between countries in a region.

Given their preoccupation with optimizing resource allocation in the short term, neoclassical analysts of the effectiveness of regional integration initiatives have focused on static welfare analysis. Viner (1950) showed that a customs union may not be welfare improving if “trade creation” through regional liberalisation is offset by “trade diversion” caused by the common external tariff blocking cheaper imports from outside the region. This was extended by Meade (1955) to consider also the extent of cost reductions caused by trade creation and cost increases caused by trade diversion, such that an overall evaluation of welfare impact could be arrived at (Krishna, 2008). As an OECD report from 1969 argues, for those whose focus is development, i.e. dynamic long run structural transformation, these critiques based on static welfare analysis are not relevant since they ignore the potential for import substitution within a customs union to promote industrialisation (Kahnert et al, 1969, quoted in Sloan, 1971).

The open or “new” regionalism is often contrasted in a casual way with a purported “old” or “closed” regionalism, associated with import-substitution industrialisation (ISI) in Latin America in the 1960s (Grugel and Hout, 1999; Bulmer-Thomas, 2001). The distinction between open and closed regionalisms is questionable because the character of Latin American ISI was arguably rather national than regional during most of that decade: “autarky was practiced in each country, and no attempt was made until the late Sixties to at least promote ISI on a regional basis” (Baer, 1972, p. 104). Those

efforts that were made by regional organisations to promote integration through the Latin American Common Market, rationalize production across the continent and increase complementarities between countries (e.g. via private “complementation agreements”) were largely unsuccessful, partly because the potential regional division of labour was not seen as desirable by individual countries (Baer, 1972; Grunwald and Salazar-Carrillo, 1972).

#### **2.4.2. Developmental regionalism**

Drawing on the “developmental state” literature that grew out of the experience of East Asian NICs, the idea of a “developmental regionalism” has been proposed as framework for understanding regional integration efforts that prioritise industrialisation and the emergence of competitive domestic firms (Nesadurai, 2002). In fact the developmental regionalism concept has a much older heritage, going back to Gordon (1961) and Sloan (1971), well before the East Asian “developmental state” paradigm. Developmental regionalism is now common parlance for UNCTAD, referring to a strategy somewhere between the open and closed conceptions of regionalism, involving a combination of regional economic coordination and strategic integration into the global economy (UNCTAD, 2011, 2013a). UNCTAD has been engaging with such issues since its inception, with the first secretary-general of the organisation, Raúl Prebisch, a key proponent of the need for developing countries to reduce their dependence on HIC markets for their exports, and early reports by the UNCTAD secretariat looking at regional approaches to industrialisation (UNCTAD, 1967). Participant countries at the second UNCTAD conference agreed regional integration among developing countries to be an important element of development strategy (UNCTAD, 1968).

In what appears to be the first use of the term “developmental regionalism”, Gordon (1961) makes the case for economic integration among developing countries seeking to industrialise, which is quoted extensively since it brings together the main themes from this literature review. In Africa Gordon notes “the establishment as sovereign units of a very large number of separate countries which are small in area and population and poor in resources”, which he sees as an “appalling problem” because “as economic units, they have no prospect of viability except as members of some wider group”. Nevertheless, “all of them are rightly preoccupied with economic development as one of their major objectives. All want to diversify their economies, to improve agricultural productivity and to industrialize.” He thinks it likely that “most or all of these countries will seek to promote industrialization through protection of domestic industry from foreign competition” and that this is justified because “even the most orthodox economists recognize the validity of the “infant industry” argument for protection as a means of stimulating economic development, and this has now been supplemented by recognition of the importance of the “external economies” flowing from a cluster of developing industries and services”. For Gordon, the question is thus “whether such protection will be based on the very small markets of the individual sovereign units, leading inevitably to inefficient

small-scale production and the frustration of many developmental opportunities, or whether it will be on a regional basis with some promise of adequate market size and investment scale, and even some hope for competitive pressures within the regional areas”. As to the form of developmental regionalism, two essential elements are identified by Gordon, namely the planning of basic infrastructure investments so as to overcome extractive colonial patterns and promote regional trade, and also “the assurance of regional-wide markets for new industries”, i.e. free trade within the region for selected industries only, alongside protection from outside competition.

Ten years later Sloan (1971) provided his own case for “developmental regionalism”, without referring to that of Gordon. He drew heavily on a 1967 UNCTAD report entitled ‘Trade Expansion and Economic Integration among Developing Countries’. Sloan defined developmental regionalism as “joint policies of economic cooperation, coordination and integration... designed to accelerate the rate of development of both the member-states and the region”, and followed UNCTAD (1967) in identifying five benefits of such a strategy: enabling the achievement of economies of scale through an enlarged market; more rational patterns of specialization and exploitation of regional complementarities; increased efficiency through greater competition due to intra-regional liberalisation (not necessarily for all product lines); increased diversification of exports towards manufactured goods for regional markets (reducing dependence on primary commodity exports to HIC markets); and improved bargaining power of the region with high income countries. An equitable distribution of these benefits among members of a given region, notwithstanding any differences in their starting points, was seen as essential for maintaining political commitment to integration.

For Sloan (1971), developmental regionalism could take a wide range of forms, from a simple agreement to build a bridge at one end of the spectrum to a full-blown customs union at the other. However in order to realise the potential benefits of regional integration listed above, Sloan argued for a more ambitious agenda going beyond “negative integration” (i.e. intra-regional liberalisation) to “positive integration”, i.e. the coordination of economic policies regarding private investment (through a regional investment policy), external trade (through a common external tariff), exchange rates, transport infrastructure, etc. Such wide-ranging coordination amounted to the need for “joint industrial planning” for some contemporaries (Pazos, 1973). Sloan (1971) thought that integration should be approached gradually in line with the development of five crucial national governance capabilities: the ability to engage in national and regional planning, to restructure their economies, to make short-term economic sacrifices for long-term gains, to bargain successfully with one another, and to bargain successfully with the industrialised world.

The idea of developmental regionalism was reinvented by Hettne (1995) without reference to Sloan or Gordon’s prior work. It is not fully elaborated but identifies similar developmental benefits of regionalism to those mentioned previously, including the achievement of economic viability and

“collective self-reliance” through the development of economic complementarities and harmonisation of policies, improved collective bargaining power with the rest of the world, reduced conflict, etc. (Hettne, 1995; Phillips, 2001). Working in the ‘economic realist’ tradition of international political economy, Nesadurai (2002) also arrives at the concept of developmental regionalism seemingly independently, taking inspiration from developmental state theories at the national level but proposing a similar approach to previous writers – protection of an expanded regional market as a way of nurturing emerging domestic firms. Most recently UNCTAD (2011, 2013a) has labelled its own approach to regionalism as “developmental” and called for relatively moderate forms of “regional industrial policy”, principally the provision of “regional public goods” such as transport, communications and energy infrastructure but also the coordination of national industrial policies and strategic investments.

The idea of a regional approach to industrialisation and industrial policy is intuitively attractive in situations where national markets are too small for domestic firms to enter sectors exhibiting increasing returns and economies of scale. Integration into a bigger regional market, alongside coordination of industrial policies and investments across member states, would in principle overcome many obstacles to industrialisation. However, approaches to developmental regionalism which amount to a transposition of a national developmental state onto a supra-national region pose several important problems.

First, it assumes a capacity for decision-making at the level of the region, either by way of a formal institution such as an intergovernmental body, or an informal arrangement to facilitate communication and negotiation between national state actors. In the absence of this, the potential for capitalising on complementarities in the expanded regional market is seen to be limited. Given the difficulties that many LLMICs face in formulating coherent industrial policies at the national level, the challenge of a similar process involving multiple countries is likely to be heightened and require either formal pooling of sovereignty or close informal collaboration based on high levels of trust, which may not be feasible.

Second, many accounts of developmental regionalism implicitly assume that once the obstacle of small domestic market size is overcome by regional integration, new or existing firms will be able to scale-up their operations rapidly to achieve regional competitiveness. However, the development of firm capabilities is not instant or automatic but involves a process of ‘structural learning’ embedded in existing production structures, requiring time for technology adoption, mastering of new production processes, acquisition of relevant skills by management and workers, learning by doing, appropriate financing instruments, provision of suitable energy and transport infrastructure, etc. (Penrose, 1959; Andreoni, 2014). Furthermore, from a CCC theory perspective Kaldor (1981) identifies how regional integration is often characterised by polarisation due to the head-start of more industrially advanced

entities, as was the case in Italy. The risk of divergence between the core and periphery countries in cases of ‘asymmetrical integration’ – where countries with very different levels of development are integrated into a common economic space, such as the European Union after 2004 – are also highlighted by Reinert and Kattel (2013).

Third, the success of any industrial policy initiative depends on its compatibility with the relevant underlying political settlement, i.e. the distribution of power across organisations in society (Khan, 2010). The diverse outcomes resulting from similar industrial policy instruments and institutional arrangements deployed in different countries can often be best explained by differences in the underlying political settlement (for example see the comparison of South Korea and Pakistan by Khan, 1999). Industrial policy involves the creation of rents aimed at buying time for firms in target sectors to learn to compete internationally, and to be successful there must be credible institutional mechanisms to remove rents from recipients who do not meet productivity or export targets (Khan, 2013a). Efforts at regional industrial policy or “joint industrial planning” must therefore not only overcome obstacles to intergovernmental decision making, but result in the design of incentivising and disciplining structures that can be enforced on firms which may be politically connected to national governments. This issue is entirely absent from what little literature exists on developmental regionalism.

Despite these problems, the potential to promote increasing returns manufacturing activities through capitalising on external economies and complementarities in expanded regional markets remains appealing, as evidenced by rapid progress towards AfCFTA implementation in Africa. This potential may be realised without the need for a powerful supra-national body if enough overlap between national policies and interests emerges to generate political pressure for targeted regional cooperation initiatives. For our purposes we define developmental regionalism as an approach to regional economic cooperation centred on the promotion of manufacturing-led structural economic transformation, which takes account of political economy as well as *de jure* dimensions of policy space, to exploit external economies and complementarities present (or potentially present) in the expanded regional market. Regional trade agreements seeking to integrate markets for goods, capital and labour are one example of this, but so are efforts at developing regional value chains through more or less coordinated development strategies.

## **2.5. Conclusion**

This literature review has sought to highlight the key debates in three strands of literature, identify gaps where the present research can contribute and lay the foundations of the argument to be developed in the rest of the thesis. Overall, regional integration was argued to have important implications for industrialisation, through two main channels. Firstly through its effect on policy

space, which was shown to be critical for permitting the necessary industrial policies to be implemented to support industrial development. Secondly, regionalism is likely to impact the structure of value chains, and therefore the types of upgrading trajectories which are viable and effective for LLMICs pursuing industrialisation.

The concept of policy space can be traced back to the idea of state sovereignty in international affairs, with control of a territory's trade policy often at the centre of conflicts over sovereignty. As the multilateral trade regime evolved after the second world war, UNCTAD became a key actor advocating for more policy space for developing countries to pursue autonomous trade and industrial policies. Although policy space is defined in various ways and its meaning is often ambiguous, the most prominent definition distinguishes *de jure* and *de facto* elements of policy space, i.e. the formal authority of policymakers, and the actual ability they have to control policy respectively. A range of criticisms of this framing of policy space were identified, especially the neglect of various international and domestic political economy factors which affect the potential to pursue transformative industrial policies. Chapter 4 attempts to forge a new framework for policy space which takes these missing factors into account.

Upgrading in value chains is increasingly accepted in the literature as the most relevant framing of contemporary industrial development, and the basis for building competence in sectors where increasing returns are present, especially manufacturing. However there has been increased focus on the challenges of achieving meaningful economic and social upgrading in GVCs. This is exemplified in the textiles and apparel sector, where the structural power of lead firms who incorporate LLMICs into their supply chains leaves little space for suppliers to develop capabilities in high-value activities.

Regionalism is a growing focus both in discussions of policy space and upgrading in value chains. Competing models were examined from 'open' or 'negative' regionalism with its focus on intra-regional liberalisation, to more 'developmental' or 'positive' forms of regionalism which prioritise the objective of industrialisation. The significance of different models of regionalism for policy space are more fully explored in Chapter 4. A prominent argument for more 'developmental' forms of regional integration is that it fosters the formation of regional value chains, which it is hoped can allow for greater upgrading possibilities than GVCs. This is a central question for this research and is explored further in Chapter 5 and especially Chapter 6.

### **3. Research design and methods**

#### **3.1. Introduction**

This chapter outlines the research strategy used to answer the questions posed in this research (listed in section 1.2). The overarching question guiding the research is about the impact of regional integration among LLMICs on prospects for industrialisation, examined through two main channels, namely industrial policy space and industrial upgrading. The overall research strategy is a case study of the East African Community (EAC) with a particular focus on the textiles and apparel (T&A) sector – as justified in section 3.2 below – involving analysis of secondary data and primary data collection through a firm survey and semi-structured interviews with industry stakeholders, which are described in this chapter.

The first sub-research question concerns the conceptualisation of industrial policy space, which is addressed in Chapter 4 through the development of an analytical framework which responds to the main problems with existing approaches identified in the literature review. Since Chapter 4's contribution is more theoretical and synthetic in nature, it is not covered in this chapter on research methods.

The second sub-research question is on the EAC's impact on industrial policy space in the region's T&A sector. This is addressed in Chapter 5 through an application of the analytical framework developed in Chapter 4 to the case study sector. Chapter 7 answers the final sub-research question on how policy rents affect firm upgrading strategies. Chapters 5 and 7 draw on primary and secondary data sources which are described in sections 3.3 and 3.5 below.

Chapter 6 answers the third sub-research question, on how industrial upgrading outcomes for EAC T&A firms engaged in regional value chains (RVCs) compare with those in national value chains (NVCs) and global value chains (GVCs). This is answered by means of a firm survey, the characteristics of which are outlined in section 3.4 below. An important contribution of this research is the firm survey design, which examines the T&A value chain functions performed by firms across domestic, regional and global markets.

The overall research strategy therefore represents a mixed-methods approach combining both quantitative and qualitative data collection and analysis. The research design is centred on a case-study of the EAC T&A sector, including cross-sectional surveys of policymakers and firms which allowed for triangulating and cross checking of data obtained from different sources. This chapter does not explicitly focus on ontological or epistemological issues, but the mixed-methods approach outlined here implies a pragmatic combination of positivism/objectivism and

constructivism/interpretivism (Bryman, 2012). The following sections are presented roughly in the chronological order by which they took place in the research process.

### **3.2. Case study approach and selection**

The research design centres on a case study approach with comparative and cross-sectional elements. The choice of the regional EAC T&A sector as the main case study is justified below, along with the decision to include a national comparative research design element (Tanzania and Kenya) and a cross-sectional dimension (the survey of firms and policymakers).

This research is grounded in an investigation into the concept of industrial policy space, which is explored through a literature review in Chapter 2 and the development of an analytical framework in Chapter 4. Since political economy research such as this has long been characterised as consisting of a dialogue between the “abstract” and the “concrete” (Marx, 1993 [1857], 1990 [1876]), it was natural to test the strength of the analytical and conceptual hypotheses generated in Chapters 2 and 4 through application in a particular context. Case studies are a common design in political economy research because detailed engagement with examples helps sharpen analytical categories and document processes of change and its underlying causes (Odell, 2001). By focusing on a particular case in all its unique complexity, findings are necessarily not generalizable to other settings, but an “exemplifying” case may capture the essential features of a broader category and therefore generate “analytical generalizations” (Bryman, 2012: 70-71).

The criteria for the geographic aspect of case study selection are based on the main themes of the research, resulting in a preference for LLMIC groupings prioritising both regional integration and industrialisation. East Africa was chosen for the study because it is one of the most integrated regions of LLMICs, with the EAC in particular often judged the most integrated Regional Economic Community (REC) in Africa (UNECA, 2019). The EAC is a regional intergovernmental organisation and customs union comprising Kenya, Tanzania, Uganda, Rwanda, Burundi and (more recently) South Sudan with a combined GDP of over US\$170 bn. The EAC has agreed an industrialisation policy and strategy at the regional level, and its member states are also actively engaged in efforts to promote industrial transformation (EAC 2012, 2017).

Although the EAC is unique and findings from studying it will not be generalizable, it has potential to be an exemplifying case because of similarities between its institutional design and those of other RECs, particularly as it is one of 6 plurilateral regional customs unions in Africa and 14 in the world (see Table 7 in section 4.3.2). Although the EAC is formally represented as a customs union (i.e. a free trade area with a shared external trade policy), a number of flexibilities afford room for manoeuvre on trade policy to member states, with interesting implications for legal policy space (Mshomba, 2017). Unlike some groupings of LLMICs (such as SADC), the EAC is not overly

dominated by a single more advanced economy, so the policy space dynamics of the bloc were expected to reflect negotiation and mutual interests rather than the preferences of a regional hegemon.

As well as the geographic focus on a region, the research also requires a sector case study to enable a more profound engagement with industrialisation dynamics in a particular value chain. The sectoral case study chosen is textiles and apparel (T&A), due to its close association with the development of global capitalism, having driven the growth of both early and late industrialisers (Beckert 2014; Riello 2015). Furthermore different EAC countries are globally competitive exporters of both cotton and apparel (USAID, 2014), suggesting the potential for T&A RVCs to play a role in regional industrial development based on trade complementarities.

Given the focus of this research on policy space at not only the regional but also the national level, as well as due to the constraints of a PhD, it was necessary to select a smaller number of countries to focus on within the EAC. Tanzania and Kenya were chosen because they are the largest economies of the region and they are the most involved in the chosen case study sector, together accounting for almost all EAC exports of T&A products. The element of national comparison in the research design is also important for the analysis, since policy space is viewed at the national as well as regional and global levels.

### **3.3. Official documents and statistics**

This section describes the methods used to collect and analyse secondary data from official sources, for the purposes of Chapter 5 on industrial policy space in the EAC T&A sector and Chapter 7 on industrial policy rents and outcomes. The analysis of policy space and rents in the EAC is supported by data in the form of official documents such as national and regional sectoral industrial policies and strategies, official notifications, legislation and regulations. It also draws on official statistics on production, trade and tariffs which is submitted by national authorities to international bodies such as the UN and WTO.

Development strategies and industrial policies for relevant sectors were collected from the websites of national government ministries. Those not available online were pursued through email and in-person requests during the fieldwork. Content analysis was carried out on the documents gathered based on the questions guiding this research, and the various sources used are referenced in the later chapters of the thesis. Insights from analysis of the documents were critical to designing the questionnaires for firms and policymakers, as well as for interpreting and triangulating responses.

These documents were often found to be very ambitious in terms of the targets set, e.g. for growth in manufacturing value added and manufactured exports, and listed a wide range of planned interventions. Often questioning during interviews revealed that implementation of the published

policy documents was fragmented and partial. While external consultants and agencies often author sector strategies on behalf of line ministries, especially ministries of trade and industry, more powerful actors such as finance ministries and donors make the ultimate decisions about funding for implementation of specific initiatives. There is an incentive for strategy documents to contain large numbers of possible projects to maximise the chances that funding can be found for at least some of them.

In light of this, the analysis centres on official documents that confer rents to specific actors, as far as possible. Within the EAC the official publication of the community is the EAC Gazette, which contains notifications of duty remissions granted to named firms to reduce their liability for input duties on imports used to manufacture specific products. EAC Gazettes are mostly available online via the EAC website, but several are missing and these were sought from interviewees in the EAC headquarters in Arusha. The Gazettes cover all sectors, but notifications relating to the textiles and apparel sectors were extracted and compiled into a database to facilitate the analysis, with results presented in section 5.2.2, representing a contribution of the thesis. EPZ schemes are another source of rents for T&A firms in EAC counties, and official documents from national authorities often reveal their approximate magnitude, which is presented in Chapter 7.

Trade data submitted by national authorities to international agencies contains valuable information on the quantity, value and unit values of imported goods which are in direct competition with the produce of domestic manufacturers. Alongside the levels at which tariffs are set, this data can indicate the extent to which domestic producers are protected from international competition, i.e. the level of rents they receive. Regional and international FTAs also provide rents since they boost the competitiveness of exporters, which are estimated with trade and tariff data of Kenya and Tanzania's main trading partners. The novel approaches to quantifying negative and positive trade policy rents are a contribution of the thesis, and are elaborated in Chapter 7.

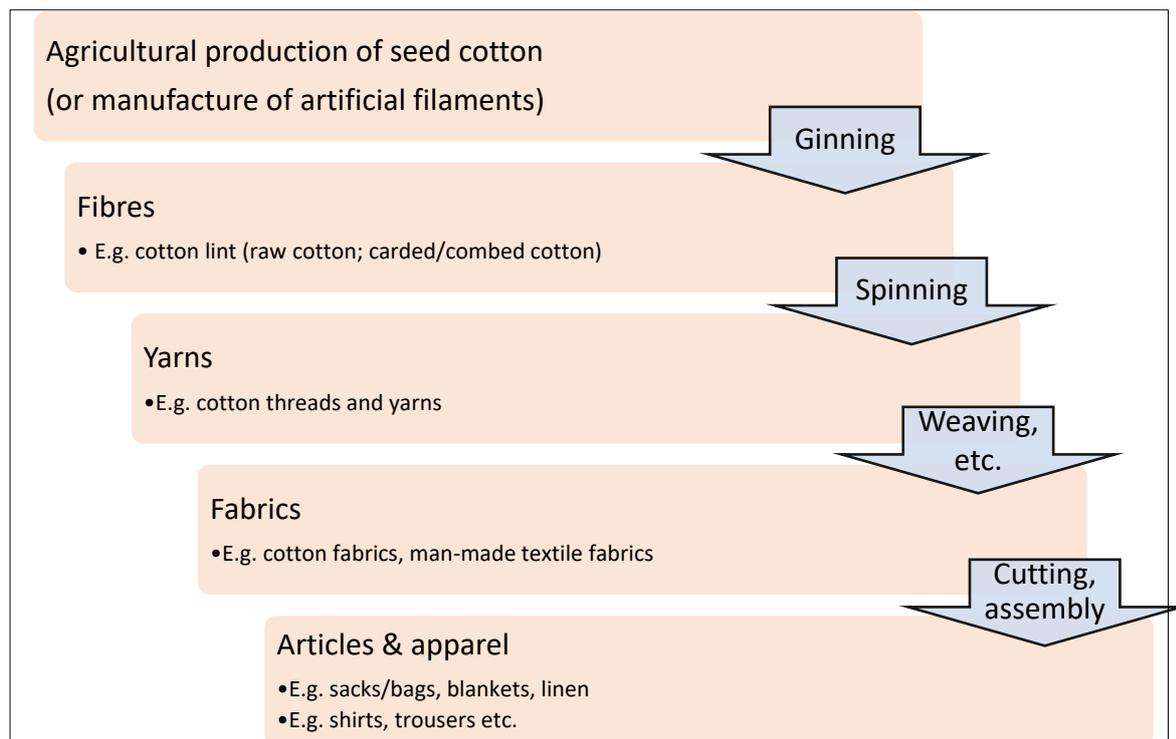
### **3.4. Firm survey**

This section describes the methods used in the primary data collection necessary for Chapter 6 on EAC T&A industrial upgrading outcomes. The survey of firms is a cross-sectional element in the research design, i.e. allowing for a comparison of different units at a single point in time (Bryman, 2012). In particular, the survey examines upgrading outcomes in national, regional and global value chains for Tanzanian and Kenyan firms.

The full T&A value chain starts with inputs to the production of fibres (e.g. cotton seeds) and follows the chain through all stages of transformation to distribution by retailers and final consumption in end markets (Kaplinsky, 2005). Since our focus is on the manufacturing sector, we exclude agricultural inputs and the post-production stages of value addition/capture, concentrating on the main

manufacturing stages of the chain. The production process for cotton-based products involves the ginning of harvested seed pods (bolls) to separate cotton lint from seeds, before the lint fibres can be spun into yarn and thread, which is transformed (e.g. through weaving, knitting or crocheting) into fabric that can be used as a direct input to the manufacture of textile articles and apparel. The main steps are outlined in the diagram below, and the stages from spinning onwards are similar for non-cotton based products. The decision was taken to exclude firms engaged exclusively in ginning due to that sector’s closer links to cotton production rather than T&A, as well as the large number of small scale operators and relatively basic technologies used, according to interlocutors (interview #35).

Figure 1: Production stages of T&A value chain



Source: author’s own based on Kaplinsky (2005) and USAID (2014) with product names from SITC revision 3

The T&A literature typically focuses on firms exporting apparel to global markets and views performance in terms of upgrading, particularly functional upgrading from basic apparel assembly operations (CMT), through providing a full package service (FOB), to doing high-value activities like design (ODM) and branding (OBM), with the possibility of vertical integration to textile manufacture along the way (Staritz et al, 2017). This is despite the well documented difficulties facing LIC firms to achieve export competitiveness and upgrade in T&A GVCs, due to a range of factors including governance arrangements and market concentration.

In light of these and other issues identified in section 2.3.2 of the literature review, a survey was designed to assess firm performance and upgrading in the East African T&A sector, with three distinguishing features. First, unlike most surveys of African T&A firms we do not focus exclusively on exporters, also including firms principally oriented to the domestic market. Second, instead of

assuming firms engage primarily in a single value chain, we asked firms about their engagement with multiple value chains at the domestic, regional and global levels simultaneously and over time. Third, we ‘unbundled’ the usual packages of functions found in the T&A literature (CMT, FOB, OBM, etc.) and look beyond apparel manufacture to establish exactly which functions were performed for each end market.

Because of the high degree of vertical integration among East African firms, functions from across the T&A value chain were included in the survey, from spinning, knitting and weaving to garment assembly and various finishing and value-adding processes such as printing, embroidery and washing. While most ‘T&A’ sector studies focus exclusively on apparel, we also include firms making textiles and fabric products. Non-production activities typically seen as adding more value were also covered such as sampling, input sourcing, design, branding and distribution. These were treated separately to avoid the “indiscriminate lumping together of such high value-added activities” commonplace in T&A studies (Tokatli, 2013).

Four upgrading channels were considered in the analysis: function, product, process and end market.<sup>2</sup> Functional upgrading is defined as the recent commencement of a higher value-adding activity or vertical integration process, while functional downgrading is when such an activity is ceased, or when a lower value function is started. Product upgrading (downgrading) is achieved by an overall shift towards more (less) complex products, as judged by interviewees and verified by the researchers where possible. Process upgrading is found when firms reported recent investments in new technologies or organisational approaches. End market upgrading occurred when a company reported having recently started selling to a higher value end market, with end market downgrading being either the withdrawal from such a market or when starting to sell to a lower value end market.

Since the literature is critical of relying on the upgrading concept alone, additional measures of firm performance and social outcomes were included. Capacity utilisation and number of employees are the focus here, with more sensitive data on sales, profits and wages not being available for the whole sample. The extent to which firms made linkages to the broader economy is captured through questions on local content and sourcing from different markets. Information was also collected about ownership, because previous studies of the African T&A sector have conclusively shown that this is a crucial determinant of firm upgrading strategies, with domestic and regional investors more likely to pursue upgrading locally (Morris et al, 2016).

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<sup>2</sup> The fourth upgrading type proposed by Humphrey and Schmitz (2000), inter-sectoral/chain upgrading, was considered through questions about involvement in other value chains by the business or parent group, but little was found and like other T&A sector studies (e.g. Frederick and Staritz, 2010; Morris et al., 2016) this is excluded here. Supply chain upgrading is considered here as a type of functional upgrading.

Tanzania and Kenya have featured little in recent academic research on the T&A sector in SSA, but their involvement in both upstream and downstream value chain segments means they are appropriate case studies. In terms of sampling, all 8 large T&A firms operating in Tanzania in 2018 were surveyed along with 11 large firms operating in Kenya, with data collection taking place in early 2019. Kenyan firms were selected based on their size and representativeness of the population of large firms (based on databases obtained of firms operating in Kenya, cross-checked with national industry experts), as well as the availability of managers during the fieldwork and responsiveness to enquiries. Most of the major large firms not surveyed were foreign owned CMT apparel manufacturers operating in EPZs, which were anyway well represented in the Kenyan sample.<sup>3</sup> The focus on large firms reflects their disproportionate actual and potential contribution to value added, employment, exports and productivity growth in East Africa (Boys and Andreoni, 2020).

The firm survey instruments are presented in annex 10.2. The instruments for Tanzania and Kenya are different in structure due to the stages of the research process at which they were carried out, and the circumstances of the survey in each country. In Tanzania the firm survey was carried out in conjunction with the Textile Development Unit (TDU), a quasi-governmental organisation.<sup>4</sup> TDU carries out an annual survey of large T&A firms in Tanzania, and they agreed to adapt their questionnaire to accommodate the aims of this research, which aligned with their own interests. This resulted in a longer survey instrument in Tanzania, to accommodate both the key questions from TDU's annual survey and additional questions for this research. Furthermore since the Tanzanian research was conducted first, some questions which were not well answered by firms were dropped for the Kenyan phase. In Kenya a slimmed down version of the Tanzanian survey was carried out while maintaining the key elements required to answer the research questions. The Kenyan firm survey was conducted alongside Nairobi-based consultants carrying out a scoping study in the T&A sector for TDU's partner organisation in Kenya, Msingi East Africa Ltd. Again, the alignment of objectives between this research project and Msingi meant it was possible to combine the consultants' scoping study with the PhD fieldwork in a single survey in Kenya.

The collaboration with TDU in Tanzania and Msingi in Kenya raised some methodological issues for the research. TDU were perceived by firms as being connected to the government, and on some firm visits, officials from the Tanzanian Ministry of Industry and Trade and the National Bureau of Statistics accompanied myself and TDU staff to conduct the data collection. There was no suggestion that firms were holding back in their criticism of government policies towards the sector based on the

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<sup>3</sup> It is known that at least 9 large Kenyan firms were not able to be surveyed. 6 were foreign owned CMT apparel manufacturers in EPZs, 1 was a locally owned CMT manufacturer in an EPZ, 1 locally owned private vertically integrated firm, 1 publicly owned vertically integrated firm.

<sup>4</sup> At the time of the research, TDU staff were embedded in the Tanzanian Ministry of Industry and Trade (MIT) but they were employees of Gatsby Africa, a branch of the UK-based Gatsby Charitable Foundation.

presence of officials, with similarly forthright views on policy issues offered regardless of the composition of the enumeration team. The access gained to all large firms operating in Tanzania would have been impossible without the collaboration with TDU. In Kenya, the consultants contracted by Msingi were responsible for arranging firm visits, and our enumeration team was not perceived as having any connection to the state. The larger number of T&A firms in Kenya and the consultants' terms of reference meant that we did not attempt to survey all firms, with the sample chosen in part based on the consultants' connections, introducing a potential element of bias into the research. However, basic information was gained on the major firms not surveyed (investor nationality, functions performed, products and end markets) and the firms surveyed were broadly representative, based on those indicators.

### **3.5. Semi-structured interviews**

This section describes the collection and analysis of qualitative data through semi-structured interviews, which informed all three main results chapters but especially Chapter 5 and Chapter 7. Semi-structured interviews are a common method in qualitative research, allowing for a more inductive approach than structured interviews since space is given for concepts and ideas to emerge from the data collection process (Bryman, 2012). This was appropriate for the current research because understanding industrial policy space in the EAC required eliciting from policymakers the key issues they faced, expressed in their own terms.

The policy interview guide (in annex 10.2) was designed after the starting the firm survey, informed by the policy issues raised by firms as they related to the research question themes such as policy space, rents and upgrading. The structure of the interviews and the questions asked depended on the role and experience of the interviewee, with an open approach to exploring issues raised by the respondents themselves. It was sometimes necessary to define terms for respondents when we did not share the same understandings of certain concepts. Informed consent was obtained after explaining the purpose and parameters of the research and giving assurances of confidentiality and data integrity. Collection of personal information was limited to name and roles, which was anonymised through coding and kept separately from the main data. Interviews were not recorded to encourage a more open and frank discussion of sometimes controversial and political issues in the T&A sector. Interviews took place in English, an official language in both Kenya and Tanzania, and in which all interviewees were comfortable given their positions in government, policy and business circles.

In total 42 interviews were conducted for the research (see annex 10.1), with the respondents chosen through purposive sampling techniques, a mixture of generic and snowball methods. An initial list of target respondents was drawn up based on the core themes and specific issues emerging from the research, ensuring as far as possible to cover institutions across the dimensions and levels of the

policy space framework. Individuals within each institution were identified through discussions with TDU staff and Msingi consultants, and meetings were requested. Interviewees sometimes recommended we speak to other individuals on specific topics, in which case we pursued further interviews according to the snowball method (Bryman, 2012). The relatively small size of the T&A sector in both Tanzania and Kenya made purposive sampling through close-knit policy and business networks an effective way to reach informed respondents.

This phase of the research was ended after 42 interviews were complete because after around that point further interviews were adding little new data – i.e. a saturation point was reached – and the resources available for conducting further fieldwork were in any case limited. Because conversations were not recorded, detailed notes were taken during the interviews, directly onto a laptop. This aided the analysis because it was not necessary to carry out further transcription, and meeting notes could be searched for keywords and codes relevant to each aspect of the research.

### **3.6. Conclusion**

This section has outlined the main elements of the research design used to answer the questions underlying this PhD. A mixed methods approach was set out with both qualitative and quantitative components. The overall research strategy is characterised by a case study, consisting of analysis of official documents and data, a firm survey and semi-structured interviews with industry stakeholders.

The main methodological contribution of the research is the approach to designing a firm survey. Unlike previous studies of firm upgrading strategies and outcomes in the T&A sector, the survey ‘unbundled’ the usual packages of functions found in the literature, and questions were asked on firm activities for domestic, regional and global markets simultaneously.

A further contribution is the approach to analysing industrial policies. Rather than looking at strategy documents alone, which may not always be fully implemented, the research attempts to identify and quantify tangible policy rents accruing to specific groups of firms wherever possible. Again, these are looked at the national, regional and global level, pointing towards a novel approach to multi-scalar industrial policy analysis.

## 4. Industrial policy space for development: an analytical framework

### 4.1. Introduction

This chapter aims to develop an analytical framework for industrial policy space for development that addresses the shortcomings in existing approaches found in the literature. Diverse strands of literature have identified neglected factors in the analysis of policy space – geopolitics, domestic political economy, public sector organisational capabilities, domestic and global economic structures, etc. – but these are not addressed in an integrated way. The wide range of factors influencing policy space presents a challenge to developing a framework that is both parsimonious and has explanatory power. There are at once national, regional and international dimensions but also political, economic and legal aspects, with large areas of crossover between each.

We propose a definition of industrial policy space as *the set of legally permitted, economically viable and politico-institutionally feasible policy options which can promote industrialisation of an economy*, i.e. the development of increasing returns activities, particularly in manufacturing. The legal dimension corresponds to the *de jure* element of policy space described in the literature, i.e. the formal rules which circumscribe state action, while the economic and political-institutional dimensions describe broad categories of the many *de facto* aspects. The political-institutional dimension covers the informal rules, political settlements and institutional structures which define which policies are feasible, while the economic dimension captures how the organisation of economic systems of production and exchange in particular sectors make some policies viable and others not. Each dimension can be analysed at the national, regional and global levels according to the constraints and enabling factors present at each level of governance.

The following section builds on the proposed definition to develop a framework comprising three analytical dimensions and three geographic levels to form a three-by-three square matrix, before populating each square with the main issues identified in the literature. Although this framework could be applied to any economy, it is developed here with a view to the specific challenges of low and lower-middle income countries (LLMICs). The subsequent section uses the framework to examine the impact of some of the most prominent models of regionalism, regional free trade agreements and customs unions, on the different dimensions of industrial policy space. We argue that regional integration may expand or limit policy space in different dimensions, calling into question assertions in the literature that its impact is negligible. In order to design effective industrial strategies it is necessary to achieve an understanding of the key features of the legal, political-institutional and economic dimensions of policy space at the national, regional and global levels for the specific country and sector in question.

## 4.2. Towards a unified multidimensional industrial policy space framework

Table 2 below develops the definition of policy space into an analytical framework for policymaking in the form of a matrix. Each square identifies some examples of likely determinants of policy space for each dimension and geographic level. The following sections of this chapter elaborate for each square of the matrix some of the key factors affecting industrial policy space from the perspective of LLMICs seeking to industrialise in the 21st Century. The fundamental purpose of the framework however is analysing particular industrial sectors, which is done in the next chapter.

*Table 2: Policy space framework*

|                                   |               | Dimensions of policy space                                   |  |   |
|-----------------------------------|---------------|--|--|---|
|                                   |               | Legal  | Political-institutional  | Economic  |
| Geographic levels of policy space | Domestic      | Domestic legal framework (adaptable in medium and long term) | Governance capabilities, domestic political settlement, elite and popular ideologies               | Productive capabilities of private and public organisations (technological, managerial, etc.), LPS structure, domestic market size, natural resources, skills, etc. |
|                                   | Regional      | Regional trade agreements (FTAs, customs union etc.)         | Regional political settlement, supra-national coordination institutions, regionalist ideologies    | Regional market size, regional value chains, economic geography, natural resources  |
|                                   | International | Multilateral trade agreements (e.g. WTO), BITs, PTAs         | Geopolitical pressures, (neo)imperial ideologies, donor preferences, aid conditionality/dependence | Macroeconomic framework (capital flows, payment clearing), GVCs, TNC strategies, market access via trade agreements   |

Source: own elaboration.

By bringing together diverse literatures covering different aspects of the design and implementation of industrial policy, a unified framework is created which highlights the opportunities, constraints and trade-offs inherent in contemporary multi-scalar industrial policymaking. Most analyses of policy space limit themselves to one or two squares of the framework's matrix, and assume that the factors identified in the analysis explain the outcomes observed in a particular context. For instance, the legal dimension has typically been the focus of policy space analyses, but the gap between legally permitted and actually utilized industrial policy instruments requires investigation of the political and economic factors which are determining the policies adopted. Recently there has been increased

attention to political and economic factors affecting policy space but without a unified framework these are often treated in a fragmented way and without reference to fundamental legal constraints.

Although the framework analytically distinguishes between dimensions and levels, in reality there will be crossover and interactions between squares which co-determine the binding constraints that affect the viability of development strategies. These interactions are too varied and context specific to be captured in Table 2, since in principle any factor from any square may combine with any other to rule out or make possible an option in a particular context. Furthermore there may be considerable grey areas between squares, for instance with formal legal rules adaptable if they are not aligned with the prevailing political settlement; political factors such as rents affecting the economic viability of business models; etc. The following sections of this chapter highlight these potential areas of interaction and crossover, but ultimately these can only be concretely analysed in particular contexts, as will be done in the next chapter's case study.

While the legal dimension is well defined in the policy space literature, the others need explanation. The concept of political feasibility has been used by Khan et al (2016) in the context of anti-corruption initiatives to refer to both the political difficulty of implementing a particular strategy (based on the extent to which the interests of powerful groups are challenged) and the governance capabilities required to enforce it. Political feasibility is closely connected to the nature of the political settlement, with policies that do not take into account the distribution of power being less likely to achieve their objectives. For the purposes of industrial policy space, to make clear the importance of institutional arrangements and governance capabilities as closely related to, but distinct from, considerations of power and politics, we add the 'institutional' suffix to our concept of political feasibility. Thus for instance the feasibility of an industrial policy measure that requires a state agency to remove a subsidy from an underperforming but politically connected firm can be considered from the perspective of both the organisational capabilities of the state agency (to monitor and evaluate performance) and its power vis-à-vis the firm.

Economic viability has been conceptualised by Andreoni and Scazzieri (2014) in terms of 'structural feasibility', i.e. the set of production processes that the structural conditions of an economic system allow for. In our conception, building on section 2.3.1, some of the key factors would include the micro-level technological and organisational capabilities of productive organisations, inter-firm linkages at the meso-level and inter-industry linkages and complementarities at the meso/macro-levels of the 'Local Production System' (LPS).

However, the ideas of political-institutional feasibility and economic viability should not result in the compilation of formidable obstacles to industrial policy in a deterministic way, they should rather be seen in the context of a Bismarckian view of policymaking as "the art of the possible" and Albert

Hirschman's (1971) advocacy of "possibilism", i.e. a focus on widening the bounds of what is, or is perceived to be possible.

#### **4.2.1. Legal policy space**

The legal or *de jure* aspect of policy space is concerned with the set of legally permitted policy instruments, and is defined by the constraints on state action imposed by legal frameworks and agreements at the global, regional and national levels.

##### *4.2.1.1. Global level*

At the global level, the key determinants of legal policy space for LLMICs seeking to industrialise relate to the rules governing international trade. As the formal control of trade practices in dominated polities through colonialism and unequal treaties came to an end, a new, global, rules-based regime emerged after World War II in the form of the GATT (General Agreement on Trade and Tariffs) which put only mild restrictions on the trade and industrial policies of newly independent developing countries (Chang, 2006; Andreoni et al, 2019). Although GATT enshrined the MFN principle it also accepted the protection of domestic industries, only insisting this be in the form of tariffs (rather than quantitative restrictions), and that although there was to be no a priori limit on tariff levels, they would be reduced over time (Hudec, 1987). The overarching approach was one of 'plurilateralism', whereby GATT members could sign up to agreements in specific areas and rounds of tariff negotiations on an 'opt-in' basis (Chang and Andreoni, 2020; Hoekman, 2005).

Changes in legal policy space at the global level cannot be separated from geo-political developments, showing the importance of an integrated policy space analysis as in the proposed framework. Over the 1960s and 1970s developing countries became increasingly successful in pushing for non-reciprocal, preferential and "special and differential" treatment (SDT) within GATT, culminating in the "Enabling Clause" of 1979 that formalised exceptions to the MFN principle (Hudec, 1987). This expansion of legal policy space was due to successful exploitation of increased (political) bargaining power which came about for various reasons including the pressure caused by the creation of UNCTAD, the negotiation of developing countries as a bloc in the G77 and the willingness of Western powers to accept their demands to keep them on side in the Cold War. Changes in the international order from the 1980s reversed these dynamics, and to some extent developing countries were willing to make sacrifices for improved market access for their exports, such that the WTO system which replaced GATT in 1994 provided much less flexibility (Finger, 2001). Plurilateralism was abandoned and the WTO agreements operated on a "single undertaking" (all or nothing) basis (Wolfe, 2009). This meant having to follow rules in all areas, including the new areas listed below (TRIPS, TRIMS etc.) to benefit from enhanced market access. The acceptance of non-reciprocity was

also undermined, with developing countries agreeing to tariff cuts as deep or deeper than those of the HICs, depending on the measure (Finger, 2001).

Whilst the Uruguay Round negotiations that culminated in the establishment of the WTO were ongoing, critics were loudly voicing concerns that the likely outcome would be damaging to the interests of developing countries (Raghavan, 1990). As soon as the outcome of the negotiations emerged, analysts confirmed the dual impact on policy space: while aspects of the new regime brought some benefits for developing countries (including enhanced market access), it came with significant costs in terms of tariff reductions and the loss of a number of important industrial policy instruments banned by WTO rules as the global trade regime expanded in scope to cover new policy areas such as investment and subsidies (Singh, 1996; UNCTAD, 1996; Das, 1998). Although the term policy space was not yet in use (the closest being “policy autonomy”), the general idea was the same.

The most important WTO Agreements thought to constrain the policy options of developing countries were TRIPS (Trade-Related Aspects of Intellectual Property Rights), TRIMS (Trade-Related Investment Measures) and SCM (Subsidies and Countervailing Measures) which respectively ruled out the use of lenient property rights laws to promote technology transfer, the imposition of local content and other requirements on foreign investors, and the use of certain subsidies to support specific sectors (Wade, 2003). For students of ‘Developmental States’ in East Asia and earlier late developers in Europe and the Americas, many of the key policy tools for catch-up development were now banned, such that Friedrich List’s analogy from 1841 was invoked of one who, having “attained the summit of greatness”, “kicks away the ladder by which he has climbed up, in order to deprive others of the means of climbing up after him” (List, 1909, p. 252). The HICs, led by the USA, in pushing for liberalisation through the WTO regime, were seen to be acting in the same way as nineteenth-century Britain when it promoted free trade after its industrial supremacy was established (Chang, 2002; Wade, 2003).

Among Developmental State scholars there is a broad consensus that the WTO constrains policy space, but there are differences in emphasis as to the extent that this poses obstacles to the industrialisation of developing countries. For Alice Amsden, “new WTO rules give ample opportunity for countries to promote their manufacturing sectors” (Amsden, 2000, p. iii) because (as shown in Table 3 below) although some specific instruments are outlawed, the key to success – various measures to support infant industries in exchange for performance outcomes, i.e. a reciprocal control mechanism – are permitted (Amsden and Hikino, 2000). For Robert Wade on the other hand, “rules being written into multilateral and bilateral agreements actively prevent developing countries from pursuing the kinds of industrial and technology policies adopted by the newly developed countries of East Asia” (Wade, 2003, p. 622). Wade’s consideration of bilateral trade agreements outside the scope

of the WTO – on which more below – goes some way to explaining the difference, but cannot completely account for the large gap between his and Amsden’s positions.

The framework proposed in this chapter helps resolve the differences in interpretations of legal policy space under WTO rules, since it puts front-and-centre the interdependencies with the political-institutional dimension of policy space (treated fully in the next section). The formal degree of flexibility written into WTO rules emphasised by Amsden (2000) is not equivalent to the ‘effective’ or actual flexibility, once political pressure from high income countries and IFIs to exceed WTO obligations is taken into account (Shadlen, 2005). We shall return to this issue below, but this cannot account for the different understandings on the rules themselves, which might simply reflect their ambiguity, since globally-applicable rules can only be clarified in specific instances through judicial processes (Shadlen, 2005). For example Wade (2003, p.627) states that the “TRIMS agreement bans performance requirements related to... export requirements”, while the WTO website clarifies that “the TRIMs Agreement does not cover... export performance... requirements (WTO, 2018b).

Table 3 presents the results of a survey of historically important industrial policies and their legal status under WTO rules, along with exceptions and loopholes most relevant to LLMICs. We find that while multilateral rules constrain industrial policy space, they allow significant room for manoeuvre which is often not utilized. For instance LLMICs rarely exploit: the large gaps between applied and bound rates to raise tariffs; legal subsidies such as export subsidies by LDCs; actionable subsidies until they are formally challenged; Article XVIII of GATT which allows flexibility for developing countries to establish a new industry by raising tariffs, quantitative restrictions on imports and performance measure on FDI such as local content requirements; and trade remedies such as anti-dumping duties and countervailing measures to protect domestic industries (Chang et al, 2016). The under-utilisation of this legal policy space suggests that the formal multilateral rules themselves are not the principle obstacle to activist industrial policy in developing countries, with formal rules at the regional level and also political-institutional and economic factors constraining policy space, further discussed below.

Table 3: Status of industrial policy measures under WTO rules

| <b>Policy area</b>        | <b>Policy instrument(s)</b>  | <b>WTO legal status, exceptions and loopholes</b>   |
|---------------------------|--|---|
| Tariff policy             | Raise tariffs to bound levels  | Permitted.  |
| Tariff policy             | Raise tariffs above bound levels   | Prohibited.<br>Exceptions: Article XVIII - permitted (DCs only) for establishment of an industry (after notification, negotiations, compensation and approval).<br>Article XXVIII provides for bound tariff renegotiation.<br>Article VI permits antidumping duties; SCM permits countervailing duties. |
| Quantitative Restrictions | Quotas   | Prohibited (Article XI).<br>Exception: Article XVIII: B – permitted in case of BoP difficulties, if procedures & conditions fulfilled.<br>Agreement on Safeguards: permitted if injury caused by imports, subject to conditions.  |
| Quantitative Restrictions | Export taxes to restrict the export of certain products  | Permitted.  |
| Investment (FDI)          | Local content requirements; export restrictions; trade/foreign exchange balancing requirements | Prohibited (TRIMS).<br>Exception: Article XVIII – permitted (DCs only).<br>Loophole: can be used until challenged.  |
| Investment (FDI)          | Export Performance Requirements  | Permitted (TRIMS) according to WTO website (prohibited according to Wade (2003)).   |
| Investment (FDI)          | Technology transfer requirements for FDI   | Permitted.  |
| Investment (FDI)          | Joint venture requirements   | Permitted.  |
| Subsidies                 | Export Subsidies   | Prohibited (SCM).<br>Exception: LDCs.   |
| Subsidies                 | Subsidies contingent on local content  | Prohibited (SCM).   |
| Subsidies                 | "Actionable" (direct/indirect) subsidies, e.g. for R&D   | Permitted (SCM) until shown to be damaging a trading partner's interests.   |
| Technology                | Government funded R&D centres with technology transfer to firms                                | Permitted.  |
| Technology                | Reverse engineering  | Prohibited (TRIPS).   |
| Technology                | Compulsory licencing of patents  | Prohibited (TRIPS).<br>Exception: permitted if attempts to acquire a voluntary licence fail; requirement to pay remuneration; decisions subject to judicial review.   |
| Technology                | Research and experimentation exceptions in patent law  | Permitted (TRIPS) under certain conditions.   |
| Skills                    | Selective skill formation  | Permitted.  |
| Skills                    | Worker training requirements for large firms   | Permitted.  |
| Investment                | Encouragement of industry-university links through non-subsidy measures                        | Permitted.  |

|                        |   |   |
|------------------------|---|---|
| Investment             | FDI promotion and targeting                                       | Permitted.  |
| Investment             | Fiscal incentives   | Permitted.  |
| Investment             | Targeted and coordinated investments, e.g. in infrastructure, R&D | Permitted.  |
| Investment             | Government-mediated mergers                                       | Permitted.  |
| Investment             | Creation of SOEs in strategic sectors                             | Permitted (though their room for manoeuvre is restricted).                                |
| Competition            | Exemption of SMEs from certain anti-trust laws                    | Permitted.  |
| Government Procurement | Strategic procurement to favour domestic suppliers                | Permitted (DCs are not signatories to the voluntary ‘plurilateral’ agreement in the WTO). |
| Macroeconomic          | Capital controls  | Permitted (with restrictions) but can be used until challenged.                           |
| Macroeconomic          | Government allocation of foreign exchange                         | Permitted.  |

Source: author elaboration based on WTO webpages; Chang et al (2016); Wade (2003); Andreoni et al (2019). DC: Developing country; TRIMS: Agreement on Trade-Related Investment Measures; SCM: Agreement on Subsidies and Countervailing Measures; TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights. Article numbers refer to GATT 1994.

Of increasing importance in setting international trade rules are bilateral trade agreements (BTAs) and bilateral investment treaties (BITs), which often go further than the restrictions imposed by the WTO (i.e. towards a “WTO-plus” system) and are considered in the following section. A final category of international agreement may have important implications for policy space in developing countries, that of Preferential Trade Arrangements (PTAs). PTAs involve industrialized countries offering preferential market access to LLMICs on a non-reciprocal basis, but require conformity with certain eligibility criteria which often place more restrictions on policy space than WTO rules. Those involving the USA tend to be most constraining, but US PTAs often impose such strict Rules of Origin – which are critical since they define the products that actually qualify for duty-free trade – that the intended beneficiaries are unable to take advantage of the preferential market access in any case (Chang et al, 2016). Quality standards, other non-tariff barriers and supply constraints are arguably the biggest factors preventing LLMIC country manufacturers with low technological capabilities taking full advantage of PTAs (e.g. ITC, 2012), factors which are addressed below in sections 4.2.2 and 4.2.3 on political-institutional and economic policy space.

#### 4.2.1.2. *Regional level*

The emerging concept of “regional policy space” captures the potential for initiatives at the (supra-national) regional level to affect the set of available policies (Pascha, 2019). The number of regional trade agreements (RTAs), bilateral trade agreements (BTAs) and bilateral investment treaties (BITs) – or international investment agreements (IIAs) – mushroomed in the 1990s and 2000s (Ravenhill, 2014), and these tend to constrain the legal dimension of policy space while expanding it in other

ways.<sup>5</sup> Recent years have shown a slowing of these trends, with the number of RTAs in force growing by only 1-2% per year from 2018-2020; the lowest number of new IIAs concluded in 2017 (18 in total) since 1983; and treaty terminations outnumbering new agreements (UNCTAD, 2018b; WTO, 2021). Instead, increased emphasis is being placed on negotiating megaregional agreements such as AfCFTA in Africa and the Regional Comprehensive Economic Partnership (RCEP) in Asia-Pacific, while in the global North economic nationalism has grown (e.g. the USA’s rejection of NAFTA and the UK’s exit from the EU), representing setbacks for regional integration.

Table 4: Number of RTAs in force

|  | <b>Plurilateral</b> | <b>Bilateral</b> | <b>Total</b> |
|--|---------------------|------------------|--------------|
| <b>Free Trade Agreement (FTA)</b>                                | <b>105</b>          | <b>190</b>       | <b>295</b>   |
| <i>FTA – goods only</i>  | 56                  | 74               | 130          |
| <i>FTA – goods &amp; services</i>                                | 49                  | 116              | 165          |
| <b>Customs Union (CU)</b>  | <b>17</b>           | <b>0</b>         | <b>17</b>    |
| <i>CU – goods only</i>   | 12                  | -                | 12           |
| <i>CU – goods &amp; services</i>                                 | 5                   | -                | 5            |
| <b>Partial Scope Agreement (PSA)</b>                             | <b>10</b>           | <b>16</b>        | <b>26</b>    |
| <i>PSA – goods only</i>  | 9                   | 16               | 25           |
| <i>PSA – goods &amp; services</i>                                | 1                   | -                | 1            |
| <b>Economic Integration Agreement (EIA) only (services only)</b> | <b>2</b>            | <b>0</b>         | <b>2</b>     |
| <b>Total</b>   | <b>134</b>          | <b>206</b>       | <b>340</b>   |

Source: WTO, 2021. NB: Bilateral is between two countries; Plurilateral involves more than two countries and /or between RTAs. FTA, PSA and CU include FTA & EIA, PSA & EIA and CU & EIA respectively. Accessions not included.

RTAs, BTAs and BITs/IIAs can be classified according to the income level of participants, with those between high-income countries labelled “North-North” (N-N), between LLMICs labelled “South-South” (S-S), and between high-income and LLMICs as “North-South” (N-S). The literature finds significant differences in terms of implications for LLMIC policy space depending on whether trade agreements are N-S or S-S, with the former imposing more restrictions on policy options (Thrasher and Gallagher, 2010; Chang, 2016; Alshareef, 2017; Gallagher et al, 2019). N-S trade agreements involving the USA are generally seen as most restrictive, followed by those with the EU (e.g. the so-called Economic Partnership Agreements, EPAs) which are on a par with WTO restrictions, while S-S agreements are the least constraining, providing “ample policy space for industrial development” (Thrasher and Gallagher, 2010, p. 313). This question will be returned to below, but it is notable that if this ranking is correct, the additional constraints of regional and bilateral trade agreements cannot explain unused legal policy space in the WTO, given that relatively few countries have signed the

<sup>5</sup> BTAs, BITs and IIAs may be between countries in different world regions but are included in the ‘regional’ section of this analysis because they share more in common with RTAs than global-level multilateral arrangements (Shadlen, 2005).

more constraining bilateral agreements with the USA.<sup>6</sup> Similarly for BITs, while those involving the US are more constraining than TRIMS provisions, relatively few low-income countries have signed up to them, and they affect a narrower range of policy options than BTAs (Chang et al, 2016).

Shadlen (2005) focuses on North-South agreements involving the US and finds that these offer enhanced access to the US market compared to that available under WTO rules, but that in return they impose greater restrictions on industrial policy options with respect to foreign investment and intellectual property rights. For instance Gallagher et al (2019) highlight that N-S RTAs are most likely to prevent participants imposing capital controls to promote financial stability, despite the IMF now approving of such measures. Gallagher (2013) questions the idea of a rational bargain of market access for policy space due to disparities of political power between the parties. On this view the loss of policy space in N-S agreements involving the US may not necessarily come with concomitant benefits in terms of enhanced market access, but effectively only result in reduced prospects for future industrialisation.

Thrasher and Gallagher (2010) suggest that N-S agreements involving the EU “retain much of the flexibility under the WTO in the areas of investment and intellectual property”. This rather sanguine assessment is contested by others, with Hurt (2012) seeing the EPAs as an attempt to “lock in neoliberalism” in participating countries from Africa, the Caribbean and the Pacific (ACP), reducing policy space because of the liberalisation of much trade with the EU but also rules that limit the possibility of measures related to investment, competition policy and government procurement. Chang et al (2016) note that EPAs rule out the possibility of using export taxes, permitted under WTO rules, and also impose an MFN clause which could be particularly significant for African countries looking to increase their engagement with emerging powers like China. The growing trend among LLMICs to reconsider their participation in EPAs with the EU, such as in the case of Tanzania and Nigeria, may suggest that the loss of policy space is seen as greater than potential gains (The Economist, 2017).

A key area where N-S RTAs often go beyond WTO rules towards a ‘WTO-plus’ framework which further limits legal policy space is in the area of Investor-State Dispute Settlement (ISDS), where trade and investment treaties allow foreign investors to sue host country states for policy measures affecting their profitability (Andreoni et al, 2019). Investors have brought over one thousand claims against states under the auspices of IIAs, with the vast majority initiated after the year 2000 and with a broadly upward trend in annual cases (UNCTAD, 2020). These lawsuits are extremely costly for states to defend against, \$8m on average and up to \$30m, such that the threat of litigation brought by disgruntled foreign investors has a ‘regulatory chill’ effect, especially in LLMICs (Alshareef, 2017).

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<sup>6</sup> Countries having signed FTAs with the USA are: Australia, Bahrain, Chile, Colombia, DR-CAFTA (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, & Nicaragua), Israel, Jordan, Korea, Morocco, NAFTA (Canada & Mexico), Oman, Panama, Peru, Singapore. Source: [www.trade.gov/fta](http://www.trade.gov/fta) (accessed June 2021)

Although UNCTAD (2020) reports that nearly all newly signed IIAs in 2019 involved efforts to limit the scope of ISDS to preserve policy space, existing agreements are unaffected and ISDS cases continue to increase year on year.

While South-South agreements are heterogeneous, the evaluation of their impact on policy space by Thrasher and Gallagher (2010) does not suggest any significant loss of policy space. For example, they find that intellectual property and tax issues do not usually figure in S-S agreements, and note the prevalence of exceptions to trade liberalisation through the use of “sensitive lists” and allowance of “regional protection of nascent industry”. Chang et al (2016) broadly agree with this assessment, viewing S-S agreements as “very lenient” with respect to policy space since they are largely limited to reductions in tariffs on goods trade. An important criticism of these perspectives is that there are great differences between LLMICs, and ‘asymmetric’ S-S agreements – involving unequal partners – such as AfCFTA, even if limited to tariff reductions, could result in de-industrialisation in the least developed countries, exacerbated structural imbalances and constrained economic policy space (Reinert and Kattel, 2013; Andreoni et al, 2019).

#### 4.2.1.3. *National level*

At the national level, legal policy space is constrained only by the domestic legislative and regulatory framework, insofar as policymakers are actually required to follow formal rules. A national legal system is clearly itself an outcome of historical processes of political, economic and social bargaining, and will evolve further with changes in society. Nevertheless for the purposes of industrial policymakers the formal rules may impose a constraint on options to catalyse industrialisation. This may simply be a matter of timing, with changes to legislation and regulation taking time such that policies needed to resolve short-term bottlenecks in industrial ecosystems are currently illegal. Alternatively, laws in place to appease one social group – for instance, workers – may impact the potential to create particular rents for industrialists. In addition the ‘good governance’ agenda advocated by the international community has resulted in LLMICs transposing ‘best practice’ legislation from other contexts in areas that impact industrialisation, e.g. for anti-corruption initiatives, such that domestic laws may not be aligned with the political settlement and pose obstacles to industrial policy implementation (Khan, 2007). This is also reflected in the preoccupation with the World Bank’s ‘Doing Business’ indicators and rankings, where policymakers adapt legal systems with a view to improving their score rather than industrial policy objectives per se.

Governments of LLMICs are increasingly turning to non-tariff barriers (NTBs) to maintain trade policy autonomy due to limits on the use of conventional trade restrictions such as tariffs and quotas imposed by the various types of international trade agreement mentioned above (Ederington and Ruta, 2016). We include here all kinds of measures imposed by governments with the effect, intended or not, of restricting trade, such as sanitary and phytosanitary (SPS) measures related to food safety and

animal/plant health, so-called technical barriers to trade (TBT) that relate to human health and the environment, bureaucratic “red-tape” (e.g. import licenses and customs procedures), etc. These are included as ‘legal’ factors that may expand a country’s policy space (since NTBs constitute extra policy options) or restrict it (if for example another country uses NTBs to restrict the access of the first country’s firms to its market). However, in some cases the consistency of NTBs with WTO agreements is disputed, in which case they are more like *de facto* political-institutional aspects of policy space.

#### **4.2.2. Political-institutional policy space**

This section focuses on the political and institutional aspects of *de facto* policy space at the global, regional and national levels, which together define the set of policy options that can be feasibly implemented by a given authority. Whereas the most commonplace definition of institutions in economics refers to the “rules of the game” (North, 1990), here we exclude the formal legal rules already discussed above, this section focusing on the informal rules arising from the realities of the political settlement, i.e. the distribution of power across organisations.

##### *4.2.2.1. Global level*

At the global level, geopolitical developments and the institutional frameworks of global governance have profound implications for the industrial policy space of LLMICs. Historical accounts of the evolution of legal policy space cite geopolitical processes as critical explanatory variables. Section 2.2 above identified how geopolitical and military power imbalances have historically resulted in oppressive systems such as colonialism where subjugated territories had no legal policy space to pursue industrialisation. The post-World War II context of the Cold War and subsequent period of neoliberal globalisation respectively have also been shown to be key to understanding the relative laxity of the GATT regime and the more restrictive WTO regime that followed it. Most recently, the relative decline of the USA as hegemon of a ‘unipolar’ world and the rise of China and other emerging powers points to a nascent ‘multipolarity’, which is connected to the recent weakening of multilateral trade governance, including the failure of the Doha round of negotiations and the incapacitation of core WTO functions such as trade dispute settlement (Baracuhy, 2012; McDougall, 2018).

International organisations such as the World Bank and especially the IMF set the terms of the global financial architecture – and therefore the policy space available to countries – but are themselves crystallizations of geopolitical power dynamics. The increasing multipolarity of global politics is manifested in the changing voting shares in the IMF, with China, Brazil, India and Russia now among the top ten shareholders. The increased engagement of these emerging powers with the IMF since the global financial crisis of 2007-8 coincided with a shift from staunch neoliberalism to an era of

‘productive incoherence’, featuring acceptance of previously outlawed policies such as capital controls (Grabel 2011, 2018). While macroeconomic policy is generally viewed as distinct from industrial policy, the two are in reality closely related and the expansion of political-institutional policy space at the global level through changes in IMF programme conditionality will be advantageous for LLMICs seeking to industrialise (Chang & Andreoni, 2020; Kentikelenis et al, 2016).

As well as mediated by international organisations, global geopolitics can have more direct impacts on industrial policy space, particularly related to financing for investment and NTBs by wealthier countries. The limitations on capital accumulation facing LLMICs force them to turn to external financing for development projects, but the prevailing orthodoxies of donors affect the kinds of conditions attached to finance and therefore limit the recipients’ policy space (Whitfield and Fraser 2009, 2010). The rise of China as a development partner for LLMICs in Africa was argued to have created policy space by providing alternative sources of finance for investment, especially in infrastructure (Oya, 2006). More recent assessments see China aligning itself with OECD donor practices such that the prospects for donor competition enlarging policy space are limited (Kragelund, 2015). The rise in prevalence of non-tariff barriers (NTBs), such as TBT and SPS measures as well others not governed by WTO agreements, are further ways that rich countries can shape policy space for LLMICs by affecting their ability to capitalise on trade preferences and export to major centres of global demand.

#### 4.2.2.2. *Regional level*

Political and institutional factors at the regional (i.e. supra-national) level also impact industrial policy space. Again, political rivalries and power imbalances between countries in a particular region are of primary importance. Regions rarely consist of countries on an equal political or economic footing, and the presence of power asymmetries has implications for the design of RTAs and their associated Rules of Origin, the latter being crucial in establishing which sectors can benefit from expanded market access in practice. The overwhelming political and economic dominance of the USA vis-à-vis Latin American countries allows the former to pursue a “hub and spokes” strategy of signing bilateral deals with countries to create a “rat race” in the region to maintain access to the US market equivalent to that of competitors (Gallagher, 2013). These bilateral agreements are often heavily restrictive of legal policy space, as discussed in section 4.2.1. Furthermore the expanding scope of RTAs and BTAs beyond trade policy to areas such as investment protection and intellectual property rights means that power asymmetries have even greater implications for policy space.

Between countries at a similar level of development, more favourable outcomes for policy space might be expected. The presence of pan-national regionalist ideologies, for instance among neighbours with a shared experience of oppression or colonialism such as in Latin America and

Africa, can contribute to a sense of mutual interests and a perceived need for shared institution building (Dabène, 2009). When relatively weak states cooperate regionally they enhance their standing and bargaining power on the international stage, and in this way expand their industrial policy space (Ravenhill, 2016).

The creation of public sector organisations at the supra-national level, associated with ‘positive integration’ within world regions, may create policy space for new forms of industrial policy at the regional level. For instance the creation of the European Commission within the EU has allowed for varieties of pan-European industrial policy, such as recent efforts to coordinate research funding across national innovation systems under the EU’s “Smart Specialization Strategy” (Morgan and Marques, 2019). Other kinds of regional institutional arrangements related to trade and industrial policy, particularly free-trade areas and customs unions, are addressed in section 4.3 below.

#### 4.2.2.3. *National level*

At the national level, the main political-institutional factors affecting policy space are captured by the nature of domestic politics and the governance capabilities of public sector organisations. This section briefly considers several competing theoretical approaches to understanding domestic politics in LLMICs, arguing that Mushtaq Khan’s ‘political settlements’ framework is best suited for the analysis of the political-institutional dimension of industrial policy space in this context.

New institutionalist, neopatrimonialist and political settlements approaches share a focus on the political-institutional characteristics of LLMICs, particularly the nature of clientelist systems of governance and their impact on economic performance. New institutionalists focus on institutions as key explanators of economic outcomes, for instance viewing private property rights as reducing transaction costs and promoting growth, but neglect how political differences result in similar institutions being associated with varied economic outcomes (Khan, 1995). The neopatrimonialist school argues that in LLMICs and Africa especially, personalized relationships of patronage pervade formally rational-legal governance systems, but these accounts also fail to explain the divergent economic outcomes across similarly ‘patrimonial’ contexts (Mkandawire, 2015). Since these frameworks each struggle to explain divergent outcomes in similar clientelist institutional contexts, they are inadequate for analysing the political-institutional feasibility of industrial policies.

By contrast, a ‘political settlements’ approach can explain divergent outcomes of similar policy packages across contexts and therefore provide a framework for understanding the feasibility of implementing an industrial policy in a given political-institutional setting (Behuria et al, 2017; Whitfield et al, 2015a; Khan 2010, 2017). Approaches to political settlements analysis vary somewhat, with different emphases on the types of actors to be focused on. For Kelsall (2018), a political settlement is defined as a ‘conflict-ending agreement among powerful groups’ or an ‘elite pact’ which is linked to a particular power distribution (Kelsall, 2018). This contrasts with Khan’s

(2010) approach which sees a political settlement as a distribution of organisational power across society (including non-elite groups) which is relatively stable, and is an outcome of historical processes of political, economic and social change. For the purposes of this research we do not limit political settlements to situations where agreements between elite groups have been brokered, since the power of non-elite groups such as workers and farmers are critical to the feasibility of implementing industrial policies.

An industrial policy initiative is understood as a more or less formal institution created to overcome obstacles to organisational learning and productivity growth in a particular sector or set of sectors, by creating rents that compensate for an initial lack of competitiveness.<sup>7</sup> From a political settlements perspective, in order for industrial policy to be successful in promoting organisational learning, the system of rent management must be compatible with the underlying distribution of power (Khan, 2010). In particular, the distribution of power across public and private sector organisations must be such that the relevant state agencies can remove rents in cases of non-performance (i.e. where agreed targets are not met around production, exports, etc.) from even politically well-connected firms (Whitfield et al, 2015a).

Khan (2010) categorises political settlements into four broad categories – capitalist, clientelist, pre-capitalist and crisis – in line with two criteria, namely whether formal institutions promote growth and whether formal institutions are aligned with the “holding power” of organisations.<sup>8</sup> Most contemporary LLMICs are seen as clientelist in this framework, since holding power is not aligned with formal institutions such that the latter do not operate as intended (i.e. with impersonal rule-following the norm), but are instead influenced by the exercise of personalised power. Within clientelist systems, Khan further categorises political settlements according to two criteria, firstly the power of excluded factions relative to the ruling coalition and secondly, the relative power of higher and lower level factions within the ruling coalition. If excluded factions are relatively weak, the ruling coalition is more stable and there is a potential for longer-term planning and higher growth potential. If lower level factions within the ruling coalition are relatively weak, the coalition has greater capacity to implement its policies effectively. The four possible outcomes are labelled as ‘potential developmental coalitions’ (weak excluded factions, weak lower levels of ruling coalition), ‘vulnerable authoritarian coalitions’ (strong excluded factions, weak lower levels of ruling coalition), ‘weak dominant party’ (weak excluded factions, strong lower levels of ruling coalition) and ‘competitive clientelism’ (strong excluded factions, strong lower levels of ruling coalition).

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<sup>7</sup> As mentioned previously, institutions are defined as rules, whether formal or informal, that govern social interactions in such a way as to overcome various types of transaction problems and costs (North, 1990; Greif, 2006; Williamson, 1985).

<sup>8</sup> “Holding power is partly based on income and wealth but also on historically rooted capacities of different groups to organize” (Khan, 2010)

The organisation of power in society affects the feasibility of different industrial strategies, particularly those that can effectively reduce ‘growth-constraining’ transaction costs and at the same time reduce associated social transition costs, which arise from the resistance of groups that stand to lose from the shift towards a developmental path (Khan, 2009). It seems likely that the greater the power of factions excluded from the ruling coalition, and the greater the power of lower levels of the ruling coalition, the more difficult and costly it will be to overcome resistance to more developmental industrial strategies.

Neglected in many political settlement analyses but of particular importance to the feasibility of industrial policy options in LLMICs is the organisational capabilities of public sector agencies charged with monitoring and enforcing policy instruments. This can be analytically separated from their political strength vis-à-vis rent recipients, which in part determines the possibility of rent removal for non-performing firms. Whitfield et al (2015a) capture the idea of bureaucratic effectiveness through the concept of “pockets of efficiency”, which they see as a critical precondition for effective implementation of industrial policy. The strength or weakness of public sector organisational capabilities at the national level is an important determinant of the extent to which legal policy space at the global level can be utilized, since many of the WTO-compliant industrial policy measures (shown in Table 3) are only permitted if demanding processes of notification, negotiation, compensation, data collection, reporting etc. are followed (Chang et al, 2016). In effect, many formally permitted industrial policies are not able to be implemented by LLMICs with weak state bureaucracies, i.e. the national political-institutional dimension of policy space is constraining even where legal policy space at the global level is permissive.

#### **4.2.3. Economic policy space**

The economic dimension of policy space captures those features of the economy at the global, regional and national levels which conspire to make certain industrial policy options more viable than others.

##### *4.2.3.1. Global level*

Here we consider constraints on policy space arising from international economic structures and private sector governance arrangements. These relate principally to the increasing concentration of economic power in the hands of transnational corporations (TNCs), their control over Global Value Chains (GVCs) and the use of private-sector led standards to manage production and trade patterns.

Andreoni et al (2019) distinguish the ‘direct’ and ‘indirect’ ways that international economic rules affect the policy space of LLMICs. The direct impact is the result of multilateral, regional and bilateral agreements discussed earlier, while the indirect impact is the effect of those agreements on concentration in the global economy, and consequently on opportunities for catch-up development.

Without taking a position on the extent to which concentration is a result of the rules laid down in trade agreements or broader patterns of globalisation, deregulation and financialisation (UNCTAD, 2017b), the extreme levels of concentration observed in the global economy clearly make the challenges for LLMIC firms to compete in the global economy, and for policymakers to support this, all the more daunting (Nolan et al, 2008).

Indices of concentration in global markets show steady long term increases over the 1995 to 2015 period, with some decreases in the years since the 2008 global financial crisis, partially attributed to the rise of Chinese firms. The UNCTAD (2017b) Trade and Development Report 2017 presents data from consolidated financial statements showing steep rises in global market concentration between 1995 and 2015 when measured in terms of market capitalization, profits, physical assets and other assets, with the last three peaking in 2011 before tailing off somewhat. It appears likely that rising global market shares of Chinese and (to a much lesser extent) other emerging market firms accounts for recent declines in concentration indices and increased ‘churn’ at the top of the distribution, although in several industries where Chinese state-owned enterprises dominate, global concentration has continued to rise (Freund and Sidhu, 2017). Increasing returns account for some of the growing concentration in international markets, with the rise of highly productive “superstar” firms and recent technological changes proposed as explanations for the correlation between higher concentration and higher productivity performance observed (Autor et al, 2017). However besides technological factors pushing towards “natural monopoly”, there are institutional factors which erect additional barriers to entry and increase concentration, such as the use of patents in the global intellectual property regime (Andreoni et al, 2019).

The phenomena described by global value chain (GVC) and global production network (GPN) literatures are intimately linked to the increased concentration observed in international markets, since cross-border production emerged as a corporate strategy to reduce costs and increase profitability (Gereffi and Korzeniewicz, 1994). For Milberg and Winkler (2013), the structure of many GVCs is characterised by “endogenous asymmetries”, i.e. asymmetries – powerful oligopolistic lead firms buying from lower-tier supplier firms facing heavy competition – which are endogenous to the nature of the GVCs, since they are at the core of cost-cutting strategies. This tendency became more evident as a result of the shift from ‘producer-driven’ to ‘buyer-driven’ value chains, governed by firms with strong brands and the ability to impose high markups (Gereffi, 1994). However there is some evidence of a power shift to LLMICs as they achieve upgrading in GVCs and diversify their end markets, such as in specific sectors like automobiles (Sturgeon and Van Biesebroeck, 2011) and electronics (Brandt and Thun, 2011), through their rising share of global value added trade (from 20% in 1990 to over 40% in 2010) (UNCTAD, 2013b), and due to efforts by lead firms to rationalize their supply chains (Gereffi, 2014).

A further aspect of concentration in the international economy is the rise of private sector managed standards as mechanisms to coordinate supply relationships within global value chains and production networks (Nadvi, 2008). It has been argued that standards may reduce transaction costs (e.g. related to information and coordination) and lower barriers to entry for LLMIC firms, providing an impetus for learning and upgrading to higher value chain segments (Gereffi et al, 2005). However, factors such as the opaque way standards are set by private sector actors, the lack of neutral conflict resolution mechanisms (in cases of disagreement, the buyer's decision is final) and the high costs of meeting standards may result in their blocking LLMIC firms from accessing higher value chain segments and end markets (Kaplinsky, 2010).

Increased concentration in international markets clearly poses major *de facto* constraints on policy space since the set of economically viable policy options is limited by the reduced market opportunities for LLMIC firms' experiential learning, and the increased level and complexity of policy support required for those firms to become competitive in global markets.

#### 4.2.3.2. *Regional level*

Economic factors at the regional level can be important determinants of industrial policy viability. These include a broad range of factors such as the size and demand characteristics of regional markets, regional economic geography, infrastructure connectivity, production complementarities, etc. A crucial motivation behind signing RTAs is the potential to access an expanded external market enabling increased productivity growth in domestic manufacturing sectors where increasing returns are present, particularly through the overcoming of factor indivisibilities. The academic and policy literatures increasingly view these factors through the lens of regional value chains (RVCs), which is the focus of this section.

Debates on the globalisation of production have often centred on the extent to which value chains and production networks are more global or regional in nature. Many studies focus on firms in advanced industrial countries outsourcing labour intensive activities to less developed neighbours in the same region, such as Japanese automakers in East Asia, German apparel firms in Central and Eastern Europe and US companies in Mexico (Doner, 1991; Gereffi, 2014). Recent World Bank (2017, p. 15) analysis of GVCs echoes Baldwin and Lopez-Gonzalez (2015), stating that “the world economy is not global; it remains regionally segregated” with production concentrated in “Factory Asia, Factory Europe, and Factory North America”.

Despite the importance of regional networks in supposedly globalised production systems, the RVC concept is relatively new in the literature, and understandings are evolving. Prominent research on RVCs in sub-Saharan Africa (SSA) by Goger et al (2014) did not provide an explicit definition but identified RVCs with “the success and proliferation of South African and Kenyan supermarkets operating across sub Saharan Africa” in the horticulture, apparel and tourism sectors. Subsequent

work in these sectors defined RVCs as value chains where the lead buyers are primarily companies operating only within one world region (Barrientos et al, 2016; Krishnan, 2018). Horner and Nadvi (2018) accept this definition but elaborate: “regional value chains are the ones for which lead firms supply markets in neighbouring and regional economies, and that source from and subcontract to regional suppliers”. In other words the lead firm, its suppliers and end markets are within the same geographic region.

This definition may not be tenable in all sectors, however. For instance Fessehaie (2015) documents the RVC for mining capital equipment in Southern Africa, whereby domestic and international Original Equipment Manufacturers (OEMs) based in South Africa supply mining companies operating in Zambia and other countries in the region. Significant value addition is taking place in the Southern African region, yet much of this activity would not constitute an RVC on the above definition, since many lead firms are from outside the region. Also, the Copper-belt mining companies who purchase the equipment are themselves often international, part of a value chain supplying metal and mineral commodities to final markets around the world.

Similarly, analysis of the South Asian RVC in the textiles and apparel sector focuses on the growing trade in intermediate goods within the South Asian Association for Regional Cooperation (SAARC), even as intra-regional trade in finished products remains low and stable (Kar, 2018). Again, much of this activity would not qualify as an RVC on the definition proposed by Barrientos et al (2016), since the majority of finished products are exported outside the region in question, yet the alternative, i.e. charactering this activity as figuring in a GVC, does not capture the important phenomenon of increasing exploitation of complementarities in production and economies of scale within the region.

For the purposes of this research, a more inclusive definition of RVCs is adopted, where the nationality of lead firm or the location of end market is not determining, but an RVC is one where significant value-addition occurs across multiple countries within a region. Since it does not exclude the possibility of value-addition across more than one region, and allows for lead firms and end markets to be from outside the region of focus, it includes some value chains that would by conventional definitions be considered ‘global’ in nature. However it is appropriate for the present research because it captures as an RVC the important case where a foreign owned firm exporting to global markets invests in an LLMIC EPZ, but sources intermediate inputs from domestic suppliers who in turn source primary inputs from neighbouring countries – a value chain which clearly supports and depends on South-South regional integration processes. With this inclusive definition, there are several key reasons why RVCs could be expected to contribute to expand the economic dimension of policy space for LLMICs in particular, through capitalising on the external economies and complementarities in expanded regional markets.

First, even before start of the global economic crisis in 2008 and more noticeably since then, global growth dynamism has originated not in high income countries but rather in emerging markets (Gereffi, 2014). This has implications for the kinds of products demanded, with cheap and undifferentiated commodities likely to see more import growth globally (Kaplinsky and Farooki, 2010). Lower quality standards and local knowledge makes upgrading to meet regional demand easier, though could lead to ‘lock-in’ to lower value end markets (Gereffi, 2014). Given current specialisation patterns in the global economy, LLMICs are better able to meet this demand for lower quality products (compared to demand for technologically sophisticated products), and RVCs offer a way of achieving the scale needed to export to emerging economies competitively.

Second, to complement RVCs involving exports of relatively low-value products to emerging markets which can generate foreign exchange, there is a strong tendency for intra-regional trade between LLMICs to be disproportionately made up of higher value products. For example in 2014, manufactured goods made up 42% of intra-African exports, compared with 15% of Africa’s exports outside the continent (UNECA, 2017). As demand for manufactured goods increases in developing regions, RVCs offer greater opportunities to meet that demand internally through exploitation of regional complementarities. There is some evidence of this taking place, with the share of African countries’ capital and intermediate imports originating from the continent increasing from 3% to 7% and from 11% to 15% respectively over the period from 2000 to 2014 (UNECA, 2017).

Third, RVCs serving end markets within developing regions could also serve as platforms to supply higher value goods to emerging and high income country markets (Fessehaie, 2018). So far there appears to be little evidence of this kind of dynamic, but there are efforts underway by apparel manufactures in Lesotho who undertook learning through supplying the regional market (particularly South Africa) to diversify their exports towards high-income countries (Morris et al, 2016).

Finally, with changing global demand and more regional integration among LLMICs (Horner and Nadvi, 2018; Gereffi, 2014), there has been an increasing focus on how upgrading is affected by a shift towards end markets in LLMICs (Staritz et al. 2011; Barrientos et al. 2016). It is established that end markets in different regional blocs offer entail distinct upgrading opportunities, e.g. with research showing the differences between the US and various EU countries in specific sectors (Palpacuer et al. 2005; Gibbon 2008). An emerging literature has highlighted the increasing role of RVCs in SSA, characterised by lead firms (particularly retailers) from middle-income African countries such as South Africa and Kenya sourcing from neighbouring countries (Das Nair et al, 2018). Most studies have focused on fresh fruit and vegetables and horticultural products, and find that upgrading opportunities for suppliers do exist in such RVCs, but often not to the same extent as in comparable GVCs (e.g. Krishnan, 2018).

#### 4.2.3.3. *National level*

According to the World Bank, most economic activity still takes place within national borders, with the proportion of global value added being domestically produced and consumed having stagnated at around 80% since the 2008 crisis hit, down from 85% in 1995 (World Bank, 2017). The characteristics of the national economy in question are therefore critical for understanding industrial policy space. A wide range of factors are relevant here, such as the size of the domestic market, the productive capabilities of firms, the skills of workers, the extent and nature of backward and forward linkages between sectors, etc. For instance, an LLMIC would need to design any industrial strategy for a particular sector with the existing level of productive capabilities in mind, with more ambitious strategies requiring greater levels of learning rents and technical support to enable local firms to rapidly acquire the necessary technological and organisational capabilities for achieving productivity growth and competitiveness.

Alongside global and regional value chains, national value chains (NVCs) are recognised as an increasingly relevant conceptual tool. Value chain based analysis has primarily focused on export markets with little attention to the functions performed in the domestic market, particularly for manufacturers in LLMICs (Navas-Alemán 2011). With the growth of demand in the ‘Global South’ the domestic market of LLMICs will only become a more important basis for capital accumulation and upgrading (Horner and Nadvi 2018). The assumptions underlying the neglect of domestic markets – that they are too small for the achievement of scale economies, or too protected to provide incentives for capability development – are becoming outdated as demand growth and import penetration continues. Furthermore as regional integration blurs the boundaries between national and regional production systems, there is increased need to consider NVCs alongside RVCs and GVCs as a crucial element shaping the economic dimension of industrial policy space.

### **4.3. Regionalism and policy space**

Here we apply the policy space framework to two commonly used ‘ideal type’ RTAs – free trade agreements and customs unions – to establish their impact on different dimensions of policy space. Although actual impacts will be highly contingent on the specificities of national and regional political economies and trade agreements in question, it is useful to consider them in the abstract to focus attention on key trade-offs between dimensions. We focus on two archetypal RTAs, namely free trade agreements (FTAs) and customs unions (CUs), which represent increasing levels of integration between regional partners, with their impacts summarised in Table 5.

Table 5: Impact of regional free trade areas and customs unions on members' policy space

|                                  |               | Dimensions of policy space   |   |   |
|----------------------------------|---------------|--|---|---|
|                                  |               | Legal  | Political-institutional   | Economic  |
| Geographic level of policy space | Domestic      | LOSS of trade policy autonomy to protect existing and potential domestic industries from FTA participants.<br><br><i>[CU only: LOSS of ability to set external tariffs unilaterally]</i> | LOSS of fiscal space as regional tariff revenues fall; reduced rents may destabilise political settlement   | LOSS where tariff liberalisation makes existing industries unviable.<br><br>GAIN where new industries made viable by expanded market access;<br><br><i>[greater GAIN for CUs]</i> |
|                                  | Regional      |  | Likely GAIN through fostering of regional cooperation and identities.<br><br><i>[greater GAIN for CUs, e.g. creation of supra-national organisations]</i> | GAIN of regional market access, potential to integrate into regional value chains, access resources etc.<br><br><i>[greater GAIN for CUs]</i>                                     |
|                                  | International |  | GAIN of bargaining power in negotiating with international trade and development partners<br><br><i>[greater GAIN for CUs]</i>                            | Potential GAIN as expanded regional market attracts investors and TNCs, boosting FDI.   |

Source: own elaboration.

#### 4.3.1. Regional free trade areas

Free trade agreements (FTAs) involve the abolition of tariffs and quantitative restrictions between participating countries, but each retains its own tariff structure towards countries outside the FTA (Balassa, 1961). The definition used in the GATT-WTO system is as follows (GATT, 1994):

*A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.*

The exceptions to the elimination of trade restrictions include situations of balance of payments difficulties and for the protection of public health and security. The meaning of “substantially all” is ambiguous, with the proposal of European Economic Community member states in 1957 to define “substantially all” as at least 80% of total trade not accepted by other countries, but it is generally accepted to mean that no sector can be excluded in its entirety. The ‘origin criteria’ is also undefined,

with FTA participants free to agree Rules of Origin (ROO) according to their circumstances to define which products are eligible for preferential treatment, so as to prevent trade deflection.<sup>9</sup>

Table 4 above shows there are 105 plurilateral regional FTAs in force, but a large number of these are made up of agreements between a regional grouping and a small number of other countries. For instance 26 are between the European Free Trade Association (EFTA) and one other country and a further 40 are between the European Union (EU) and one or two other countries. Table 6 below lists the main plurilateral regional FTAs, excluding: deals between trade blocs, between trade blocs and another/several countries, and between a small number of countries not geographically co-located.

*Table 6: Selected plurilateral regional FTAs in force*

| <b>Region</b> | <b>RTA Name</b>   | <b>Coverage</b>  |
|---------------|---|------------------|
| Africa        | Southern African Development Community (SADC)                       | Goods            |
| Americas      | United States-Mexico-Canada Agreement (USMCA/ CUSMA/ T-MEC)         | Goods & Services |
| Americas      | Dominican Republic - Central America - United States FTA (CAFTA-DR) | Goods & Services |
| Americas      | Mexico - Central America  | Goods & Services |
| Americas      | Colombia - Northern Triangle (El Salvador, Guatemala, Honduras)     | Goods & Services |
| Americas      | Pacific Alliance  | Goods & Services |
| Asia; Pacific | ASEAN Free Trade Area (AFTA)  | Goods            |
| Asia; Pacific | Pacific Island Countries Trade Agreement (PICTA)                    | Goods            |
| Asia; Pacific | South Asian Free Trade Agreement (SAFTA)                            | Goods            |
| Asia; Pacific | Trans-Pacific Strategic Economic Partnership                        | Goods & Services |
| CIS           | Commonwealth of Independent States (CIS)                            | Goods            |
| CIS           | Common Economic Zone (CEZ)  | Goods            |
| CIS           | GUAM  | Goods & Services |
| Europe        | European Free Trade Association (EFTA)                              | Goods & Services |
| Europe        | Central European Free Trade Agreement (CEFTA) 2006                  | Goods            |
| Middle East   | Agadir Agreement  | Goods            |
| Middle East   | Pan-Arab Free Trade Area (PAFTA)                                    | Goods            |

Source: compiled by author based on WTO RTA database (2021).

In broad terms, signing up to a regional FTA can be said to principally impact the legal and economic dimensions of industrial policy space. The commitment to liberalising almost all trade with participating countries is in principle voluntary, and could be reversed by revoking the FTA, but for the duration of its implementation results in a loss of legal policy space. It implies that an FTA participant is not permitted to use tariff protection or other restrictions to nurture productive capabilities in a sector where other FTA members are already established. While other support

<sup>9</sup> In practice Rules of Origin may also be designed to protect sensitive sectors, as will be seen in later chapters, and are therefore an important means of maintaining industrial policy space despite the liberalisation targeted by an FTA.

measures may be used such as subsidies (transfers, credit, infrastructure etc.), assuming the FTA does not extend to those areas too, the substantive liberalisation will tend to make it more costly or even impossible to establish or maintain economic activity in an area where other FTA participants are more competitive. Absent other forms of cooperation and coordination therefore, FTAs will tend to “lock-in” existing patterns of specialisation, imposing opportunity costs on less developed participants.

In the economic sphere an FTA results in an expansion of the effective demand for domestic production through access to the wider regional market, increasing the magnitude of external economies. For existing industries this results in greater economies of scale and reduced costs, enabling output and productivity growth and enhancing export competitiveness. In sectors where the country is dependent on imports, and where other FTA participants are not active, a threshold may be reached whereby investment becomes profitable, creating policy space for initiatives to promote the development of new capabilities and strengthening industrialisation efforts.

In the political-institutional sphere, an immediate impact of liberalising trade with regional partners will be a loss of tariff revenue, often a major source of revenue for LLMICs, such that fiscal space will be reduced and options for public investment to promote industrialisation will be reduced, until alternative sources of revenue can be found (e.g. taxing newly viable regionally oriented manufacturers). Over the medium to long term, changes in economic structures wrought by an FTA may result in changes to the domestic political economy, further altering policy space. At the regional level, the cooperation required to agree and implement the FTA may create space for other forms of regional cooperation relevant to industrial policy, such as infrastructure development. At the global level, participation in an FTA is likely to increase bargaining power with respect to other trading partners (by negotiating as a bloc, as done by EFTA and ASEAN) such that more favourable trading arrangements and market access can be secured.

In the abstract, the overall impact of an FTA on policy space is therefore ambiguous, with some of the key variables being the level of development of participants, existing economic structures and relative competitiveness, and the potential gains in terms of regional market size.

#### **4.3.2. Customs Unions**

A Customs Unions involves the same internal trade liberalisation element as an FTA, with the addition of a common external tariff (CET) on imports from third countries. The GATT (1994) definition of a CU adopts identical language to that cited previously on FTAs with respect to internal trade liberalisation, and adds the following requirement regarding CETs, that “substantially the same duties and other regulations of commerce are applied by each of the union to the trade of territories not included in the union”. Again, “substantially the same” is not defined in the GATT, leaving some

flexibility for CU members to impose their own tariffs on a small proportion of product lines. The need for Rules of Origin within the CU is avoided to the extent that a CET is genuinely common to members of the union.

Table 4 above shows there are 17 customs unions in force globally. The main ones are listed below, excluding those where one party is a trade bloc, i.e. three effectively bilateral agreements between the EU and Andorra, San Marino and Turkey respectively. Table 7 below show that of the remaining customs unions, the largest number are located in Africa. Notably there are no customs unions located in the Asia-Pacific region, despite its higher level of economic development and greater degree of intra-regional trade. The impetus towards signing up to customs unions in Africa is linked to colonial history, when adjacent territories were often governed collectively (e.g. French West Africa), but is also due to present day power dynamics, especially the influence of the EU as a source both of legitimate ideas (i.e. the European integration model) and finance for the design and implementation of regional cooperation initiatives (Ravenhill, 2016).

*Table 7: Selected plurilateral regional customs unions in force*

| <b>Region</b> | <b>CU name</b>  | <b>Coverage</b>  |
|---------------|---|------------------|
| Africa        | Common Market for Eastern and Southern Africa (COMESA)    | Goods            |
| Africa        | East African Community (EAC)                              | Goods & Services |
| Africa        | Economic and Monetary Community of Central Africa (CEMAC) | Goods            |
| Africa        | Economic Community of West African States (ECOWAS)        | Goods            |
| Africa        | Southern African Customs Union (SACU)                     | Goods            |
| Africa        | West African Economic and Monetary Union (WAEMU)          | Goods            |
| Americas      | Caribbean Community and Common Market (CARICOM)           | Goods & Services |
| Americas      | Central American Common Market (CACM)                     | Goods            |
| Americas      | Andean Community (CAN)                                    | Goods            |
| Americas      | Southern Common Market (MERCOSUR)                         | Goods & Services |
| CIS           | Eurasian Economic Union (EAEU)                            | Goods & Services |
| CIS           | Russian Federation - Belarus - Kazakhstan                 | Goods            |
| Europe        | EC Treaty   | Goods & Services |
| Middle East   | Gulf Cooperation Council (GCC)                            | Goods            |

Source: compiled by author based on WTO RTA database (2021).

The addition of a CET to an FTA does not expand the size of the market covered by the agreement, so would not appear to increase policy space in the economic dimension. However in the real world where enforcing the Rules of Origin in an FTA is costly, the addition of a CET may bring benefits through the prevention of trade deflection, increasing the integrity of the free trade area and the effectiveness of trade policy such that investment to exploit regional complementarities may rise. As a result of the greater expansion of economic policy space at the regional level, it is more likely that new industries will be made viable in a given country, making new industrial policies possible.

Agreeing to a CET clearly reduces the legal aspect of policy space since countries lose the ability to set and adapt their external tariff policy independently. The regional political settlement will affect how the CET is set, such that weaker countries may lose more policy space than stronger partners because they have less bargaining power in negotiations to ensure the CET reflects their economic structures. Also, the loss of flexibility to adjust external tariffs autonomously will have a greater impact on less industrialised countries, whose catch-up strategies are more likely to be facilitated by use of tariff sequencing.

The creation of a CU with common external trade barriers is likely to expand the political-institutional dimension of policy space beyond that of an FTA. The size of a regional market, and the more comprehensively shared trade policies of a CU (e.g. with no need for Rules of Origin) may make external trading partners willing to offer greater concessions in negotiating trade agreements, which in turn may expand market access and economic policy space for members of the CU. Again, the regional political settlement will be key to outcomes, with weaker members of the CU finding it more difficult to influence negotiations of the bloc as a whole, potentially limiting the benefits accruing to them. At the regional level, the greater degree of cooperation required to agree and implement a CU, especially the increased likelihood that shared supra-national organisations will be needed, may expand political-institutional policy space more than an FTA.

On balance then, from the perspective of a particular country the impact on policy space of shifting from an FTA to a CU is ambiguous, depending on how ROO are enforced in the region, initial industrial structure, geopolitical power and industrial policy approach.

#### **4.4. Conclusion**

This chapter has argued that analyses of policy space in the literature are inadequate because they are fragmented and lack a comprehensive conceptual approach. We have presented an analytical framework that allows for an integrated view of the legal, political-institutional and economic dimensions of policy space at the national, regional and global levels. This allowed for a synthesis of disparate branches of literature on the design and implementation of industrial policies, highlighting interactions and trade-offs between dimensions and levels that are generally under-researched.

This chapter also offered an initial application of the framework to two ideal types of S-S regional trade agreements, FTAs and CUs, to establish the broad contours of their impact on policy space. Overall we found that the net impact on policy space may be positive or negative depending on contextual specificities, in contrast to the existing literature on S-S agreements which suggests their impact on policy space is negligible. The next chapter builds on this finding by applying the framework to a sector case study, showing how a coherent and integrated analytical approach to policy space can support research on multi-scalar industrial policy.

## 5. Industrial policy space in the EAC T&A sector

### 5.1. Introduction

The previous chapter defined industrial policy space – hereafter also sometimes referred to as simply ‘policy space’ – as the set of legally permitted, economically viable and politico-institutionally feasible policy options at the national, regional and global levels which can promote industrialisation of an economy. An analytical framework consisting of a three by three matrix was developed to operationalise this definition, and this chapter applies this framework to analyse industrial policy space in the East African Community (EAC) textiles and apparel (T&A) sector. Table 8 below outlines the main issues in each square of the matrix which emerged from policy documents and semi-structured interviews and that are discussed in this chapter.

*Table 8: Multidimensional industrial policy space in the EAC T&A sector*

|               | Legal  | Political-institutional   | Economic  |
|---------------|--|---|---|
| Domestic      | National legal systems: procurement acts, EPZ frameworks, trade remedies regimes                                     | Domestic political settlements, national implementation capabilities, skills training systems, industrial financing mechanisms. | Local production system, national value chains, sector performance, power and transport infrastructure, domestic demand |
| Regional      | EAC shared policy frameworks (CET, duty remission scheme, EPZs etc.); Rules of Origin in SADC, COMESA, AfCFTA, TFTA, | Stays of Application, NTBs, regional industrial policies and implementation capabilities, used clothes phase-out.               | Regional market demand, regional value chains, trade and industrial complementarities, buyer demands                    |
| International | Preferential trade arrangements (AGOA, EBA, etc.), multilateral agreements (WTO).                                    | Geopolitical pressures (e.g. conditions on market access), aid dependence and donor interests                                   | Market access via trade agreements, concentration and asymmetric power in GVCs, TNC strategies                          |

Author elaboration.

To recap, the legal dimension refers to the *de jure* component of industrial policy space described in the literature, i.e. the formal rules which determine what industrial policies can be pursued (Mayer, 2009). The political-institutional dimension captures one aspect of the *de facto* component of industrial policy space, namely the informal rules emerging from political settlements and institutional arrangements which restrict the kinds of industrial policies that can be feasibly implemented. Finally the economic dimension covers the remaining part of *de facto* policy space, i.e. how the organisation of economic systems of production and exchange make some policies more economically viable than others.

The distinctions made in this framework are by their nature analytical, so factors affecting sectors and policies observed in the real world will not straightforwardly correspond to a certain box of the matrix. There will be plenty of overlap and interaction between the different dimensions and levels, for instance legal policy space is in many ways an outcome of long term political-institutional and economic processes; the distinction between formal and informal rules is often blurred such that powerful actors are able to operate in the grey area in-between; changes in formal and informal rules affect economic structures; and technological paradigm shifts in the economic sphere have implications for the political settlement and ultimately legal policy space. Nevertheless the framework is analytically useful in locating some of the key aspects of industrial policy space sketched out in the literature, and illuminating some key areas of tensions and trade-offs.

The following sections analyse each dimension of industrial policy space in turn. In the legal dimension, the creation of a customs union in the EAC has nominally transferred trade policy powers from the national to the regional level, but the duty remission (DR) scheme allows national authorities to provide targeted trade policy rents to domestic T&A firms and maintain national legal policy space. By charting the use of the DR scheme in the T&A sector over time by partner states, as set out in the EAC Gazettes which represent concretely the political economy dynamics of industrial policymaking across the region, we argue that the EAC CET's much maligned deviation from a textbook customs union (Mshomba, 2017) actually provides important national flexibility to pursue strategic industrial policy.

This comes at a cost in the economic policy space dimension, since firms benefiting from these national duty remission rents may not sell their goods duty free in other EAC countries, so the expanded economic policy space offered by regional integration is under-exploited. This is also demonstrated by the case where Kenya was granted an exemption on EPZ export requirements in the garment sector, which was followed by a breakdown of free trade within the customs union. In the political-institutional sphere, policy space created at the regional level by the EAC's shared institutions allowed new policy options to emerge – namely the phase-out of EAC used clothing imports – but hard political-institutional policy space constraints at the global level prevented implementation, because US authorities threatened to remove the duty-free market access underpinning thousands of jobs. This case illustrates industrial policy space dilemmas at the intersection of political-institutional and economic dimensions, and between regional and global levels. The chapter concludes with reflections for the design of regional integration policies, especially the importance of taking into account tensions between different dimensions of industrial policy space and their geographic levels to maximise prospects for sustainable industrial development.

## **5.2. Legal policy space**

The legal or *de jure* dimension of industrial policy space captures the formal rules which permit and also circumscribe state action, and is analysed at the national, regional and global levels. The creation of the EAC customs union has nominally transferred trade policy powers from the national to the regional level, but we present evidence showing how the duty remission scheme allows national authorities to provide targeted trade policy rents to domestic T&A firms and maintain national legal policy space.

### **5.2.1. National-level legal policy space**

A comprehensive analysis of the national legal systems of the countries studied, and their impact on industrial policy (e.g. competition policy, intellectual property system, judicial system etc.) is beyond the scope of the research but instead we point to some key issues most relevant to the T&A sector based on data from Tanzania and Kenya. A national legal framework is itself the expression of a political settlement at a given point in time, and it could be argued not to be a constraint on industrial policy space since laws decided at the national level could in principle be changed to allow the desired policies to be implemented. Also, in many LLMICs informal institutions are key determinants of policy rent allocation, rather than formal rules alone (Khan, 2010). We therefore spend relatively little time on the national-level legal dimension of industrial policy space in isolation, focusing on migrant labour regulation, public procurement and trade remedies.

In some cases, national rules set in related but distinct policy areas can become a constraint on industrial policy options, from the perspective of some actors according to their interests and time horizons. For instance Tanzanian labour regulations pertaining to the employment of expatriates are seen as restrictive by firms, requiring costly applications for each foreign worker with uncertain outcomes (e.g. interviews #2, #5, #7). This is linked to fears among policymakers that some employers would prefer to bring in skilled foreign workers through their own networks rather than recruiting in the local labour market or training local workers (interview #36). More broadly, the rules are an expression of the political imperative to create skilled jobs for locals and are aligned with a long-term strategy for economic transformation. Any changes to the rules would require sustained high-level political advocacy and engagement which is beyond the means of T&A industry stakeholders. From the short-term perspective of firms therefore, legal policy space is constraining in this area: the foreign worker rules are an outcome of the political settlement which cannot be easily modified, so the ability of policymakers to respond to calls for more flexible rules in the T&A sector is restricted.

In various ways the national-level legal dimension of industrial policy space is expanded by favourable laws and regulations. One such area highlighted by interviewees was public procurement,

where in both Tanzania and Kenya respondents said that national legislation enables policymakers to use state purchasing power to favour domestic suppliers and build the capabilities of local firms (e.g. interviews #1, #2, #9). Generally firms complained that these legal provisions are under-utilised, but policymakers reported increasing awareness of the potential to use public procurement as a strategic industrial policy tool. The role of this policy in creating rents for learning and upgrading is further explored in Chapter 7.

Another way the national legal framework can prove a constraint on industrial policy is if certain policy options used widely in other countries are not provided for in domestic legislation. Although this could in principle be amended through the introduction of new rules and institutions, for political reasons or due to weak state organisational capabilities this may not occur. One example of this in Tanzania and Kenya is the WTO-permitted ‘trade remedies’ policy regime of anti-dumping, countervailing measures, and safeguards which are listed in Table 3 of section 4.2.1. These allow WTO members to raise tariffs above bound levels and impose restrictions on imports where they threaten domestic producers, e.g. in cases of dumping by exporters or the use of certain subsidies (Coppens, 2014). Tanzania and Kenya did not at the time of the research have a functional trade remedies policy framework, although in 2019 Kenya was in the process of establishing a responsible institution, the Kenya Trade Remedies Agency, to implement the Trade Remedies Act of 2017 (interview #41). Although Tanzania passed The Anti-dumping and Countervailing Measure Act in 2004, in 2018 it reported to the WTO that it had never been applied because the necessary implementing authority had not been established (WTO, 2019). Until such domestic policy frameworks are up and running, as WTO members Tanzania and Kenya may not enact trade remedies, so in this case the national-level legal context is ruling out important policy options for domestic industry protection in the contemporary context.

### **5.2.2. Regional-level legal policy space**

Regional policy frameworks may expand or contract the set of legally permitted policy options in different ways. In the case of Tanzania and Kenya, the main impact of regional cooperation on legal policy space is the loss of autonomy over trade policy to the EAC regional bloc, but this is mitigated in various ways.

#### *5.2.2.1. East African Community (EAC)*

##### *Common External Tariff (CET)*

The EAC aims to become a monetary union by 2024 and eventually a full political federation, but is currently viewed as a customs union which was implemented from 2005, with the CET as the primary instrument defining a shared trade policy. As shown in Chapter 4, a customs union by definition curtails policy space by removing trade policy from the exclusive oversight of national authorities.

However the EAC CET as implemented limits the loss of national autonomy through two main mechanisms, a duty remission (DR) scheme and ad hoc ‘stays of application’ (SOA), which provide flexibility for partner states to deviate from custom union rules, for example by imposing higher or lower tariffs than the CET. These are often viewed purely as the result of lobbying by interest groups (see Bündler, 2018) but we argue they also represent a reclaiming of industrial policy space by state authorities. Since SOA have no basis in law they are primarily covered in the political-institutional section below.

The EAC customs union limits policy space by making tariff-free trade the legal norm for products originating in partner states, including cotton lint, yarn, fabrics, etc. This means that member states have agreed in principle not to use a potentially significant option for industrial policy, namely protecting domestic industries from regional competition. This would make it harder for an EAC member to build production capabilities in an area where another member state has already gained competitiveness, i.e. cases of “asymmetrical integration” (Reinert and Kattel, 2013). The trade complementarities established before the intra-regional liberalisation are therefore likely to become entrenched. The choice to introduce an FTA within the EAC from 2005 contrasts with the earlier incarnation of the East African Community of the 1960s, where free trade was limited to certain sectors, allowing countries to designate sectors they wanted to protect from regional competition (Mshomba, 2017). Under such an arrangement which prioritises national legal policy space over regional economic policy space, there is a risk that multiple countries could seek to protect the same sector (resulting in a failure to develop regional complementarities) and furthermore it relies on national markets having levels of demand sufficient for import substitution.<sup>10</sup>

The Common External Tariff (CET) is agreed by all EAC members and fixes tariffs on imports from outside the EAC at the same level. In principle therefore a crucial area of state sovereignty, namely trade policy, has been transferred from the national to the regional level. EAC member states have committed in general that they will be bound by the consensus decision of the Community over which sectors should be protected from foreign competition. The autonomy of national policymakers to use trade policy to develop new manufacturing sectors or protect existing ones, e.g. through import substitution, is heavily impaired and industrial policy space thus lost.

Limiting this loss of industrial policy space, EAC members can use SOA or the DR scheme to deviate from the CET in response to national circumstances. DR reduces tariffs paid and is granted to individual firms for specified quantities of inputs used to make specific goods, the sale of which may be subject to conditions. Although national requests for DRs are invariably granted by other EAC members, a common condition is that goods produced may not be sold in other EAC countries

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<sup>10</sup> Arguably this also occurs in FTAs where countries may exclude certain products or sectors from liberalization (Odijie, 2019).

without attracting the CET rate of duty (to maintain a level playing field across the EAC for companies not benefitting from the DR), meaning they are bound for national domestic markets (known as a “national DR”) or markets outside the EAC (an “export DR”), whereas a “regional DR” would not specify any condition (interview #52). SOAs and DRs have the effect of limiting the loss of legal policy space engendered by the EAC customs union, but in the many cases where they are accompanied by restrictions on sale in other EAC countries, this is achieved only through limiting the expansion of economic policy space, one of the main benefits of the EAC.<sup>11</sup>

### *Textiles and apparel in the CET*

Industrialisation is a top strategic development objective for most EAC countries, and T&A is a priority sector for driving the early stages of the industrialisation process in national industrial policies (interviews #35, #40). Since trade policy has historically been critical to the development of the T&A sector in a range of countries, understanding the approach of the EAC’s shared trade policy to T&A is important for this research, particularly the use of the duty remission scheme.

The EAC CET itself is the main trade policy tool at the regional level and finding the necessary consensus between partner states is challenging. The CET applies a zero tariff to raw materials and capital goods, 10% on intermediate goods, 25% on finished goods and over 25% on sensitive items (SI).<sup>12</sup> EAC countries commenced a review of the structures of the CET in 2016 which was due to take one year but was still ongoing in 2020, with plans to limit national policy space proving difficult to agree in practice. Proposals include removing (or reducing use of) the sensitive item list and introducing an additional higher tariff band of either 30% or 35%. The level at which to set the new higher tariff band is uncertain, with Tanzania and Uganda pushing for a 35% rate but with Kenya preferring a 30% rate. The divergent positions were ascribed to differences in political settlements and dominant ideological narratives between countries, with industrialists and ideas of industrial protectionism dominant in Tanzania and Uganda while in Kenya the emphasis is on keeping prices

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<sup>11</sup> SOA and DRs are agreed and implemented by EAC Gazettes, the official EAC publication. Notifications of SOA are usually published in the official EAC Gazette at the beginning of each financial year, i.e. 30<sup>th</sup> June, and expire after one year unless renewed. Products eligible for national DRs must be listed in the first EAC Gazette of each year and unless renewed, eligibility lasts only one year. For regional DRs, eligible products must be listed once in a notification but they are not time limited unless cancelled by a subsequent notification. Any input used to produce for export outside the EAC is eligible for export DRs without needing to be listed individually in a notification (Legal Notice 32 in 2009 provides the basis for export DRs). To operationalise any of the three types of DR, another notification must be published in an EAC Gazette specifying the name of the beneficiary company, products to be imported, quantity allocated, duty rate applicable, finished products to be made and any conditions attached to their sale.

<sup>12</sup> Since 2017 the rates specified in the EAC CET applicable to key T&A value chain products are as follows: 0% on cotton lint and synthetic fibres; 10% on cotton and synthetic yarns, buttons and zippers; 25% on cotton and synthetic sewing threads; 25% on woven cotton or synthetic fabrics; 25% on made-up garments and textile articles; 50% (SI) on Khanga, Kikoi and Kitenge; 35% or USD 0.40/kg, whichever is higher (SI) on used clothing.

low for consumers (interviews # 23, #27, #57). This shows the difficulty of finding compromises which respect national industrial policy space but allow for meaningful shared policies to emerge at the regional level.

The CET review also highlights tensions between groups over tariffs on intermediate and finished goods. When the new tariff band structure is finalised there will reportedly be a comprehensive reallocation of products between tariff bands, reflecting production capacities in the region and the status of products as inputs or finished products. T&A manufacturers integrated into RVCs and GVCs highlighted the paradox that some intermediate inputs such as fabric currently attract the same duty rate as finished garments, and other inputs with negligible regional production capacity such as synthetic yarns have tariffs of 10% (interviews #4, #5, #18, #19). Policymakers explained that the presence of local fabric production capacity justified high tariffs to protect domestic suppliers, and it was observed that tariffs are an instrument of revenue raising as well as industrial policy (interviews #36, #41, #53). This highlights the presence of tensions at multiple levels – between consumers and manufacturers, between manufacturers with different value chain orientation, and between industrial and fiscal policymakers.

The final outcome of the CET review will define legal policy space in the sector at the regional level for years to come, representing a settlement between conflicting interests. Policymakers said that the key decisions about moving products to higher or lower bands will be based on criteria for establishing whether sufficient production capacities exist in the region, but these criteria will be highly contested. Quality and price considerations are critical to manufacturers, as although local capacity may exist to produce a certain type of yarn/fabric, their prices may not be competitive with imports, e.g. from Asia. The shape of the new CET for T&A products and therefore its impact on national industrial policy space remains uncertain at the time of writing.

#### *EAC Duty Remission scheme*

The approach to the use of DRs in the T&A sector within the EAC has varied between countries and over time, with important implications for legal policy space. Table 9 and Table 10 below shows the evolution of approaches to the DR scheme, with Table 9 showing the number of products listed as eligible for DRs, and Table 10 showing the actual uptake of duty remission requested on those products by individual firms (note that all products are automatically eligible for export DRs – marked with an ‘X’ or ‘x’ in Table 10 – without needing to be listed in Table 9, see footnote 11 above). From 2009 to 2020, seven of the firms surveyed participated in the EAC duty remission scheme. The use of the duty remission scheme has increased dramatically in recent years, with an overwhelming emphasis on national DRs, i.e. firms granted duty remission may only sell finished products within their home country, foregoing the expanded market access offered by the EAC. This suggests that the DR benefits available to firms in terms of reduced input costs are greater than the potential benefits of

regional market access, although there are also anecdotal reports from other research (not T&A specific) that DRs are prone to corruption and used to import final products instead of intermediates to avoid taxes (Frazer and Rauschendorfer, 2019).

Rwanda has been by far the most prolific user of the duty remission scheme, mostly through national DRs. At the opposite extreme, Kenya has granted very few national DRs, instead opting for export DRs where firms must sell finished goods outside the EAC – again foregoing the regional market access benefits of the EAC. This likely reflects the higher level of export capabilities of Kenyan T&A firms. Uganda and Tanzania have in recent years tended to opt for national DRs, but firms from those countries have seen far less uptake than in Rwanda. In Tanzania the low uptake was attributed to a lack of trust between the business community and politicians such that firm requests for duty remission are less likely to be approved (interview #24).

*Table 9: Number of products listed as eligible for duty remission in June EAC Gazette*

| Country                           | 2013      | 2014      | 2015      | 2016      | 2017       | 2018       | 2019       | 2020       | Grand Total |
|-----------------------------------|-----------|-----------|-----------|-----------|------------|------------|------------|------------|-------------|
| Rwanda                            | 0         | 26*       | 12*       | 12        | 12         | 294        | 209        | 257        | 822         |
| Uganda                            | 12*       | 12*       | 11*       | 11        | 111        | 100        | 10         | 51         | 318         |
| Tanzania                          | 0         | 0         | 0         | 0         | 0          | 113        | 36         | 36         | 185         |
| Uganda, Rwanda, Burundi, Tanzania | 0         | 0         | 0         | 0         | 0          | 0          | 75*        | 75*        | 150         |
| Not specified                     | 0         | 1*        | 0         | 0         | 0          | 1          | 23*        |            | 26          |
| Burundi                           | 0         | 0         | 0         | 0         | 0          | 0          | 0          | 23         | 23          |
| Kenya                             | 0         | 0         | 0         | 0         | 0          | 0          | 0          | 11*        | 11          |
| <b>Grand Total</b>                | <b>12</b> | <b>39</b> | <b>23</b> | <b>23</b> | <b>123</b> | <b>508</b> | <b>353</b> | <b>453</b> | <b>1535</b> |

NB: all are specified as eligible for National DRs except those starred (\*), where no restriction on sale of final goods is specified. Eligible products did not feature in Gazettes prior to 2013. All products are automatically eligible for export DRs so do not feature in this table.

*Table 10: Duty remission granted on T&A inputs in EAC member states*

|                  |                 | 2010     | 2011      | 2012     | 2013       | 2014       | 2015       | 2016       | 2017       | 2018       | 2019        | 2020        |
|------------------|-----------------|----------|-----------|----------|------------|------------|------------|------------|------------|------------|-------------|-------------|
| Rwanda           | Companies       | 0        | 1         | 0        | 1          | 1          | 1          | 1          | 8          | 17         | 41          | 61          |
|                  | Products        | -        | 23        | -        | 1          | 21         | 11         | 32         | 222 x      | 696        | 3010        | 2995        |
| Uganda           | Companies       | 0        | 0         | 0        | 1          | 3          | 5          | 2          | 4          | 6          | 10          | 9           |
|                  | Products        | -        | -         | -        | 4*         | 16*        | 21         | 4*         | 27         | 44         | 92          | 89          |
| Tanzania         | Companies       | 0        | 0         | 0        | 0          | 0          | 0          | 0          | 0          | 2          | 1           | 1           |
|                  | Products        | -        | -         | -        | -          | -          | -          | -          | -          | 59         | 74          | 84          |
| Kenya            | Companies       | 1        | 5         | 3        | 6          | 1          | 2          | 5          | 2          | 1          | 4           | 9           |
|                  | Products        | 2 X      | 16 X      | 9 X      | 35 X       | 24 X       | 8 x        | 71 X       | 5 X        | 6 X        | 11*x        | 24*x        |
| Burundi          | Companies       | 0        | 0         | 0        | 1          | 1          | 1          | 1          | 1          | 1          | 1           | 1           |
|                  | Products        | -        | -         | -        | 73         | 73*        | 73*        | 73         | 111        | 15         | 19          | 22          |
| <b>EAC total</b> | <b>Products</b> | <b>2</b> | <b>39</b> | <b>9</b> | <b>113</b> | <b>134</b> | <b>113</b> | <b>180</b> | <b>365</b> | <b>820</b> | <b>3206</b> | <b>3214</b> |

NB: 2020 data is incomplete; Jan-Aug only. All are specified as exclusively eligible for National DRs except those starred(\*), where for some products no restriction on sale of final goods is specified. A capitalised “X” indicates all products fall under an export DR, a small “x” indicates some products fall under an export DR.

Policy interviews with regional-level officials point to frustration at the use of national DRs, which reduce the cost of production but also limit market access by outlawing duty free sale within the EAC (interviews #54, #57). As a result, there have been concerted efforts towards producing a common list of inputs eligible for regional DRs, from which all regional manufacturers could benefit while retaining EAC market access. This was anticipated to be agreed for the 2018-19 financial year, but Kenya withdrew support at the last minute, and in the end Uganda, Tanzania and Rwanda submitted separate lists of T&A products eligible for national DRs. The process resulted in some confusion, with a Tanzanian firm applying for a regional DR but being granted a national one instead, resulting from them withdrawing from the scheme altogether, preferring to pay 10% duties on inputs and be able to sell duty free within the EAC (interview #5).

In June 2019, Legal Notice 81 in the EAC Gazette contained a list of 22 products eligible for regional DR, mainly composed of synthetic yarns and accessories used to make textiles and garments, with no conditions on sale of finished goods or expiration date (i.e. the list does not need to be published each year). Interestingly, a further list of 75 products was eligible for a novel, hybrid national-regional DR: Rwanda, Uganda, Burundi and Tanzania agreed a common list of T&A inputs eligible for duty free import for one year, with finished products able to be sold duty free in participating countries but attracting CET rates if sold in Kenya. This was valid only for one year, and the list was re-published in June 2020. In addition Rwanda, Uganda and Tanzania submitted lists of 257, 51 and 36 products respectively eligible for purely national DRs in 2020.

The attempt to reform the duty remission scheme to enable benefitting companies to retain duty free EAC market access has been a partial success. So far only Kenyan firms have been granted regional DRs, around 10 firms importing polyester yarn in 2019 and 2020. Despite firms in other countries importing inputs which were listed as eligible for either the regional or hybrid DRs, they were overwhelmingly granted national DRs such that CET rates apply in case of sale within the EAC. This is likely due to the complications of implementing the overlapping DR schemes, with the same firms able to apply for multiple DRs on inputs with different conditions to make the same finished products.

Several major reasons were cited by interviewees for the difficulty in agreeing a common EAC approach to T&A inputs despite the sector being a strategic priority at the regional level. First, there is a perceived lack of information about what is available in the region, with some regional (especially Kenyan) producers reporting capacity to produce inputs which manufacturers in other countries think have to be imported from global markets (interviews #4, #9, #12, #18, #19). A second issue is cost, with those inputs that are produced in the region often more expensive than those imported from e.g. China, especially if the latter can be brought in tariff free with a duty remission (interviews #5, #21). A third issue is difficulty agreeing the duty remission rates granted, with industrialists favouring zero rates while some EAC national government actors facing severe fiscal constraints are unwilling to

forego revenues entirely (interview #41). A fourth issue results from informal trade, smuggling and trade mis-invoicing (for Tanzania, see Andreoni and Tasciotti, 2019) and the difficulties enforcing complicated rules by under-resourced customs and border authorities, leading to the suspicion that conditions in national DRs outlawing duty free sale within the EAC are not always adhered to, and the imposition of NTBs such as bans on imports of affected product categories by neighbours (interview #36). A fifth issue is the tendency for tit-for-tat retaliatory measures in response to restrictions by other countries, for example some interviewees cited Kenya's withdrawal from the proposed shared EAC list of T&A inputs for 2018-19 as retaliation for other EAC countries' imposition of restrictions on T&A imports from Kenya the previous year, in turn because of Kenya's SOA waiving the rules on sales of produce from EPZs, on which see more below (interview #5, #54).

### *EAC industrial policies*

A range of formal rules governed at the EAC level shape the legal dimension of industrial policy space, particularly Rules of Origin (ROO), trade remedies and Export Processing Zones (EPZs). The EAC's ROO govern the conditions under which a product qualifies as originating in an EAC country, therefore making it eligible for free trade within the region. These rules are relatively relaxed for most products and a 'cumulation' rule applies, such that inputs imported from another EAC member state count as originating in the producing country (EAC, 2015). For yarns, woven fabrics and articles of apparel the EAC has 'single transformation' ROO, meaning that only one stage of transformation in the value chain must take place in the EAC, whether it be spinning for yarn, weaving for fabric or sewing for clothing (EAC, 2015; Chamroo, 2016). The inputs for each of these processes (e.g. fibre, yarn, fabric etc.) can be imported from outside the EAC with the final product still qualifying for duty free EAC trade. For knitted fabric however a stricter 'double transformation' ROO is applicable, meaning that the yarns used for knitting must also be produced in the EAC, ruling out an industrial policy premised on supplying knitted fabrics within the EAC based on imported yarn.

Trade remedies are industrial policy options sanctioned by the WTO, i.e. an area of policy space at the global level, but their implementation in the context of regional integration is institutionally demanding and there was a lack of clarity from interview respondents about how a trade remedies regime could operate in the EAC (interview #34, #42, #54). At the EAC level there is a law and regulations governing the use of trade remedies, which some respondents suggested only covers intra-EAC dumping. Regulation 4 does indeed state that they cover cases where EAC countries initiate investigations against each other, but only during the transitional period of customs union implementation, which is now over (EAC, 2004a). The definition of dumping in the regulations refers to goods being imported "into the Community", suggesting it covers dumping from outside the EAC. Other sections of the EAC regulations suggest both are covered, with references to dumping as determined by the export price of "another Partner State or a foreign country", and investigating

authorities carrying out investigations “in the territory of other Partner States or foreign country as required”.

The EAC anti-dumping regulations state that they should be applied in conjunction with the national legislation of partner states, but as discussed in section 5.2.1 only Kenya is actively moving to establish a functioning domestic policy regime in this area. Since the EAC is a customs union with a common trade policy, any measure would apply at the EAC level so Kenya cannot impose a trade remedy measure independently according to EAC officials interviewed (interview #54), suggesting EAC rules may constrain Kenyan policy space. The EAC Secretariat is therefore supporting the preparation of draft legislation for other partner states, so they can establish institutions to carry out investigations in their own territories. Furthermore a regional institution may also need to be created to coordinate across countries and make decisions about EAC measures. Given the delays inherent in such a process it appears likely Kenya might proceed unilaterally, for example imposing national trade remedy measures through existing CET flexibilities like SOA, or the possibility was mooted of the Kenyan institution serving the region in the interim (interview #42, #54).

Export Processing Zones (EPZs) are among the most prominent industrial policy instruments in the EAC, with national legal policy space constrained by the framework at the regional level. EPZs offer favourable fiscal incentives and other arrangements for investors in strategic sectors producing for export, justified by the potential to earn foreign exchange and the discipline imposed on exporters by global markets, requiring firms to meet the highest standards (interviews #33, #46). EAC rules state that EPZs in partner states may not sell more than 20% of their output in the ‘domestic’ market, in this case the EAC single customs territory, to prevent unfair competition with domestic producers (EAC, 2004b). The entry into force of the EAC customs union required member states to modify their national EPZ regimes to comply with the 20% rule, but most importantly to change the definition of the “domestic” market to the EAC region. As a result, companies formerly exporting a significant share of sales to other EAC countries had to reduce this to only 20% of total sales, and find new export markets for the remainder. Paradoxically therefore, the approach to regionalism in the EAC resulted in less policy space for national authorities to pursue industrial policies based on regional exports from EPZs.

Some policymakers interviewed expressed frustration at the 20% limit on EAC sales for EAC-based producers, arguing that it acts against regional integration and arbitrarily reduces incentives for investment in T&A manufacturing in EAC EPZs, ultimately reducing the potential for employment creation in the EAC (interviews #33, #44, #45). It was noted that producers outside the EAC often receive generous state subsidies through EPZ and other incentive regimes, and if the host country has an FTA with the EAC, those firms have unlimited duty free access to the EAC market. As a result there are suggestions to increase the limit on domestic sales by EAC EPZs from 20% to 49%, along

with moves to increase the use of Special Economic Zones (SEZs) which offer some fiscal and other incentives (though no corporate tax holiday) to investors without restrictions on domestic sales (interviews #33, #44, #45). Efforts to circumvent the 20% limit on EAC sales through Stays of Application (i.e. the non-application of the EAC's rules) are detailed in section 5.3.2 below.

#### 5.2.2.2. SADC, COMESA, TFTA and AfCFTA

This section explores how several existing or proposed regional cooperation initiatives in Africa offer the potential to expand economic policy space, at the cost of lost legal policy space to protect domestic industries from regional competition. In many cases the expanded economic policy space is limited by constraints in the legal dimension of industrial policy space, particularly Rules of Origin (ROO) in the case of the T&A sector.

Tanzania's membership of The Southern African Development Community (SADC) would be expected to expand its economic policy space considerably, but this potential is not realised in T&A due to restrictive ROO, i.e. legal policy space constraints at the regional level.<sup>13</sup> Making up around 60% of total SSA apparel imports due to its significant middle class and developed retail sector, the South African market in SADC was highly prized by the T&A companies interviewed (interviews #4, #5, #7, #11). Respondents operating in Kenyan EPZs said they could significantly scale up their investments ("fill whole factories") if they could sell their garments duty free in South Africa instead of under the current 45% tariff (interview #11). This would require not only participation by Kenya and South Africa in the same FTA (e.g. the AfCFTA or TFTA discussed below), but also for South Africa to agree to more relaxed single transformation ROO in those agreements, because of the assembly-only business models of Kenyan EPZ firms .

SADC's ROO for T&A products are relatively restrictive, imposing a "double transformation" requirement (although this does not apply within SACU), a legal stipulation that limits the industrial policy space benefits otherwise offered by SADC. In order to qualify as originating in a (non-SACU) SADC member state and be eligible for duty free treatment, garments must be manufactured from yarn, i.e. requiring both the knitting or weaving of fabric and stitching of garments to take place within SADC (cumulation is permitted). This is motivated by the policy objective of building an integrated value chain based on local and/or regional inputs, as well as to protect existing textile manufacturers, particularly in South Africa.

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<sup>13</sup> SADC comprises South Africa, Tanzania and 13 other member states (but not Kenya). These are Botswana, Comoros, Democratic Republic of Congo, Eswatini, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Zambia, Zimbabwe. All but 2 SADC members (DRC and Angola) are part of a free trade area, established in 2008, and 5 members are also part of the Southern African Customs Union (SACU) - Botswana, Lesotho, Namibia, South Africa and Eswatini.

Garment manufacturers operating in Tanzania who import their fabrics from global markets are therefore not eligible for duty free access to the South African market. Vertically integrated, regional market oriented Tanzanian firms are favourable towards SADC's double transformation ROO, since they benefit from privileged market access. However the business models of those firms were established in the 1960s and negligible new investment has been made in Tanzania to serve the South African market under SADC, in either garment or textile manufacture. It has therefore been argued that SADC's double transformation ROO are restricting the expansion of economic policy space in a critical sector for industrialisation, and that a shift to single transformation rules would increase prospects (Iwanow, 2011). However to date there has been no sign of a shift in the SADC position or that of its dominant member, South Africa, so the potential for regional integration to support industrialisation is hamstrung by constraints in the legal dimension of policy space.

Less restrictive rules apply in the Common Market for Eastern and Southern Africa (COMESA) but the national markets of participating countries were not prized by interviewed firms, suggesting the potential economic policy space is limited.<sup>14</sup> COMESA's Rules of Origin are more relaxed than those of SADC or the EAC, being single transformation in all product categories, i.e. either requiring transformation involving a simple change in tariff heading (CTH) or "manufacture from materials classified in a heading other than that of the product" (COMESA, 2015; Chamroo, 2016). A small share of exports of the Kenyan firms interviewed was bound for COMESA countries (mostly Zimbabwe, DRC and Ethiopia) but the vast majority of their sales were made in Kenya and the EAC, suggesting the economic policy space offered by COMESA is limited even with relaxed ROO.

A major expansion of economic policy space is promised by the proposal for a new regional economic community (REC) comprising members of COMESA, SADC and the EAC, to be called the Tripartite Free Trade Area (TFTA).<sup>15</sup> The intention is to cover all products with no exclusion list, but actual coverage will depend on ROO and tariff negotiations. Almost all ROO negotiations were reported to have been concluded in August 2020, with outstanding areas related to T&A products in HS chapters 60-63. ROO for T&A products in other chapters have tended to be relatively relaxed, with single transformation rules allowing manufacture of fabric from imported yarn. For the remaining chapters, most SADC members want their more strict double transformation rules to apply in the TFTA, COMESA members want their more relaxed single transformation rules, while the EAC prefers its hybrid rules. Although also part of SADC, Tanzania officially adopts the EAC position since the EAC is a more integrated customs union, but respondents often argued that given Tanzania's

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<sup>14</sup> COMESA is a free trade area involving 21 participating countries including several EAC partner states (Kenya, Uganda, Rwanda and Burundi) and important T&A producers such as Egypt, Ethiopia, Madagascar, Mauritius and Eswatini. Tanzania and South Africa are notably not members.

<sup>15</sup> As of February 2021, 10 countries (including Kenya and South Africa but not Tanzania) had ratified it of the 14 required to do so before the agreement can come into force. The completion of tariff negotiations between the SACU and EAC customs unions was reported in July 2019.

domestic cotton and textile manufacture, double transformation ROO would be more favourable for the country (interview #24). Kenya tends to favour more flexible single transformation rules because its export-oriented garment sector is politically powerful and a major employer, and also for lack of upstream input manufacture. It is not clear how the various positions will be reconciled on TFTA ROO, but the impasse in technical negotiations means it may have to be settled at the political level, making the overall impact on policy space unpredictable (interview #35, #42).

The African Continental Free Trade Area (AfCFTA) is another pan-continental free trade agreement offering huge gains of economic policy space, and which has overtaken the TFTA in terms of progress towards implementation, but again the final impact on the T&A sector depends on uncertain ROO negotiations.<sup>16</sup> As at August 2020 around 90% of ROO for AfCFTA had been finalised, with T&A products in chapters 50-63 the main areas outstanding, showing the importance of T&A in the development strategies of member states. The parties to the TFTA are pushing the same positions in the AfCFTA, with the main new set of players being the cotton growing West African countries like Burkina Faso, Côte d'Ivoire, Mali and Benin who are keen to maximise sales of cotton within Africa so are pushing for more strict ROO in the hope of promoting regional sourcing. The outcome of AfCFTA ROO negotiations is uncertain, with a potential compromise mooted by UNCTAD (2019) involving an undefined 'two-track' approach which ensures "ambitious preference margins for upstream textile producers" at the same time as maintaining flexible ROO for weaker downstream apparel exporters.

Interviewees expressed a mixture of concern and positivity at the prospect of greater tariff liberalisation at the regional level, notwithstanding proposed exclusion provisions. AfCFTA plans to allow countries to exclude 3% of products from liberalisation permanently with the possibility for a further 7% to be listed as sensitive and not liberalised for up to 10 years. There are also anti-concentration provisions to ensure whole sectors cannot be excluded. The loss of national legal policy space to protect industries from regional competition was lamented by some policymakers interviewed, but in return the greater regional economic policy space (e.g. through enhanced market access and cross-border investment) was also recognised. In Tanzania especially, which is not a member of COMESA, there was alarm among industry stakeholders at the possibility of stronger North African manufacturers (in Egypt, for example) having duty free access to the Tanzanian market (interview #23). As mentioned, Kenyan exporters were particularly positive about the improved market access to South Africa under AfCFTA (interview #11). The actual impact of regional tariff

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<sup>16</sup> The AfCFTA agreement has been signed by 54 out of the 55 African Union member and ratified by 30 of them. AfCFTA came into force in May 2019 and trading started in January 2021, however the final schedules of tariff concessions and rules of origin are yet to be concluded. It was planned that these would be finalised by February 2020 and that the dismantling of tariffs would start by July 2020 (Erasmus, 2019) but this was delayed in part by the Covid-19 pandemic.

liberalisation in the T&A sector on industrial policy space depends very much on the ROO agreed, and the potential for exclusion lists and other mechanisms (e.g. DRs and SOA seen in the EAC) to protect T&A manufacturers.

### **5.2.3. Global-level legal policy space**

At the global level, legal policy space in the EAC T&A sector is defined by the terms of the preferential trade arrangements (PTAs) that member states are eligible for. Each preference granting country's scheme has an incentive structure depending on its coverage, MFN tariffs and rules of origin, which are particularly varied in T&A products and have major implications for the industrial policy space of beneficiary countries. In particular, the USA's African Growth and Opportunity Act (AGOA) offers unparalleled market access (and expanded economic policy space) but the rules conditioning that access make it harder for EAC countries to pursue industrial policies focused on backward linkage creation in line with their comparative advantage, limiting the actual expansion of industrial policy space.

The most important PTA for East African T&A producers is the USA's AGOA, which is highly prized by benefitting firms but has important knock-on effects for policy space.<sup>17</sup> 39 SSA countries are eligible (including Tanzania and Kenya) so long as they are deemed to fulfil political and institutional criteria, which have the potential to impose significant constraints on the industrial policy options of recipients – dealt with in the political-institutional dimension below. AGOA has relaxed ROO provisions favouring industrial policies based on integration into global value chains (GVCs). The Third Country Fabric (TCF) derogation allows duty free access for apparel made from fabric originating anywhere in the world, i.e. a single transformation requirement. This increases the value of rents to manufacturers in benefitting countries, but at the same time reduces incentives for investment in local yarn and fabric production (Edwards and Lawrence, 2010). Indeed, some interviewees viewed the main beneficiaries of AGOA as Asian textile manufacturers, since such a significant share of the cost of garments (60-70%) is accounted for by imported fabric (interview #4). The structure of AGOA rents resulting from the ROO has major implications for the legal dimension of policy space, as industrial strategies prioritising the development of backward linkages will be more costly and difficult to pursue.

The USA's MFN tariff from which AGOA deviates determines the rents for products exported, and inhibits the EAC from following its comparative advantage in cotton-based T&A products. US tariffs on imported clothing vary by material, with those made from synthetic fabrics attracting higher rates at 25-32% than cotton at 13-17% (Staritz, 2011; MITI, 2017). As a result, by reducing tariffs on all

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<sup>17</sup> AGOA covers 97.5% of tariff lines including T&A products, was signed into law in 2000 and has been modified and renewed four times, the latest extension being until 2025.

T&A products to zero, AGOA provides greater duty advantages for manufacturers using synthetic over cotton fabrics. Given the availability of cotton lint in East Africa, this acts in the opposite direction to the region's comparative advantage, so limiting the extent to which AGOA contributes to backward linkage creation, exacerbating the effect of the TCF derogation.

Most of the foreign owned companies operating in Tanzania and Kenya stated that AGOA, and particularly the TCF derogation, was very important or even essential for their competitiveness in East Africa. Some reported they would close down their production facilities entirely if AGOA was not renewed, while others would seek alternative markets but likely have to scale down their operations (interviews #6, #8, #11, #20). Going forward, the USA has made known its preference for bilateral FTAs with individual African countries, involving reciprocal tariff reductions, instead of unilateral trade preferences schemes like AGOA (interview #28). With the signing of the AfCFTA, African policymakers expressed hopes that the continental grouping could negotiate as a bloc with the US, but this would require significant progress in AfCFTA implementation and unity in the face of US diplomacy promoting bilateral deals, with Kenya already negotiating a bilateral trade deal with the USA. In any case, the likely end of AGOA in 2025 severely undermines the efforts of African countries to promote investment in garment manufacturing on the prevailing model of duty free access to the US market and single transformation ROO, with interviewees reporting that a clear 10 year window of policy stability is preferred in order for new investments to be considered (interview #21).

The European Union also offers duty-free and quota-free (DFQF) to LDCs and while uptake is low by EAC T&A manufacturers, differing trade policies between EAC countries towards the EU highlight tensions between national, regional and global levels of legal policy space. The EU's Everything But Arms (EBA) initiative provides LDCs with full DFQF access to the EU market for all exports except weapons with no expiration date and relaxed single transformation ROO for T&A products (Curran and Nadvi, 2015). None of the firms interviewed sell a major share of their exports to EU markets at present, except for the unusual case of a foreign-owned SME in Kenya which employs less than 100 workers. Kenya ceased to be eligible to benefit from the EBA scheme when it 'graduated' from LDC status, however by agreeing to implement the reciprocal Economic Partnership Agreement (EPA) between the EAC and the EU, Kenya maintained access to EU markets on the same terms as EBA. The refusal by Tanzania and Uganda to implement the EPA means it cannot come into force, but so far Kenya's EU market access has remained unaffected (interview #55). The divergent approaches to the EU EPA within the EAC, despite them nominally having a shared trade policy within the customs union, suggests that the need for national policy space on trade with the EU – either to allow for tariff

protection against EU imports or to guarantee EU market access – is greater than imperative towards policy integrity at the regional level.<sup>18</sup>

All EAC countries except South Sudan are members of the WTO, which is a global-level legal framework that can impose severe limitations on industrial policy space (Wade, 2003). The Trade Policy Review by the WTO in 2019 revealed that EAC countries are breaking their commitments on applied tariffs, since applied rates exceed a number of bound rates in Burundi, Kenya and Rwanda (WTO, 2019). This shows that despite the WTO’s potential to constrain industrial policy space, in reality transgressions of formal rules at the global level are likely to often go unchallenged, unless particular economic interests are at stake, as confirmed by other recent research on policy space in the WTO (Chang et al, 2016).

### **5.3. Political-institutional policy space**

Within *de facto* policy space conceptualised in the literature (Mayer, 2009) we distinguish political-institutional and economic dimensions. The political-institutional dimension covers the informal rules, political settlements and institutional structures that define which policies are feasible, and are analysed here at the national, regional and global level. We argue that political-institutional policy space created at the regional level by the EAC allowed new policy options to emerge – e.g. the phase-out of used clothing imports – but hard policy space constraints at the global level prevented implementation, because US authorities threatened to remove the duty-free market access underpinning EAC countries’ export-oriented industrial strategy.

#### **5.3.1. National-level political-institutional policy space**

Given their low income levels, the political structure of EAC countries is argued to correspond to North et al’s (2007) idea of limited access orders, i.e. where there is a close connection between economic and political power with different elite factions capturing rents from the areas they control (Booth et al, 2014). The political settlements of EAC member states also fall into the broad category of ‘clientelist’, meaning that the ‘holding power’ of organisations (firms, trade unions, government agencies etc.) is not aligned with formal institutions such that the latter do not operate as intended (i.e. with impersonal rule-following the norm) but are instead influenced by the exercise of personalised power (Khan, 2010, 2017; Gray, 2018). Different varieties of clientelism (outlined in section 4.2.2.3) are evident in Kenya and Tanzania, as explored below, but we first address several policy space issues common to both countries.

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<sup>18</sup> The inclusion in the EPA of rules around competition policy, government procurement and export taxes means that were they to be enforced, there could be implications for the possibility of EAC countries’ growing their T&A exports to the EU.

In both Kenya and Tanzania, a common complaint by industry stakeholders was that their respective domestic markets have seen high levels of import penetration such that domestic firms are struggling to maintain competitiveness and market share. This is partly linked to the rise of export powerhouses in Asia, especially China in recent years, but of particular interest from a national policy space perspective is the role of national authorities, who are alleged to preside over the systematic undervaluation of imported T&A products, particularly new and used clothing (Andreoni and Tasciotti, 2019). These are seen as an important source of rents for the financing of the political settlement, since politically connected elites control the import trade ensuring that cheaper goods reach disadvantaged groups more likely to mobilise, while domestic manufacturers suffer from lower levels of demand and depressed prices. This issue is explored in more depth in Chapter 7 but is flagged here to show how the political-institutional dimension of industrial policy space is key to determining the feasibility of industrial policies, with those that threaten the interests of powerful groups less likely to succeed.

VAT is a both a national and regional policy issue for the firms surveyed, with the political weakness of some regionally oriented T&A firms making it difficult to overcome bureaucratic delays. At the level of national policy, firms in Kenya and Tanzania complained that delays in VAT refunds negatively impact their business (interviews #4, #17). This has implications for regional value chain development as firms procuring inputs (e.g. cotton) in other EAC countries must pay VAT but are due a refund from national authorities, which if delayed (as is the case, sometimes for years) then regional sourcing is strongly discouraged.

### *Tanzania*

Whitfield et al (2015b) view Tanzania as having moved from a strong to a weak dominant party since the 1960s, with an increasing tendency towards competitive clientelism – i.e. stronger excluded factions and similarly strong lower levels of the ruling coalition – under President Kikwete. For Andreoni (2017a), Tanzania’s political settlement under President Magufuli was characterised as a vulnerable authoritarian coalition with some moves towards a more developmental coalition (through reductions in the power of factions excluded from the ruling coalition, while lower levels of the ruling coalition remain weak). Gray (2018) argues that Tanzania’s political settlement before its liberalisation reforms did not correspond to any of Khan’s (2010) categories of clientelism, but advances a new one – the socialist political settlement – before arguing that in recent years a dominant party system has prevailed.

Evidence of the clientelist nature of the political settlement in Tanzania in relation to the T&A sector has been strong in the EPZ policy area. Gray (2012) and Whitfield et al (2015b) document how the formal rules established around EPZs in Tanzania – often drawn up by foreign consultants – were not effectively enforced, with powerful firms able to successfully lobby responsible government agencies

to gain exemptions from export requirements. By allowing one firm to export only 50% of its output instead of the 80% mandated in the EPZ act, the state created a rent for the individual firm outside of the formal rules, suggesting that industrial policies based on formal rules not aligned to real-world power distributions are unlikely to succeed – a crucial feature of national political-institutional policy space in Tanzania, explored further in Chapter 7.

Some important features of national political-institutional policy space from the perspective of firms were gathered during the course of interviews, which used lists of challenges from the national industrial census that firms were already familiar with. Table 11 presents these ‘general challenges’ below along with more T&A specific ‘policy challenges’, grouped by firms’ value chain orientation. The table includes factors more closely associated with economic policy space; these are explored in section 5.4.1.

*Table 11: National policy issues in Tanzania*

| Firm                                     | NVC firms |     | RVC firms |      |      | GVC firms |    | TOTAL |
|--|-----------|-----|-----------|------|------|-----------|----|-------|
|  | A         | B   | C         | D    | E    | F         | G  |       |
| General challenges (industrial census)   |           |     |           |      |      |           |    |       |
| Shortage of qualified labour             | Y         | Y   | Y         | Y    | Y    | Y         | Y  | 7     |
| High cost of production                  | Y         | Y   | Y         | Y    | Y    | Y         | Y  | 7     |
| Taxes                                    | Y         | Y   | Y         | Y    | Y    | Y         | Y  | 7     |
| Complicated administrative procedures    | Y         | Y   | Y         | Y    | Y    | N         | Y  | 6     |
| Inadequate physical infrastructure       | Y         | Y   | N         | Y    | Y    | N         | Y  | 5     |
| Unfair competition                       | Y         | Y   | Y         | Y    | Y    | N         | N  | 5     |
| Infant Private Sector with weak support  | Y         | Y   | Y         | N    | Y    | N         | Y  | 5     |
| Uncertain economic environment           | Y         | Y   | Y         | Y    | Y    | N         | N  | 5     |
| Inadequate financial services            | Y         | Y   | Y         | Y    | Y    | N         | N  | 5     |
| Inadequate technology                    | Y         | Y   | Y         | N    | N    | N         | Y  | 4     |
| Shortage of raw materials                | N         | Y   | Y         | N    | N    | N         | Y  | 3     |
| Insufficient demand                      | Y         | Y   | Y         | N    | N    | N         | N  | 3     |
| Insufficient production capacity         | N         | N   | N         | N    | Y    | N         | Y  | 2     |
| Environmental challenges                 | Y         | N   | N         | N    | N    | N         | N  | 1     |
| Policy challenges (T&A)                  |           |     |           |      |      |           |    |       |
| Employment of expatriates*               | 3         |     | 4         | 4    |      | 3         | 2  | 16    |
| Customs and trade regulations            | 2         | 3   | 0         | 3    | 3    | 2         | 1  | 14    |
| Supply of electricity                    | 2         | 3   | 0         | 4    | 1    | 1         | 0  | 11    |
| Tax administration                       | 0         |     | 3         | 3    | 2    | 2         | 0  | 10    |
| Access to finance                        | 3         | 1   | 4         | 2    |      | 0         | 0  | 10    |
| Labour regulations                       | 0         |     | 0         | 1    | 3    | 2         | 2  | 8     |
| Skills training system (VETA, SDL etc.)* | 3         | 3   | 3         |      | -2   | -2        | -1 | 4     |
| Business licencing and permits           | 0         | 2   | 0         | 0    | 0    | 0         | 1  | 3     |
| Electricity unit cost (US cents per kWh) | 7.9       | 13  | 8.5       | 9    | 11.5 | 13        |    |       |
| EAC duty remission scheme participation  | No        | Yes | No        | Yes^ | No   | No        | No | 2     |

NB. Y = Yes (it is a challenge), N = No (it is not a challenge). Policy/issues rated as 0: Not a challenge, 1: minor challenge, 2: moderate challenge, 3: major challenge, 4: very severe challenge. \* (Starred questions): also offered -2: good, -1: fair. ^ signifies was granted a duty remission but withdrew from scheme – see regional policy section.

An effective skills training system is essential for any industrial policy, yet in Tanzania this system is not delivering skilled workers to key sectors because the financing mechanism (the Skills Development Levy imposed on firms) creates rents that are controlled centrally and get channelled to other areas of the political settlement (Andreoni, 2018). The Tanzanian skills training system was viewed unfavourably by domestic-market oriented firms but in a better light by exporters, although all had to do their own in-house training for employees. Several firms suggested a default allowance of a fixed percentage of foreign workers, e.g. 5% of the total workforce, rather than having to apply for a permit for each new foreign worker. There were also calls to make it easier to renew foreigner work permits.

Other policy issues with direct government oversight such as taxes and administrative procedures, especially for importing and exporting, were also highlighted as areas where either weak governance capabilities or political clientelism constrains industrial policy implementation. Firms reported it taking longer (more than twice as long as previous years, in some cases) to clear goods through customs than before, particularly for imports where storage costs were elevated as a result. This was in particular noted for companies participating in the EAC duty remission (DR) scheme, with storage costs from delays at port sometimes outweighing the benefit of the DR, and some companies no longer participating in the scheme.

There was a clear split among Tanzanian firms on unfair competition, with global exporters unaffected but all others strongly emphasising the negative impact on their businesses of imports deemed to be undervalued to reduce tax liability, and/or misclassified as second hand. For many domestically and regionally oriented firms the undervaluation of imports was the most important challenge; some recent improvements in the situation were acknowledged but firms called on the government to do more, for example by levying import duties on fabric and clothing based on weight rather than value, since weight is easier to measure. There were also allegations that new, finished clothes from factory overruns or the surplus stock of retailers abroad are passed off as second hand or intermediate products by importing them without labels or packaging and even prior to washing or pressing to avoid appearing finished.

The government's vision and objectives for the T&A sector in Tanzania are captured in the 'Cotton to Clothing Strategy 2016-2020' and related documents, part of a project funded by DFID with technical support from the International Trade Centre (ITC) (URT 2016; URT, 2017). A long and detailed set of interventions are listed, but interviewees reported that implementation has been weak because the human and financial resources necessary were not available (interview #35). For example the industry

association TEGAMAT (Textile and Garment Manufacturers Association of Tanzania) was assigned important responsibilities but lacks the personnel to fulfil its mandate, as well as not being fully representative of the national sector since several large producers are not members (interview #23). As the national policy framework is reviewed for the 2020 period, there were suggestions to focus efforts on a few feasible initiatives to boost competitiveness – i.e. to design industrial strategy taking into account the features of national political-institutional policy space.

### Kenya

Analysts of the political settlement in Kenya generally concur that it corresponds to ‘competitive clientelism’, characterised by the relative strength both of political factions excluded from the ruling coalition, and of lower ranks within the ruling coalition (Wanyama and McCord, 2017; Hickey et al, 2015b; Berg-Schlusser, 2003). Booth et al (2014) find no dominant party in Kenyan politics and highlight the high levels of competition between elite factions, often exploiting ethnic differences. Tyce (2019) argues that at least the export oriented Kenyan T&A firms were shielded from competitive clientelism, because the EPZ authority (EPZA) was shielded from political interference and enforced rules more stringently than in Tanzania, but we question this narrative in section 7.4.1.

Table 12: National policy issues in Kenya

| Firm                                     | NVC firms |     |     |      | RVC firms |      |      | GVC firms |    |    |    |    | TOTAL |
|--|-----------|-----|-----|------|-----------|------|------|-----------|----|----|----|----|-------|
|  | A         | B   | C   | F*   | D         | E    | G*   | H         | I  | J  | K  | L  |       |
| Electricity                              | Y         | N   | Y   | Y    | Y         | Y    | Y    | Y         | N  | Y  | Y  | Y  | 10    |
| Administrative procedures                | Y         | Y   | Y   | Y    | Y         | N    | Y    | N         | N  | N  | N  | Y  | 7     |
| Cost of Finance                          | Y         | Y   | Y   | N    | Y         | Y    | N    | Y         | N  | N  | N  | N  | 6     |
| Infrastructure                           | N         | Y   | Y   | Y    | Y         | N    | Y    | N         | N  | N  | N  | Y  | 6     |
| Import undervaluation                    | Y*        | Y   | Y   | N    | Y         | Y*   | N    | N         | N  | N  | N  | N  | 5     |
| Skills                                   | N         | N   | N   | Y    | Y         | N    | Y    | N         | N  | N  | N  | Y  | 4     |
| Labour regulation                        | N         | Y   | N   | N    | Y         | N    | N    | N         | N  | Y  | N  | Y  | 4     |
| Customs clearance                        | N         | N   | N   | Y    | N         | Y    | N    | N         | Y  | Y  | N  | N  | 4     |
| Used clothing imports                    | Y         | Y   | Y   | N    | N         | Y    | N    | N         | N  | N  | N  | N  | 4     |
| Raw materials                            | N         | N   | N   | Y    | N         | N    | N    | N         | N  | N  | Y  | Y  | 3     |
| Taxes                                    | N         | N   | Y   | Y    | Y         | N    | N    | N         | N  | N  | N  | N  | 3     |
| Workforce                                | N         | N   | N   | Y    | N         | N    | N    | N         | Y  | N  | N  | N  | 2     |
| Industry association(s)                  | N         | N   | N   | N    | Y         | N    | N    | N         | Y  | N  | N  | N  | 2     |
| Space                                    | N         | N   | N   | N    | N         | N    | N    | N         | N  | N  | Y  | N  | 1     |
| Cost of electricity (¢/kWh)              | 16        | 16  |     | 15.6 | 16.5      | 16.9 | 15.6 |           | 19 | 16 | 22 |    |       |
| EAC duty remission scheme participation? | No        | Yes | Yes | No   | No        | Yes  | No   | No        | No | No | No | No | 3     |

NB. Y = Yes (it is a challenge), N = No (it is not a challenge). \* Two small firms (one NVC, one RVC) are included here that are excluded from analysis in Chapter 6. One large RVC firm did not provide the above data so is excluded here.

Table 12 presents policy challenges identified by Kenyan firms during interviews. The data suggest that from the perspective of firms the key features of political-institutional policy space are electricity (cost and supply), administrative procedures, the cost of finance and import competition. Although policy challenges were framed in different terms in the Tanzanian and Kenyan surveys (due to the different fieldwork partners in each country), the main issues raised were similar. Notable differences are that the availability of skilled workers was less commonly cited as a constraining factor in Kenya as compared to Tanzania, and taxes were considered a bigger problem in Tanzania than in Kenya.

On policy issues there was a divide among Kenyan firms between those oriented to NVCs and RVCs and those oriented to GVCs. The most important issue for NVC and RVC firms was import competition, which relates to several practices, some legal and some not. The legal import of second hand clothes was mentioned but a far greater concern was the (illegal) misdeclaration of new clothes as second hand to reduce tax liability. This is a form of import undervaluation, which was also thought to be an issue for imports of new clothes. Domestic firms did acknowledge their competitiveness as part of the reason why clothes imported from China, India, Bangladesh etc. could be sold for below the cost of production of Kenyan firms. This was often linked to the high cost of electricity at an average of 17 US cents (compared to 10.5 cents in Tanzania), especially important for vertically integrated firms with more energy-intensive machinery.

Kenya's National Industrialization Policy identifies T&A as a priority sector and despite the global competitiveness of the apparel export sector, interventions focus on reviving the moribund cotton and textiles parts of the value chain (ROK, 2012). As in the case of Tanzania, the Kenyan national strategy document for the T&A sector was funded by DFID and supported by the ITC and contains a longlist of interventions to be conducted by a wide range of national public and private sector organisations (ROK, 2015). Interviews suggested that many of the implementing agencies lacked the resources to carry out the interventions assigned to them (interviews #37, #48). Despite warm words for regional integration in policy documents, Kenyan policymakers interviewed showed a preoccupation with building an integrated domestic/national value chain (NVC) from 'cotton to clothing' in the long term rather than relying on RVCs based on trade complementarities, since they viewed imports of cotton from Tanzania and Uganda as unreliable (interviews #38, #41).

### **5.3.2. Regional-level political-institutional policy space**

At the regional level, the political-institutional dimension of industrial policy space is marked by the use of Stays of Application (SOA) and attempts at regional industrial policy in the EAC, particularly with regard to used clothing imports. A full assessment of the EAC political settlement is not attempted, but the balance of power between EAC member states and the institutional and organisational characteristics of the main regional community structures are briefly outlined.

Regional cooperation in East Africa originated in the colonial era with Tanzania, Kenya and Uganda sharing a common currency and customs union in the 1920s under British control (Mshomba, 2017). As the only formal British colony and with more long-term European settlers, Kenya was politically and economically privileged, having more advanced infrastructure and manufacturing industries.<sup>19</sup> Post-independence regional integration initiatives focused on addressing inequalities between countries through industrial planning and fiscal transfers, but largely without success (Mshomba, 2017). Kenya remains the regional hegemon but Tanzania gained influence under Magufuli's leadership, with Rwanda and Uganda rerouting their railway and oil pipeline respectively through Tanzania, scrapping previous agreements with Kenya (Booth et al, 2014; Große-Puppenthal, 2016). The EAC Secretariat is one of the most prominent supra-national institutions, with functions including drafting regulations and regional policies, but its mandate to operate independently of member states is limited (Bagabo, 2017).<sup>20</sup>

Variations in VAT policy between different EAC countries were highlighted by respondents as having significant implications for T&A regional value chains. Firms in Tanzania and Kenya complained of Uganda's VAT regime, which results in Ugandan-made T&A products being exempt from VAT (interview #19). Firms located in other EAC countries exporting to Uganda have lost market share there, since their Ugandan buyers must pay VAT when they import, effectively meaning products from other EAC countries are not VAT exempt. Efforts towards harmonisation of VAT rates across EAC countries have stalled but firms surveyed called for a greater emphasis on equal treatment of firms across the EAC.

Although EAC member states have created a customs union, aiming to eliminate tariff barriers to regional trade, non-tariff barriers (NTBs) have become increasingly prominent and are cited by many as one of the major obstacles to regional integration. Data from the NTB monitoring portal established by member states of the planned TFTA comprising SADC, COMESA and the EAC shows that as of September 2020, 204 complaints of NTBs within the EAC had been resolved, and 14 were outstanding (TFTA, 2020). By far the biggest category of complaints relate to 'Customs and administrative entry procedures', with the largest share of these (56 of 102) accounted for by 'Issues related to the rules of origin'. T&A products were the subject of 6 NTBs, mostly in response to the SOA granted by Kenya on EPZ products.

SOA allow EAC members to deviate from the CET – or any aspect of the customs union protocol – to provide rents to manufacturers or in response to national circumstances, but having no basis in law they are considered political-institutional in nature. In principle an EAC member wanting to introduce

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<sup>19</sup> Uganda was a protectorate and Tanzania a mandated territory

<sup>20</sup> Some of the main EAC governance arrangements are the CET itself (including duty remission and SOA exemption regimes), Rules of Origin, EAC Customs Union Protocol, EAC Customs Management Act, EAC Industrialization Policy, EAC Investment Policy and the EAC Competition Act.

an SOA must seek EAC permission, but in practice this is almost always granted, although to maintain a level playing field in the case of input tariffs being lowered, the resulting produce may not be sold within the EAC without attracting CET duties (like the duty remission scheme). SOA are usually used to raise tariffs on imports above CET rates, as in the case of finished T&A products, locally available inputs and used clothing.<sup>21</sup> This is a case of political-instructional policy space at the regional level allowing national authorities to provide rents to manufacturers of those products. For example in the EAC Gazettes issued on 30<sup>th</sup> June for each of 2018, 2019 and 2020, Kenya notified that it would raise the tariff on imported garments from the EAC CET rate of 25% to 35% for the following financial year. Several countries also used SOA to raise tariffs on inputs deemed to be locally available, such as Kenya in 2018 and Uganda in 2020, where tariffs were increased on various fabrics used to make clothing from 25% to 35% or more. Other important applications of SOAs have been on EPZ rules and also used clothes, with the latter being a main source of tension between industrial policy space at the regional and global levels.

The review of the EAC CET underway since 2016 (mentioned above) has resulted in agreement in principle to discontinue the use of SOA. Instead member states may use a DR to reduce a tariff, move products to the new 30-35% band if a higher rate is deemed necessary, or use safeguard measures if this is inadequate. While there is legal provision for safeguard measures in the EAC legal framework, this has yet to be operationalised with regulations and institutions (see trade remedies discussion in section 5.2). The immediate discontinuation of SOAs would therefore curtail national policy space, so appears unlikely in the near term (interview #54).

While SOAs allow countries to carve out national policy space by deviating from regional commitments, their use also often comes with negative impacts on market access and therefore economic policy space. A prominent example in the EAC T&A sector was in 2017 when Kenya requested and was granted a stay of application of EAC rules, to remove the limit on EPZ sales in the Kenyan market, on the condition that any goods sold in other EAC countries would attract the CET rate. Kenyan manufacturers oriented to the domestic market complained that this impacted their businesses negatively. Crucially from an industrial policy space perspective however, following the Kenyan SOA, Tanzanian and Ugandan authorities imposed the CET tariff on all imports of garments from Kenya, citing unfair competition and an inability to differentiate between goods produced inside and outside EPZs. Kenyan firms complained that they lost duty-free access to Tanzania and Uganda for up to 2 years, resulting in major loss of market share (interview #19).

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<sup>21</sup> Rwanda was the only country to use an SOA to reduce the input tariff burden of manufacturers, with sales in other EAC countries attracting CET rates in the same way as a national DR, with interviewees uncertain about why an SOA was preferable to a national DR in that case (interview #52).

### *Regional industrial strategies*

Regional integration within the EAC, especially the creation of shared institutions such as the EAC's Secretariat and Council of Ministers, should create political-institutional policy space for new kinds of shared cooperation in strategic policy areas. The EAC published its vision for transforming the region into an upper-middle income economy in 2016 (EAC Vision 2050) and the 5th EAC Development Strategy aims to implement the vision in the 2016-2021 period. EAC officials view the regional industrial policy towards T&A as defined by a combination of policy documents, directives by heads of states at EAC summits, and the various measures implemented to promote the sector (interview #53). A number of policy and strategy documents at the regional level set out the approach to key sectors in the EAC. In 2012 the EAC published industrialisation policy and strategy documents for the 2012-2032 period, which highlighted agro-processing as a priority sector and the T&A value chain as a component part, but did not provide a detailed sector plan (EAC, 2012).

In April 2019 a final version of the EAC's 'Regional Cotton, Textiles and Apparel Strategy and Implementation Roadmap' was circulated among stakeholders, having been drafted by a team of Nairobi-based consultants (EAC, 2019). Like the national policy documents of Kenya and Tanzania, it lists a large number of strategic objectives, programme areas and actions in support of all stages of the value chain but does not provide clear guidance on prioritisation, sources of funding, or implementation modalities. For example, the document calls for "harmonization" of electricity tariffs to US\$0.05 per kWh, based apparently on prevailing charges in Uganda, without detailing how this is to be achieved in countries like Tanzania and Kenya, where firms reported electricity costs being on average US\$0.10 and US\$0.17 per kWh respectively. The strategy document takes contradictory positions or no position at all on critical issues, such as the approach to backward integration in the region, calling for removal of all duties on all inputs and accessories while simultaneously calling for a 10% tariff on imported grey fabric and 25% on printed fabric.

The validation workshop for the draft strategy made recommendations for "quick wins" emerging from the strategy. These included a suggestion for an EAC "Fashion Friday" and "Buy East African" campaigns to promote consumption of clothes made in the region, an idea that arose in several policy interviews (interview #56). The validation workshop also proposed a verification mission to understand T&A manufacturing capacities in the region (information which could usefully have informed the strategy design at an earlier stage), the imposition of a US\$5/kg tariff on used clothes (the subject of longstanding controversy – see below) and featured familiar calls to address cotton supply and import undervaluation.

A key tension in the regional strategy document and validation meetings is the blurring between areas of competency reserved for nation states and EAC regional bodies, i.e. the issue of 'subsidiarity'. There are calls for regional action in areas that would typically be presumed to be the exclusive

competency of national authorities – such as over electricity prices. EAC officials acknowledged that despite the nominally regional strategy, the lack of implementation capabilities and resources in the chronically underfunded EAC Secretariat means that national authorities will be responsible for taking forward any regional policy initiatives (interviews #53, #55, #56). In practice therefore the political-institutional policy space created by regional cooperation within the EAC towards the T&A sector is effectively limited to coordination of national initiatives, and will remain so until such time as nation states transfer significant power and resources to regional institutions.

### *Used clothes*

Perhaps the most high-profile recent example of regional industrial strategy in the EAC T&A sector is in the area of used clothes, a case which illustrates the tensions between industrial policy space at the regional and global level. As part of efforts to promote the domestic textiles and clothing industry, in 2015 EAC heads of state announced their intention to stop imports of used clothes, and in 2016 the tariff was doubled. After complaints from USA-based used-clothing exporters, US officials began to exert pressure to reverse the tariff increase and threatened to remove AGOA trade preferences, eventually doing so in the case of Rwanda, while other countries complied. We argue that while coordination through the EAC created political-institutional policy space at the regional level to pursue import substitution, this was negated by a more binding constraint on policy space at the global level, i.e. the ability of a major trading partner to remove unilaterally granted preferential market access – i.e. economic policy space – underpinning employment and exports.

Since trade liberalisation in the 1980s and 90s, imports of used clothes (*mitumba* in Swahili) have exploded from almost nothing to nearly US\$350m in 2018. Used clothes provides low-income consumers in particular with unparalleled diversity of high quality garments at low prices, and many now make a living from sorting and trading them. Used clothes are consistently highlighted by firms and the media as a major factor in the decline of the domestic industry. This may be in part due to its greater visibility than other causes of industrial decline, having come alongside a change in consumer tastes from *kanga* and *kitenge* (K&K) fabrics to Western style clothing.

In February 2015 EAC leaders signalled their intention to phase out used clothes, confirming in March 2016 that this would take place over 3 years. For 2016-17, the specific duty rate on worn clothing increased from USD 0.20/kg to USD 0.40/Kg, so that the applicable rate was 35% or USD 0.40/Kg, whichever was higher (see Table 13 below). Officials report that an increase in the specific duty rate had been planned since 2013 because the difference between USD 0.20/kg and 35% had become too great due to inflation (interview #34). The tariff increase and phase out announcement were not therefore meant to be connected, however one of the main US exporters of used clothes to the EAC complained to the Office of the U.S. Trade Representative (USTR) and the new Trump administration responded by threatening to remove AGOA access if the tariff increase was not

reversed. After lengthy negotiations all EAC countries complied with US demands except Rwanda, who was removed from the list of countries eligible for the AGOA scheme.<sup>22</sup>

*Table 13: Applied tariffs on worn clothing in EAC countries (HS 6309.00.10)*

|          | 2012-16                  | 2016-17                  | 2017-18                  | 2018-19                  | 2019-20 | 2020-21 |  |
|----------|--------------------------|--------------------------|--------------------------|--------------------------|---------|---------|--|
| Rwanda   | 35% or<br>USD<br>0.20/kg | USD 2.5/Kg               |                          |                          |         |         |  |
| Kenya    |                          | 35% or<br>USD<br>0.40/Kg | 35% or USD 0.20/Kg       |                          |         |         |  |
| Tanzania |                          |                          | 35% or<br>USD<br>0.40/Kg | 35% or<br>USD<br>0.40/Kg | 35%*    |         |  |
| Uganda   |                          |                          |                          |                          |         |         |  |
| Burundi  |                          |                          |                          |                          |         |         |  |

Source: own elaboration based on EAC Gazettes. \*Tanzania, Uganda and Burundi switched to the 35% ad valorem rate in February 2018

Stopping used clothing imports was not seen as a panacea by industry stakeholders, but there were calls for more regulation. Although a visible symbol of the regional T&A industry’s decline, used clothes were recognised not to be the most important cause. Weak regional demand stemming from low income levels, low skill levels in the workforce, high costs, weak infrastructure etc. are seen as more important. Doubts were expressed about the advisability of pursuing an aggressive policy to phase out used clothes given their importance to consumers and small traders. Greater regulation of used clothing imports was generally seen as desirable, for example to deal with hygiene concerns (especially around imports of used underwear) by increasing restrictions in certain categories, or requiring imports to be grouped according to product type so as to increase costs to importers and create non-tariff barriers. A greater perceived problem than used clothes per se is the mis-declaration of new clothes as used for the purpose of reducing tax liability, a form of import undervaluation which largely falls under the purview of national policy (see above).

### **5.3.3. Global-level political-institutional policy space**

Global-level factors define the set of politically and institutionally feasible policy options for the EAC T&A sector. The dependent position of East Africa in the global political economy means EAC members are vulnerable to political developments in key export markets in the Global North, which affect trading arrangements. For instance AGOA offers major benefits to eligible beneficiaries because of the high value of rents available, but it comes at a price in terms of compliance with US demands on a host of political issues. In particular, to access AGOA countries must work towards “a market-based economy, the rule of law, the elimination of trade barriers, economic policies that reduce poverty, systems to combat corruption, and protection of workers’ rights” (Ismail, 2017: 6). The extension of AGOA from 2015 to 2025 strengthened conditions on US market access to beneficiaries; provided for the withdrawal of AOGA market access in case of non-compliance with

<sup>22</sup> Tanzania, Uganda and Burundi have now dropped the specific duty rate (\$0.4/kg) which is obsolete, being always less than 35% of value. Nevertheless EAC policymakers would prefer the \$0.4/kg rate since it is easier to implement, not requiring containers to be opened and the value of goods to be assessed.

US demands; and introduced out-of-cycle reviews of beneficiary eligibility at the discretion of the US President. Together these rules impose major restrictions on the industrial policy options of beneficiaries, particularly as the final arbiter of compliance with conditions are organs of the USA state. This was demonstrated by the case of used clothes, examined above, where the accession of Trump to the US Presidency, and his administration's willingness to support the complaints of the used clothes trading association, effectively ruled out the possibility of introducing greater restrictions on the import of used clothing in the EAC.

EAC countries rely on donor funding for many development projects, with donor priorities likely to influence project selection and design such that certain industrial policies are not supported. Around half the budget of the EAC institutions is funded by donors, meaning that the strategic priorities of the regional integration project are not directed solely by regional actors. Interviews with EAC officials reported that donors are mixed in their approaches, with some more willing to fund EAC priorities while others only finance areas of their own interest such as trade in services, competition policy and intellectual property rights (interview #54). This makes it more difficult for resource constrained regional institutions to finance ambitious industrial policy initiatives that aim to capture market share from TNCs located in donor countries in the global North. In Tanzania for example, donor financing of scoping studies built momentum towards the construction of an industrial park to house GVC-integrated production facilities owned by foreign TNCs (interview #35).

In the global T&A industry, a key axis of power is over labour standards which govern which kinds of production practices – and therefore industrial policy options – are permissible (Dallas et al, 2019). Multi-stakeholder initiatives (MSIs) bring together consumer groups, unions, NGOs and firms to agree principles and standards to be followed in factories, which must be implemented by suppliers in the global South. Interviews with firms revealed that a common social compliance schemes, WRAP (Worldwide Responsible Accredited Production), was falling out of favour since several firms were not required by their US buyers to maintain WRAP accreditation, although meeting the buyers' own codes of conduct through regular audits was seen as more demanding than WRAP (interviews #5, #6).

#### **5.4. Economic policy space**

The economic dimension of policy space captures how the organisation of economic systems of production and exchange in particular sectors make some policies viable and others not. Several aspects of economic policy space, especially market access arrangements, have been discussed already as these are integrally linked to legal and political-institutional dimensions of policy space through the design of trade agreements at the regional and global level. The low level of economic policy space in national markets is a motivating factor behind regional integration efforts. Productive complementarities between EAC countries in terms of T&A inputs and outputs suggests potential for

the EAC FTA to expand economic policy space, but this is realised only to a limited extent due to the limitations on intra-EAC trade imposed by the use of national DRs and SOAs already discussed.

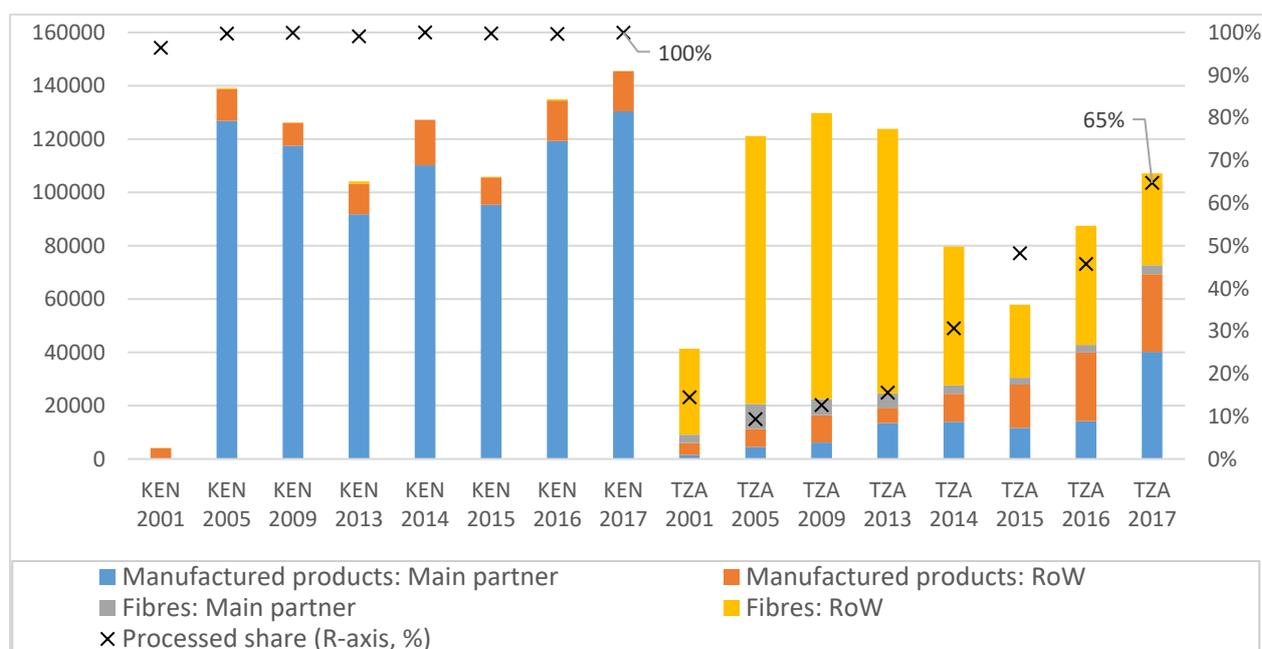
### 5.4.1. National-level economic policy space

The status of Kenya and Tanzania as LLMICs, with GDP per capita of between \$1000-2000 in 2019, means that the extent of the domestic market – and therefore national economic policy space – is limited, and the sustained growth of industries with economies of scale such as T&A depends on exports, which we examine next. We then draw on data from interviews to elucidate some of the main features and constraints of the local production system in each country.

#### *Productive capabilities for export*

Economic policy space in a sector is strongly affected by existing firm structures, capabilities and their knowledge of end markets, with export data suggesting competitiveness across the T&A value chain in Tanzania and Kenya. Figure 2 focuses on cotton-based exports, given the EAC’s production of this key input and the potential for RVC development. Kenya exports significant volumes of cotton-based apparel, overwhelmingly to the USA under AGOA. Tanzania exports cotton and cotton-based apparel to world markets but is also increasing its apparel exports to the region, especially South Africa via SADC. The share of manufactured goods in Tanzania’s T&A exports has steadily increased, to 65% in 2017, suggesting functional upgrading (i.e. moving from lower to higher value functions) from the export of raw cotton towards fabric and garment manufacture).

Figure 2: Kenyan and Tanzanian exports of cotton value chain products, selected years



Source: UN Comtrade and national statistical authorities via WITS and ITC/TradeMap.org. KEN = Kenya, TZA = Tanzania, RoW = Rest of World. Main partner for Kenya is USA and for Tanzania is Africa. Exports are in 1000 USD (left axis). Includes cotton fibre and predominantly cotton-fibre based products only. Manufactured

products are yarns, fabrics, articles and apparel. Processed share calculated as share of manufactured products in total exports (right axis).

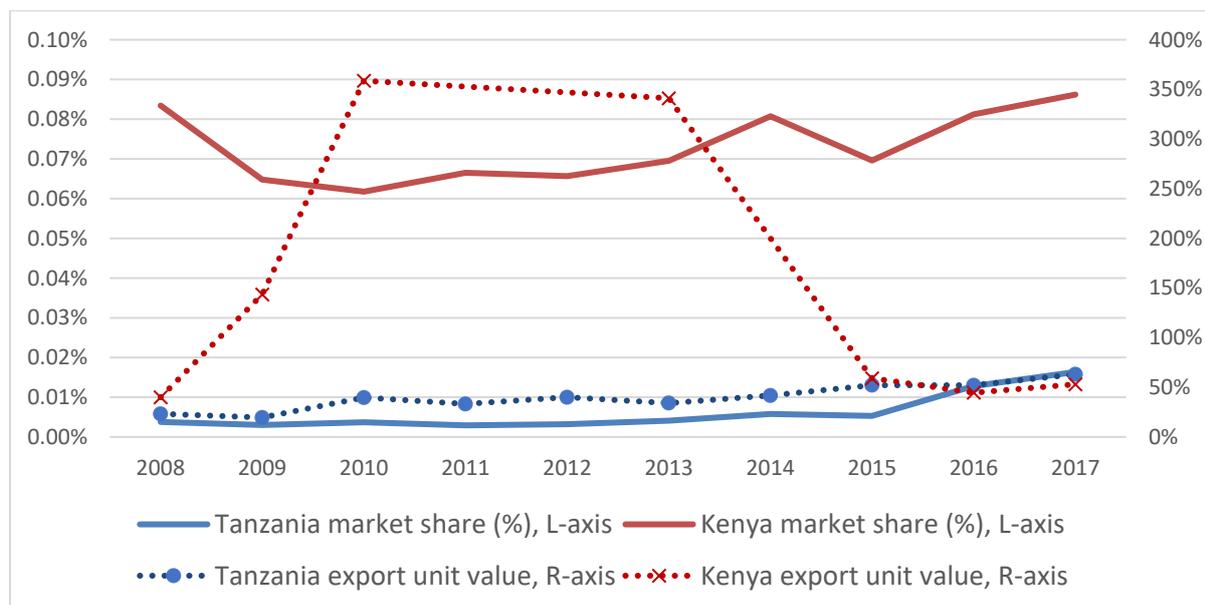
We now turn to unit values and market shares as indicators of export performance following Kaplinsky and Readman (2005) who argue that an increase in market share despite rising relative unit value indicates successful product upgrading, while failed product upgrading is suggested by rising prices not being offset by increasing quality, resulting in falling market share. Falling unit values alongside rising market share may signal process upgrading, however it could also be caused by falling producer incomes. Finally, falls in both unit values and market share is argued to suggest failed product and process upgrading. This type of analysis is subject to important restrictive assumptions<sup>23</sup> but can provide a useful initial overview of trends within a sector (UNIDO, 2012, 2015).

Figure 3 suggests that the unit values of Tanzania's (all-fibre) apparel exports relative to world export unit values have risen steadily, reaching a level slightly above those of Kenya, which dropped sharply between 2013 and 2015 before rising again between 2016 and 2017. Tanzania's market share of world apparel exports rose concurrently, suggesting that successful product upgrading occurred in recent years alongside engagement with regional markets. Kenya's overall fall in relative export unit values alongside a rise in world market share may indicate successful process upgrading, potentially linked to different incentives for producers exporting to the USA under AGOA. Although suggestive of broad trends, the high level of aggregation and wide range of products captured here limits the possible insights, so we turn next to more disaggregated analysis.

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<sup>23</sup> Several assumptions must be made. Firstly that one main product or type of product is captured by the analysis – otherwise what appears as rising unit values may in fact be due to withdrawal from lower value products. Secondly that changes in market share reflect costs as driven by process efficiency rather than input prices. Stable exchange rates and producer incomes are also assumed.

Figure 3: Kenya & Tanzania share of world exports and relative unit values of all-fibre apparel exports



Source: Comtrade via WITS; Comtrade and Kenya National Bureau of Statistics via ITC/Trademap.org. HS chapters 61 and 62, i.e. all-fibre apparel products. Kenya’s unit values only available for years shown. ‘Market shares’ is share of world exports (%) on left axis, relative export unit value on right axis (USD/kg, expressed as % of world unit values).

Table 14 presents analysis of Tanzania and Kenya’s top apparel exports to give greater insight into product-level upgrading trajectories.<sup>24</sup> Trade flows are ordered first by exporting country, then by trade value as reported by the exporter (not shown). The main end market for each exporter and product is listed in the next column, with most oriented to the USA except for two Tanzanian products exported primarily to South Africa. The UV column shows the relative unit value reported by the importing country in 2016, expressed as a share of China’s unit value for the same product sold to the same end market (1 indicates parity with Chinese unit values). The next column shows change in relative unit value over 2013-16 or the nearest available period, in percentage terms (100 indicates doubling). “Mkt sh. %” represents the exporter’s market share of the importer’s total imports of that product (100 indicates entire market) in the latest available year, 2017. The next column shows change in market share from 2013-17, or the closest available period, in percentage terms (i.e. 100 indicates doubling). The final column in the table points to potential interpretations of the relative unit value and market share trends, following Kaplinsky and Readman (2005).

<sup>24</sup> Table 14 lists apparel products (both cotton and non-cotton) that appear in the top 10 of exports reported by Kenya and Tanzania *and* the top 10 imports from Kenya and Tanzania as reported by trading partners (i.e. mirror data), on average over the 2015-17 period (due to errors and different classifications of the same goods by exporting and importing countries, reported exports and their “mirror” - reported imports - do not always match). The only exception is Kenya’s exports of HS 610910 (cotton t-shirts), which ranks around 15th but is included to enable comparison with Tanzania’s exports of the same product. The 4 products included for Tanzania represent 57-71% of apparel exports (i.e. HS chapters 61 and 62) based on reported and mirror data respectively, while those included for Kenya represent 50-54% of apparel exports.

Table 14: Kenya and Tanzania apparel export unit values, market shares and upgrading outcomes

| Expo-rtter | Product                     | End mkt | UV  | UV %Δ | Mkt sh. % | Mkt sh. %Δ | Up/downgrading outcome   |
|------------|-----------------------------|---------|-----|-------|-----------|------------|--------------------------|
| TZA        | 620342 M/b trousers...(c)   | USA     | 1.0 | 92    | 0.3       | 37286      | Product upgrading        |
| TZA        | 610990 T-shirts... (nc)     | USA     | 1.3 | 147   | 0.9       | 117        | Product upgrading        |
| TZA        | 610910 T-shirts... (c).     | ZAF     | 1.2 | 24    | 2.8       | 162        | Product upgrading        |
| TZA        | 610510 M/b shirts... (c)    | ZAF     | 0.9 | 8     | 3.1       | 99         | Product upgrading        |
| KEN        | 620342 M/b trousers... (c)  | USA     | 1.3 | 11    | 1.4       | 168        | Product upgrading        |
| KEN        | 620462 W/g trousers... (c)  | USA     | 1.3 | 8     | 0.8       | -32        | Failed product upgrading |
| KEN        | 620463 W/g trousers... (nc) | USA     | 1.1 | 12    | 2.9       | 40         | Product upgrading        |
| KEN        | 610990 T-shirts... (nc)     | USA     | 1.8 | 32    | 0.2       | -80        | Failed product upgrading |
| KEN        | 611030 Jerseys... (nc)      | USA     | 1.3 | 12    | 0.8       | -0.4       | Failed product upgrading |
| KEN        | 610910 T-shirts... (c)      | USA     | 1.4 | 15    | 0.2       | 22         | Product upgrading        |

NB: TZA: Tanzania, KEN: Kenya, ZAF: South Africa, USA: United States of America. Cotton based products marked (c); (nc) = non-cotton; M/b = Men's/boys'; W/g = Women's/girls'; codes beginning 61 are knitted or crocheted, those beginning 62 are not. Source: CEPII TUV database for unit values; Comtrade via ITC/Trademap.org for market shares.

Across all products included, results for Tanzania suggest successful product upgrading, while for Kenya falling market shares and rising unit prices suggest failed product upgrading in half of the cases. When comparing exports of the same products (620342, cotton trousers and 610990, non-cotton t-shirts) to the same market (USA), Tanzania shows lower unit values than Kenya in each case, suggesting either lower quality products or lower cost production. The fact that Kenya is losing market share in one of these products (610990) may suggest the latter, i.e. Tanzania's higher competitiveness, at least for that product. For one product (610910, cotton t-shirts) we can compare exports to different end markets, and again it appears that Tanzania's exports to South Africa are either of lower quality or produced at a lower cost, due to the lower unit value than for Kenya's exports to the USA. In any case, Tanzania's market share in South Africa is growing faster than Kenya's in the USA, suggesting more successful product upgrading. Looking at Tanzania alone, the unit values and market shares of products exported to the USA appear to be rising faster than those for products exported to South Africa, suggesting a higher degree of product upgrading for the American market.

Comparison of product and sector-level results points to the need for detailed firm-level research on upgrading. For Kenya, the product level data shows rising unit values in all cases, appearing to contradict the sector data presented in Figure 3 which showed unit prices decreasing from 2013 to 2016. This may be a result of the different data sources used in each case (Comtrade and US data via CEPII respectively) or the different comparator for relative unit values (the world and China), but in any case points to the need for further research. For Tanzania, the two data exercises point in the same direction, to rising relative unit prices and market shares. However the fact that product level data suggested higher degrees of upgrading for the US market than for South Africa does not appear to give support to the earlier hypothesis (from Figure 2) that Tanzania's upgrading success was driven by engagement with regional markets. Again, more detailed research at the national and firm level is

needed to build a clearer picture of industrial upgrading and outcomes, which is presented in Chapter 6. To complement the initial analysis of productive outcomes in terms of export performance in this section, the following sub-sections give a broad overview of the local production system characteristics as identified by firms during interviews. More detail on the local production system in each country is given in later chapters, particularly the background and capabilities of firms in Chapter 6 and the key policy rents in Chapter 7.

#### *Local production system overview - Tanzania*

Table 11 (National policy issues in Tanzania) above showed that insufficient demand was highlighted by all the domestic market oriented firms as a major constraint to their business. This relates not only to the unfair import competition already discussed but the low level of domestic demand, especially for traditional fabrics like *kanga* and *kitenge* (K&K), where consumption was said to be at half the level it was two decades ago as tastes shift towards western style clothing. This justifies the categorisation of K&K as a ‘sunset’ industry by policymakers, with state efforts viewed as necessary to support factories to diversify in line with market trends, e.g. towards garments and other textile products (interview #36).

A number of domestic issues were raised regardless of end market orientation, particularly around the supply of skilled workers. This was in relation to the great difficulties experienced by firms wishing to bring in skilled foreign workers, but also the low skill levels of Tanzanian workers. Firms also complained of high labour turnover and absenteeism negatively affecting capacity utilisation and productivity (interview #6, #7). The high cost of production was another point of agreement among firms, linked to the cost and reliability of electricity supply (especially for vertically integrated firms) as well as weak infrastructure and the high cost of finance. Although it was agreed that the reliability of electricity supply had improved, issues with surges and power cuts remain and cost (at US\$0.10/kWh) compares unfavourably to others in the region such as Ethiopia (at US\$0.05/kWh).

The unavailability of affordable finance (with commercial loans costing 15-18% in interest per year) was highlighted as a constraint on new investment, with frequent calls for subsidised loans to promote investment. Others expressed interest in joint ventures with foreign investors as a source of capital but also knowledge, which could be a focus for investment promotion efforts by government (e.g. interview #2).

#### *Local production system overview- Kenya*

Table 12 (National policy issues in Kenya) above showed that political-institutional factors with a strong economic dimension ranked high on the challenges facing Kenyan firms, especially electricity, finance and infrastructure. The cost of finance was viewed as too high, at around 9% for USD loans

(interview #9). Infrastructure quality was seen to negatively impact competitiveness, particularly transportation between Mombasa and Nairobi.

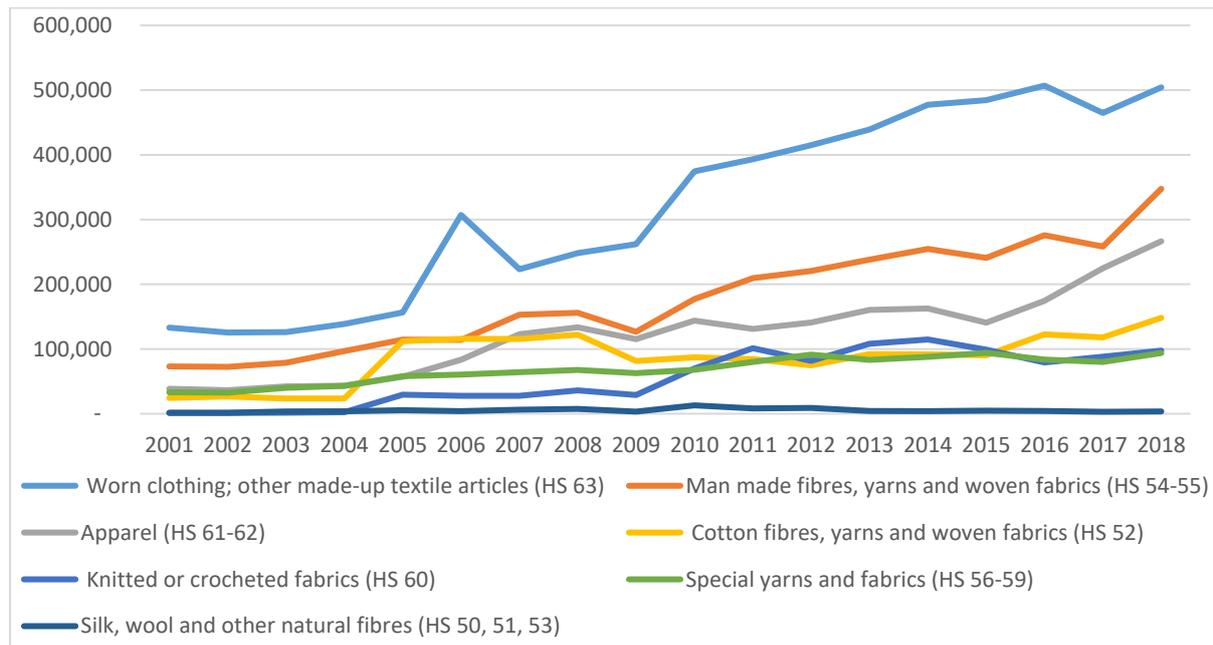
Among GVC-oriented firms, electricity was also raised as an issue but as garment manufacturers the nature of their cost structure meant more emphasis was placed on labour cost, particularly unforeseen minimum wage increases in recent years. More generally there was disappointment in national policymaking which was seen as unpredictable and lacking in consultation or dialogue with the private sector.

As mentioned above, interviews with Kenyan policymakers on government priorities for T&A revealed a focus on building an integrated domestic value chain from cotton to clothing. This is despite Kenya's current low levels of production of cotton, and the clear opportunities at the regional level to import cotton lint from neighbouring Tanzania and Uganda. The opportunities of RVCs were acknowledged, but they were seen as a necessity in the short term due to lack of Kenyan cotton production, with NVC development a more desirable end goal.

#### **5.4.2. Regional-level economic policy space**

Countries in the region have made strong commitments to industrialisation and to the development of the T&A sector in particular, with the presence of complementarities in productive structures at the regional level (USAID, 2014). Figure 2 showed the presence of cotton fibre exports alongside cotton-based apparel manufacture for export, suggesting potential for RVC development and contributing to the selection of this sector as a case study in this research. Figure 4 shows the growing expenditure in the EAC on imported T&A products, further supporting the suggestion that strategic support for regional production could build on complementarities between countries and meet some of this demand.

Figure 4: EAC imports from world, HS 50-63, thousand USD



Source: Trademap.org. Figures for Rwanda in 2017 and 2018 are partner reported ('mirror') data.

Interviewees agreed that complementarities are important for the success of regional integration, but there was scepticism about the quality of economic policy space created within the EAC, particularly given its vulnerability to political interference. Given productive structures and complementarities observed at the national level, EAC officials suggested that regional value chains should capitalise on Tanzania and Uganda's strengths in the production of cotton, while Kenya and Tanzania build their existing capabilities in manufacturing (interviews #53, #55). At the national level however, policy respondents were unwilling to accept their country being confined to existing specialisation patterns. This would be expected where countries are currently focused on relatively low-value agricultural production for export, but Kenyan officials were even unwilling to accept their country focusing on high-value manufacturing segments of a regional value chain, insisting that Kenya will also invest in increasing its cotton production (interviews #38, #41). This was partly due to their view of the supply of raw materials from regional markets as unreliable due to the ongoing trade disputes between EAC member states, but also to benefit politically important agricultural producers who, it is hoped, will profit from greater local demand for cotton.

In the presence of multiple value chains, a key issue is the nature of buyers in domestic, regional and global markets and their respective requirements of suppliers. The literature suggests that regional buyers, particularly South African retailers, have similar standards around product quality, lead times, cost etc. to global buyers, but impose fewer requirements related to social compliance accreditation (Staritz, 2011; Morris et al. 2016). To test this, questions were put to firms around the requirements of buyers from different end markets, but strong conclusions cannot be drawn from the responses for a number of reasons. Few Kenyan and Tanzanian firms had direct experience of South African buyers

(due to Kenya not being in SADC and the small number of RVC firms in Tanzania). Furthermore the main regional markets for Tanzania are richer neighbours Kenya and South Africa, while for Kenyan firms the most easily accessible regional markets (in the EAC and COMESA) have lower levels of income per capita than Kenya itself. In Tanzania, only a few firms have direct experience of both South African, other regional and global markets. With limited evidence, from only a few buyers in a certain country, it is difficult to generalise about buyers in that country as a whole, since different buyers target different market segments and requirements of suppliers vary as a result.

When comparing buyers from the region and the rest of the world, there were mixed views from respondents but global buyers appear more demanding on quality than those from Eastern and Southern Africa. Firms with limited experience of one or the other opined that buyer demands are broadly the same regardless of nationality, pointing to the ability of both regional and global buyers to source from internationally competitive suppliers around the world (e.g. China, Bangladesh, Vietnam, Cambodia etc.). While this may be the case in general, a more nuanced view was forthcoming from the more experienced suppliers questioned. On product quality, a Tanzanian firm with current experience of a range of regional and global buyers ranked them by how demanding they were (interview #5). Tanzanian buyers had the lowest quality standards followed by those from Kenya, then South Africa, the US and finally Japan, whose buyers were the most demanding. Being in the process of upgrading from serving South African to US buyers, the firm could reliably assert that the latter were more demanding on product quality and demonstrate that regional markets can serve as stepping stones to global markets.

On price, the same Tanzanian firm reported South African buyers to be more forgiving than US counterparts. This is partly because the South African tariff on imported clothing is higher than that of the US, imposing a median 45% duty on imported clothing, after an increase across most categories from 40% in 2009. As a result, South African buyers are willing to pay more to source duty free within SADC compared to importing from more competitive suppliers like China where the 45% tariff is due, since landed cost from SADC countries (e.g. Tanzania) is still lower.

On order size, US buyers reportedly place the biggest orders, which to some extent offsets the unfavourable prices they insist on. US buyers also require evidence of compliance with particular social, safety and environmental standards, unlike South African buyers. Overall, South African buyers were seen as more demanding than those from East African countries, but less so than US buyers.

No firms surveyed were exporting to the EU market in significant quantities. However the interview with a brand sourcing manager for East Africa along with other sources suggest similarities between South African and European buyers, both demanding of their suppliers short runs of more fashionable products with short lead times (interview #64; Staritz, 2011; Pickles et al, 2015). The emergence of

Ethiopia as a T&A powerhouse in the East African region raises the possibility of industrial strategies that seek to build supply linkages with manufacturers based in Ethiopia. Several firms reported being interested in supplying fabric to apparel exporters based there.

### **5.4.3. Global-level economic policy space**

The global T&A industry has undergone a series of transformations over time, with major implications for the economic policy space of countries seeking to industrialise through participation in export markets. We do not attempt a full analysis of the economic context of the global T&A industry, but outline some of the most important factors that define the economically feasible industrial policy options for EAC countries.

The T&A industry – and apparel in particular – has historically been a first step on the pathway to industrialisation because it is a labour-intensive sector with relatively simple technologies and low barriers to entry (Gereffi, 1999). The fragmentation of international production into global value chains (GVCs) facilitated production for export, with Export Processing Zones and FDI incentives commonly used to attract manufacturers to locate in LICs (Whittaker et al, 2020). The T&A industry was early to exploit these mechanisms, adopting flexible strategies to reduce costs by locating production in LMICs, whose share of global clothing exports increased from 25% in the 1960s to 80% in 2013 (Pickles et al, 2015). Global trade policy has been a key driver of change in the T&A industry, with the Multi-Fibre Arrangement (MFA) quota system resulting in production relocation to LMICs from 1975 onwards. The phase-out of the MFA from 2005 reduced incentives to maintain production in the least competitive geographies to the benefit of more efficient Asian producers, with China in particular becoming the leading exporting country, its share of global apparel exports increasing from 26% in 2002 to 43% in 2010 (Frederick and Daly, 2019). The EU 27 and USA remain the biggest end markets, making up 43% and 20% respectively of global clothing imports in 2019, compared to only 2% for the African continent and 0.4% for South Africa (UN Comtrade).

T&A is still viewed by policymakers as having strong developmental potential to rapidly create employment, earn foreign exchange, and build linkages to upstream sectors such as textiles and cotton production. However, a number of recent developments call into question the possibility of building on participation in GVCs to achieve broad based development. Firstly, the high level of competition between countries already exporting apparel results in difficulties for newcomers to establish market share, with China being a major source of competitive pressure. Second, the reservation of higher value design and branding value chain functions for buyers and first tier suppliers in high and middle income countries relegates LIC firms to lower value apparel assembly activities, with functional upgrading difficult to achieve. Third, extreme asymmetries in market power allows buyers and first tier suppliers to squeeze LIC supplier margins while placing increasing demands in terms of quality, lead times and labour standards (Milberg and Winkler, 2013; Whitfield et al, 2020a).

## 5.5. Discussion and conclusions

This section draws conclusions from the application of the analytical framework to industrial policy space in the EAC T&A sector. First, despite blanket assertions in the literature that ‘South-South’ regional trade and cooperation initiatives have minimal impact on policy space (Thrasher and Gallagher, 2010; Chang et al, 2016), the range of impacts identified in this chapter shows the need for detailed contextual analysis of specific arrangements. Second, it is important to differentiate between factors shaping industrial policy space at the national, regional and global level to identify trade-offs, since positive developments in one area can be offset by unfavourable conditions in another, as seen most clearly in the case of used clothes. Third, it is necessary to consider the legal, economic, and political-institutional dimensions of industrial policy space, such that an assessment of a trade agreement’s impact on industrial policy space takes into account at least (a) any loss of legal policy instruments (e.g. to restrict trade from partners to the agreement), (b) any increase in market access or potential investment for key economic sectors and (c) any changes to the relevant national/regional political settlements affecting specific sectors and the capabilities of the institutions implementing and enforcing policies.

In our analysis of industrial policy space in the EAC T&A sector we identified strong interactions and tensions between the national and regional dimensions of policy space, with much of the control of trade policy – nominally transferred to the EAC through the creation of a customs union – in fact retained by national authorities through the use of duty remission and SOA. As a result, the expansion of economic policy space – which is a major motivation of regional integration in the first place – is undermined because of the potential for unilaterally granted DRs and SOA to rule out duty-free sale in other EAC countries, reducing investor confidence in the integrity of the regional market. The correlation between SOA and NTBs highlighted in interviews (e.g. #54) is well illustrated by the case of Kenya’s SOA to permit firms in EPZs to sell more output in Kenya, to which Tanzania and Uganda responded by banning all duty free T&A imports from Kenya, harming the interests of non-EPZ firms in Kenya and damaging trust in regional value chain development.

Tension in the relations between dimensions of policy space was also evident at the regional and global levels, with regional cooperation expanding political-institutional policy space by providing mechanisms for industrial policymaking at the supra-national level, especially the proposal of a coordinated phase-out of used clothing imports in the EAC. However the regional proposal was not implemented by most countries because of industrial policy space constraints at the global level, namely the ability of the US to threaten the removal of unilateral trade preferences underpinning thousands of jobs and the entire model of export-oriented light manufacturing in EPZs. For Kenya and Tanzania the loss of this economic policy space at the global level was considered to outweigh the

benefits of the economic policy space to be created by phasing out used clothing imports, resulting in non-implementation.

The findings have important implications for the EAC's regional integration strategy. Current plans are for the EAC to become a monetary union with a single currency by 2024. The unwillingness of EAC member states to give up national policy space in the area of trade policy should call into question attempts to rapidly harmonise monetary policies across the region without building in flexibilities. In general regional integration initiatives should take into account political realities, particularly the accountability mechanisms and rent distribution systems which remain largely contained within national borders.

## **6. EAC T&A firm upgrading outcomes in national, regional and global value chains**

### **6.1. Introduction**

This chapter explores whether regional value chains (RVCs) offer comparable prospects for industrial upgrading to global value chains (GVCs) and national value chains (NVCs), based on a case study of the East African Community (EAC) textiles and apparel (T&A) sector. We present the results of a firm survey carried out in Tanzania and Kenya in 2019 which asked firms about the functions performed and upgrading outcomes achieved in national, regional and global value chains.

In presenting the survey findings, this chapter introduces the concept of ‘value chain directionality’ and argues that it should be considered independently from other aspects of governance (such as ownership, embeddedness etc.) in assessing drivers of firm outcomes. Amsden (1986) identified that the direction of trade or ‘trade directionality’ matters, i.e. the destination of exports is an important factor underlying processes of structural transformation in late industrialisers, with greater ‘learning effects’ expected from South-South trade. Updating this concept for the contemporary era of globalised production characterised by a shift from GVCs to RVCs and NVCs (Horner and Nadvi, 2018), we find that value chain directionality, i.e. orientation to different value chains (which capture input sourcing as well as end markets for finished products), has distinct but similarly important implications for development strategies and outcomes.

The next section presents the concept of value chain directionality and related literature for the T&A sector in more depth, after which the results of the firm survey are described and analysed. Survey results are organised primarily by upgrading type – end market, functional, product and process – to allow an ongoing comparison of outcomes across NVCs, RVCs and GVCs and therefore explore the importance of value chain directionality. It is argued that although value chain directionality intersects with other aspects of value chain governance, such an analysis brings new insights to bear on why firms pursue the upgrading strategies observed.

### **6.2. Value chain directionality in T&A**

This section situates the concept of value chain directionality in historical debates around the direction of trade, and elaborates some of the key mechanisms by which integration into different value chains has implications for industrial outcomes and policy. Debates about the developmental value of trade with different partners is related to foundational questions in economics around the benefits of trading different products, and whether the real ‘engine of growth’ is trade or industry. While Ricardian classical and neoclassical economists are largely commodity blind (indifferent about exporting ‘potato

chips or computer chips'), dependency theorists highlighted the deterioration of the terms of trade of ex-colonies in the global periphery with respect to advanced capitalist countries, linked to their specialisation in the production of primary commodities and manufactured goods respectively, and the need for industrialisation in the periphery (Singer, 1950; ECLAC, 1950; Prebisch, 1959). These arguments along with the global recession in the mid-1970s led to an increased policy focus on the potential benefits of "South-South" cooperation and especially trade between LDCs, since this is more likely to be composed of manufactures, instead of the South relying on primary commodity exports to the global North (Lewis, 1980; Havrylyshyn, 1987).

Arguments for the benefits of South-South trade depend on the product composition of exports, and the extent to which they allow for learning, skill development and growth in technological and organisational capabilities. In the 1980s these debates took place between neoclassical researchers at the World Bank on one side and 'developmentalist' scholars like Alice Amsden and Sanjaya Lall on the other (Havrylyshyn, 1987, Amsden, 1986). They generally agreed that South-South trade was more capital intensive than South-North trade (which consisted mainly of raw materials) but differed in their interpretations of this – neoclassicals worried that this was an inefficient result of misguided import substitution policies, while developmentalists saw potential for gains from dynamic comparative advantage. In particular, Amsden (1986) highlighted the importance of South-South trade – particularly exports by the NICs to other Southern countries – being more *skill-intensive* than South-North trade, which is critical since skill-intensive activities offer dynamic gains through 'learning effects', i.e. the tacit skills and knowledge that can only be acquired through the production process itself (also known as technological and organisational capabilities).

Although the product composition of exports underpins the significance of trade directionality, this is itself a function of the scale and nature of demand in different markets. Section 2.3 discussed how overseas exports expand the 'extent of the market' and the potential for increasing returns, while section 4.2.3 highlighted how the shift in global demand dynamism from North to South in recent decades may result in greater demand for cheaper, undifferentiated goods with generally lower quality standards (Kaplinsky, 2010; Kaplinsky & Farooki, 2010). However, more recent work on the new geography of global trade points to the need for in-depth research in particular sectors to investigate how the context of multiple overlapping value chains impacts developmental prospects (Horner and Nadvi, 2018).

When analysing a specific sector – as is the case in this research on T&A – it is possible to examine products across the value chain to assess whether their production is more skill, capital or labour intensive. This can be combined with information about the directionality of imports and exports to arrive at an overall view of prospects for upgrading and development. Textiles is generally viewed as a capital and skill-intensive sector, while apparel is more labour intensive with skill-intensity

increasing through the functional upgrading trajectory from garment assembly (CMT) to the addition of input sourcing (full package/FOB), design (ODM) etc (Staritz et al, 2017). It is well documented that T&A firms often fulfil different value chain functions – with differing levels of skill intensity – for different end markets (Bazan and Navas-Alemán, 2004; Pickles et al 2006). Furthermore, across sectors there is evidence of the significance of input origin for productive outcomes, with imports from other LLMICs contributing to greater diversity of manufactured exports (Amighini and Sanfilippo, 2014). This suggests the need for analytical attention not only ‘forwards’ in value chains (i.e. sales of finished products in end markets) but also ‘backwards’, capturing how the procurement of inputs in from different sources affects upgrading outcomes.

These considerations point to the need to look beyond trade directionality – with its emphasis on the destination of a country’s exports – to value chain directionality, which captures inputs and outputs and is more suited to the contemporary era characterised by globalised production and the tendency for firms to engage in different value chains simultaneously and over time. This chapter argues that the value chain directionality of firms has important implications for their learning, upgrading outcomes and capability development, and can be analysed independently from other firm characteristics such as age, embeddedness and ownership. Table 15 shows a simplified schema of some possible value chains types according to the main source markets for inputs and the main end markets for finished products. In the following discussion we categorise firms as oriented to NVCs, RVCs and GVCs based on their core business strategy.<sup>25</sup>

*Table 15: Value chain categorisation by input and output markets*

|                          |          | End market for outputs |          |        |
|--------------------------|----------|------------------------|----------|--------|
|                          |          | National               | Regional | Global |
| Source market for inputs | National | N-NVC                  | N-RVC    | N-GVC  |
|                          | Regional | R-NVC                  | R-RVC    | R-GVC  |
|                          | Global   | G-NVC                  | G-RVC    | G-GVC  |

Author elaboration

Existing evidence from the T&A sector suggests that value chain directionality – i.e. orientation to different value chains – has significant implications for learning effects and upgrading outcomes. Studies of apparel GVCs have long found different end markets in the global North to offer distinct upgrading opportunities (Palpacuer et al. 2005), but this chapter contributes to the emerging literature on the implications for structural transformation of value chain regionalisation in the South (Morris et al., 2016). The firm survey was designed to address two main issues in value chain research,

<sup>25</sup> In most cases firms defined their strategies principally based on their end market orientation, since changing sources of inputs is generally easier than finding new end markets.

especially in the T&A sector of SSA. Studies generally focus on exporting firms despite the fact that domestic markets/NVCs in other regions have been shown to support higher value functions and capital accumulation (Bazan and Navas-Alemán, 2004; Pickles et al 2006). Also, GVC studies in particular tend to study firm engagement in a single value chain type for one end market, without accounting for firm engagement with multiple value chains and end markets simultaneously (Navas-Alemán, 2011).

The apparel sector in Africa has typically been seen through a GVC lens – as a platform for mainly Asian firms to gain DFQF access to US and EU markets – with NVCs and RVCs neglected. A recent research project on technological capabilities in Ethiopia’s apparel sector focused exclusively on exporting firms despite the significant domestic market there (Staritz and Whitfield 2018). The EAC has made major progress in regional integration, yet no studies have looked at the importance of regional value chains for T&A manufacturers there. Research has also not explored whether African T&A firms engage in multiple value chains simultaneously, or the extent to which the domestic market can provide an impetus for upgrading. For instance Phelps et al (2009) carried out a survey of firms operating in Kenyan EPZs and unsurprisingly came to the conclusion that “the industry is essentially... export-oriented”, apparently without interviewing any non-EPZ firms serving the domestic or regional markets.

T&A RVCs within SSA have received little direct attention, but Morris and co-authors have conducted several studies of exporting firms in the main SSA apparel producing countries, comparing how regional investors compare to transnational and indigenous investors in terms of value chain governance and upgrading outcomes (Morris et al 2016). Although their work is not explicitly focused on RVCs since investor nationality does not always correlate with end market served, in case where regional investors serve regional end markets their research output provides insights into SSA T&A RVCs. For manufacturers in Lesotho and Swaziland, slightly improved upgrading outcomes were found among firms oriented to the South African market compared to those exporting to the USA, mediated by ownership characteristics and the extent of ‘embeddedness’ of investors (Morris et al. 2011; Morris et al. 2016; Morris and Staritz 2017, 2014).

### **6.3. Description of survey results**

Tanzania and Kenya were the focus of the survey as the two EAC countries with by far the most developed T&A sectors, together accounting for almost all the region’s exports of apparel products. All eight large T&A firms operating in Tanzania in 2019 were surveyed, an approach chosen because of the overwhelming preponderance of the largest firms, with the eight T&A firms employing over 500 employees in 2013 contributing nearly two-thirds of sector value added and 70% of employment (Boys and Andreoni, 2020). There were around 19 large T&A firms operating in Kenya in 2019, of

which 11 were selected to be surveyed. The sample in Kenya was chosen so as to be representative of the population of large T&A firms (in terms of their value chain directionality, ownership, functional range etc.) and also based on the availability of managers during the fieldwork and responsiveness to enquiries. Most of the large Kenyan firms not surveyed were foreign owned CMT-focused apparel manufacturers operating in EPZs, a group which was anyway well represented in the survey.<sup>26</sup> Several Tanzanian and Kenyan ‘firms’ in our sample consist of multiple legal entities across different factories and sites, but are managed as an integrated business so considered as single firms for our purposes.

Table 16 presents the survey data, listing firms according to their value chain directionality, i.e. their engagement with domestic/national, regional and global markets and value chains (NVCs, RVCs and GVCs). To categorise firms in this way we draw on data about their input sourcing and output sales by end market, along with qualitative data about firm history and strategy. Firms 1-5 are overwhelmingly oriented to domestic markets for both inputs and outputs, so are labelled ‘NVC firms’. Although Firms 6 and 7 source relatively few inputs and sell only one quarter outputs regionally, they both re-oriented their exports from global to regional markets so the latter are crucial to their strategy and we denominate them ‘RVC firms’. Regional sourcing and/or sales are also essential to the strategies of Firms 8-11, so these naturally fall into the same group. Firms 12-19 can be straightforwardly termed ‘GVC firms’ due to their global market orientation for inputs and outputs. Functions are listed in approximately according to their sequential order in the production process.

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<sup>26</sup> Of the eight large Kenyan firms not surveyed, six were foreign owned CMT apparel manufacturers in EPZs, one was a locally owned CMT manufacturer in an EPZ and one was a locally owned vertically integrated firm.

Table 16: Firm characteristics, value chain directionality, functions and outcomes

| General characteristics |         |           |             |     | Input sourcing by market |          |        | Backward integration functions |           |            | Apparel and fabric value chain functions by end market |        |              |              |       |            |      |       | Outcomes and products |           |            | Sales by market (%) |          |          | Up/ downgrade outcomes |          |         |         |        |
|-------------------------|---------|-----------|-------------|-----|--------------------------|----------|--------|--------------------------------|-----------|------------|--|--------|--------------|--------------|-------|------------|------|-------|-----------------------|-----------|------------|---------------------|----------|----------|------------------------|----------|---------|---------|--------|
| ID                      | Country | Ownership | Decade est. | EPZ | National                 | Regional | Global | Spin                           | Knit/fin. | Weave/fin. | Design   | Sample | Input source | Cut/sew/fin. | Print | Embroidery | Wash | Brand | Distribution          | Employees | Cap. Ut' n | Product groups      | National | Regional | Global                 | Function | Product | Process | Market |
| 1                       | T       | L         | 1960s       | -   | C                        | -        | D      | NR                             | -         | N          | N  | N      | N            | -            | N     | -          | N    | N     | N                     | 500       | 35         | Fp Y                | 96       | 4        | -                      | -        | -       | ↑       | ↑      |
| 2                       | K       | Lg        | 1950s       | -   | C                        | C        | Ys T   | NR                             | NR        | NR         | NR   | NR     | NR           | NR           | NR    | NR         | NR   | NR    | N                     | 1765      | 70         | Fp A Y              | 90       | 5        | 5                      | -        | -       | ↑       | -      |
| 3                       | K       | L         | 1950s       | -   | C                        | C Ys     | Ys     | NR                             | -         | NR         | NR   | NR     | NR           | -            | NR    | -          | NR   | NR    | -                     | 650       | 60         | Fp                  | 90       | 10       | -                      | -        | -       | ↑       | -      |
| 4                       | T       | Lg        | 1980s       | -   | C                        | -        | Ys     | NRG                            | N         | NR         | NR   | NR     | NR           | N            | NR    | -          | N    | N     | N                     | 2600      | 70         | Fp Fi A             | 85       | 14       | 1                      | ↑        | -       | -       | -      |
| 5                       | K       | L         | 1970s       | -   | -                        | -        | Ys S   | NR                             | NR        | NR         | NR   | NR     | NR           | NR           | NR    | NR         | -    | NR    | -                     | 1530      | 85         | Fp A Y              | 80       | 20       | -                      | -        | -       | ↑       | -      |
| 6                       | K       | L         | 1970s       | -   | Yc                       | Yc       | Ys D   | -                              | NR        | -          | -  | -      | NR           | -            | -     | -          | -    | NR    | -                     | 200       | 75         | Fp                  | 75       | 25       | -                      | ↓        | -       | ↑       | ↓      |
| 7                       | K       | L         | 1970s       | -   | Yc                       | -        | Ys     | -                              | NRG       | NRG        | NR   | NRG    | NRG          | NRG          | NRG   | NRG        | NRG  | NR    | -                     | 425       | 40         | A                   | 70       | 27       | 2                      | -        | -       | ↑       | ↓      |
| 8                       | K       | L-P       | 1970s       | -   | C                        | C        | S      | NR                             | -         | NR         | NR   | NR     | NR           | N            | NR    | NR         | NR   | NR    | -                     | 700       | 30         | Fp Fi Y A           | 60       | 40       | -                      | -        | -       | ↑       | -      |
| 9                       | T       | Lg        | 1960s       | -   | C                        | -        | D      | NR                             | -         | NR         | NR   | NR     | NR           | -            | NR    | NR         | NR   | NR    | N                     | 1900      | 42         | Fp                  | 60       | 40       | -                      | -        | -       | ↑       | -      |
| 10                      | T       | Lg        | 1960s       | -   | -                        | Y        | Y T    | -                              | NRG       | -          | N  | NRG    | NRG          | NRG          | NRG   | NRG        | -    | N     | -                     | 1200      | 60         | A                   | 50       | 50       | 1                      | -        | -       | ↑       | ↑      |
| 11                      | T       | L         | 1960s       | -   | C                        | C        | Y T    | NRG                            | NRG       | NR         | NG   | NRG    | NRG          | NRG          | NR    | NRG        | N    | NG    | N                     | 2500      | 100        | A Fp Fi Y           | 25       | 71       | 4                      | -        | -       | -       | -      |
| 12                      | K       | L         | 2010s       | ✓   | -                        | -        | All    | -                              | -         | -          | -  | NG     | NG           | NG           | NG    | NG         | -    | -     | -                     | 320       | 75         | A                   | 10       | -        | 90                     | ↑        | ↑       | ↑       | ↑      |
| 13                      | T       | Fc        | 2010s       | ✓   | C                        | -        | -      | G                              | -         | -          | -  | -      | G            | -            | -     | -          | -    | -     | -                     | 150       | 50         | Y                   | -        | -        | 100                    | -        | -       | -       | -      |
| 14                      | T       | Fc        | 2010s       | ✓   | P                        | -        | FT     | -                              | -         | -          | -  | G      | -            | G            | -     | G          | G    | -     | -                     | 2560      | 91         | A                   | -        | -        | 100                    | -        | -       | ↑       | -      |
| 15                      | T       | Fc        | 2000s       | ✓   | -                        | -        | All    | -                              | -         | -          | -  | -      | -            | G            | -     | -          | -    | -     | -                     | 2550      | 85         | A                   | -        | -        | 100                    | -        | ↑       | ↑       | -      |
| 16                      | K       | Fi        | 2010s       | ✓   | -                        | -        | All    | -                              | -         | -          | -  | G      | -            | G            | -     | G          | G    | -     | -                     | 2000      | 90         | A                   | -        | -        | 100                    | -        | ↑       | -       | -      |
| 17                      | K       | Fc        | 2010s       | ✓   | -                        | -        | All    | -                              | -         | -          | -  | G      | -            | G            | -     | G          | -    | -     | -                     | 6000      | 100        | A                   | -        | -        | 100                    | -        | -       | ↑       | -      |
| 18                      | K       | Mi        | 2000s       | ✓   | P                        | -        | FT     | -                              | -         | -          | -  | G      | G            | G            | G     | G          | G    | -     | -                     | 2500      | 100        | A                   | -        | -        | 100                    | -        | -       | ↑       | -      |
| 19                      | K       | Fc        | 2000s       | ✓   | -                        | -        | All    | -                              | -         | -          | -  | -      | -            | G            | G     | G          | G    | -     | -                     | 6690      | 100        | A                   | -        | -        | 100                    | -        | ↑       | ↑       | -      |

Notes:

- Country - T: Tanzania, K: Kenya
- Ownership - L: local (national); Lg: part of locally owned business group; P: Publicly owned; Fc: Foreign company; Fi: Foreign individual; Mi: mixed (foreign and local) individuals.
- Input sourcing: C: cotton, Y: yarn (of any fibre) Ys: yarn (synthetic), Yc: yarn (cotton), P: packaging, F: fabric, T: trims (zips, buttons, etc.), S: synthetic fibre, D: Dyes, All: all inputs for apparel manufacture (fabrics, trims, threads, packaging, etc.)
- Functions: N, R, G mean that function is performed for national, regional and global value chains respectively
- CU: capacity utilisation, average for 2018, %.
- Product groups (listed by share of sales): A: apparel, Fi: fabric (intermediate/unfinished/greige/grey), Fp: fabric (processed - kanga & kitenge, bedsheets, etc.), Y: yarn
- Sales by market, share of total (%). National (Kenya or Tanzania), regional (sub-Saharan Africa), global (elsewhere).
- Percentages do not sum to 100 due to rounding

## **6.4. Upgrading and value chain directionality**

This section presents the findings from the survey about how value chain directionality affects firm upgrading outcomes. We examine upgrading in terms of end markets, value chain functions performed, products and process technologies in turn before also examining other firm characteristics and non-upgrading outcomes.

### **6.4.1. Buyers and end market upgrading**

The importance of the ‘forward-facing’ aspect of value chain directionality is reflected in the upgrading literature through its focus on lead firms – mostly buyers – and end market (or ‘channel’) upgrading, with T&A characterised as being part of ‘buyer-driven’ chains with different end markets offering distinct upgrading opportunities (Gereffi, 1994; Palpacuer et al. 2005; Gibbon 2008). For the purposes of this research, end market upgrading – a partial change in value chain directionality – occurred when a company reported having recently started selling to a ‘higher value’ end market, with end market downgrading being either the withdrawal from such a market or when starting to sell to a lower value end market. To some extent the question of which end markets offer the greatest potential for value creation, capture and upgrading is the subject of this research, but from the perspective of individual firms the entry to or withdrawal from a particular end market is usually clearly associated with a judgement as to the strategic value offered by it (usually in terms of profitability), which is the approach taken here. We therefore do not assume that global markets necessarily offer ‘higher value’ to suppliers, since the nature of GVCs – and arguably their purpose – is to squeeze supplier margins.

As would be predicted by the literature on triangular manufacturing networks in T&A, GVC firms formed a clearly distinct group among the surveyed firms, located in EPZs and exporting almost all their production to the USA duty free under AGOA to avoid US tariffs of 13-32% on finished clothing. The only exceptions were locally owned Kenyan Firm 12 which maintained a small share of sales (10%) in the domestic market, and the spinning mill (Firm 13) which exported all its yarn to China. For GVC firms owned by foreign companies, links with buyers were managed by the parent company, with buyers including major retailers and owners of household name brands such as VF/Kontoor (Lee, Wrangler, Dickies), The Children’s Place, Walmart, Haddad Brands (Levi’s), PVH, etc. For GVC firms with other forms of ownership, links to buyers were either direct or through agents, with products including branded items and more generic lines such as uniforms.

The remaining (non-GVC) firms combine sales in domestic and regional markets, with no obvious threshold in terms of sales between those that are more or less oriented to regional markets. As mentioned Firms 6-11 indicated that regional markets were critical to their strategy, so this group is designated as RVC firms, having 25% or more of sales in the region. RVC firms differed in end market orientation based on home country trade arrangements, with Tanzanian firms more oriented to

SADC (particularly South Africa but also Mozambique and others) while Kenyan firms exported more to EAC countries and the Democratic Republic of Congo (DRC). South African buyers were retailers such as Edcon/Edgars, who act as lead firms governing RVCs originating in Tanzania with less hierarchical, more arm's length/contractual arrangements than their sourcing strategies in Lesotho and Swaziland, where they directly own production facilities (Morris et al, 2016). For sales in other countries (including the Tanzanian and Kenyan domestic markets), buyers were mostly distributors and wholesalers where governance arrangements were relatively non-hierarchical. Several NVC and RVC-oriented firms exported a small share of sales to global markets (North America and EU), but this was marginal to their business. Kenyan firms were overall more NVC-oriented while Tanzanian firms were more RVC-oriented, reflecting the larger size of the domestic market in Kenya and Tanzania's duty free access to the high-value South African market via SADC.

In the area of end market upgrading, the survey findings suggest support for the commonplace idea among researchers and policymakers that RVCs can be a "stepping stone" to enter GVCs (e.g. UNCTAD, 2019: 39; Franssen, 2020). There were three cases of end market upgrading with one in each firm group, the most notable being Firm 10 in Tanzania which at the time of the survey was in the process of starting to export to the USA, having been focused on the regional (South African) market. From the firm's perspective this was a clear case of end market upgrading because in order to meet the stricter product quality and consistency requirements of US buyers (compared to South African buyers) it was necessary to invest in improved production processes and systems, however the long term profitability of this strategic decision could not be judged at such an early stage. Tanzanian ownership was important for this upgrading to have occurred, by contrast the South African owned manufacturers in Lesotho and Swaziland have been set up to serve the South African market, making end market upgrading unlikely (Morris et al, 2016). Locally owned GVC-oriented Firm 12 also exported to South Africa, albeit only briefly, before turning to the US market. Tanzanian NVC-oriented Firm 1 recently started exporting yarn to the regional market but only for a very small proportion of sales, which according to managers was more a way of finding outlets for surplus produce than a 'stepping stone' to GVCs.

There were two cases of end market downgrading, driven by changes in the global trade policy regime alongside the increased competitiveness of Asian producers. Kenyan RVC-oriented Firms 6 and 7 both exported to EU markets in the 1990s and 2000s, but after the phase out of quotas under the Multi-Fibre Arrangement (MFA) they lost market share to Asian (especially Chinese) producers and found it necessary to strategically downgrade to regional markets. Rather than being a case of 'strategic downgrading' (Ponte and Ewert, 2009) or even 'strategic diversification' (Barrientos et al, 2016) this is more simply a case of being excluded from global markets due to competitive pressures following the removal of a quota-based policy rent. Nevertheless, these cases provide supporting

evidence for the argument that even relatively weakly protected domestic markets/NVCs can be more lucrative than GVCs, especially given the competitive pressures in the latter.

Views of respondents around the opportunities available in each value chain type in terms of end markets varied because of heterogeneities at each level across countries and buyers (see also section 5.4.2). Generally global markets (especially lead firms based in the US and EU) were seen as the most demanding and potentially profitable to serve, but perceptions of regional and domestic markets differed due to a combination of economic and policy factors. Relative income levels were important, as were market access arrangements, along with the degree of domestic market protection and enforcement by national authorities. The latter mattered not only for domestic firms but for their neighbours, for example with some Tanzanian firms unable to compete in the Zambian market due to high levels of import penetration by Asian producers. Expectations and quality standards were explained by interviewees as similar and rising across the region (for a given market segment) due to the availability of highly competitive goods imported from global markets.

For Tanzanian firms, regional markets were often seen as more demanding and attractive than the domestic market because of access to the higher-income markets of South Africa and Kenya under SADC and the EAC respectively. This was particularly true for the few Tanzanian apparel producers who were vertically integrated and therefore eligible under SADC's Rules of Origin to export duty free to South Africa, and had developed supply links to lead firms there – mainly retailers – serving higher-value 'middle-class' market segments with relatively demanding quality standards for the region. For other Tanzanian firms, especially those focused on processed fabrics, regional markets such as Zambia and Mozambique were on a par with the domestic market in terms of profitability and quality requirements, with sales taking place to wholesalers with their own onward distribution channels.

For Kenyan firms the presence of tariff barriers with South Africa makes direct exports there prohibitively expensive,<sup>27</sup> so regional markets generally consist of lower-income countries than Kenya itself. NVCs are often therefore seen as more demanding and attractive to enter than RVCs for Kenyan firms. But again the type of buyer is decisive, with Kenyan department stores the most demanding lead firm in NVCs while wholesale buyers operating in Kenya are seen to be on a par with counterparts in regional markets of DRC, Tanzania, Zambia, Malawi etc.

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<sup>27</sup> Although there are informal trade routes between Kenya and South Africa, for example with reports of Zimbabwean buyers air freighting goods from Nairobi to Harare and transporting them on to South Africa by bus.

#### 6.4.2. Functions and functional upgrading

The range of functions carried out by firms is a crucial determinant of the value they add or obtain in the course of their activities, with the literature often explaining the functional range of actors through analysis of value chain governance, e.g. whether buyers or suppliers have more relative power and the types of market and non-market coordination observed (Gereffi et al, 2005). In T&A GVCs, the evolution of global trade policy regimes has resulted in ‘triangular’ governance and manufacturing arrangements whereby lead firms based in the USA and EU retain overall dominance as brand owners and retailers, but outsource production to increasingly powerful first-tier suppliers in East Asia, who often carry out actual manufacturing in subsidiaries based in LICs to benefit from preferential duty-free access schemes (Pickles et al, 2015).

Functional upgrading is defined as changing the activities carried out in value chains towards higher value areas such as design and branding, which could also include supply chain upgrading to incorporate vertical integration processes like textile manufacture (Humphrey and Schmitz, 2000; Morris and Staritz, 2014). Scepticism about the potential for LIC suppliers to functionally upgrade in the prevailing hierarchical form of T&A GVCs, due to the presence of endogenous power asymmetries favouring lead firms, is a motivating factor underlying this and other research on the potential of other value chain types (e.g. RVCs and NVCs) to support functional upgrading (Milberg and Winkler, 2013; Morris et al, 2016). This section explores how value chain directionality is linked to functional range and upgrading outcomes, arguing that the former is a key aspect of value chain governance affecting the latter.

A clear finding from the research is that firms oriented to NVCs and RVCs carry out a much greater range of functions – from input manufacture to design and branding – for a wider range of end markets (the latter especially in the case RVC firms) than those oriented to GVCs, suggesting the importance of a value chain directionality lens in analysing outcomes. The finding is in line with those from previous studies in other geographies, e.g. in Brazil (Bazan and Navas-Alemán, 2004; Navas-Alemán, 2011), but a contribution of this research is corroborating this trend among African LLMICs. In our survey, all NVC and RVC oriented firms incorporated at least some elements of vertical integration (spinning yarn, knitting or weaving fabric) into their business model, while no GVC oriented apparel firms were vertically integrated (although one GVC firm is a spinning mill). Furthermore NVC firms were all fully vertically integrated, i.e. able to spin their own yarn and knit/weave their own fabric), while half of RVC firms were.

Nevertheless all firms still bought in some inputs to their production processes, and the capability to independently source inputs is an important function in the T&A literature, allowing the provision of a ‘full package’ (aka FOB) service which is valued by buyers (Bair and Gereffi, 2003). The NVC and RVC-oriented firms all sourced their own inputs but only three of eight GVC firms could, while the

remaining five relied on buyers to nominate suppliers or overseas headquarters to provide them directly, i.e. operating on a cut, make, trim (CMT) only basis. Notably the three full package GVC firms all differed from other GVC firms in important ways, through their ownership characteristics – being wholly or partially locally owned, like NVC and RVC firms – or their unusual business model, i.e. a spinning mill producing only yarn from local cotton. The two full package GVC apparel firms also had direct links to buyers, while for the others links to buyers were established and maintained by overseas headquarters. These findings support the growing scepticism in the literature and mentioned above towards hierarchically governed T&A GVCs as routes to meaningful upgrading for LLMICs.

For the core garment and fabric production value chain functions the picture was more nuanced but a similar picture holds overall. The NVC and RVC oriented firms mostly offered the full range of value-addition services relevant to their product group, i.e. fabrics and/or apparel, with the exception of RVC-oriented Firm 10, which did not have washing capacity at the time of the survey but planned to invest in this area. Of the seven GVC apparel manufacturers, one was CMT (cut, make, trim) only, with the rest also having capabilities for embroidery (6 firms), sampling (5), washing (4) and printing (3). The need for these extra production capabilities varies with product choice and firm strategy, but generally allows greater flexibility to respond to buyer needs.

Largely due to their place in the triangular manufacturing networks described above, no GVC-oriented firms carry out any of the higher value added functions of design, branding or distribution in East Africa (regardless of ownership characteristics) while almost all NVC and RVC oriented firms perform at least two. Although NVC and RVC firms carry out a similar range of higher value functions, RVC firms outperform NVC firms since they perform them for higher value end markets. This is by virtue of their higher proportion of sales in regional markets, the fact that several Tanzanian RVC firms export clothing to South Africa (the most demanding regional market), and also that three RVC firms also export to global markets. A contribution of a value chain directionality lens is to bring the differences between NVC and RVC firms into analytical focus, whereas by looking at e.g. ownership or embeddedness alone these two groups would appear homogeneous since they are all locally owned.

There were only two cases of functional upgrading among the firms surveyed, which is surprisingly few given the high proportion of NVC and RVC firms in the sample and the suggestion in the literature that such firms are more likely to functionally upgrade due to less hierarchical governance (Navas-Alemán, 2011). Both cases of functional upgrading found were by locally owned firms, as might be predicted (e.g. Morris et al, 2016), however the remaining 10 locally owned firms did not functionally upgrade. The scarcity of recent cases of functional upgrading partly reflects the well-established business models of NVC and RVC firms due to their age, as well as the fact that they already carry out many high value functions. In both cases of functional upgrading, investment was

made on the guarantee of a 'rent', i.e. policy induced transfers at the national and global levels, which are explored more in the next chapter. Other firms with hopes to invest in functional upgrading also made clear the importance of rents to finance their learning.

One case of upgrading was by a Tanzanian NVC firm which added knitting and garmenting capacity for the domestic market on the basis of public procurement contracts, which served as a firm-specific rent. The other case of functional upgrading was the only fully locally owned GVC-oriented firm, which upgraded from garment assembly on a CMT basis as a subcontractor, first to having direct buyer links then to full package production and added embroidery and printing services for its (AGOA-focused) clients. In this case local ownership – and ensuing greater embeddedness – clearly explains why this was the only GVC firm to functionally upgrade, since the local owners have strong incentives to maximise profits in Kenya and saw potential for better margins through providing a full package service. Foreign owned firms interviewed stated that there was no intention to functionally upgrade operations in East Africa, with high-value functions reserved for their head offices, mainly first-tier suppliers in Asia. This reflects the above discussion that powerful firms in GVCs can exploit 'endogenous asymmetries' in GVCs to reserve higher value functions for themselves, which is especially evident in the case of apparel (Milberg and Winkler, 2013; Pickles et al, 2015).

One case of functional 'downgrading' was found in the survey, that of Kenyan Firm 6 which strategically sold off its garmenting section to focus on its core business of fabric manufacture. While the movement out of a high value activity justifies the functional downgrading categorisation on conventional definitions, the firm simultaneously invested in process upgrading for fabric manufacture and successfully maintained competitiveness with imports from Asian producers. This lends support to criticisms of the conceptual framework of upgrading, since it ignores or downplays the imperative of strategic downgrading to maximise or maintain profitability which often presents itself to firms, and posits a 'value hierarchy' of activities despite the fact that any given one can be performed at different levels of technological and organisational complexity (Tokatli, 2013; Ponte and Ewert, 2009).

The relative scarcity of cases of functional up or downgrading suggests business models are well established, but for NVC and RVC firms which were established from the 1950s to the 1980s this may reflect inertia rather than success, especially for those with low rates of capacity utilisation. Given the hopes of policymakers that the development of RVCs can support industrial upgrading and industrialisation within African free trade areas, the disappointing performance of locally owned RVC-oriented firms in the critical area of functional upgrading is a cause for concern, and is explored more in the following chapter.

### 6.4.3. Products and product upgrading

Product upgrading is the shift towards more complex or higher value products by firms (Humphrey and Schmitz, 2000). The complexity and diversity of products produced by a firm is a good indicator of its level of technological capability, particularly in the areas of production and innovation (Lall, 1987, 1992, 2000), and shows the outcome of historical product upgrading and downgrading processes. We find that unlike with value chain functions, where GVC oriented firms carry out more basic activities, for products the situation is reversed, with GVC oriented firms tending to make more complex products than NVC and RVC-oriented firms in our sample. This is in line with a longstanding finding in the literature that while hierarchical governance arrangements in GVCs are not conducive to functional upgrading, they are associated with better results in the areas of product and process upgrading (Bazan and Navas-Alemán, 2004; Kaplinsky et al, 2002).

NVC firms focus predominantly on processed fabric products such as *kanga* and *kitenge* (K&K), bed linen, masai shuka cloth and uniform fabric which are demanded by NVC buyers, mainly wholesalers and distributors. According to interview respondents these products are generally less complex to manufacture than garments in terms of technology and skill levels required, as also reflected in lower export unit values. The few NVC oriented firms producing garments focused overwhelmingly on basic products such as T-shirts and uniforms. RVC-oriented firms produced the widest range of products, from finished fabric and textile items, through basic T-shirts to more complex polo shirts, tops and bottoms. The most complex, highest quality products in RVCs and NVCs were sold to lead firms in South Africa and Kenya, mainly retailers and supermarkets.

Among GVC-oriented firms there was varied product complexity, with some making basic items like uniforms (and yarn in one case) but generally firms have the capability to produce a range of garment types according to buyer demands and the specialisation of parent companies. Surveyed firms offered knitwear, wovens, sportswear, casualwear, workwear etc. across a wide range of categories, almost exclusively to the USA under AGOA. The most complex products were made by GVC firms, for example denim jackets by a firm in a Kenyan EPZ.

Firm-level export data was not available for Kenyan firms, but in Tanzania for apparel products only, RVC firms showed slightly higher export unit values than GVC firms in 2017, at US\$9.76/kg compared to \$8.70/kg (see also Boys and Andreoni, 2020). This in part reflects the particularities of the small number of firms captured in this data, with the RVC firms concerned exporting relatively small volumes of clothing to the highest value regional market – South Africa – and the GVC firms exporting larger volumes of more homogeneous products to the USA. If all RVC firm exports were included, especially lower value processed fabric products to less demanding regional markets, average export unit values would be much lower. The literature has noted the potential for regional markets to support high value apparel exports, mainly in the case of Swaziland and Lesotho's exports

to South Africa where factories are directly controlled by South African investors and production runs are short with relatively complicated products (Morris et al, 2016). Importantly, the evidence of Tanzanian RVC firms' high value exports to South Africa shows that the phenomenon is not limited to cases of direct ownership by South African investors, but is also possible in arm's length and market-based contractual arrangements.

Cases of product upgrading were exclusively found among GVC oriented firms, especially more embedded ones, with no significant changes to product mix reported by NVC and RVC-oriented firms. Cases of product upgrading were driven by a range of factors including the changing strategies of parent companies overseas; the need to find new buyers outside the US if AGOA is not renewed; the changing demands of US buyers; and firm strategies to move into higher value market segments.

The survey data finds only two cases of product upgrading in the most hierarchical governance arrangement, where Asian first-tier suppliers have established wholly owned and controlled production units in East Africa for the purpose of preferential market access (particularly AGOA) and low labour costs. One such case of product upgrading was driven by parent firm strategy directly, while in the other case the prospect of AGOA's expiry in 2025 and the need to explore new markets was the primary motivation behind producing a new, more complex product in East Africa. In this latter case the potential loss of access to a crucial market can be considered a 'vulnerability shock' threatening the viability of the firm's strategy, which Pipkin and Fuentes (2017) find to be a common factor behind many cases of upgrading.

The other two cases of product upgrading were by GVC firms in less hierarchical governance structures. One was the locally owned Kenyan GVC firm which increased the complexity of its products, for instance from making very basic t-shirts from 5 pieces of fabric to more complex ones from 12 pieces, requiring different machinery, more complicated operations and consequent upskilling of workers. This is part of a long term strategy to maximise value generation and capture in Kenya, as would be expected of a locally owned firm.

The other case of product upgrading was a Kenyan based firm owned by a foreign individual with no overseas parent company, which moved from producing only the most basic 'scrubs' (hygienic medical overalls) in 2012 to now also more complex casualwear including jeans and denim jackets for major US brands. The foreign owner came to Kenya to work as a manager in another factory but then stayed on to start his own company, and therefore has a strong incentive to maximise profits in Kenya like a local investor, explaining its efforts to upgrade to more complex products. This shows that not all foreign investors are alike, with some being more 'embedded' than others, an area which is under-explored in the literature on embeddedness (Morris et al, 2016). The success of the garment industry in Bangladesh has been partly attributed to factory managers setting up their own companies (Khan,

2013b) but this was the only such case found in East Africa, suggesting an area of exploration for industrial policymakers.

#### **6.4.4. Technology and process upgrading**

The age of technology used by firms is another strong indicator of their technological capabilities in the domain of investment (Lall, 1987, 1992), and of their technologies generally when defined in terms of the capacity to generate and manage technical change (Bell, 1984; Bell et al, 1994). Results in this area lend further support to an analytical focus on value chain directionality, since there was a clear ranking of firms on measures of technological performance – first GVC firms, then RVC firms and lastly NVC firms.<sup>28</sup>

The survey results show that GVC firms use the most up to date technologies followed by RVC and lastly NVC firms. Most NVC oriented firms were using equipment aged 20-30 years old or more, especially in the spinning and weaving sections of vertically integrated producers. RVC firms had newer equipment on average but with a wide range, some firms having equipment around 20-30 years old alongside more recent acquisitions, and a few having only technology from the last 10 years or less. GVC firms' production technologies were all less than 10 years old and several only had equipment less than 5 years old.

Firms were asked about their engagement in process upgrading, i.e. investment in new equipment and improved production processes, as a more direct measure of their ability to manage technical change. Process upgrading was found among all groups of firms in order to maintain and enhance competitiveness, but there was variation in the types of investment and motivation according to value chain directionality. NVC oriented firms mostly reported replacing obsolete machinery for which spare parts were becoming difficult to find, but also investing in equipment necessary to compete with imported products. RVC and GVC oriented firms tended to be engaged in more continuous processes of upgrading, often driven by the business strategies of foreign owners (for GVC firms), the demands of buyers (e.g. live order tracking, reduced lead times) and the need to maintain and expand market share in highly competitive T&A export markets. Although this still mostly took the form of acquiring new machines, there were also some concerted efforts to improve factory organisation (e.g. adopting the Kaizen system; skills training; tightening quality assurance) resulting in improved productivity, particularly among GVC-oriented firms.

Having the newest technologies and engaging in more organisational forms of process upgrading, GVC firms can be said to perform best in this area. This was expected due to hierarchical governance arrangements being conducive to process upgrading (see above and Navas-Alemán, 2011), and most

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<sup>28</sup> By contrast a focus on e.g. ownership/embeddedness alone would miss the differences between NVC and RVC firms, which would be lumped together as locally owned and juxtaposed to foreign-owned GVC firms.

GVC firms in our sample being directly foreign owned and controlled. However process upgrading was also reported by the wholly and partly locally owned GVC firms, as well as the locally owned RVC and NVC firms. Again, this shows the importance of incorporating value chain directionality into analyses of governance and upgrading outcomes, particularly to look beyond the binary of local and foreign ownership.

Several other factors must be taken into account to help explain the correlation between process upgrading outcomes and value chain directionality. The date of initial investment is clearly a decisive factor, with older NVC and RVC firms obliged to at least replace their oldest machines to remain operational. GVC firms in our sample all established operations in East Africa since the year 2000, making them likely to have more recent technologies for that reason alone. Furthermore the type of investment is important, with NVC and RVC firms all having some capital-intensive vertical integration processes where machinery is more costly to upgrade. By contrast the main machinery for GVC apparel manufacturers is sewing machines which are generally cheaper to replace.

#### **6.4.5. Firm characteristics and other outcomes**

Having analysed the main survey results on the links between value chain directionality and upgrading outcomes, we now turn to some general characteristics of firms – especially ownership and age – as well as other (non-upgrading) outcomes. In the GVC literature on value chain governance, ownership is closely linked to key strategic decisions around firm set-up, sourcing and sales which determine the distribution of power between actors and resulting access to resources and potential to upgrade (Gereffi et al, 2005). In SSA T&A value chains, ownership has been established as a useful proxy for how governance more broadly affects firm-level upgrading outcomes, with locally owned firms being more embedded and more likely to engage in upgrading (Morris et al, 2016).

In our sample ownership and embeddedness were highly correlated with value chain directionality, but we argue that while these aspects of governance may be intertwined empirically, they can be usefully analytically distinguished when assessing drivers of firm outcomes. All NVC and RVC firms were locally owned and almost all GVC firms foreign owned, but a close reading of the results suggests that ownership and value chain directionality have independent effects on upgrading. The case of Firm 12 demonstrates the potential for GVC firms to be locally owned, while RVC-oriented Firm 9 has been described in other studies and media reports as foreign owned although we classify it as locally owned. Local ownership was critical to the strategy of GVC firm 12 to pursue functional and product upgrading, corroborating the importance of embeddedness (Morris et al, 2016). However GVC Firm 18 – with mixed local and foreign ownership – had no inclination to upgrade its products or functions, and GVC Firm 16 owned by a foreign individual was engaged in product upgrading (although had no plans to functionally upgrade). Most crucially, among all 11 locally owned NVC and RVC firms, only one had functionally upgraded and none had upgraded their products, supporting the

idea that analyses of upgrading outcomes should flexibly combine a broad range of governance factors including firm characteristics and value chain directionality.

Another clear difference observed between the groups of firms surveyed is their age, which along with changing policy regimes (explored in Chapter 7) is an important factor explaining variations in outcomes. NVC firms were the oldest group of firms on average, with several having started operations in the 1950s. RVC firms started on average slightly more recently, mostly in the 1960s and '70s, while GVC firms were all established in EPZs since the year 2000. NVC and RVC firms were therefore all set up on the basis of protected domestic markets, several as state-owned enterprises (SOEs) in the case of Tanzania. Rents from tariff protection and a policy stance favouring import-substitution industrialisation (ISI) encouraged vertically integrated business models, explaining their predominance. The era of liberalisation from the 1990s and a policy shift towards export-oriented industrialisation (EOI) laid the ground for the establishment of GVC firms on the basis of rents from EPZs and international trade policy regimes. Many former NVC and RVC firms have ceased operating, while the remaining ones are often operating at low levels of capacity utilisation and struggling to maintain competitiveness.

Upgrading in various forms is the main framework for interpreting the firm survey results below, but the literature has highlighted the limitations of upgrading outcomes as indicator of firm performance in value chains (Gibbon, 2008; Tokatli, 2013; Ponte and Ewert, 2009). We therefore sought information from firms in a number of other areas and report here on employment, local content and capacity utilisation.<sup>29</sup> A major motivation for government efforts to promote the T&A industry in LLMICs is employment creation, so outcomes in this area are particularly important. More capital-intensive functions such as spinning, knitting, weaving and fabric processing tend to require fewer employees, and RCV and NVC firms are more engaged in these activities. Partly as a result, GVC firms were largest in terms of employment with most having over 2000 workers and two having 6000 or more. NVC firms had on average more employees than RVC firms, at around 1400 and 1200 respectively, although among RVC firms, the most regionally oriented producers (with 40% or more of sales in regional markets) tended to have more employees. The results show the potential for sustaining mass employment in firms oriented to all end markets, particularly in more labour-intensive garment manufacture, but investment in GVC-oriented production has had the greatest jobs creation impact in the last two decades. In terms of quality of employment, GVC firms selling to US lead firms were subject to demanding social compliance requirements, through schemes like WRAP (Worldwide Responsible Accredited Production) or the buyers' own codes of conduct. By contrast,

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<sup>29</sup> Firms were unwilling to share detailed information about their profits and wages, so no data is available in that area.

the most prominent lead firms in RVCs and NVCs – South African and Kenyan retailers – did not impose notable social compliance requirements.

Just as the end markets of value chains have implications for upgrading opportunities, so too do the source markets for inputs. Policymakers are highly concerned with the amount of local content in finished products, i.e. the extent to which manufacturing companies develop backward linkages within local production systems. NVC and RVC firms were far more likely to source inputs – particularly cotton – from their own and neighbouring countries, meaning they are truly NVC and RVC oriented in both inputs and outputs. This is in large part due to firms in these groups mostly being vertically integrated, with cotton lint (the key input to their spinning operations) being available and commonly sourced locally. There was some bias towards domestic rather than regional sourcing of cotton, especially in Tanzania where availability is greater, but overall most firms engaged in spinning also sourced cotton at the regional level. Several firms also sourced cotton and synthetic yarn at the regional level (the latter spun from imported inputs). GVC oriented garment assemblers sourced negligible inputs locally, only packaging in a couple of cases, which they put down to the unavailability of appropriate fabrics and trims (rather than price or quality concerns per se). Supporting this explanation, GVC firms pointed to the strong incentives they face to source locally wherever possible as it would allow lead times to be dramatically reduced, a major priority of global buyers.

The level of capacity utilisation can be used as a proxy of productive efficiency, but also captures the extent to which business strategy is aligned with market demand and adaptable to changes in buyer requirements as fashions change. Among a heterogeneous group of firms making a wide range of products with varying technologies, as in our survey, it is a simple measure allowing comparison of performance and one which is well understood by firm managers. There is a clear tendency for GVC-oriented firms to be operating at higher levels of capacity utilisation, at 90-100% in more than half of cases and 86% on average. NVC and RVC firm operate at lower levels of capacity utilisation, at 64% and 58% respectively on average. RVC and NVC-oriented firms stressed the importance of weak demand in explaining low capacity utilisation, as well as a range of internal and external factors that negatively impact productivity and competitiveness (see Chapters 5 and 7).

## **6.5. Conclusion**

The survey found that there were important variations in firm characteristics and upgrading outcomes according to value chain directionality. We argue that whether firms are primarily oriented to NVCs, RVCs or GVCs is in itself an important factor for understanding outcomes at firm-level, and may be analysed independently from other aspects of value chain governance such as ownership and embeddedness even where they are closely correlated, as in our survey.

Cases of changes in value chain directionality – particularly end market or ‘channel’ upgrading – confirm that NVCs and RVCs can serve as ‘learning grounds’ or ‘stepping stones’ to participation in higher value RVCs and GVCs, but such cases were relatively rare. Furthermore, views of firms on ‘regional’ markets varied between Tanzania and Kenya because of differences in income level relative to neighbouring countries, market access arrangements and domestic trade and industrial policies. Lead firms in South Africa and Kenya were seen as the most demanding on quality, particularly supermarkets and retailers serving ‘middle-class’ market segments, while wholesalers and distributors in the EAC and DRC are less demanding. Two cases of end market downgrading were found, highlighting the role of RVC and NVC-based strategies as a fall-back option for firms excluded from global markets due to heightened competition and changing global trade regimes.

RVCs and NVCs support a wider range of functions than GVCs, with all RVC and NVC firms being vertically integrated to some extent and most doing higher value functions like design and branding. GVC firms focused on a much narrower range of activities, mostly garment assembly with some auxiliary functions like embroidery and printing. This was generally to be expected according to the literature on other geographic regions but has been less documented in SSA (Pickles et al, 2006).

Given the variations in functions described, cases of functional upgrading were surprisingly rare across all groups of firms. One case of upgrading was found by an NVC firm and another by a GVC firm, and one case of downgrading was seen by an RVC firm. Otherwise business models were well established, often dating to the era of protected domestic markets prior to liberalisation in the 1990s. Ownership was critical in explaining functional upgrading by the only locally owned GVC firm, reflecting a common finding in the literature (Morris et al, 2016), but most locally owned NVC and RVC firms did not functionally upgrade. A more important explanation for those firms appears to be value chain directionality, particularly the types of rents available through national, regional and global trade and industrial policies, explored in the next chapter.

GVC firms generally produced the most complex products, mainly because of their focus on apparel, and all cases of product upgrading were found in this group. NVC firms focused primarily on lower value processed fabric products, while RVC firms produced across all product categories. The higher value clothing products in RVCs were mostly sold to South African and Kenyan retailers. When Tanzanian exports of apparel are considered in isolation, RVC firm export unit values in regional markets are higher than those of GVC firms selling to the USA, showing the potential of RVCs to support high value products under certain circumstances, explored in the next chapter. While the literature finds that product upgrading is facilitated by the hierarchical governance arrangements in which most GVC firms surveyed operate (mainly triangular manufacturing networks), half of the cases of product upgrading occurred in the more ‘embedded’, less hierarchically governed firms – one locally owned and one owned by a foreign individual. The fact that not a single locally owned NVC

or RVC firm reported recent product upgrading also suggests that in this context value chain orientation itself may have explanatory power, with policy factors including rents available in different value chains a key variable, as discussed in the next chapter.

GVC firms had the most up to date technologies, followed by RVC firms and then NVC firms, but all groups were engaged in process upgrading, albeit in different ways. Like with product upgrading, strong performance on process upgrading is expected in the literature for GVC firms in hierarchically governed value chains, since foreign owners have the resources and expertise to invest in maximising efficiency to lower unit costs. However locally owned RVC and NVC firms were just as likely to have engaged in recent process upgrading, though of slightly different types. NVC firms with older equipment are more focused on modernisation projects to remain competitive, while RVC and GVC firms undertake more continuous upgrading of both production technologies and factory organisation.

This chapter builds on criticisms of the upgrading framework, highlighting that strategic changes in business model and functional range may be difficult to classify as simply upgrading or downgrading (Tokatli, 2013; Ponte and Ewert, 2009). The survey therefore also included non-upgrading outcomes, namely employment, backward linkages and capacity utilisation. GVC firms have created more jobs in recent decades by virtue of their more recent establishment and their focus on labour-intensive apparel assembly, but NVCs and RVCs also show the potential to sustain mass employment. NVC and RVC firms source more inputs locally, particularly cotton due to their vertically integrated business models, while GVC apparel firms import almost all their inputs from overseas. Capacity utilisation is commonly used as a measure of firm performance and GVC firms perform best here, while NVC and RVC firms struggle because of a range economic and policy factors, explored in the next chapter.

Overall the results point to the different types of benefits offered by NVCs, RVCs, and GVCs from the perspective of firms and policymakers. While integration into GVC-oriented triangular manufacturing networks offers the potential for rapid employment creation, prospects for upgrading are largely limited to products and process technologies. Locally owned GVC firms are more likely to functionally upgrade, and NVC and RVC firms can engage in end market upgrading to eventually become integrated into GVCs. However the cases of upgrading found in the survey were underpinned by rents in various ways, to which we now turn.

## **7. The political economy of multi-scalar industrial policy rents and outcomes**

### **7.1. Introduction**

This chapter develops a multi-scalar approach to policy analysis, examining rents at the national, regional and global levels to understand their impact on the investment and upgrading strategies of firms operating in the EAC T&A sector. We argue that the structure of rents and their relative magnitude is critical to understanding the firm-level outcomes presented in the previous chapter. The analysis here builds on the policy space mapping of Chapter 5, which set out the factors shaping the set of feasible and viable policy options, but focuses on the concrete rents which emerged and directly impacted firm strategy.

The main area of literature to which this chapter contributes is around the political economy of industrial policy rents in the contemporary context of overlapping value chains and trade regimes at the national, regional and global levels. The academic literature on industrial policy has not kept pace with changes in the global economy, with a lack of research into the complexities of policymaking at multiple levels simultaneously (Behuria, 2019). Further, questions of power and political economy are rarely given due attention in value chain studies (Dallas et al, 2019; Andreoni, 2019). This chapter examines policies at different levels and how they interact, the effects on rent distribution among competing actors, and the extent to which multi-scalar industrial policy rents are successfully supporting strategic engagement in different value chains by East African T&A firms.

The next section defines the main types of rents discussed in this chapter, after which rents in the EAC T&A sector originating at the national, regional and global level are presented. The analysis draws on semi-structured interviews with firms and policymakers; trade and tariff data; and official notifications, legislation and regulations (see Chapter 3 and annexes for full details of methods). Rather than premising our analysis on policy and strategy documents which may not be fully implemented, we focus on concrete measures that allocate rents between actors as far as possible. At the national level this includes analysing the valuation of imported products using international trade data, as well as public procurement policy and the granting of duty remission, drawing on official documents. For regional-level policies we use trade data to assess the rents provided by regional trade agreements (RTAs) and official statistics to gauge the impact of Export Processing Zone (EPZ) schemes. At the global level we examine rents from preferential trading arrangements (PTAs) using trade data.

Rents from duty-free trade arrangements are calculated as the product of trade values and MFN tariff rates, an approach which to our knowledge has not been used in prior studies and represents a

methodological contribution of this research. More cross-cutting policy issues affecting firms across value chains and sectors – such as constraints linked to power supply, infrastructure (roads, railways and ports), skills, credit, etc. – were discussed briefly in Chapter 5 and are not addressed here.

## **7.2. Rents: definition, typology and measurement**

It is first necessary to revisit the concept of rents, and draw out some of the main characteristics of the different types of rents discussed in this chapter. As seen in Chapter 2, for the purposes of this research a rent is an incremental change in income created by institutions, and can be generated by industrial policies to encourage firm entry and learning in currently unprofitable but socially desirable areas like manufacturing (Khan, 2017). All economic policies generate some form of ‘rent’, from obvious examples like subsidies (i.e. direct transfers of resources), to import licences or preferential market access where states allocate the right to operate in a certain market or activity, granting firms access to otherwise unavailable income streams.

Rents have largely been considered as an outcome of policies at the national level, but this chapter’s contribution is a holistic analysis of rents arising at the national, regional and global levels of policymaking. Early discussions of industrial policy centred on the nation state as unit of analysis, such as Alexander Hamilton’s (1791) work in the USA and Friedrich List’s (1909) in Germany. The approach developed in Chapter 4 highlighted how, in the contemporary context, factors at regional and global levels also impact a country’s policy space. We argue that in analysing rents in a particular sector, it is critical to examine not only national policies, but also how regional and global-level policy frameworks create income flows for particular actors over others. This is especially important where the countries in question are participants of ambitious regional integration initiatives, or where sectors are embedded in international trade and production systems, as is the case for EAC T&A. Drawing on Chapter 5, it also appears likely that there will be interactions and tensions between rents created at different levels, with potentially important implications for development and upgrading trajectories.

Another distinguishing feature of this chapter is its attention to *negative rents*, which are largely neglected in academic analyses of industrial policy despite being widely acknowledged in policymaking circles as critical to industrialisation outcomes. By altering income flows to create rents for winners, policies simultaneously also create negative rents for losers who are made worse off. The concept of negative rent is mentioned by Khan (2013a) but remains underexplored in the literature; in this chapter we employ the term to explain some of the key empirical outcomes in the EAC T&A sector. Negative rents may arise through purposeful policy decisions to allocate resources to one group over another, such as in the case of used clothes in the EAC where low tariffs on used clothes provide a positive rent to consumers and impose a negative rent on clothing manufactures whose

products are outcompeted. Negative rents may also arise less intentionally through non-implementation of policies due to the nature of the political settlement, for instance where the undervaluation of imported T&A products in EAC countries benefits powerful groups but results in lower market prices, squeezing the margins of local manufacturers compared to a scenario of ‘proper’ implementation of customs procedures.

We also distinguish *ex ante* and *ex post* rents, which as Table 17 shows are given respectively before or after success has been achieved in the competitive production of a product, since they each have different implications in terms of the governance capabilities required to ensure rents are productively used for learning (Khan, 2013a). In particular, *ex ante* rents such as subsidies require governing agencies to be able to effectively monitor the effort in learning made by recipients, and to have the political autonomy to withdraw them from non-performing firms. By contrast *ex post* rents – such as the benefits conferred on exporters through trade preferences – are disciplined by the market and only conferred after effective effort in learning has been made, lessening the demands on state agencies. Although this categorisation is analytically helpful, it is important to note that real-world rents may contain both *ex ante* and *ex post* components. For instance public procurement contracts (discussed below) may be agreed *ex ante*, facilitating favourable access to finance from private lenders to invest in the necessary resources for production, but part or all of the actual remuneration may be *ex post* and therefore conditional on products meeting agreed specifications.

Table 17: Typology of industrial policy rents with examples

|         | Positive  | Negative  |
|---------|---|---|
| Ex-ante | Policy induced income conferred before competitiveness in production achieved, e.g. subsidies | Lost/foregone income due to policy, occurring before competitiveness in production achieved, e.g. premature trade liberalisation            |
| Ex-post | Policy induced income conferred after competitiveness in production achieved. E.g. FTA rents  | Lost/foregone income due to policy, occurring after competitiveness in production achieved, e.g. windfall profit tax, minimum wage increase |

Author elaboration

Although it is widely acknowledged that trade agreements and trade preferences create and destroy income flows – i.e. rents – for different actors, there is little attempt to quantify these in the literature. We propose an approach to measuring trade policy rents from the perspective of manufacturers as the product of trade values and MFN tariff rates. This is based on interviews where firms highlighted that to them the benefits offered by a given trade agreement are primarily a function of the demand in the end markets in question and the level of tariffs which would otherwise apply.<sup>30</sup> This approach does

<sup>30</sup> Interviewees stressed that the higher the tariffs which would otherwise have applied, the more buyers are willing to pay for a given product to a manufacturer based in a country benefitting from duty free market access under trade preferences.

not mean to suggest that trade policy rents are equal to the amount which would be due under tariffs prevailing in the absence of a trade agreement, since trade volumes are usually lower in the presence of tariffs. An alternative approach might value the rent as the whole trade flow on the basis that the sales revenue is income linked to the trade agreement, but this ignores the possibility of smaller flows taking place even in the absence of the agreement, and the need for the firm to cover its costs. If data on firms' profits by end market was available this could also be a proxy for trade rents, but this is rarely available and not for our sample.<sup>31</sup> By estimating rents as the product of trade values and tariffs we combine two critical factors identified by firms as determining the benefits offered by trade agreements, and use readily available trade and tariff data.

### **7.3. National rents**

This section focuses on the rents controlled primarily by national authorities, which are the most important rents driving the outcomes seen in national value chains. We discuss changes in national rents over time from the era of import substitution to liberalisation, but focus mainly on current policies related to the valuation and taxation of imports, duty remission for manufacturers and public procurement policies. These policies primarily impact the five firms surveyed that were integrated into NVCs, i.e. sourcing inputs and selling outputs primarily in their national markets of either Tanzania or Kenya, but some impacts on RVC firms are also discussed. Established in the pre-liberalisation period from the 1960s, most NVC and RVC firms benefited from policy rents in the protected domestic market as governments pursued import substitution strategies. The reduction of these rents in the period since liberalisation has resulted in many firms struggling to remain competitive.

Unlike Kenyan NVC firms which were always private, Tanzanian NVC firms were established as state-owned enterprises (SOEs), in at least one case with the support of concessional loans and grants from bilateral donors, and likely receiving subsidies from the state during periods of low capacity utilisation and weak demand (see also Bagachwa and Mbelle, 1995; James, 1996; Gray, 2013). Factories of Tanzanian NVC firms were privatised during the 1990s, losing the rents associated with state-ownership. Survey respondents highlighted difficulties with privatisation processes, which occurred in a rapidly changing political and institutional environment, resulting in a perception that factories were acquired for less than market value (interview #36). The NVC factories and assets were acquired by Tanzanian family-owned business groups of South Asian origin historically focused on

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<sup>31</sup> Yet another approach would be to calculate trade rents based on the higher prices buyers are willing to pay to suppliers within an FTA to avoid paying tariffs on importing the same products from outside. However the relatively small volumes of apparel exported from Tanzania in particular, and the nature of trade statistics make it difficult to identify benchmarks of the same type and quality.

trading, with little experience of running industrial enterprises. Ownership has changed little since privatisation, and managers interviewed were often from the same family.

NVC and RVC firm owners do not rely on earnings from T&A alone; factories are often part of diversified business groups, with intra-group financing providing working capital and supporting operations in lean periods (see also Andreoni and Sial, 2020). In Tanzania some of the wider groups engage in unrelated activities, such as gold trading, or areas with apparently contradictory interests to their textiles factories, e.g. the import of used clothes. This suggests their T&A manufacturing may be marginal to their overall business activities, reflective of a liberalised policy environment favouring traders over producers.

Trade liberalisation in the 1990s resulted in NVC and RVC firms losing much of the rents from trade protection, and many struggled to remain competitive even in the domestic market. In Tanzania the MFN applied weighted average tariff rates on manufactured T&A products fell sharply from 35.6% in 1993 to 14.5% in 1997 after the country's accession to the WTO, then increased to reach 25.2 % in 2019. In Kenya the corresponding figures were 44.8% in 1994, 26.1% in 1999 and at 22.7% in 2019.<sup>32</sup> In Tanzania alone, nine other NVC-oriented factories were closed at the time of the survey (TDU, 2019).

### **7.3.1. Trade misinvoicing: import undervaluation**

Trade liberalisation in East Africa was followed by increased import competition, not only due to tariff reductions and the increased export competitiveness of Asian producers (particularly China), but also the underreporting of import values, i.e. a form of trade mis-invoicing.<sup>33</sup> During interviews NVC and RVC firms complained that importers underreport the value of goods to evade taxation, enabling them to sell in the domestic market at lower prices than if tariffs were applied to proper values, a practice allegedly tolerated by national customs authorities and which imposes a negative rent on manufacturers (e.g. interviews #4, #19). For Tanzania this is corroborated by Andreoni and Tasciotti (2019), who use mirror statistics to show that textiles products see the highest levels of trade underreporting of all product groups, to the tune of \$563m in 2017 resulting in foregone tax revenue of \$165m, equivalent to around one third of the total for all product groups. For Kenya in 2013 it was found that under-invoicing totalled around \$2bn with lost revenues of \$907m, with T&A products among the most affected (GFI, 2018). An earlier study comparing Tanzania and Kenya found that import underreporting is relatively more severe in Tanzania, but the research used outdated data from 2000 and 2004 (Levin and Widell, 2014).

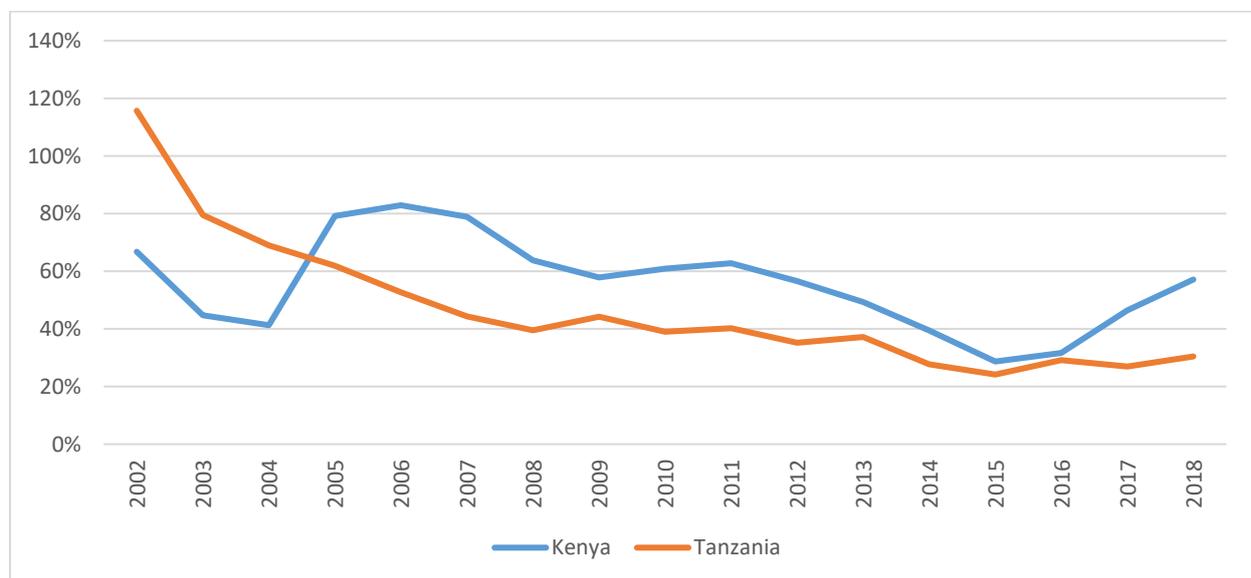
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<sup>32</sup> Data is from WITS/TRAINS.

<sup>33</sup> Trade mis-invoicing occurs primarily through either under-reporting of imports or over-reporting of exports, which respectively aim to reduce import tax liability and transfer capital out of a country.

We provide an up to date assessment of trade underreporting in T&A by presenting Tanzania and Kenya’s reported imports as a share of the rest of the world’s reported exports to each country. While some difference is expected due to transport costs – imports are reported by most countries on a CIF (cost, insurance and freight) basis and exports on an FOB (free on board) basis – the mark-up for CIF is usually in the region of 6-10% (so import values should be around 106-110% of export values), but Figure 5 below shows imports to be only 57% of export values in Kenya in 2018, and 30% in Tanzania. The chart shows that Tanzania’s import valuations for T&A products consistently represent a lower share of partner reported export valuations than Kenya’s, corroborates the finding of Levin and Widell (2014) that underreporting is more severe in Tanzania. Note that the data is likely to capture the net effect of both over- and under-reporting of T&A imports, since importers may underreport products with higher tariffs and overreport similar products with lower tariffs.

Figure 5: Import values/partner-reported export values for T&A products

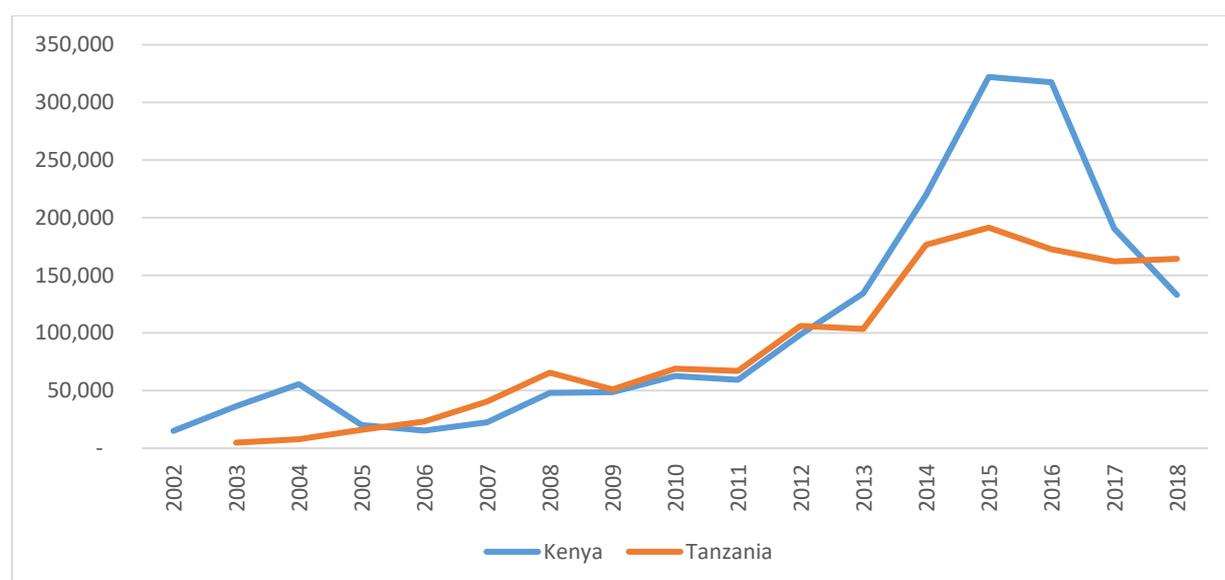


NB: Kenya and Tanzania’s reported imports of T&A products (HS 50-63) are divided by world’s reported exports to each country. Data from UN Comtrade and national authorities via Trademap.org and WITS.

We estimate the value of negative rents due to import undervaluation – approximated as the value of tariff revenue evaded – to be valued at \$1.6bn and \$1.3bn for Kenyan and Tanzanian T&A manufacturers respectively over the decade from 2009 to 2018, as shown in Figure 6 below. Tariffs on finished products give rents to domestic producers, and the non-application of the tariff regime through import undervaluation results in lower income for producers because the tax avoided allows importers to sell goods at lower prices than otherwise would have prevailed, lowering the market price and forcing domestic producers to reduce their prices accordingly, depressing their sales revenues and profits. The negative rents to producers are a combination of both foregone/unrealised benefits, which producers may never have received if there has always been some degree of import undervaluation, and actual falls in income due to the declining import valuations from the mid-2000s to the mid-2010s shown in Figure 5 (which we presume lowered market prices).

Evaded revenues are calculated simply as the weighted average tariff for each HS chapter 50-63, multiplied by the difference between importer and export-reported trade values.<sup>34</sup> When apparel products from chapters 61 and 62 are combined, they make up the category most affected by negative rents, representing 57% and 37% of evaded revenues in Kenya and Tanzania respectively from 2009-18. In both Kenya and Tanzania, several respondents interviewed reported recent improvements in the implementation of levying tariffs on imports (interviews #23, #29), reflected in Figure 5 by the uptick in import valuations from 2016-18 in Kenya, but not yet in Tanzania.

Figure 6: Lost tariff revenue due to import underreporting, HS 50-63



Trade data from UN Comtrade and national authorities via Trademap.org and WITS. Tariff data is weighted average, from WITS/TRAINS. Calculations done at 2 digit HS level.

Another way in which national-level customs authorities can play an important role in delivering rents to T&A producers is the extent to which imports are correctly assigned to product categories for tax purposes, as opposed to being mislabelled to evade taxes. Although Andreoni and Tasciotti (2019) did not find econometric evidence for mislabelling in Tanzania across all product categories, several interviewees in our survey alleged that this is common practice in EAC T&A product subcategories (e.g. interviews #9, #17, #18, #49). In particular new clothes are allegedly imported disguised as second hand clothes, a practice tolerated by some customs authorities. Since used clothes are imported in large bundles of mixed items haphazardly jumbled together, new clothes can be packaged in a similar way to get through customs before being pressed, folded and sold as the brand new clothes they are. Although tax rates on new and second hand clothes are similar, the lower value of second hand clothes reduces overall tax liability significantly.

<sup>34</sup> The decision to do calculations at the 2-digit level was made because the objective is to estimate the total revenues evaded rather than identify which products see most evasion. Our approach yields similar results as compared to calculations at the 6-digit level, e.g. Andreoni and Tasciotti (2019).

The combined effect of negative rents due to privatisation, liberalisation, import underreporting and mislabelling is to diminish the competitiveness of manufacturers and make it difficult for them to accumulate capital to invest or gain access to loans to finance new projects. The importance of these factors in East Africa is a major factor explaining the relatively low levels of capacity utilisation among both NVC and RVC firms, and the old age of these firms who are mostly ‘holding on’ in an environment that does not attract new firms to invest. The same policy factors also partly explain the lack of upgrading among the 11 NVC and RVC firms surveyed: no cases of product upgrading were found, only one case of functional upgrading, two of end market upgrading and the widespread process upgrading observed was often limited to replacing obsolete machinery, particularly for NVC firms. We now turn to the remaining rents arising from policy factors at the national level, arguing that these lie behind some of the upgrading cases seen.

### **7.3.2. Duty remission**

*Ex ante* rents granted under the guise of the EAC duty remission scheme (DR) are an important industrial policy tool of national authorities, disproportionately benefitting a few selected NVC firms and often for specific purposes such as product diversification, though at the cost of losing access to regional markets. In principle the EAC DR scheme is a regional policy but national authorities can in practice grant exemptions unilaterally on the condition that the resulting finished products cannot be sold duty free in other EAC countries, i.e. are only for the national domestic market (a ‘national DR’) or for export outside the EAC (an ‘export DR’). Although the main raw material of NVC firms is domestically produced cotton, they also import a significant share of their production inputs so DR rents can be significant.

Four of the five NVC firms in our sample have participated in the scheme in recent years, with the total value of tariff exemptions totalling approximately \$11.8m in the 2010-2020 period, calculated based on the quantities of goods permitted to be imported by each firm and the average import unit values for those goods in the importing country in each year.<sup>35</sup> Around \$9m of this was accounted for by a single firm in the three years from 2018-2020, while another \$2.3m worth was for another firm in the 2010-2013 period. Kenyan NVC firms have mostly been granted ‘export DRs’, i.e. with eligible finished goods destined for sale outside the EAC and any goods sold within the EAC attracting CET rates. In Tanzania national DRs were granted, i.e. for production for the domestic market, also preventing duty free sale in other EAC countries. The final products to be made from the inputs are designated in the notifications and in some cases firms historically focused on traditional processed fabric products are granted DRs on inputs like buttons, zippers etc. for the purpose of apparel production. This suggests the rent is conditional on being used productively by NVC firms to

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<sup>35</sup> We assume that the firms make full use of the exemptions granted. 2020 data is for January to August only.

diversify away from traditional products such as *kanga* and *kitenge* (K&K), which are seen as ‘sunset’ industries due to changing consumer tastes. However, as an *ex ante* rent it would be necessary for implementing agencies to monitor and enforce the conditions attached to the duty remission, and little evidence of this was found.

RVC firms have also benefitted from rents granted by national authorities under the duty remission scheme, but to a much lesser extent than NVC firms. Only half of the RVC firms in the sample, i.e. 3 out of 6, participated in the scheme since 2010, receiving tariff exemptions worth only \$1.1m. The fact that national and export DRs rule out duty-free sale in EAC markets makes them unattractive to RVC firms relying on regional exports, explaining the low uptake. Illustrating this, one RVC firm interviewed applied for a regional DR (allowing duty-free EAC sales) in 2018 but was granted only a national DR (valued at \$0.7m, not included in total) and chose to withdraw from the scheme, preferring to pay tariffs on inputs and retain duty free EAC market access for its finished products. The introduction of regional DRs from 2019 encouraged an RVC firm to participate in the duty remission scheme for the first time in 2020, for a value of \$0.2m. Notably the latter firm applied for duty remission only on the limited number of inputs which are eligible for regional DRs, mostly synthetic yarn, to avoid the situation of some NVC firms described in Chapter 5 who applied for DRs on inputs eligible for national and regional DRS such that finished products were subject to multiple conditions and the most restrictive won out, i.e. duty free EAC market access was lost.

### **7.3.3. Public procurement and policy (in)stability**

Public procurement contracts have been an important mechanism by which national authorities provide rents to domestic firms, with NVC firms in particular having benefitted. Facing intense import competition, declining domestic demand for traditional products and a lack of affordable credit, NVC firms want to diversify but struggle to accumulate or borrow capital to finance investment in inherently risky new ventures. As mentioned above, although procurement contracts are nominally *ex post* rents in the sense that payment is expected to be conditional on the successful manufacture of products to an agreed standard, the knowledge that a firm has such contracts in place is likely to facilitate their access to inputs before production takes place, especially finance for necessary equipment.

In Tanzania, the functional upgrade to apparel manufacture by NVC firm 4 was enabled by two policy-based rents from national authorities, namely duty remission described above and public procurement contracts. A government procurement contract for public sector uniforms provided a secure enough revenue stream to allow the firm to invest in learning to manufacture apparel. This was made easier by Tanzanian procurement rules which require procuring entities to give special preference (a margin of up to 15%) to domestically manufactured goods (URT, 2013). Such a margin can serve as a productive rent, compensating for the risk and cost of learning associated with

developing capabilities in a new activity, if accompanied by sufficiently strict disciplining measures such as quality requirements by procuring entities (Khan, 2000). Other Tanzanian firms expressed interest in upgrading to apparel manufacture if public procurement contracts could be secured. In Kenya the government's 'Buy Kenya Build Kenya' policy targets at least 40% local procurement by the public sector, and although this has not been achieved generally, a resulting high-level commitment to procure fabric for police uniforms from a Kenyan NVC firm enabled investment in process upgrading.

Additionally, a major issue identified in interviews with Kenyan firms was the volatility of domestic policies and the lack of consultation with stakeholders before major changes in policy direction, which we attribute to competitive clientelist nature of the Kenyan political settlement. For instance, an agreement was reached with several exporting firms to reduce their electricity costs through a rebate scheme, but this only lasted for a few months before being rescinded (interviews #10, #19). In another case, firms were given little warning of an 18% increase in the minimum wage in 2017 and another 5% rise in 2018, which some respondents from labour-intensive apparel manufacturers stated severely impacted the viability of their operations. The wage hike in May 2017 was followed by a general election in August of the same year and was seen as a key initiative to win support from unions and workers. Despite the complaints of apparel manufactures, employment in Kenyan apparel EPZs increased in every year from 2015 to 2019, passing from 41,597 to 49,489 and suggesting that profitability was in fact maintained (EPZA, 2020).

In conclusion therefore, rents controlled at the national level are more strongly felt by their absence – or their negative value – than their presence, or positive impact, from the perspective of T&A manufacturers. The combined effects of privatisation, liberalisation, import underreporting and mislabelling and policy volatility has damaged the competitiveness of NVC and RVC firms and the remaining rents from duty remission and public procurement are unable to make up the shortfall.

#### **7.4. Regional rents**

Rents allocated at the regional level, mainly through regional trade agreements and policy coordination initiatives, were important primarily to RVC firms and, to a lesser extent, NVC firms. Six of the T&A firms surveyed were oriented principally to regional markets and designated as RVC firms, although they retain a footholds in their respective domestic markets to differing extents with own-branded products. RVC firms were mostly established as private businesses in the 1960s and 1970s by African entrepreneurs of South Asian descent, and have remained predominantly in the control of the same families ever since as part of diversified business groups. While not affected directly by privatisation, RVC firms have been strongly affected by several other issues affecting NVCs described above, especially liberalisation across regional markets.

#### 7.4.1. EAC

The EAC FTA implemented from 2005 allows for duty free trade between members, removing tariffs on imports from other EAC countries – thereby also eliminating a potentially important source of rents for firms serving their respective domestic markets, especially NVC firms. At the same time the introduction of a Common External Tariff (CET) had differential impacts on protection from non-EAC imports. In Kenya the EAC CET resulted in a fall in the weighted MFN tariff for manufactured T&A products, from 24.6% in 2004 to 22.2% in 2010, reducing tariff rents for domestically oriented manufacturers. In Tanzania the opposite trend was seen, with the weighted average rising from 18.0% in 2003 to 23.3% in 2010, providing greater tariff protection.

In general the EAC CET aims to encourage investment in manufacturing through zero tariffs on raw materials, low tariffs on intermediate goods and the highest rates on finished products. In the T&A sector this manifests as 0% tariff rates on cotton lint and synthetic fibres; 10% on cotton and synthetic yarns; 25% on buttons, zippers, cotton and synthetic sewing threads, woven cotton and synthetic fabrics, made-up garments and textile articles; 35% on used clothing and 50% on *kanga* and *kitenge* (K&K) printed fabrics. As mentioned in Chapter 5 the EAC CET is under review at the time of writing, with plans to change the rate on most finished T&A products from 25% to between 30% and 35%. Although there is a duty remission scheme for inputs this is not used by most firms in most years, so tariffs on inputs reduce competitiveness, and have not provided sufficient rents to encourage new productive investment.

Rules of Origin (ROO) are critical determinants of who benefits most from trade agreements, and in the EAC these rules are relatively relaxed, especially for apparel. Restrictive double transformation requirements apply to knitted fabrics (HS 60) but relaxed single transformation rules apply for woven fabrics and apparel, i.e. manufacture from imported inputs is allowed. Firms wanting to export knitted fabrics duty free to other EAC countries must therefore either carry out not only knitting itself but also at least one other process such as spinning or dyeing, or they must source inputs within the EAC. Only one RVC firm (Firm 6) in our sample focused exclusively on knitted fabrics, having adapted its business model to the EAC ROO through sourcing cotton yarn within the EAC and carrying out dyeing in addition to knitting. All apparel producers interviewed were eligible to export duty-free within the bloc due to the relaxed apparel ROO, but no GVC firms interviewed were selling in the EAC due to a perceived lack of market opportunities.

Capitalising on the *ex post* rents arising from the EAC free trade area is a core element of RVC firm strategy, which we estimate – based on actual trade flows and MFN tariffs – to value \$12.8m and \$15.3m for Tanzanian and Kenyan T&A exports respectively in the five years to 2018, as shown in Table 18 and Table 19. These rents are divided between buyers who would otherwise have had to pay tariffs on imports (where domestic products weren't available), and producers who otherwise would

not have been able to export competitively within the region. Negative rents will by definition also have arisen for domestic and foreign producers whose goods are now outcompeted by newly competitive regional exporters. No mention was made during interviews of any negative impacts of the EAC FTA on domestic manufactures, so it is likely that producers outside the EAC bore the negative rents in the form of reduced sales to the bloc. The fact that intra-EAC trade in manufactured T&A products rose from \$12.5m in 2004 to \$30.5m in 2008 after the implementation of the free trade area suggests rents to RVC-oriented manufactures were significant.

*Table 18: Tanzania's EAC trade policy rents, manufactured T&A products*

|   | 2014   | 2015   | 2016   | 2017   | 2018   | Total  |
|---|--------|--------|--------|--------|--------|--------|
| EAC imports from Tanzania, USD 000          | 12,124 | 11,055 | 12,630 | 14,218 | 13,931 | 63,958 |
| Weighted average MFN tariff, EAC (%)        | 17.23  | 15.09  | 23.15  | 23.15  | 20.57  |        |
| Rent from duty free market access, USD 1000 | 2,089  | 1,668  | 2,924  | 3,291  | 2,866  | 12,838 |

Source: Trademap/Comtrade for trade values; WITS/TRAINS for tariffs. NB: 2017 tariff data is missing, 2016 value used. EAC is composite of Burundi, Kenya, Rwanda and Uganda. No data for South Sudan. For products included, see annex 10.3.

*Table 19: Kenya's EAC trade policy rents, manufactured T&A products*

|   | 2014   | 2015   | 2016   | 2017   | 2018   | Total  |
|---|--------|--------|--------|--------|--------|--------|
| EAC imports from Kenya, USD 000             | 15,449 | 14,173 | 15,487 | 16,996 | 15,605 | 77,710 |
| Weighted average MFN tariff, EAC (%)        | 21.47  | 21.43  | 20.69  | 18.55  | 16.43  |        |
| Rent from duty free market access, USD 1000 | 3,317  | 3,037  | 3,204  | 3,153  | 2,564  | 15,275 |

Source: Trademap/Comtrade for trade values; WITS/TRAINS for tariffs. NB: 2017 tariff data is missing, 2016 values used. EAC is composite of Burundi, Rwanda, Tanzania and Uganda. No data for South Sudan. For products included, see annex 10.3.

### *Used clothes*

Regional policies towards imports of used clothing (*mitumba*), which are in direct competition with locally made T&A products, have similar effects to import undervaluation (discussed above) and are an important determinant of the rents available for firms selling in regional markets. Although this trade affects both NVC and RVC firms, the latter are far more focused on clothing production, and since EAC policy towards used clothes has a strongly regional element, it is touched on here as a regional policy issue (see also Chapter 5). Since trade liberalisation, EAC imports of used clothing have exploded from negligible levels in the early 1990s to around US\$350m in 2018, and this was consistently highlighted by industry stakeholders as a major factor in the decline of the regional industry.

The permissive policy stance towards used clothing imports provides rents to consumers who benefit from high-quality garments at very low prices, but producers have been hit by the concomitant negative rents over several decades as local demand for new but relatively costly domestically produced clothing is weak. In 2015 EAC leaders announced their intention to rectify this situation by phasing out used clothes, confirming in March 2016 that this would take place over 3 years and subsequently raising tariffs on used clothes (Wolff, 2020). When one of the main US-based exporters of used clothes to the EAC complained to the Office of the U.S. Trade Representative, the incoming Trump administration responded by threatening to remove AGOA access if the tariff increase was not reversed. After lengthy negotiations Tanzania and Kenya complied with US demands, unlike Rwanda which was removed from the list of countries eligible for the AGOA scheme. Kenyan and Tanzanian authorities understandably chose to prioritise access to rents at the global level for GVC firms – maintaining thousands of already-existing jobs in EPZs – over eliminating negative rents for NVC and RVC firms in the hope of longer term NVC and RVC development.

### *EPZs*

The regional-level EAC policy framework towards EPZs is one of the most prominent industrial policy instruments in the T&A sector, and provides significant rents favouring integration into GVCs. Although national EPZ policy frameworks were established before their unification under the regional EAC Customs Protocol, the EAC EPZ Regulations now govern the key elements of national EPZ programmes, principally the minimum export requirement. EPZs give favourable fiscal incentives and other arrangements to investors, on the condition that no more than 20% of output may be sold in the ‘domestic’ market, i.e. the EAC single customs territory in this case. The priority on export outside the EAC – and therefore integration into GVCs – is justified by the potential to earn foreign exchange and the discipline imposed on exporters by global markets, requiring firms to meet the highest standards.

The literature suggests that EPZ rules are weakly enforced in Tanzania, especially the export requirement (Whitfield et al, 2015b) and although the Kenyan EPZA is sometimes portrayed as a ‘pocket of efficiency’ isolated from political pressures (Tyce, 2019) we present evidence which suggests otherwise. The lack of effective enforcement in Tanzania would mean that EPZ rents targeted at GVC firms in fact also benefit more regionally and domestically oriented firms, but we found no evidence that this is still occurring in the T&A sector. In Kenya we found evidence that firms are able to “roll-over” their 10 year window of corporate tax exemption, by renaming their business and applying as a new company despite having the same factory, personnel and buyers (interviews #15). This suggests that the Kenyan EPZA also struggles to implement and enforce rules effectively and is unable to discipline firms seeking to evade core principles of the EPZ programme, calling into question the idea of Kenya’s EPZA being a ‘pocket of efficiency’ (Tyce, 2019).

The 80% export requirement is highly controversial among EAC countries, with Kenya in particular arguing against the prioritisation of integration into GVCs to the detriment of NVC and RVC development. Instead Kenya has proposed an export requirement of 51%, which has been rejected by other EAC countries, partly due to fears that produce from Kenyan EPZs would out-compete other domestic producers within the EAC (interviews #47, #33). In this way the political economy dynamics resulting from uneven development within the EAC, particularly Kenya's higher level of economic development and the more advanced productive capabilities of its firms, make regional policymaking contested and conflictual with other countries using any available mechanisms to protect their national firms and markets from regional competition.

The EPZ regime provides rents to GVC firms in a number of ways, the most prominent amongst these being a 10 year corporation tax holiday. Although firm-level profit data is not available, official data made public by national authorities allow estimates to be calculated for Tanzania and Kenya of the revenue foregone. Tanzania's Annual Survey of Industrial Production (ASIP) allows the calculation of a proxy for profit – gross operating surplus – for apparel firms employing 500 or more employees, which captures the two Tanzanian GVC apparel firms in our sample only (NBS, 2018).<sup>36</sup> Kenya's Export Processing Zone Authority's Annual Performance Reports contain data on sales, imports and local expenditure for garment firms in EPZs allowing an estimate of profit (EPZA, 2020).<sup>37</sup> After converting the profit estimates to USD with average annual exchange rates and assuming the standard corporate tax rate of 30% in the absence of EPZs, the revenue foregone by national authorities and therefore the rent to GVC firms is presented in Table 20 below on a per firm and per worker basis. Although the different data sources and cost categories in each country make direct comparison difficult, rents in Kenya's EPZs appear much higher than in Tanzania even after accounting for the larger number of firms.

*Table 20: EPZ rents to apparel firms in Tanzania and Kenya*

|          |                       | <b>2013</b> | <b>2015</b> | <b>2016</b> | <b>2017</b> | <b>2018</b> | <b>2019</b> |
|----------|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Tanzania | Total rent (USD m)    | 0.25        | 0.66        | 1.24        |             |             |             |
|          | Rent per firm (USD m) | 0.25        | 0.66        | 0.62        |             |             |             |
|          | Rent per worker (USD) | 196         | 276         | 398         |             |             |             |
| Kenya    | Total rent (USD m)    |             | 104.23      | 104.35      | 47.89       | 101.01      | 54.00       |
|          | Rent per firm (USD m) |             | 4.96        | 4.97        | 2.28        | 4.59        | 2.25        |
|          | Rent per worker (USD) |             | 2,506       | 2,456       | 1,089       | 2,184       | 1,091       |

Own calculation from EPZA (2020) and NBS (2018)

<sup>36</sup> Gross operating surplus is gross output less intermediate consumption, less employee compensation, which amounted to TZS 1.360 bn, 4.374 bn and 9.024 bn in 2013, 2015 and 2016 respectively for GVC apparel firms. This differs from profit because it does not consider depreciation, taxes, interest, office costs etc., but it does provide a rough approximation, especially for a labour intensive industry with comprehensive tax exemptions and negligible local financing.

<sup>37</sup> Kenya's EPZA data does not cover the salaries of foreigners and other non-local expenditure, and may not include depreciation.

The magnitude of these rents is significant compared to other rents for integration into GVCs, especially in Kenya. Although caution is needed when comparing very different kinds of rents calculated using different data sources and methodologies, it is notable that AGOA rents discussed in the next section are less than half of EPZ rents in Kenya in 2016, but more than four times the value of EPZ rents in Tanzania. This contrasts with evidence from surveys of investor motivations which tends to downplay the importance of incentives to investors, with James (2013) suggesting that 91% would have invested in Tanzania without incentives, and 61% in Kenya. Other advantages for EPZ firms – such as exemptions from withholding taxes on dividend and other payments to owners overseas as well as from customs duty, VAT and other taxes on imports – are likely to be less financially important than the corporation tax holiday, partly because there are various national exemptions on many of these taxes outside of the EPZ framework (WTO, 2019). EPZ firms also often have access to serviced land in publicly maintained industrial parks at subsidised rates, and benefit from facilitated customs administration.

#### **7.4.2. SADC**

*Ex post* rents from the SADC FTA are crucial to Tanzanian RVC firm competitiveness, particularly due to its Rules of Origin. SADC allows for duty free trade in goods originating in member states (including Tanzania but not Kenya), with restrictive ROO for T&A products imposing a “double transformation” requirement for apparel and fabrics. Being vertically integrated, the Tanzanian RVC firms comply with the double transformation requirement and can export fabrics and apparel duty free to South Africa, a highly prized market which makes up around 60% of total SSA apparel imports due to its significant middle class and developed retail sector. By contrast, Tanzanian GVC firms which import fabrics and produce apparel, e.g. on a CMT or FOB basis, are not eligible to export duty free to South Africa. The SADC FTA and accompanying ROO therefore have the effect of providing a targeted rent to vertically integrated, regionally oriented producers. The rent is accessible on an ‘*ex post*’ basis, being disciplined by market relations: to benefit, Tanzanian RVC firms must maintain good relationships with South African buyers and comply with requirements around cost, quality, delivery timelines etc.

Capitalising on the targeted rents available through SADC for exports to South Africa is a core element of RVC firm strategy. The total rent generated is estimated based on the value of SADC’s imports of manufactured T&A products from Tanzania and the MFN tariffs otherwise due, shown in Table 21 to be around US\$26.3m over the five years to 2018. We take this as principally benefitting Tanzanian RVC firms, since South African buyers are able to import duty free from Lesotho and

Swaziland, so trade volumes would have been much lower in the absence of SADC.<sup>38</sup> RVC firms interviewed reported that because of SACU's high MFN tariffs on imports from other countries, South African buyers were willing to pay higher than market rates to Tanzanian firms meeting ROO criteria, which is captured in the trade policy rents below.

*Table 21: Tanzania's SADC trade policy rents, manufactured T&A products*

|  | 2014   | 2015   | 2016   | 2017   | 2018   | Total  |
|--|--------|--------|--------|--------|--------|--------|
| SADC's imports from Tanzania, USD 000      | 16,122 | 15,826 | 15,023 | 16,793 | 11,863 | 75,627 |
| Weighted average MFN tariff, SADC (%)      | 36.43  | 28.19  | 26.42  | 40.17  | 43.9   |        |
| Rent from duty free market access, USD 000 | 5,873  | 4,461  | 3,969  | 6,746  | 5,208  | 26,257 |

Source: Trademap/Comtrade for trade values; WITS/TRAINS for tariffs. NB: SADC includes all members. Import values for DRC are mirror data, i.e. Tanzania reported exports. For products included, see annex 10.3.

### 7.4.3. COMESA

Rents from the COMESA (Common Market for Eastern and Southern Africa) free trade area are of some importance to Kenyan RVC firms. Table 22 shows the magnitude of rents in this case to be the lowest of all regional agreements examined here, due to the low trade volumes and relatively low levels of MFN tariffs.

*Table 22: Kenya's COMESA trade policy rents, manufactured T&A products*

|  | 2015  | 2016  | 2017  | 2018  | 2019  | Total  |
|--|-------|-------|-------|-------|-------|--------|
| COMESA's imports from Kenya, USD 000       | 7,994 | 6,632 | 5,527 | 5,782 | 5,382 | 31,317 |
| Weighted average MFN tariff, COMESA (%)    | 24.4  | 23.67 | 25.04 | 24.41 | 9.07  |        |
| Rent from duty free market access, USD 000 | 1,951 | 1,570 | 1,384 | 1,411 | 488   | 6,087  |

Source: Trademap/Comtrade for trade values; WITS/TRAINS for tariffs. NB: COMESA includes all members except those who are also EAC members, to avoid double counting. Import values for DRC are mirror data, i.e. Kenya reported exports. For products included, see annex 10.3.

To conclude this section, rents at the regional level from regional trade agreements like the EAC, SADC and COMESA have largely failed to boost the competitiveness of RVC firms, who see the lowest levels of capacity utilisation of any firm group and poor performance in terms of functional, product and end market upgrading. This is partly explained by the 'negative rents' at the regional level arising from used clothing imports, as well as the impact of liberalisation, import underreporting and mislabelling described at the national level which diminishes the rents available in domestic

<sup>38</sup> This is evidenced by the fact that apparel exports from Tanzania to South Africa were at much lower levels before the implementation of the SADC FTA in 2008, after which the rate of growth increased substantially. Furthermore, GVC firms in Kenya and Tanzania (who do not meet ROO criteria) are not competitive exporting to South Africa with tariff barriers.

markets where RVC firms retain a strong foothold. Furthermore, we have argued that a key policy framework at the regional level – that pertaining to EPZs – prioritises rent creation for GVC-oriented firms, removing a potential source of competitiveness from RVC firms.

## **7.5. Global rents**

Rents allocated by international policy factors were critical drivers of T&A firm strategy, particularly preferential trade arrangements (PTAs) which primarily benefitted GVC firms. Eight of the firms surveyed were integrated into global value chains and are designated as GVC firms. All have been established with EPZ status and therefore benefit from the significant EPZ rents allocated by national and regional authorities described above. Nevertheless, according to firms surveyed, the main policy tool driving integration into GVCs is preferential market access, especially the unilateral trade preferences of the USA under AGOA.

### **7.5.1. AGOA**

The USA's AGOA is currently the most important preferential market access scheme for Tanzania and Kenya, providing duty free market access across 97.5% of tariff lines. Key to the uptake of AGOA for T&A products is its relaxed ROO, particularly the Third Country Fabric (TCF) derogation which allows duty free access for apparel made from fabric originating anywhere in the world (i.e. a single transformation requirement), but has the side-effect of reducing incentive for local textile production. AGOA creates the potential for significant rents for GVC-oriented apparel assemblers, incentivizing them to create labour intensive jobs in industrial districts of eligible countries. Crucially, these are '*ex post*' rents realised only after goods have been produced at a low enough cost to be competitive once the rent is taken into account. AGOA underpins a large number of urban jobs in GVC firms in the EAC and is a powerful foreign policy tool to protect the interests of US actors, as shown by most EAC countries reversing used clothes tariff increases (aimed at supporting NVC and RVC firms) on the threat of AGOA's withdrawal (see above). AGOA's design and the attached conditions have costs to EAC countries in terms of constraints on industrial policy space, particularly to support NVC and RVC development, as outlined in Chapter 5 and this section.<sup>39</sup>

AGOA's expiry is scheduled for 2025 and the USA would prefer bilateral trade deals involving reciprocal tariff reductions over either AGOA renewal or the African Union proposal for a continental AfCFTA-USA FTA; unsurprisingly the US approach appears to be prevailing with Kenya already opening negotiations on a bilateral deal with the US to safeguard its market access. It appears likely

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<sup>39</sup> Note that AGOA creates rents for eligible countries; negative rents are experienced by non-eligible countries who lose US market share as a result. The magnitude and design of AGOA rents impact policy space in eligible countries by making GVC-oriented industrial strategies more viable at the expense of NVC and RVC-oriented strategies.

that Tanzania’s duty free US market access would continue in some form, but uncertainty over its future is already reducing incentives for new GVC investment in the apparel sector, with interviewees preferring at least a 10 year time horizon of policy stability for new investment, and existing firms anticipate having to find alternative markets or reduce their production (interviews #6, #11, #20).

AGOA has broader impacts on T&A value chain development at the national and regional levels. The TCF increases the value of rents to manufacturers in eligible countries, but at the same time reduces incentives for investment in local textile production (Pickles et al, 2015). Furthermore the incentives created by AGOA are different across value chain types because US MFN tariffs rates are higher (at 25-32%) for synthetic than cotton apparel products (13-17%) (Staritz, 2011). By reducing tariffs on all T&A products to zero AGOA provides greater duty advantages for manufacturers using synthetic over cotton fabrics, and indeed Table 14 above shows that Tanzania’s second largest apparel export is non-cotton T-shirts to the USA despite the presence of an established cotton sector in Tanzania. Thus although AGOA promotes integration into T&A GVCs, its current design ensures that the local demand generated for fabric will be met through imports rather than backward integration, and linkages with NVCs and RVCs are likely to remain weak.

Rents from AGOA are central to the strategy of the GVC apparel firms, and indeed are the principal reason for their location in Tanzania and Kenya. As before, bilateral tariff and trade data are used to estimate the size of the rent from AGOA, which gives the figures shown in Table 23 and Table 24 below. Since US buyers can easily source duty free from other countries, the rents are considered to principally benefit Tanzanian and Kenyan GVC firms.

*Table 23: Tanzania’s AGOA trade policy rents, manufactured T&A products*

|   | 2015   | 2016   | 2017   | 2018   | 2019   | Total   |
|---|--------|--------|--------|--------|--------|---------|
| USA imports from Tanzania, USD 000          | 27,999 | 37,879 | 42,055 | 42,910 | 53,425 | 204,268 |
| Weighted average MFN tariff, USA (%)        | 16.09  | 14.42  | 13.37  | 13.33  | 13.05  |         |
| Rent from duty free market access, USD 1000 | 4,505  | 5,462  | 5,623  | 5,720  | 6,972  | 28,282  |

Source: Comtrade, WITS/TRAINS. For products included, see annex 10.3.

*Table 24: Kenya’s AGOA trade policy rents, manufactured T&A products*

|   | 2015    | 2016    | 2017    | 2018    | 2019    | Total     |
|---|---------|---------|---------|---------|---------|-----------|
| USA imports from Kenya, USD 000             | 380,763 | 352,231 | 348,532 | 403,555 | 466,769 | 1,951,849 |
| Weighted average MFN tariff, USA (%)        | 13.3    | 13.02   | 12.95   | 13.35   | 13.06   |           |
| Rent from duty free market access, USD 1000 | 50,641  | 45,860  | 45,135  | 53,875  | 60,960  | 256,471   |

Source: Comtrade, WITS/TRAINS. For products included, see annex 10.3.

### 7.5.2. EU EBA

The European Union’s preferential market access arrangements are of relatively low importance to EAC T&A sectors overall, but the rents bestowed are likely to be highly valued by the small number of firms involved in exporting to the EU. Tanzania benefits from the EU’s Everything But Arms (EBA) DFQF initiative for LDCs, but Kenya has similar terms of access under the Economic Partnership Agreement (EPA), with both featuring relaxed single transformation Rules of Origin. Trade volumes are relatively low for Tanzania but higher for Kenya, with the EU’s low levels of MFN tariffs meaning that rents are anyway small.

*Table 25: Tanzania’s EU EBA trade policy rents, manufactured T&A products*

|   | 2015  | 2016  | 2017  | 2018  | 2019  | Total  |
|---|-------|-------|-------|-------|-------|--------|
| EU-28 imports from Tanzania, USD 000        | 3,776 | 2,859 | 2,733 | 1,738 | 2,382 | 13,488 |
| Weighted average MFN tariff, EU-28 (%)      | 8.85  | 9.7   | 9.2   | 10.31 | 10.76 |        |
| Rent from duty free market access, USD 1000 | 334   | 277   | 251   | 179   | 256   | 1,298  |

Source: Comtrade, WITS/TRAINS. For products included, see annex 10.3.

*Table 26: Kenya’s EU EPA trade policy rents, manufactured T&A products*

|   | 2015  | 2016   | 2017   | 2018  | 2019  | Total  |
|---|-------|--------|--------|-------|-------|--------|
| EU-28 imports from Kenya, USD 000           | 5,930 | 10,053 | 10,622 | 8,991 | 9,233 | 44,829 |
| Weighted average MFN tariff, EU-28 (%)      | 11.8  | 11.64  | 11.83  | 11.86 | 11.73 |        |
| Rent from duty free market access, USD 1000 | 700   | 1,170  | 1,257  | 1,066 | 1,083 | 5,276  |

Source: Comtrade, WITS/TRAINS. For products included, see annex 10.3.

### 7.5.3. Canada

Canada’s GSP scheme consists of two different preferential tariffs, the least developed country tariff (LDCT) which provides duty-free access for 98.6% of tariff lines and the General Preferential Tariff (GPT) for which the corresponding figure is 73.7% (UNCTAD, 2018a). Tanzania is eligible for the LDCT tariff, while Kenya is only eligible for the GPT tariff. Kenya’s main exports to Canada (in HS categories 6107, 6101, 6203, 6103, 6109) are not eligible for duty-free treatment under the GPT regime, with the MFN tariff applying instead (CBSA, 2020). Tanzania has only recently started exporting to Canada, with its main export – non-cotton T-shirts (HS 610990) – eligible for duty free treatment. This product category, along with a small number of other T-shirts and pants is one of the few falling in Canada’s A3 product group (introduced in 2017) for which there are relaxed single transformation Rules of Origin, allowing assembly from fabrics imported from a wide range of countries including China and India.

Table 27: Tanzania's trade policy rents due to Canada's GSP, manufactured T&A products

|   | 2015  | 2016  | 2017  | 2018  | 2019  | Total |
|---|-------|-------|-------|-------|-------|-------|
| Canada's imports from Tanzania, USD 000     | 265   | 585   | 449   | 4,010 | 4,674 | 9,983 |
| Weighted average MFN tariff, Canada (%)     | 17.41 | 17.54 | 15.48 | 17.74 | 17.61 |       |
| Rent from duty free market access, USD 1000 | 46    | 103   | 70    | 711   | 823   | 1,753 |

Source: Comtrade, WITS/TRAINS. For products included, see annex 10.3.

#### 7.5.4. China

China has no preferential trading arrangements in place with Kenya, but as an LDC Tanzania benefits from duty-free market access on 97% of tariff lines. Tanzania's exports to China consist overwhelmingly of cotton yarn (HS 520512) which is eligible to be imported duty free under China's GSP scheme for LDCs (WTO, 2020).

Table 28: Tanzania's trade policy rents due to China's GSP, manufactured T&A products

|   | 2015  | 2016   | 2017  | 2018   | 2019  | Total  |
|---|-------|--------|-------|--------|-------|--------|
| China's imports from Tanzania, USD 000      | 7,527 | 11,261 | 3,746 | 14,004 | 4,016 | 40,554 |
| Weighted average MFN tariff, China (%)      | 5.0   | 5.0    | 6.3   | 5.0    | 5.0   |        |
| Rent from duty free market access, USD 1000 | 377   | 563    | 234   | 703    | 201   | 2,078  |

Source: Comtrade, WITS/TRAINS. For products included, see annex 10.3.

To conclude this section, rents for integration into GVCs have driven significant investment in East African T&A sectors in recent decades, particularly the USA's AGOA scheme with its relaxed Rules of Origin. The structure of AGOA rents is linked to the particular set of governance arrangements – foreign owned apparel assembly operations integrated into triangular manufacturing networks – which largely prevail in East African GVC firms, and explains their good product and process upgrading performance and weaker outcomes in functional upgrading, especially the hoped-for investment in upstream textile manufacture which has not materialised.

#### 7.6. Tensions between rents at different levels

Multi-scalar analysis of industrial policy rents as presented in this chapter highlights the existence of tensions between rents at different levels of policymaking. These have important implications for policy space and the design of industrial policy. The most prominent tensions are between the national and regional level, as in the case of the duty remission scheme, and the regional and global level, most evident in the links between AGOA and the used clothing trade.

The EAC duty remission scheme was shown above to be an important source of *ex ante* rents, but its design and implementation highlights tensions between national policy space and regional market

access, resulting in a bias towards granting rents at the national rather than regional level. The EAC DR scheme has been largely implemented by means of ‘national DRs’ – in effect granted unilaterally by national authorities – which prevent duty-free sale in other EAC countries, removing a crucial source of rents for RVC firms and therefore precluding their participation in the DR scheme. Recent efforts to agree a list of inputs eligible for ‘regional DRs’ – which are compatible with duty-free EAC market access – have therefore been welcomed by RVC firms, but policymakers appear unwilling to grant regional firms access to their own national market where those firms have benefitted from duty remission rents, perhaps because they consider this to be unfair competition for domestic firms who have not enjoyed similar benefits. As long as the granting of duty remission rents at the regional level must be accompanied by the granting of regional market access by national authorities on an ad hoc basis, tensions will remain and NVCs will be prioritised over RVCs regardless of the opportunities offered by the latter.

Rents from AGOA arising at the global level have been critical drivers of EAC integration into T&A GVCs, yet their structure has also limited the potential for positive rents at the regional level. Most obviously, the US administration decided to prioritise upholding the complaint of a US-based used clothing exporter against efforts by EAC policymakers to raise tariffs on used clothes, and threatened to remove AGOA preferences. This forced EAC countries to choose between maintaining existing rents to GVC firms and reducing longstanding negative rents in regional markets, with the former option preferred because of the political imperative to avoid job losses in urban areas. Furthermore the structure of AGOA rents – both the relaxed ROO allowing use of third country fabrics and the greater incentives for products made from synthetic materials – limit the potential for building backward linkages between GVC firms and the regional cotton-based textiles sector in the EAC.

Analysis of the interactions between rents at different levels is essential for industrial policymaking in the contemporary context of overlapping policy instruments at the national, regional and global levels. This is related to but goes beyond the attention to multidimensional policy space in Chapters 4 and 5, since rents emerge from the policy context in sometimes unpredictable ways. There is a need for greater academic and policy focus on how different industrial policy regimes interact, the trade-offs created and the impact on industrial development and upgrading outcomes in different value chains.

### **7.7. Conclusion: towards multi-scalar industrial policy analysis**

This chapter has examined the concrete policy rents – both positive and negative – which have impacted firms in the EAC T&A sector. These rents have emerged from the policy space in more or less planned ways, and highlight the potential for considered interventions to support firms’ capability development as well as for unintended consequences to spill over from other policy areas and undermine progress. We have argued that rents are critical for upgrading, and that in particular the

structure of rents – their design, implementation and the incentives created – explains the range of firm performance outcomes presented in Chapter 6. Furthermore the approach taken in this chapter – analysing rents allocated at the national, regional and global levels – has highlighted the value of multi-scalar industrial policy analysis, contributing to an emerging literature (Behuria, 2019). A key first lesson from the analysis of this chapter is the importance of considering *interactions and tensions between rents at different levels*, as argued in the previous section.

Second, a fundamental principle of multi-scalar industrial policymaking which emerges from the analysis is the need to *align rents with upgrading opportunities*. The previous chapter found distinct opportunities in NVCs, RVCs and GVCs which constitute a defining aspect of economic policy space, so in order to be effective in supporting upgrading, policymakers should aim to create rents targeted at opportunities in particular value chains. For instance the use of public procurement contracts by national authorities has been an effective way to promote functional and process upgrading by NVC firms through the provision of targeted, conditional rents. By contrast the policy stance towards import undervaluation and used clothing imports at the national and regional levels has channelled non-productive rents to consumers while NVC and RVC firms engaged in T&A manufacturing have suffered the inverse ‘negative rents’ and have struggled to remain competitive, explaining their poor upgrading performance overall.

Third, policymakers should take into account the *political economy of rents* when designing industrial policies, as a key aspect of policy space. In particular, policies which threaten the interests of powerful groups are likely to be difficult to implement. At the national level, efforts to implement tariffs on new and used T&A products have foundered due to the power of large trading companies, e.g. to subvert the customs regime through undervaluation of imports. For used clothes, although the US threat to remove AGOA preferences stymied proposed tariff increases in most countries, strong domestic opposition was also voiced by small traders and consumers who represent a powerful, if fragmented interest group. Furthermore, given the importance of rents from preferential trading arrangements for the EAC T&A sector, the design of national and regional industrial policies must take into account not only powerful domestic actors but also those based overseas, especially the USA (e.g. used clothes traders) but also East Asian suppliers with investments in East Africa. The relaxed ROO of PTAs like AGOA also reflect political economy realities, e.g. the interests of the US apparel industry to access low cost products, such that those schemes contribute little to Tanzania and Kenya’s industrial policies pursuing backwardly integrated cotton-to-clothing value chains at the national level. In the next chapter we apply some of these conclusions to ongoing policy debates relating to the design of regional integration policies, particularly on the African continent.

## **8. Conclusions and policy implications**

### **8.1. Introduction**

This chapter summarises the main findings and contributions of the thesis and draws out some lessons for policymakers. Through studying the case of the EAC, this thesis has found that regional integration can have significant impacts on policy space for industrial upgrading, and be either positive or negative across different dimensions. For instance, findings from studying the EAC's duty remission scheme and stays of application suggest that the greater the expansion of economic policy space through the creation of a more integrated and coherent regional market, the greater the loss of legal policy space at the national level. This implies an increased policy focus on managing the trade-offs inherent in regional trade agreements, particularly between expansions of market access and loss of national autonomy to protect strategic sectors from regional competition.

Expanded economic policy space at the regional level may manifest as the deepening of regional value chains (RVCs), and this research compares the contribution of RVCs and other value chain types to industrial development objectives. The different types of upgrading opportunities identified in NVCs, RVCs, and GVCs point towards the development of industrial policies which do not rely on a single value chain type, but strategically combine the benefits and rents available in each over time for the development of productive capabilities.

The next section presents conclusions from the main chapters of the thesis. The subsequent section focuses on the main theoretical and methodological contributions. Policy implications are then drawn out before the final section identifies the limitations of this thesis and possible avenues for future research.

### **8.2 Main conclusions and contributions**

#### **8.2.1 An analytical framework for policy space**

A main contribution of this thesis is the development of a new, unified analytical framework for studying policy space in specific contexts. Existing literature using the term 'policy space' is fragmented across disciplinary boundaries, from fiscal policy and macroeconomics to legal analyses. In the domain of industrial and trade policy, the most prominent definition distinguishes *de jure* and *de facto* policy space, which refer respectively to the formal powers policymakers have, and their actual ability to translate this into control of key policy variables (Mayer, 2009). While this definition provides a useful starting point, it does not easily accommodate the wide range of political economy factors at the domestic and international level that affect the ability of policymakers to implement effective industrial policies.

To address this, Chapter 4 proposed a definition of industrial policy space as the set of legally permitted, economically viable and politico-institutionally feasible policy options, given constraints present at the national, regional and global levels, which can promote industrialisation of an economy. This was operationalised for research purposes as a multidimensional framework comprising three analytical dimensions and three geographic levels of governance, forming a three-by-three square matrix. Essentially the framework builds on Mayer's (2009), but splits the *de facto* domain of policy space into political-institutional and economic dimensions, prompting engagement with how the distribution of power affects the feasibility of implementing different policies and also how economic structures affect their viability. This is particularly relevant because of the interconnection between industrial, macroeconomic and financial policy areas. The inclusion of three geographic levels of governance encourages consideration of how factors at the national, regional and global level affect each dimension of policy space in a given context.

After introducing the framework, Chapter 4 presented some of the main factors highlighted in the literature affecting policy space in each square of the matrix, from the perspective of LLMICs. In the domain of legal policy space – the set of legally permitted policy instruments – there has been a particular focus at the global level, where multilateral rules under the auspices of the WTO are found to impose severe constraints on state action, especially given their extension beyond trade policy to areas such as investment protection and intellectual property rights (Chang, 2002; Wade, 2003). It was argued that despite the constraints of WTO rules there remains significant unused legal policy space, suggesting that other factors may be more important in explaining current approaches to industrial policy in LLMICs. Looking at legal policy space at the regional level for instance, the proliferation of regional trade agreements has in many cases imposed new restrictions on industrial policy as there is a move to 'WTO-plus' rules in agreements with the USA and EU countries. Furthermore at the national level it was argued that domestic legal frameworks may impose limitations on industrial policy, for example when they are not conducive to the creation of learning rents in promising new industrial sectors.

Analysis of the political-institutional dimension of industrial policy space provided insights into how informal rules stemming from the distribution of power affect macroeconomic and financial policies and therefore the ability of policymakers to support industrial development. At the global level this has manifested over the last decade as a shift in prevailing policy orthodoxies away from staunch neoliberalism to an era of 'productive incoherence' as a result of changing geopolitics hastened by the aftermath of the 2007-8 global financial crisis when emerging powers increased their engagement with the IMF (Grabel, 2018). Although in principal this may have eased political-institutional constraints on policy space, the experience of a given country will also depend on their regional context, for instance the extent of power asymmetries with neighbours and who they favour, and the capability of any supra-national institutions to coordinate shared development initiatives. At the

national level the distribution of power has been shown to be a critical factor explaining why some industrial policy instruments are more feasible to implement than others (Khan, 2010, 2017) and a contribution of this thesis is to bring the political settlements and policy space literatures into dialogue with each other.

The economic dimension of policy space draws attention to how market and production structures across geographies affect which industrial policies can be successfully implemented. At the global level, the organisation of production into GVCs characterised by ‘endogenous asymmetries’ of power between lead firms and suppliers reduces opportunities for LLMIC firms’ experiential learning and increases the cost of supporting them to achieve competitiveness. Factors at the regional level such as the presence of economic complementarities and infrastructure connectivity between neighbouring countries affect the extent to which RVCs can support ambitious industrial policymaking. Finally, at the national level, economic fundamentals such as the size of the domestic market and the level of existing productive capabilities are essential to understanding what industrial strategies are viable to implement.

Several reflections are offered on the value of the framework and its operationalisation. By bringing together legal, political and economic aspects of policy space the framework highlights the opportunities, constraints and trade-offs inherent in contemporary industrial policymaking. Further, by encouraging consideration of constraining and enabling factors at the national, regional and global levels independently, the framework allows for the kind multi-scalar analysis presented in Chapter 7, an approach increasingly recognised in the literature as essential to understanding contemporary industrial policy (Behuria, 2019). The wide and heterogeneous range of factors that are encompassed by the framework mean it is more tractable when applied to a specific context, such as a particular industrial sector in a country, as demonstrated in Chapter 5.

### **8.2.2 Regionalism and policy space: the case of the EAC**

A central aim of the thesis is to understand the implications of regional integration for industrialisation through its impact on policy space. This was achieved through an analysis of two of the main ideal-type regional trade agreements – free trade agreements and customs unions – in section 4.3, before moving to a case study of the EAC to examine a concrete example (Chapter 5).

Regional integration initiatives have rapidly increased in number and scope in recent decades, and are usually centred on shared commitments in the area of trade policy, commonly taking the form of a free trade agreement (FTA) or customs union. A regional FTA principally involves a bargain by members to increase economic policy space through expanded opportunities for regional investment and duty-free market access, in exchange for a loss of legal policy space, namely the freedom to use tariffs to protect domestic industries from regional competition. A customs union involves the same

liberalisation bargain as an FTA but with the addition of a common external tariff (CET), which results in a further loss of the legal policy space for member states to autonomously set tariffs to protect domestic industries from global competition, but with some potential benefits in terms of expanded economic policy space (through greater integrity of the regional market) and expanded political-institutional space (e.g. new supra-national institutions and greater bargaining power with extra-regional trading partners).

Overall then, the impact of a regional FTA or customs union will have an ambiguous effect on policy space, with less industrially advanced and politically weaker countries likely to see more downsides through an inability to protect infant industries in which their neighbours are already established, and by having less power to ensure a CET is aligned to their long term industrial development objectives. This finding contrasts with optimistic assessments of the impact of South-South regional trade agreements on policy space as negligible or positive in the literature (Thrasher and Gallagher, 2010).

Chapter 5 examines the impact of a particular regional integration initiative on industrial policy space, applying the framework introduced above to the case of the EAC. The empirical data used for the analysis is drawn from semi-structured interviews with industry stakeholders at the national and regional level, as well as from official documents and publications. Regional cooperation in the EAC has been criticised by some analysts for its deviation from the textbook model of a customs union (Mshomba, 2017), but we argue that the flexibility afforded to EAC members to support strategic sectors is a valid approach to maintain national-level legal policy space, albeit at the expense of regional-level economic policy space, shown by the fragility of regional value chains.

The set of legally permitted policy options in the EAC T&A sector – i.e. legal policy space – was found to be largely defined by factors at the regional and global levels, with national constraints playing a smaller role. National level legal frameworks can largely evolve with changes in the political settlement and according to the needs of priority sectors, for instance with public procurement rules in Tanzania and Kenya providing space for strategic industrial policy. Several legal constraints were nevertheless identified, such as where rules seen as unfavourable by firms are core elements of the political settlement (e.g. on foreign workers), and where national legal frameworks do not include legislation allowing policymakers to enact permitted measures, e.g. WTO trade remedy measures (anti-dumping duties, countervailing measures, and safeguards).

At the regional level, the East African Community is a defining feature of legal policy space for member states. Formally it involves the transfer of trade policy sovereignty from the national to the regional level, as per the above analysis of a standard customs union, but in reality there are several flexibilities in the EAC framework that allow members to maintain control in key industrial sectors. The duty remission (DR) scheme is primarily a legal mechanism to allow member states to deviate from the EAC CET by reducing tariffs paid on inputs by particular firms making specified products.

In the T&A sector, most EAC members have increased their use of the DR scheme in recent years, but this has largely happened in ways which prevent benefitting firms from selling finished products in the EAC, i.e. they can produce for the domestic market or non-EAC exports only. This was explained as ensuring a level playing field within the EAC, but the loss of EAC markets – and therefore regional economic policy space – was a source of frustration for regionally-oriented firms and policymakers. Responding to this, efforts to agree a list of inputs eligible for duty remission for finished products sold across the EAC have gathered pace, with a limited number (22) agreed from 2019, mainly synthetic yarns and accessories. A further 75 inputs were eligible for DR for products sold in Rwanda, Uganda, Burundi and Tanzania, but would attract CET rates if sold in Kenya. Difficulties agreeing a common approach across the EAC reflect different industrial policy priorities across countries, and demonstrates the tensions between the national and regional dimensions of legal policy space.

Rules of Origin (ROO) and Export Processing Zones (EPZs) are other areas where legal rules set at the regional level impose constraints on industrial policymaking. Firms with EPZ status benefit from a range of fiscal and non-fiscal incentives, but are limited to selling only 20% of their produce within the EAC such that national EPZ regimes are constrained, e.g. export strategies based on integration into regional value chains would be more difficult to implement. Tanzania is a member of SADC and therefore has duty-free market access to one of the region's largest consumer markets, South Africa, but SADC's restrictive double transformation ROO in the T&A sector mean that garment manufacturers who import their fabrics from outside SADC are not eligible. In the T&A sector at least, the expanded economic policy space offered by the SADC agreement comes with strict conditions on legal policy space via ROO, limiting the overall impact.

The main policy frameworks at the global level shaping legal policy space in the EAC T&A sector are preferential trading arrangements (PTAs), with WTO rules not seen as restrictive by industry stakeholders. The USA's AGOA was identified as the most important PTA in the region, providing EAC countries duty-free US market access for T&A products alongside relaxed single transformation ROO allowing use of fabric imported from anywhere. This arrangement generates significant rents for GVC-integrated garment manufacturers and has resulted in large scale employment creation, especially in Kenya, but has important implications for industrial policy space. By allowing the use of imported fabric, AGOA does not encourage investment in local textiles manufacture or building backward linkages to the cotton sector – where the region has a comparative advantage – and therefore contributes little to the stated EAC policy goals of building fully integrated cotton-to-clothing value chains within the region.

The political-institutional dimension of policy space is mainly defined by factors at the national and global level, with little power invested in the EAC's supra-national regional structures. Domestic

political economy factors have been neglected in studies of policy space (Dagher, 2019), but the analysis in section 5.3 shows how the presence of clientelist political settlements in Kenya and Tanzania makes it harder to enforce discipline on rent recipients, such as firms located in EPZs, and also harder to enforce customs rules so as to prevent undervalued imports reducing prices and margins for domestic manufacturers. This demonstrates the importance of designing industrial policies to take into account the national political-institutional dimension of policy space, particularly whether policy rents can be removed from politically connected but underperforming firms (see also Khan, 2017).

The creation of the EAC involved the nominal transfer of powers from the national to the regional level, especially over trade policy. However, supra-national institutions remain weak, national governments retain flexibility to opt-out of regional policies, and powerful actors at the global level often restrain regional initiatives. Stays of Application (SOA) have no legal basis but are nevertheless commonly used by member states to deviate from the CET, which in the T&A sector are often used to raise tariffs on finished products to afford greater protection to domestic manufacturers. Efforts at regional industrial policymaking have foundered, with the EAC Secretariat lacking resources to design and implement policies, instead relying on national governments to take forward their preferred initiatives. Coordination enabled by EAC institutions resulted in leaders announcing a regional industrial policy of import substitution towards used clothes, however political-institutional constraints at the global level – namely the oppositional stance of the US government and its ability to unilaterally remove AGOA preferences – meant that implementation was deemed too costly and largely abandoned in Tanzania and Kenya. Furthermore, external funding of the EAC institutions results in donors having significant power to shape the regional integration agenda and prioritise projects aligned with their own interests. In these ways, regionalism as pursued in the EAC has so far failed to create significant political-institutional policy space for regionally coordinated and resourced industrial strategies.

In the economic dimension of policy space, the limited extent of domestic markets is a motivating factor behind regional integration efforts, and the development of RVCs may yet provide a viable alternative to the challenges of upgrading in GVCs. In the T&A sector there are promising signs of productive complementarities between EAC member states such as the presence of globally competitive exports of both cotton and apparel, with signs of product upgrading across multiple apparel subcategories. Yet policymakers interviewed expressed scepticism about the viability of RVCs as vehicles for long term development. For some this was due to unfavourable existing patterns of specialisation (e.g. cotton in Tanzania), but even Kenyan officials did not want their manufacturers to be reliant on regional cotton imports, preferring to develop a fully national value chain. This is partly due to the demonstrable vulnerabilities of regional supply chains, for instance in 2017 EAC T&A free trade broke down when Tanzania imposed tariffs on imported clothing from Kenya after the latter applied a SOA to allow its EPZ manufacturers to export more produce to the region. On the

other hand, many firms interviewed during this research expressed interest in the development of RVCs, suggesting that regional T&A buyers offered distinct advantages over national and global buyers, e.g. South African buyers being as demanding on quality but more forgiving on price than US buyers. At the global level, economic policy space is heavily constrained by the organisation of T&A production in GVCs characterised by high levels of competition among suppliers and value capture by lead firms, which make upgrading in GVCs challenging for LLMICs. Given the constraints of GVC-based strategies, RVCs for T&A in Africa offer potential benefits in terms of learning and upgrading, but they remain vulnerable to trade disputes and may appear less attractive to countries specialising in lower value segments of a particular chain.

The analysis of regionalism and policy space in the EAC has demonstrated the value of the proposed policy space framework. By focusing attention on different dimensions and levels of industrial policy space, the key tensions which constitute the dilemmas of regional integration and industrial policy were brought into focus. For instance the tolerance of deviations from common EAC trade policies allows each country to retain a large degree of national legal and political-institutional policy space, yet this weakens the integrity of the EAC market and so limits the expansion of regional economic policy space. EAC cooperation seemed to expand political-institutional policy space by creating the possibility of regional import substitution of used clothes, yet the response of the USA showed that hard constraints at the global level must be considered by regional policymakers. A structured approach to analysing policy space, such as the one presented in this thesis, may support the design and implementation of more effective industrial policies in LLMICs.

### **8.2.3 Upgrading in EAC T&A value chains**

Regional integration aims to build on and foster the development of regional value chains (RVCs), but there are few studies that rigorously compare opportunities and outcomes across different value chains in a particular sector. This section summarises and draws conclusions from Chapter 6, which aims to understand whether RVCs offer comparable prospects for industrial upgrading as compared to global value chains (GVCs) and national value chains (NVCs). The chapter introduces ‘value chain directionality’ as an organising concept and describes the main features of the survey (for both of which see section 8.3 below), before presenting primary data collected as part of this PhD research, a main contribution of this thesis which is the focus in this sub-section.

Table 16 presents data for the 19 firms surveyed, which sit on a spectrum in terms of their value chain directionality, i.e. their engagement with NVCs, RVCs and GVCs, with significant variations in firm set-up and outcomes according to value chain directionality. Five firms were found to be overwhelmingly oriented to domestic markets for both inputs and outputs, so are labelled NVC firms. Six firms were identified as RVC firms due to the centrality of regional markets to their input sourcing and sales strategies, even though many retain a strong foothold in national markets. There

were eight GVC firms, so called for their strong orientation to global market for both inputs and outputs. The key characteristics of firms such as age and ownership were presented, alongside information on their value chain directionality in terms of inputs, outputs and functions performed, and finally key outcomes such as employment, capacity utilisation and upgrading in terms of functions, products, processes and end markets.

Results were first presented for the area most closely associated with value chain directionality, particularly its ‘forward-facing’ aspect, i.e. related to the nature of buyers and end markets. Generally, firms viewed global markets as the most attractive to serve and the most demanding in terms of quality and cost, followed by regional markets, with national markets at the bottom of the hierarchy. This was particularly demonstrated by the case of Tanzanian Firm 10 which was in the process of upgrading from primarily South African to US export markets, requiring investment in improved production processes and systems (although the long term profitability of this decision could not be judged at this early stage). For Kenyan firms unable to export duty-free to South Africa (Kenya not being in SADC, unlike Tanzania), regional markets are lower-income countries than Kenya itself, but Kenya’s domestic market includes a wide range of buyers, from more demanding department stores to wholesale buyers, with the latter seen as on a par with counterparts in neighbouring countries. Therefore the relative merits of national and regional markets depend on the countries concerned and the trade agreements they are party to. What constitutes end market upgrading must therefore be grounded in the experience of a particular firm, country and region, but the survey findings suggest support for the idea that RVCs can be a “stepping stone” to enter GVCs (UNCTAD, 2019; Franssen, 2020). Cases were found of end market downgrading where firms were excluded from higher value EU markets and turned instead to regional markets, showing that RVCs can be stepping stones on the way down as well as up. Firm set-up is also a limiting factor for end market upgrading, with lead firms in GVCs requiring a level of flexibility of suppliers that is inherently difficult for vertically integrated NVC and RVC producers producing cotton fabric on outdated machinery.

The value chain functions performed by firms are a major determinant of their performance and outcomes, and a contribution of this research is to examine the functions performed across different value chains. The survey results show that RVC and NVC firms carry out a wide range of functions, and all of them have sales in both national and regional markets, albeit to differing extents according to their value chain directionality. All RVC and NVC firms were vertically integrated to some extent, and most also performed higher value functions like design and branding. GVC firms focused on a narrower range of activities, mainly garment assembly with some auxiliary functions like embroidery and printing, which is linked to their mostly foreign ownership and integration into ‘triangular’ manufacturing arrangements driven by PTA rents. However, the partly and fully locally owned GVC firms (Firms 12 and 18) had similar operating models to foreign-owned GVC firms – with no vertical

integration, design or branding – although they were the only ones to provide a full package service to buyers. This demonstrates the importance of value chain directionality in determining functional range alongside other governance factors like ownership and embeddedness which are rightly emphasised in the literature (Morris et al, 2016).

Functional upgrading was rare across all groups, which was expected for GVC firms but more surprising for NVC and RVC firms, which the literature suggests are more likely to functionally upgrade (Navas-Alemán, 2011), and disappointing given the hopes of AfCFTA policymakers that RVCs might drive industrialisation. The most notable upgrading cases were an NVC firm (Firm 4) which started producing garments and the aforementioned locally owned GVC firm (Firm 10) which moved from having indirect to direct buyer links, and started providing a full-package service. Ownership was important in explaining Firm 10's upgrading experience, but its expanded functional range is still within the norm for GVC-integrated firms. Most locally owned NVC and RVC firms did not functionally upgrade, their business models being well established and often dating to the era of protected domestic markets prior to liberalisation in the 1990s. We argue that value chain directionality is central to explaining these findings since it determines which rents firms can access at the national, regional and global levels to support upgrading, as developed further in Chapter 7.

Results in the area of product sophistication and value chain directionality showed a similar ordering of firm groups to the findings for end markets. On average, GVC firms produced the most complex products, followed by RVC and then NVC firms, but there were important nuances by end market and product category. GVC firms mostly produced apparel products, from basic uniforms to higher-value fashion items, and all cases of upgrading were found among this group. This is to some extent expected since the hierarchical governance arrangements found in GVCs are conducive to product upgrading (Bazan and Navas-Alemán, 2004), but interestingly half (2) of the cases occurred in the more 'embedded', less hierarchically governed firms – one locally owned and one owned by a foreign individual. Again, this suggests that value chain directionality is important independently from governance arrangements, supported by the fact that not a single locally owned NVC or RVC firm reported recent product upgrading. NVC firms focused primarily on lower value processed textile products, while RVC firms produced the widest range of products from basic and complex apparel to processed textiles. Tanzania-specific data shows that for apparel only, RVC firms selling to South Africa have higher export unit values than GVC firms selling to the USA. Although this data covers a small number of firms and end markets it shows the potential of RVCs to support high-value apparel exports, which has been shown in Lesotho and Swaziland where South African investors directly own factories (Morris et al, 2016), but has not previously been highlighted in the literature where arm's length and market-based contractual arrangements are present, as in Tanzania.

In the domain of technology and process upgrading, GVC firms were found to have the most up to date technologies, followed by RVC firms and then NVC firms. All groups of firms were engaged in process upgrading but NVC firms were focused on replacing old equipment to maintain competitiveness, while RVC and GVC firms undertook continuous upgrading of both production technologies and factory organisation. Our results therefore lend support to the finding in the literature that GVC firms in hierarchically governed value chains perform well on technology and process upgrading (see also Navas-Alemán, 2011), but wholly and partly locally owned GVC firms, as well as the locally owned RVC and NVC firms also invested in this area, albeit in differing ways. A range of other factors were found to be important to explain patterns of investment in technology, including ownership, date of initial investment and degree of capital intensity, but the clear differences across firm groups show the importance of incorporating value chain directionality into analyses of industrial upgrading outcomes.

Ambiguities in defining and measuring upgrading were found in this and other research, with the literature critical of relying exclusively on upgrading as a measure of firm performance (e.g. Tokatli, 2013). A key outcome from a public policy perspective is employment and in this area GVC firms performed best, with most firms employing over 2000 workers and two having 6000 or more, and all of these jobs were created since the year 2000. NVC and RVC firms had fewer employees, at around 1400 and 1200 respectively, and with less dynamic jobs growth than GVC firms in recent decades. Policymakers are also concerned to maximise the local content of industries, and on this GVC firms performed poorly with negligible local sourcing, due to a lack of availability of suitable locally produced inputs (fabrics, trims etc.) rather than price or quality concerns. NVC and RVC firms – being mostly vertically integrated – were far more likely to source inputs from their own and neighbouring countries, particularly locally available cotton as a crucial input to their spinning operations. The level of capacity utilisation by firms was also captured as an indicator of productive efficiency and alignment with market demand, which revealed GVC firms to be performing best with 86% capacity utilisation on average while NVC and RVC firms were operating at 64% and 59% respectively. For all these outcomes there were clear difference between firms according to their value chain directionality, with GVC firm business models being more labour intensive, based on imported inputs and maximising efficiency to maintain profitability despite slim margins, while NVC and RVC firms are older, more capital intensive and vertically integrated so source more inputs locally but employ fewer people. The rents available to firms are central to explaining these outcomes, and they have important variations with value chain directionality – for instance, GVC firms can access rents from PTAs with relaxed ROO, while negative rents in liberalised regional markets hamper NVC and RVC firm performance – which are explored in the next section.

#### 8.2.4 Multi-scalar industrial policy rents

Having investigated the effects of regionalism on policy space and firm outcomes in previous chapters, the thesis turned to one of the main mechanisms by which industrial policies concretely impact firms, namely through the creation of rents. Chapter 7 examines how industrial policy rents at the national, regional and global levels affect EAC T&A firm upgrading strategies and outcomes, with contributions made through the kinds of data drawn on, the way they are analysed, as well as the development of key concepts such as negative rent, as set out in section 8.3.

At the national level we highlight the importance of specific rents which emerged from interviews with respondents, especially related to the valuation and taxation of imports, duty remission for manufacturers and public procurement policies. These must be situated in the context of East Africa's trade liberalisation in recent decades, which the already established NVC and RVC firms experienced as a loss of protection from foreign competition, i.e. a policy induced loss of income or a 'negative rent'. In addition to the decline in effective tariff rates for T&A products, we found strong evidence both in interviews and trade data of import undervaluation, which allows importers to evade taxation and sell at lower prices, squeezing the margins of domestic producers. Kenya and Tanzania's reported import values for T&A products in 2018 represented 57% and 30% respectively of the export values reported by their trading partners. The value of negative rents due to import undervaluation – i.e. non-enforcement of EAC customs rules – is a combination of both foregone and unrealised benefits, and was estimated as the value of tariff revenue evaded over the 10 years from 2009 to 2018 to total \$1.6bn and \$1.3bn for Kenyan and Tanzanian T&A manufacturers respectively. Interviewees also reported that mislabelling occurs to avoid taxes, such as when new clothes are disguised as second hand, but the value of the resulting negative rent could not be estimated. The negative rents in national and regional markets from privatisation, liberalisation, import underreporting and mislabelling damage the competitiveness of NVC and RVC firms, making it harder for them to finance new investment and contributing to the relative lack of productive upgrading among those groups.

A positive rent granted at the national level came in the form of duty remission (DR), but the political-institutional structures of the EAC meant that recipients had to largely forego access to regional markets in order to benefit. The EAC DR scheme is nominally regional in nature, but in practice national governments can grant domestic companies DR unilaterally, so long as finished products are not sold in other EAC countries. As a result the main participants in the scheme are NVC firms, and we calculate that four NVC firms were granted tariff exemptions valued at around \$11.8m in the 2010-2020 period, based on official EAC notifications compiled for this thesis and trade data. These were positive rents granted to specific firms and for particular finished products, sometimes aimed at supporting upgrading strategies, e.g. where firms were attempting to diversify away from processed fabrics to apparel. However because DR rents are *ex ante* and granted prior even to production taking

place, state agencies would need to be able to monitor and enforce adherence to the attached conditions, for which little evidence was found. Few RVC firms have chosen to participate in the DR scheme because of their reliance on access to EAC markets, but efforts to enhance regional cooperation around the DR scheme so recipients can maintain access to regional markets have gathered pace.

Stable policy commitments were an important feature of rents granted by national authorities, being positive in the case of public procurement contracts and negative where policy changes increased manufacturing costs. For example in Tanzania the government's commitment to purchase uniforms from an NVC firm was sufficient to support functional upgrading through the establishment of an apparel manufacturing section, while in Kenya a similar announcement enabled investment in process upgrading by an NVC firm. These rents consist of both *ex ante* and *ex post* elements, since firms can gain favourable access to finance before production takes place on the basis of the commitment, but the full benefit is only received upon delivery of the goods. However, ensuring productive use of rents requires procuring entities be willing and able to judge whether goods meet required standards and withhold payment for substandard items. This may not be credible once a procurement commitment has been made, but could not be ascertained for the cases studied in this research. In Kenya, policy volatility linked to the competitive clientelist political settlement was identified by firms as a source of negative rents, for instance where electricity subsidies were removed prematurely, and when the minimum wage increased significantly without notice prior to a general election. Overall, although it was not possible to reliably quantify them all, at the national level it appears likely that negative rents from policies such as import liberalisation and underreporting are likely to outweigh positive rents from duty remission and public procurement, as also supported by the scarcity of significant upgrading cases among NVC and RVC firms.

At the regional level the EAC, SADC and COMESA regional trade agreements (RTAs) confer significant *ex post* rents by providing duty free market access if Rules of Origin (ROO) criteria are met. In principle the removal of tariffs between EAC countries benefits both regional buyers and producers, but in practice we argue that RTA rents in the T&A sector mainly benefit RVC firms based on evidence from interviews, import undervaluation and the widespread availability of highly competitive goods from outside the EAC. The rents arising in relation to Tanzanian and Kenyan exports to the EAC were approximated as the tariffs which would be due in the absence of the EAC FTA, at \$12.8m and \$15.3m respectively in the five years to 2018. Using the same approach Tanzania's participation in the SADC FTA and Kenya's membership of COMESA generated rents of around US\$26.3m and \$6.1m respectively. ROO for T&A products determine which firms are eligible to benefit from RTA rents, with the EAC and COMESA having relaxed single transformation rules that most firms could access, while SADC has stricter double transformation ROO which advantage

vertically integrated firms (such as Tanzanian RVC firms) while firms assembling garments from imported inputs (e.g. GVC firms) are ineligible.

Other major rents deriving from regional-level governance arrangements are related to used clothing and export processing zones (EPZs). Similar to the discussion of import undervaluation at the national level, the permissive policy stance towards used clothing imports in the EAC creates negative rents for RVC-oriented T&A firms since regional demand for new clothes is weakened. EAC leaders announced a shared intention to phase-out used clothing imports across the region, but when the US responded by threatening to remove AGOA trade preferences, the plan was aborted. The EAC's EPZ regime allows countries to offer a range of incentives to investors who export at least 80% outside the EAC, such that rents are primarily channelled to GVC firms while NVC and RVC firms are not eligible to benefit. Drawing on data from national authorities, we estimate EPZ rents to GVC firms in terms of corporate tax revenue foregone as around \$1.24m in Tanzania in 2016 and \$54m in Kenya in 2019, the latest years available. Proposals to lower the export requirement and partially redirect EPZ rents to RVC firms have met with opposition on fears that Kenya's more competitive EPZ firms would outcompete others in regional markets.

At the global level, the main source of rents for EAC T&A firms are from preferential trading arrangements (PTAs), which primarily benefit GVC firms. The USA's AGOA scheme is by far the most important PTA for East African T&A firms, generating rents in the order of \$28.3m and \$256.5m respectively on Tanzanian and Kenyan exports to the USA over the 2015-2019 period. Exports to the EU were much lower such that its trade preferences were linked to rents of only \$1.3m in Tanzania and \$5.3m in Kenya, while Tanzania's exports to Canada and China under GSP preference schemes generated rents of \$1.8m and \$2.1m respectively. The availability of rents under the AGOA scheme was a primary reason for GVC firms' investment in East Africa, and while they made a major contribution to employment creation, other policy objectives such as the development of backward linkages to local cotton and textiles production were not supported due to AGOA's relaxed single transformation ROO which facilitate use of inputs imported from third countries.

The multi-scalar analysis of industrial policy rents in the EAC T&A sector has explained some of the upgrading outcomes seen in the previous chapter, and demonstrated how this kind of approach has value in highlighting tensions between rents at different levels. Rents at the national and regional level from public procurement contracts, duty remission and RTAs have supported a small number of upgrading cases, but most NVC and RVC firms have struggled to maintain competitiveness due to negative rents connected to liberalised regional markets, import undervaluation and the presence of used clothes. Rents at the global level from trade preferences have supported investment and job creation, but are structured in ways that limit their contribution to backward linkage development. By looking at multiple levels of governance together we identified tensions between rents at different

levels, for instance where duty remission granted by national authorities involves losing access to rents from regional market access, and when conditions attached to AGOA rents at the global level stymied efforts at the regional level to reduce negative rents from used clothing imports. More attention to how different levels of governance interact is likely to lead to improved understanding of policy space in particular sectors, and therefore more successful design and implementation of industrial policy rents for upgrading.

### **8.3 Theoretical and methodological contributions**

This section sketches some of the broader implications of the thesis for researchers focusing on other geographical and thematic areas in the sphere of industrial policy and development. One of the most important contributions of the thesis falling under this heading – the analytical framework for policy space – has already been summarised in section 8.2.1, so this section focuses on the concept of value chain directionality, its application in research on the T&A sector, and multi-scalar industrial policy analysis.

#### **8.3.1 Value chain directionality**

The concept of value chain directionality was introduced through this research and its development is a contribution of the thesis, which this section presents in summary form. The context is the reorganisation of global capitalism into cross-border production systems with a diversity of governance and organisational arrangements, known as Global Production Networks (GPNs) or Global Value Chains (GVCs) in different strands of literature. It was argued that this has major implications for the economic development prospects of LLMICs, for whom the main challenge is achieving local industrial upgrading through strategic integration into these international production systems. The approach has been termed ‘vertically specialized industrialisation’ and is associated with a time-compression of the development process, purportedly in contrast to previous import substitution and export-oriented industrialisation strategies based on building national production systems (Milberg and Winkler, 2013; Whittaker et al, 2020).

It is well established in the context of export-oriented industrialisation that ‘trade directionality’ – i.e. the destination of exports – is an important factor explaining industrial development outcomes (Amsden, 1986). This is largely driven by the composition of exports to different trading partners, with South-South trade tending to be made up of more skill and capital-intensive manufactured goods than South-North trade. In an era of value chains and vertically specialised industrialisation, where countries not only export products but also import inputs from abroad, there is growing evidence of the significance of input origin for productive outcomes (Amighini and Sanfilippo, 2014). This suggests that value chain directionality – i.e. integration into different types of cross-border input-output supply relationships – is likely to have important implications for industrialisation.

The concept of value chain directionality draws critical attention to the question of which types of networks are likely to support the industrial strategy in a given sector and country. There is growing scepticism in many sectors of the benefits offered to LICs from integrating into GVCs dominated by a small number of powerful TNCs and lead firms, because of the lack of upgrading prospects, linkages and skill development seen (Milberg and Winkler, 2013). Instead, researchers and policymakers are turning to the potential for regional value chains to support industrial strategies (e.g. Barrientos et al, 2016; Pasquali et al, 2020). There is also a growing focus on national value chains due to the blurring of national and regional markets through regional integration, the detrimental impacts of trade liberalisation and renewed interest in the need to build integrated domestic economies (Andreoni et al, 2019). By introducing the concept of value chain directionality and using it to guide this research, it is hoped that it may demonstrate the how this analytical lens can support a more coherent and strategic approach to industrial development research and policymaking.

### **8.3.2 Researching value chain directionality in textiles and apparel**

This thesis aims to contribute to research on the textiles and apparel sector through the novel approach to surveying firms used, operationalising the concept of value chain directionality. Studies of the T&A sector tend to focus on apparel firms operating in GVCs and use standard models of functional packages such as CMT, ODM, OBM etc (e.g. Frederick and Gereffi, 2011). There is generally little attention to firms operating in multiple value chains simultaneously, and a neglect of the importance of firms' activities in domestic markets. There is also little attention to vertical integration, i.e. the strategy often found in LLMICs of combining apparel and textile manufacture in the same organisation.

The firm survey used in this research was designed to capture exactly which functions firms carry out in different value chain types. Functional packages were therefore unbundled and questions were asked about firms' activity in each stage of the production process, from vertical integration functions such as spinning and weaving to 'high value' activities such as design, branding and distribution (see Table 16). Furthermore firms were asked about the end markets for which they performed each activity, with destinations grouped into the categories national, regional and global markets. Sourcing strategies were also examined by finding out where key inputs originated for each firm, to build a more complete picture of value chain directionality. Overall, the approach followed operationalised the concept of value chains directionality, permitting the diversity of firms' engagement with different markets and value chains to be captured, supported by qualitative data collected on recent changes in firm strategy.

Although upgrading and downgrading were the core focus in terms of firm outcomes, there were some noteworthy distinguishing features. Labelling changes in strategy as upgrading or downgrading was done through a more participatory process than some studies, where researchers decide based on

external criteria. Instead, respondents' judgements about the motivations behind and impact of changes in the mix of products made, functions performed, end markets served etc. were used to arrive at up/downgrading classifications. Also, due to criticisms of reliance on up/downgrading alone as a metric of firm performance (e.g. Tokatli, 2013), questions were asked to capture other economic and social outcomes, especially employment and capacity utilisation.

### **8.3.3 Multi scalar industrial policy rents analysis**

A further contribution of the thesis is its approach to researching industrial policies in the case study countries. Often, studies of industrial policy centre on strategy documents which contain longlists of interventions that may not be fully implemented. Instead, Chapter 7 attempts to identify and quantify specific policy rents conferred on textiles and apparel firms, through a combination of interview data and information from official documents and statistics. For instance, it emerged from interviews that duty remission schemes provided important benefits to some firms, so official notifications of duty remission granted to specific firms were collected and combined with unit value data from trade statistics to estimate the value of rents. A novel approach to quantifying rents from trade preferences is also proposed, as the product of trade flows without tariffs and the MFN tariff rates which would otherwise have applied, based on the key factors identified by firms in interviews affecting the benefits offered by trade preferences.

In addition, these rents were analysed at the national, regional and global levels in recognition of the complexity of contemporary industrial policymaking (Behuria, 2019). We argue that such a multi-scalar analysis is essential given that industrial policy is not a national endeavour – in fact, the most valuable rents to firms in a given country could in principle be conferred by outside actors, e.g. through a unilaterally-granted preferential trading arrangement. Also the interaction of policy rents emanating from different levels of governance may be important, for instance where rules of origin from regional trade agreements affect the viability of particular industrial strategies in a given country. In this way the multi-scalar analysis of tangible rents in Chapter 7 is outcome focused, building on the policy space analysis in Chapter 5 which is more concerned with the range of options that are permitted, feasible and viable given constraints at different levels of governance.

Insofar as industrial policy rents are directly studied, there is a focus in the literature on positive rents, i.e. policy-induced increases in income to a particular actor or group. A contribution of Chapter 7 is to also analyse *negative* rents, i.e. policy induced losses of income, which emerged from the firm survey and interviews as critical to their competitiveness, or lack thereof. The presence of negative rents is a logical consequence of defining rents as policy-induced changes in income which create winners and losers, and while the concept is mentioned in passing by Khan (2013a) it remains heavily underexplored. By identifying and quantifying negative as well as positive rents, Chapter 7 is able to build a more comprehensive picture of the institutional context for firm strategy-making and

government policymaking. The inclusion of negative rents draws attention to how factors such as liberalized domestic markets and unofficial customs practices negatively affect the potential for firms to invest in upgrading and expansion.

In analysing rents, attention is also paid to their *ex ante* or *ex post* nature, i.e. whether they are received before or after success has been achieved in the competitive production of a product respectively. This distinction is identified by Khan (2013a) as important in determining the type of governance capabilities required and therefore the feasibility of implementation in a given context, but industrial policy analyses rarely consider this explicitly. Further, Table 17 presents a typology of rents along two axes, whether they are positive or negative and *ex ante* or *ex post*, with examples to illustrate each combination. By bringing together in one framework these critical but neglected factors determining the impact of specific rents, it is hoped the thesis may contribute to improved industrial policy design.

#### **8.4 Policy implications**

This thesis has been concerned with the challenges of contemporary industrial policy, and this section brings together the insights from the research that may be relevant to policymakers. We outline the importance of understanding the key features of policy space in a particular sector to inform the design of policies capable of delivering learning rents to support firms achieve meaningful upgrading outcomes.

Industrial policy documents often include a brief ‘SWOT’ situation analysis, listing the strengths, weaknesses, opportunities and threats of a particular country or sector. While this has value, we suggest that a deeper engagement with a sector’s context could be guided by the framework for policy space presented in this thesis. This would entail mapping the legal, economic and political-institutional dimensions of policy space at the national, regional and global levels as they relate to a particular sector. Rather than being simply an academic exercise, this would enable policymakers to evaluate the merits of competing industrial strategies according to whether they are legally permitted, economically viable and politico-institutionally feasible, and therefore identify policy interventions that are most likely to support industrial transformation in a given sector.

Taking account of the context, policymakers must decide a strategy to achieve their industrial development objectives. We have framed this challenge in terms of the creation and management of learning rents to support different kinds of productive upgrading by firms in value chains at different levels. Each component of such a strategy – the types of rents, upgrading and value chains targeted – is informed by the policy space mapping exercise as well as policymaker objectives. For instance, decisions about which rents can be feasibly implemented are informed by analysis of the national political settlement in the political-institutional dimension of policy space, and which value chains to

target depends on the kinds of outcomes each can support as explored in the economic dimension of policy space.

This research has shown some of the benefits offered by different value chain types, at least in the textiles and apparel value chains of East Africa. Industrial strategies premised on joining global value chains (GVCs) offer prospects for rapid employment creation and product and process upgrading, although this is generally achieved through foreign investment in a limited range of activities and with few local linkages. By contrast, national and regional value chains are more likely to support a wider range of value chain functions by locally owned firms included higher value-added activities such as design and branding, and can also serve as stepping stones to GVCs. Despite the advocates of regional integration touting the improved prospects for functional upgrading in RVCs over GVCs, no cases of functional upgrading were found among RVC firms in our sample, which should serve as a cautionary note. Overall, these findings point towards the need for ‘smart’ industrial strategies involving value chain prioritisation and sequencing to capitalise on the distinct opportunities offered by national, regional and global value chains.

Policy rents at different levels of governance have the potential to support or hinder upgrading, but rents should be well aligned with upgrading opportunities and interactions between rents should be considered. Public procurement contracts and duty remission granted by national authorities may support functional upgrading by targeted firms, but if negative rents in liberalised national and regional markets go unaddressed then the overall context for accumulation and investment in upgrading is likely to remain overwhelmingly adverse. Furthermore, rents granted at one level may shape the policy space for industrial strategies in important ways, for instance rents favouring integration into GVCs such as those from the USA’s AGOA or the EAC’s EPZ schemes often make it harder to promote regional and national value chains, as shown by the USA’s blocking of efforts to reduce negative rents from used clothing imports. There is a clear imperative for policymakers to examine the whole landscape of current and potential rents in target sectors – whether positive, negative, *ex ante* or *ex post* – and consider their various conditions, interactions and implementation requirements in the design of industrial policies.

A major focus of this research has been how regional integration affects industrial policy and development. It has been argued that regional free trade areas are not always and everywhere positive for industrial policymaking; they have different impacts across the various dimensions and levels of policy space. For instance joining a regional FTA means losing the legal policy space to protect a national industry from regional competition, but access to an expanded regional market may enhance the economic dimension of policy space by making new industrial strategies based on regional investment and exports viable. It is critical for policymakers to examine the risks and opportunities of

a particular regional FTA, with less industrially advanced countries potentially having more to lose in terms of policy space if their neighbours are already established in strategic sectors.

Emerging supra-regional integration initiatives such as the pan-African AfCFTA also present risks as well as opportunities from the perspective of individual countries' industrial strategies. AfCFTA's stated objectives include both liberalisation and industrialisation, but the thrust of implementation effort is on tariff elimination rather than coherent regional strategies for industrial development (AU 2018; Erasmus, 2019). Provisions which do exist for infant industry protection are vague, not mentioning specific measures permitted or timeframes, with these details still to be negotiated. Meanwhile tariff liberalisation plans are clearly specified, with 90% of tariff lines to be liberalised over 5 years (10 years for LDCs), 7% to be designated sensitive products and liberalised over 10 years (13 for LDCs) and up to 3% able to be excluded (so long as excluded products make up no more than 10% of the value of imports from African countries).

The exclusion list provision secures some national policy space at the expense of regional economic integration, but also comes with the risk that countries will exclude similar sectors from liberalisation and lack the domestic market size to become regionally competitive. Calls for coordination of national exclusion lists, to avoid duplication of industrial policy efforts between neighbours and to capitalise on regional complementarities, echo East African efforts at regional central planning in the 1960s (Odijie, 2019; Mshomba, 2017). However, meaningful industrial policy coordination across countries requires strong political commitment to regional policymaking which does not appear evident even in Africa's most integrated regional economic community, the EAC, where this research has shown how in the T&A sector key regional policies such as duty remission and stays of application are implemented unilaterally in ways that favour national over regional value chains. A lack of economic complementarity between countries is an issue for any African RTA including AfCFTA, but even where regional complementarities do exist – such as in EAC countries for T&A value chains – we have shown how policymakers still often want to develop fully integrated national value chains rather than relying on regional markets for inputs and/or outputs.

While the ratification of the high-level AfCFTA agreement proceeded at a rapid pace, several of the most contentious issues are still the subject of protracted negotiations at the time of writing, especially Rules of Origin for strategic sectors such as T&A. South Africa favours strict double transformation ROO for AfCFTA as found in SADC to protect its domestic industry and promote regional value chains, while Kenya and others prefer relaxed single transformation ROO to increase market access for their export-oriented garment assembly sector (interview #42). Evidence from this research cautions against the idea that double transformation ROO for T&A products will create sufficient incentives for new investment in the regional cotton-to-clothing value chain, because Tanzania has seen negligible new investment in textiles manufacture despite its access to the highly prized South

African market under strict SADC ROO. The lengthy negotiations over ROO suggests that policymakers are hesitant about the risks of regional liberalisation to strategic industrial sectors, and may point to implementation issues (e.g. in the form of NTBs) even when all rules and protocols are formally agreed. The case of the EAC shows that allowing institutional flexibility for national authorities to retain trade policy sovereignty within regional structures is a valid approach to managing these tensions, but comes at the cost of the integrity of the regional market.

### **8.5 Limitations and avenues for further research**

Some of the main limitations of this thesis relate to the resources available and the data that could be collected. There are numerous possible avenues for further research following on from this thesis, but we focus mainly on the potential to apply the approaches here in other geographies and value chains, especially in the wake of the Covid-19 pandemic.

Despite the privileged access gained to industry stakeholders in Tanzania and Kenya for this research, there were limits to the data that could be collected. Firms were reluctant to share detailed data on worker wages, making a meaningful comparison of social upgrading outcomes across NVCs, RVCs and GVCs impossible, and this is an important area for further research. Comprehensive data on revenues, costs, profits and financing was also not readily available on a comparable basis across firms, such that a valuable alternative metric to upgrading – capital accumulation – could not be used to assess firm performance, which again could be fruitful for further investigation. We were also unable to reach all Kenyan firms due to resource and access constraints, such that some unknown biases may be present in the results. It was also not possible to gain access to policy officials and ministers at the highest levels, so some of the policy analysis may not fully reflect the most informed perspectives. My own positionality as a researcher from outside the EAC, especially a white UK national, may also have affected the kind of data that could be accessed for this research, though this may have been partly mitigated by the supporting presence of TDU and Msingi representatives in most interviews.

The case study approach taken in this research is at once a strength and a limitation, since although detailed findings were uncovered in the EAC T&A sector, the generalizability of lessons to other regions and sectors is uncertain. An agenda for further research would be to apply some of the analytical approaches developed in this thesis to new contexts, such as other regional groupings of LLMICs in Africa (especially AfCFTA), or to regional (dis)integration among high-income regions such as the European Union, where the policy space dilemmas of Brexit may prove illuminating. A comparative element to the study of different regional integration experiences in terms of their policy space impact would also be likely to yield interesting results, as opposed to the focus on a single regional bloc that was conducted for this thesis. Furthermore while T&A has been a fruitful sector to

focus on, the industry has specific characteristics which limit the applicability of findings to other sectors. Future research could examine sectors such as automotive and pharmaceuticals, where regional value chains between LLMICs show promising signs for upgrading as compared to GVCs.

Although the Covid-19 pandemic occurred after the data collection phase of this research was complete, it nevertheless cast a long shadow over the writing-up stage with potentially valuable interactions with peers impossible as conferences were cancelled or moved online, and shared workspaces closed. Anecdotal evidence suggests that many of the firms interviewed for this research were heavily impacted by the pandemic as orders were cancelled, borders closed and workers laid off. Further research is needed on the extent to which national, regional and global value chains differed in their resilience to the shocks caused by the pandemic. The pandemic along with other developments – such as the intensification of the climate emergency and the implementation of AfCFTA – have major implications for industrial policy space in LLMICs, presenting an ongoing topic of interest for researchers.

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## 10. Annexes

### 10.1 Interview codes

| Interview code (#) | Country/region | Type                 |
|--------------------|----------------|----------------------|
| 1                  | Tanzania       | Firm                 |
| 2                  | Tanzania       | Firm                 |
| 3                  | Tanzania       | Firm                 |
| 4                  | Tanzania       | Firm                 |
| 5                  | Tanzania       | Firm                 |
| 6                  | Tanzania       | Firm                 |
| 7                  | Tanzania       | Firm                 |
| 8                  | Tanzania       | Firm                 |
| 9                  | Kenya          | Firm                 |
| 10                 | Kenya          | Firm                 |
| 11                 | Kenya          | Firm                 |
| 12                 | Kenya          | Firm                 |
| 13                 | Kenya          | Firm                 |
| 14                 | Kenya          | Firm                 |
| 15                 | Kenya          | Firm                 |
| 16                 | Kenya          | Firm                 |
| 17                 | Kenya          | Firm                 |
| 18                 | Kenya          | Firm                 |
| 19                 | Kenya          | Firm                 |
| 20                 | Kenya          | Firm                 |
| 21                 | Kenya          | Firm                 |
| 22                 | Kenya          | Firm                 |
| 23                 | Tanzania       | Industry association |
| 24                 | Tanzania       | Industry association |
| 25                 | Tanzania       | Industry association |
| 26                 | Kenya          | Industry association |
| 27                 | Kenya          | Industry association |
| 28                 | Kenya          | Industry association |
| 29                 | Kenya          | Industry association |
| 30                 | Kenya          | Industry association |
| 31                 | Kenya          | Industry association |
| 32                 | Tanzania       | State                |
| 33                 | Tanzania       | State                |
| 34                 | Tanzania       | State                |
| 35                 | Tanzania       | State                |
| 36                 | Tanzania       | State                |
| 37                 | Kenya          | State                |
| 38                 | Kenya          | State                |

|    |          |                      |
|----|----------|----------------------|
| 39 | Kenya    | State                |
| 40 | Kenya    | State                |
| 41 | Kenya    | State                |
| 42 | Kenya    | State                |
| 43 | Kenya    | State                |
| 44 | Kenya    | State                |
| 45 | Kenya    | State                |
| 46 | Kenya    | State                |
| 47 | Kenya    | State                |
| 48 | Kenya    | State                |
| 49 | Tanzania | Research             |
| 50 | Tanzania | Research             |
| 51 | Tanzania | Research             |
| 52 | EAC      | Regional Institution |
| 53 | EAC      | Regional Institution |
| 54 | EAC      | Regional Institution |
| 55 | EAC      | Regional Institution |
| 56 | EAC      | Regional Institution |
| 57 | EAC      | Industry association |
| 58 | EAC      | Industry association |
| 59 | EAC      | Development program  |
| 60 | EAC      | Development program  |
| 61 | Africa   | Industry association |
| 62 | EU       | Research             |
| 63 | EU       | Donor                |
| 64 | USA      | Buyer                |

## 10.2 Survey instruments

### 10.2.1. Firm survey – Tanzania

|   |  |
|---|--|
| <b>Company Name</b>                     |  |
| <b>Respondent name and role</b>         |  |
| <b>Contact number and email address</b> |  |

#### **Strategy and markets**

**ST1.** *What is the firm's current strategy with respect to different end markets?*

|  | <i>Domestic market</i> | <i>Regional market - specify countries:</i> | <i>Global market - specify countries:</i> |
|--|------------------------|---|---|
| <i>Inputs sourced</i>                                |                        |   |   |
| <i>Products sold</i>                                 |                        |   |   |
| <i>When entered the market?</i>                      |                        |   |   |
| <i>Main competitors</i>                              |                        |   |   |
| <i>Unit values</i>                                   |                        |   |   |
| <i>Market share (%)</i>                              |                        |   |   |
| <i>Number and nature of buyers</i>                   |                        |   |   |
| <i>Duration and stability of buyer relationships</i> |                        |   |   |
| <i>Buyer requirements (eg. run length, etc.)</i>     |                        |   |   |
| <i>Product complexity -high, medium, low</i>         |                        |   |   |
| <i>Value chain functions</i>                         |                        |   |   |
| <i>Outsourcing (specify subcontractor and tasks)</i> |                        |   |   |

**ST2.** *How has this strategy evolved over time?*

*List any changes to above strategy in last 3-5 years, particularly with respect to products, markets and the extent of regionalism (sourcing of inputs and sale of outputs in the region):*

---



---

Explanation:

---

**ST3.** What is the firm's future strategy for growth and upgrading with respect to products, end markets and regionalism?

List any planned changes to current strategy in next 3-5 years:

---



---

Explain, with reference to relative pros and cons of each market for reaching scale, upgrading, standards, learning etc.:

---

**ST4.** What additional capabilities does the firm need to build and roll out this strategy over time?

---

**ST5.** Are your key inputs available domestically or regionally, and at what average market price compared to global benchmarks?

|                        | Sufficiently available?<br>(Yes or no) |                                 | Price comparison<br>(even if not sufficiently available) |   |  |
|------------------------|--|---------------------------------|--|---|--|
|                        | Domestically                           | Regionally<br>(specify country) | Domestic price<br>(specify unit)                         | Regional price<br>(specify unit and source) | Global price per unit<br>(specify unit and source) |
| Cotton                 |  |                                 |  |   |  |
| Yarn                   |  |                                 |  |   |  |
| Fabric                 |  |                                 |  |   |  |
| Accessories            |  |                                 |  |   |  |
| Other (specify: _____) |  |                                 |  |   |  |

**ST6.** How demanding, in terms of the firm capabilities required to meet the demands, are domestic, regional and global buyers on the following measures?

1: not demanding at all (i.e. very low capabilities required); 2: a little demanding; 3: medium; 4: quite demanding; 5: very demanding (i.e. very high capabilities required).

| Measure                 | Domestic buyers | Regional buyers | Global buyers |
|-------------------------|-----------------|-----------------|---------------|
| Tolerance to defects    |                 |                 |               |
| Product quality         |                 |                 |               |
| Price                   |                 |                 |               |
| Lead times              |                 |                 |               |
| Order size              |                 |                 |               |
| Labour/safety standards |                 |                 |               |
| Environmental standards |                 |                 |               |
| Other measure (specify) |                 |                 |               |

**ST7.** How have the demands (e.g. JIT production, order tracking, standards) of buyers in different end markets changed in recent years and how have you met them?

Domestic buyers

Changes in demands:  Yes;  No

How met: \_\_\_\_\_

Regional buyers (specify main country)

Changes in demands:  Yes;  No

How met: \_\_\_\_\_

Other international buyers (specify main country)

Changes in demands:  Yes;  No

How met: \_\_\_\_\_

**ST8.** What support (e.g. technical advice, staff training, provision of equipment, financial grants, loans etc.) does the firm receive to upgrade to meet specific buyer demands (e.g. around lead times, product quality, standards on safety, environmental issues etc.)?

Support from regional buyers (specify country): \_\_\_\_\_

Support from other buyers (specify country): \_\_\_\_\_

Support from government: \_\_\_\_\_

Other support: \_\_\_\_\_

If negligible support is received from some buyers/markets, indicate  and specify:

\_\_\_\_\_

**ST9.** For which upgrading or expansion priorities would the company like further support, information, or resources?

\_\_\_\_\_

\_\_\_\_\_

### **Sales and performance**

**SA1.** 2018 actual sales

|                      | Proportion used as input (%) | Proportion sold locally (%);<br>quantity | Proportion exported (%);<br>quantity | Value of local sales (TSh) | Value of exports (USD) | Export destinations |
|----------------------|------------------------------|--|--------------------------------------|----------------------------|------------------------|---------------------|
| <i>Lint (ginned)</i> |                              | ____%;<br>____ tons                      | ____%;<br>____ tons                  |                            |                        |                     |
| <i>Yarn</i>          |                              | ____%;<br>____ tons                      | ____%;<br>____ tons                  |                            |                        |                     |

|                              |                       |                                  |                                  |  |  |  |
|------------------------------|-----------------------|----------------------------------|----------------------------------|--|--|--|
| <i>Fabric (intermediate)</i> |                       | ____%;<br>____ Mil<br>Lin Meters | ____%;<br>____ Mil<br>Lin Meters |  |  |  |
| <i>Fabric (processed)*</i>   | <i>Not applicable</i> | ____%;<br>____ Mil<br>Lin Meters | ____%;<br>____ Mil<br>Lin Meters |  |  |  |
| <i>Garments</i>              | <i>Not applicable</i> | ____%;<br>____ Mil<br>Pcs        | ____%;<br>____ Mil<br>Pcs        |  |  |  |

\* includes kitenge, kanga, kikoi, bedsheets etc.

**SA2.** Projected sales for 2019

|                              | Proportion used as input (%) | Proportion sold locally (%);<br>quantity | Proportion exported (%);<br>quantity | Value of local sales (TSh) | Value of exports (USD) | Export destinations |
|------------------------------|------------------------------|--|--------------------------------------|----------------------------|------------------------|---------------------|
| <i>Lint (ginned)</i>         |                              | ____%;<br>____ tons                      | ____%;<br>____ tons                  |                            |                        |                     |
| <i>Yarn</i>                  |                              | ____%;<br>____ tons                      | ____%;<br>____ tons                  |                            |                        |                     |
| <i>Fabric (intermediate)</i> |                              | ____%;<br>____ Mil<br>Lin Meters         | ____%;<br>____ Mil<br>Lin Meters     |                            |                        |                     |
| <i>Fabric (processed)*</i>   | <i>Not applicable</i>        | ____%;<br>____ Mil<br>Lin Meters         | ____%;<br>____ Mil<br>Lin Meters     |                            |                        |                     |
| <i>Garments</i>              | <i>Not applicable</i>        | ____%;<br>____ Mil<br>Pcs                | ____%;<br>____ Mil<br>Pcs            |                            |                        |                     |

\* includes kitenge, kanga, kikoi, bedsheets etc.

**SA3.** In five years time, what is the firm's anticipated sales target by product and end market, as % of total sales and in absolute terms?

|                  | Domestic sales |     | Regional (SSA) sales |     | Global sales |     |
|------------------|----------------|-----|----------------------|-----|--------------|-----|
|                  | %              | Tsh | %                    | USD | %            | USD |
| Yarn             |                |     |                      |     |              |     |
| Fabric           |                |     |                      |     |              |     |
| Processed fabric |                |     |                      |     |              |     |
| Garments         |                |     |                      |     |              |     |
| Other            |                |     |                      |     |              |     |

|           |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|
| (specify) |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|

**SA4.** What is the average delivery time for a consignment to reach the market/customer from the factory?

For Exports \_\_\_\_\_ (specify country: \_\_\_\_\_)

For imports \_\_\_\_\_ (specify country: \_\_\_\_\_)

**SA5.** What is the average lead time, from receiving an order to delivery, by end market?

Domestic market: \_\_\_\_ days

Regional market (specify country: \_\_\_\_\_): \_\_\_\_ days

Global market (specify country: \_\_\_\_\_): \_\_\_\_ days

Have there been any changes in lead times in recent years?

---

**SA6.** What are average inventory holdings?

Raw materials/inputs: \_\_\_\_ days; \_\_\_\_ % of sales

Works in progress: \_\_\_\_ days; \_\_\_\_ % of sales

Finished goods: \_\_\_\_ days; \_\_\_\_ % of sales

Are there differences by end market?

---

Have there been any changes in inventory practices in recent years? [] Yes; [] No

If yes, specify:

---

**SA7.** How often do production problems lead to an inability to fulfil orders as planned?

Number of not in-full deliveries<sup>40</sup>: \_\_\_\_ /year; \_\_\_\_ % of orders

Number of not on-time deliveries<sup>41</sup>: \_\_\_\_ /year; \_\_\_\_ % of orders

Number of orders air freighted: \_\_\_\_ /year; \_\_\_\_ % of orders

Number of discounts offered: \_\_\_\_ /year; \_\_\_\_ % of orders

Are there differences by end market? [] Yes; [] No

If yes, specify:

---

What are the main reasons leading to the above problems?

---

Have there been any changes in these indicators in recent years?

---

<sup>40</sup> A not in-full delivery is when an order does not meet buyer specifications on quantity, quality etc.

<sup>41</sup> A not on-time delivery is when an order cannot be delivered by the date originally agreed

**SA8.** What are the Key Performance Indicators (KPIs) used by the firm?

KPIs (e.g. labour productivity: % of international standard):

\_\_\_\_\_

Current values and units: \_\_\_\_\_

Differences for domestic, regional and global markets?

\_\_\_\_\_

Recent changes in KPI measures?

\_\_\_\_\_

**SA9.** What quality management systems are in place?

Description: \_\_\_\_\_

Key indicator (e.g. average internal reject rate per order):

\_\_\_\_\_

Recent changes in key indicator: \_\_\_\_\_

Differences by end market? \_\_\_\_\_

**General information**

**G1.** Total number of employees in 2018 \_\_\_\_\_

**G2.** Number of employees the factory will be having by the end of this Year (2019)

\_\_\_\_\_

**G3.** What was the average labour cost in 2018?

Gross: \_\_\_\_\_ per worker, per month (Tsh/USD - specify), including taxes, levies, etc.

Net: \_\_\_\_\_ per worker, per month (Tsh/USD - specify)

**G4.** What was the labour turnover in your factory in 2018? \_\_\_\_\_ %

**G5.** What was the average production cost in 2018? \_\_\_\_\_ (specify unit)

Breakdown of production cost:

Material inputs: \_\_\_\_%

Labour: \_\_\_\_%

Capital/machinery depreciation: \_\_\_\_%

Energy/electricity: \_\_\_\_%

Financing/interest: \_\_\_\_%

Comments and any additional major costs:

\_\_\_\_\_

**G6.** Is the factory having any international certification? [] Yes; [] No

If yes, which type, and for which end market?

Quality management systems (e.g. ISO 9001): \_\_\_\_\_ . For end market: \_\_\_\_\_

Labour and safety standards (e.g. WRAP): \_\_\_\_\_ . For end market: \_\_\_\_\_

Environmental standards (e.g. ISO 14001): \_\_\_\_\_ . For end market: \_\_\_\_\_

**G7.** Is the firm interested in acquiring certification?  Yes;  No

Which type?

For which end market? \_\_\_\_\_

**G8.** What is your capacity utilisation? \_\_\_\_\_%

Variations during the year:

Lean season: \_\_\_\_\_%                      Months: \_\_\_\_\_

Normal season: \_\_\_\_\_%                      Months: \_\_\_\_\_

Peak season: \_\_\_\_\_%                      Months: \_\_\_\_\_

Main constraints to full capacity utilisation:

\_\_\_\_\_

**G9.** What investments have been made in recent years, are planned, and for which end markets in each case?

Specify type of investment in plant, technology, processes, skills, energy, etc.

Past 5 years

Main investments:

\_\_\_\_\_

For which end markets?

\_\_\_\_\_

Future plans:

Main investments:

\_\_\_\_\_

For which end markets?

\_\_\_\_\_

**G10.** Are the skills of new employees generally adequate?  Yes;  No

What training have they usually received? \_\_\_\_\_

Do you do on the job training? \_\_\_\_\_

How long does it take for each worker, on average? \_\_\_\_\_

What is expenditure on training as % of payroll, and how has this changed?

\_\_\_\_\_

**G11.** Is the factory a member of Textiles and Garments Manufacturers Association of Tanzania (TEGAMAT)?  Yes;  No  
(If no, go to next question; if yes, go to final question of section)

**G12.** Reasons why not a TEGAMAT member

Not aware of the association

Don't know the benefits of the association

Don't know the procedures to join

Not a priority at the moment

The fees are too high

Other (Specify) \_\_\_\_\_

None

**G13.** Are you intending to join TEGAMAT?  Yes;  No

If the answer is no, what are the reasons why not?

\_\_\_\_\_

\_\_\_\_\_

**G14.** In what ways can TEGAMAT improve its operations to best serve you and the industry in General? What you like TEGAMAT to do for you?

\_\_\_\_\_

**G15.** Are you a member of the CTI (Confederation of Tanzania Industries)?  Yes;  No

### Policy

**P1.** What are the most important regional trade and industrial policies affecting the firm, and how does the current policy stance impact the business' competitiveness and growth prospects?

Rating system:

0: no impact

1: very negatively

2: quite negatively

3: neutral overall

4: quite positively

5: very positively

| Policy  | Rating | Explanation |
|---|--------|-------------|
| EAC CET: Applied tariff rates on imports (e.g. inputs & competing products) |        |             |
| EAC: Stays of application on imports  |        |             |
| EAC: Duty remissions granted to firm or competitors                         |        |             |
| EAC: CET review process (if ongoing) or outcome                             |        |             |

|   |  |  |
|---|--|--|
| <i>EAC FTA: assured market access for inputs</i>                                  |  |  |
| <i>EAC FTA: assured market access for outputs</i>                                 |  |  |
| <i>EAC NTBs: Restrictions on internal EAC trade in inputs or outputs</i>          |  |  |
| <i>EAC Rules of Origin</i>  |  |  |
| <i>EAC regional industrial policy</i>   |  |  |
| <i>Infrastructure/energy cooperation in East Africa (e.g. AfDB, gas pipeline)</i> |  |  |
| <i>SADC assured duty free market access for inputs</i>                            |  |  |
| <i>SADC assured duty free market access for outputs</i>                           |  |  |
| <i>SADC Rules of Origin</i>   |  |  |
| <i>SADC industrial policy initiatives</i>   |  |  |
| <i>Other regional policies (e.g. COMESA, investment treaties, etc. - specify)</i> |  |  |

**P2.** *What is the value of tariffs and duties due on your imported inputs under the EAC Common External Tariff, does the company hold any exemptions, and thus what is the rate actually paid?*

|                        | <i>CET rate</i> | <i>Rate paid</i> | <i>Exemptions held (e.g. duty remission, SEZ)</i> |
|------------------------|-----------------|------------------|---|
| <i>Cotton lint</i>     |                 |                  |   |
| <i>Yarn</i>            |                 |                  |   |
| <i>Fabric</i>          |                 |                  |   |
| <i>Accessories</i>     |                 |                  |   |
| <i>Packaging</i>       |                 |                  |   |
| <i>Other (specify)</i> |                 |                  |   |

**P3.** *How could regional policies be changed to make investment in upgrading and expansion more viable?*

*Examples: (note trade-off between market access and national policy flexibility)*

- *Institutionalise national flexibilities of regional policies (e.g. possibility for transparent restriction of internal trade without recourse to NTBs)*
- *More secure market access at the regional level (e.g. eliminate national flexibilities – NTBs, stays of application, duty remission within the EAC)*
- *Strengthen industrial policy coordination at regional level (e.g. coordinate investment decisions to promote industrial convergence)*
- *Greater market access at the regional level through liberalisation: more and bigger FTAs, e.g. AfCFTA*
- *Greater responsiveness of regional policy to industry (e.g. strengthen EABC)*

Discuss:

---

---

**P4.** Regional policy aims to promote regional value chains, i.e. regional sourcing of inputs and marketing of outputs. Do you see that objective as good for your firm's prospects?

Yes;       No

Explanation: \_\_\_\_\_

**P5.** Did you initially, and do you now, oppose or support the EAC used clothes phase-out? (Note that the improper classification of new clothes as used is addressed separately below.)

Initial position: opposed  or supported:

Explanation: \_\_\_\_\_

Current position: oppose  or support:

Explanation: \_\_\_\_\_

Why did the policy emerge, and why was it not implemented?

---

If it were implemented, how might it affect firm strategy?

---

---

**P6.** What are the key international trade agreements and rules for the firm, and how do they impact firm competitiveness/ strategy, particularly with regard to regionalism (in inputs and outputs)?

Key FTAs, PTAs, BTAs (e.g. AGOA, WTO, EBA, etc.)

---

Key rules (e.g. rules of origin)

---

Impact on strategy and competitiveness (for example, would you continue manufacturing in Tanzania without the key trade agreements mentioned?)

---

Impact on regionalism? (e.g. AGOA special fabric provisions → less regional sourcing; duty preference advantage for non-cotton clothing → less RVC development)

---

**P7.** What are the most important national trade and industrial policies affecting the firm, and how does the current policy stance impact the business' competitiveness and growth prospects?

Rating system:

0: no impact

1: very negatively

2: quite negatively

3: neutral overall

4: quite positively

5: very positively

| <i>Policy</i>  | <i>Rating</i> | <i>Explanation</i>  |
|--|---------------|---|
| <i>EPZ/SEZs (specify which) – tax and other benefits</i>                             |               |   |
| <i>EPZ/SEZs (specify which) – Compliance requirements</i>                            |               |   |
| <i>Other investment incentives (specify)</i>   |               |   |
| <i>Electricity – cost</i>  |               | <i>(\$/kWh: ___)</i>  |
| <i>Electricity - reliability</i>   |               | <i>(Cost of power outages: ___ (\$, days, % of revenue - specify)</i> |
| <i>Infrastructure quality</i>  |               |   |
| <i>Customs clearance: speed and reliability</i>                                      |               |   |
| <i>Access to foreign exchange</i>  |               |   |
| <i>Adequacy of skills training from public/private providers</i>                     |               |   |
| <i>Supply of skilled workers</i>   |               |   |
| <i>Labour market regulation and enforcement</i>                                      |               |   |
| <i>Access to and affordability of finance</i>  |               |   |
| <i>Research and technology institutions</i>  |               |   |
| <i>Misclassification of new clothes as second hand; under declaration of imports</i> |               |   |
| <i>Other (specify)</i>   |               |   |

**P8.** How do political issues at the national, regional and international levels affect the business climate/ policymaking in the sector and what impact is there on investment in upgrading?

*Domestic political issues:*

\_\_\_\_\_

*Regional political issues (e.g. Tensions between Kenya and Tanzania):*

\_\_\_\_\_

*Global political issues:*

\_\_\_\_\_

**P9.** How do you rank the Quality of service provided by the training Institutions like VETA in Relation to the SDL you pay?

| <i>Extremely Poor</i> | <i>Very poor</i> | <i>Poor</i> | <i>Fair</i> | <i>Good</i> | <i>Very good</i> | <i>Excellent</i> |
|-----------------------|------------------|-------------|-------------|-------------|------------------|------------------|
|                       |                  |             |             |             |                  |                  |

*Give reasons to your answer*

\_\_\_\_\_

**P10.** How do you rank the extent to which Electricity is an obstacle to the current operations of this establishment?

| <i>No Obstacle</i> | <i>Minor obstacle</i> | <i>Moderate obstacle</i> | <i>Major obstacle</i> | <i>Very severe obstacle</i> |
|--------------------|-----------------------|--------------------------|-----------------------|-----------------------------|
|                    |                       |                          |                       |                             |

**P11.** Percentage of electricity received compared to that required \_\_\_\_\_%

**P12.** Average number of electrical outages in a typical month \_\_\_\_\_

**P13.** Average total time of power outages per month (Hours) \_\_\_\_\_

**P14.** Overall challenges facing the establishment

| Challenge   | Yes/No | Rank | Explanation |
|---|--------|------|-------------|
| High cost of production                                 |        |      |             |
| Inadequate technology                                   |        |      |             |
| Inadequate physical infrastructure (roads, water, etc.) |        |      |             |
| Complicated administrative procedures                   |        |      |             |
| Shortage of qualified labour                            |        |      |             |
| Insufficient production capacity                        |        |      |             |
| Shortage of raw materials                               |        |      |             |
| Taxes   |        |      |             |
| Insufficient demand                                     |        |      |             |
| Unfair competition                                      |        |      |             |
| Infant Private Sector with weak support                 |        |      |             |
| Environmental challenges                                |        |      |             |
| Uncertain economic environment                          |        |      |             |
| Inadequate financial services                           |        |      |             |

Other \_\_\_\_\_

**P15.** The extent to which Labour Regulations is an obstacle to the current operations of this establishment

| No Obstacle | Minor obstacle | Moderate obstacle | Major obstacle | Very severe obstacle |
|-------------|----------------|-------------------|----------------|----------------------|
|             |                |                   |                |                      |

Give reasons to your answer

\_\_\_\_\_

**P16.** Level of difficulty in the process to employ the Expatriates

| Very Easy | Easy | Fair | Difficult | Extremely difficult |
|-----------|------|------|-----------|---------------------|
|           |      |      |           |                     |

Give reasons to your answer

\_\_\_\_\_

What are the challenges in transitioning from having expatriates to employing locals?

\_\_\_\_\_

What additional support will make this process easier?

\_\_\_\_\_

**P17.** The extent to which Tax administration is an obstacle to the current operations of this establishment

| No Obstacle | Minor obstacle | Moderate obstacle | Major obstacle | Very severe obstacle |
|-------------|----------------|-------------------|----------------|----------------------|
|             |                |                   |                |                      |

Give reasons to your answer

---

**P18.** The extent to which Business Licencing and Permits are obstacles to the current operations of this establishment

| No Obstacle | Minor obstacle | Moderate obstacle | Major obstacle | Very severe obstacle |
|-------------|----------------|-------------------|----------------|----------------------|
|             |                |                   |                |                      |

Give reasons to your answer

---

**P19.** The extent to which Customs and Trade regulations are obstacles to the current operations of this establishment

| No Obstacle | Minor obstacle | Moderate obstacle | Major obstacle | Very severe obstacle |
|-------------|----------------|-------------------|----------------|----------------------|
|             |                |                   |                |                      |

Give reasons to your answer

---

**P20.** Days to clear Cargo

| Average days to clear exports through customs for bonded cargo | Average days to clear imports through customs for bonded cargo | Cargo dwell time in ICDs |
|--|--|--------------------------|
|  |  |                          |

**P21.** The extent to which Access to Finance is an obstacle to the current operations of this establishment

| No Obstacle | Minor obstacle | Moderate obstacle | Major obstacle | Very severe obstacle |
|-------------|----------------|-------------------|----------------|----------------------|
|             |                |                   |                |                      |

Give reasons to your answer

---

Main source of financing and interest rate for...

Investment capital:

Working capital:

### **Cotton production and ginning**

**C1.** Did the firm engage directly in seed cotton production in 2018? Yes []; No []

How much seed cotton was produced? \_\_\_\_\_

**C2.** Did the firm engage directly in ginning in 2018? Yes []; No []

How much cotton was ginned? \_\_\_\_\_

Where was the cotton sourced? \_\_\_\_\_

How much lint was produced? \_\_\_\_\_  
 What was the quality of lint? \_\_\_\_\_% classified at grade "GANY" or higher

**C3.** Has the firm recently started or stopped cotton production or ginning for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)?

Recent changes: \_\_\_\_\_  
 Planned changes: \_\_\_\_\_  
 Explanation: \_\_\_\_\_

**C4.** How difficult, in terms of firm capabilities required, is it for a textiles/apparel firm operating in Tanzania (not yours specifically) to grow its own cotton and carry out ginning to supply production lines serving each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).

|                   | Domestic market | Regional market | Global market |
|-------------------|-----------------|-----------------|---------------|
| Cotton production |                 |                 |               |
| Ginning           |                 |                 |               |

### Spinning Department

**S1.** What was your cotton consumption in 2018? \_\_\_\_\_ Tons

**S2.** Source of cotton:  
 Locally sourced []; suppliers : \_\_\_\_\_  
 Imported [, source countries: \_\_\_\_\_  
 Amount sourced locally \_\_\_\_\_ Tons; Price: \_\_\_\_\_ Tsh/Ton  
 Amount imported \_\_\_\_\_ Tons; Price: \_\_\_\_\_ USD/Ton

**S3.** What count range are you spinning? \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_

**S4.** Select your spinning method? Ring Spinning []; Rotor Spinning []

**S5.** Number of spindles: Installed \_\_\_\_\_  
 Running \_\_\_\_\_

**S6.** Number of Rotors Installed \_\_\_\_\_  
 Running \_\_\_\_\_

**S7.** What is the main machinery used for spinning, its age and source?

Machinery:  
 Age: >20 years []; 10-20 years []; 5-10 years []; <5 years []  
 Specify: \_\_\_\_\_ years

Source:  
 Are different machinery used for different end markets? Yes []; No []  
 If yes, please specify: .....

**S8.** Select the type of yarn: Carded []; Combed []

**S9.** Your Installed<sup>42</sup> production capacity \_\_\_\_\_ TONs

| Available capacity <sup>43</sup> | Achievable capacity <sup>44</sup> | Actual production in 2018 <sup>45</sup> | Production target in 2018 | Production target by 2019 |
|----------------------------------|-----------------------------------|---|---------------------------|---------------------------|
|                                  |                                   |   |                           |                           |

Main constraints to full spinning capacity utilisation: \_\_\_\_\_

**S10.** Total number of operatives in the spinning department: \_\_\_\_\_

Of these, how many are:

|                | Local | Expatriate |
|----------------|-------|------------|
| Direct workers |       |            |
| Supervisors    |       |            |
| Managers       |       |            |

Which of these positions are you planning to hire for in 2019, and how many?  
\_\_\_\_\_

**S11.** Has the firm recently started or stopped spinning for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)?

Recent changes:

Planned changes:

Explanation:  
\_\_\_\_\_

**S12.** How difficult, in terms of firm capabilities required, is it for a textiles/apparel firm operating in Tanzania (not yours specifically) to be competitive in spinning cotton to supply yarn to production lines serving each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).

| Function | Domestic market | Regional market | Global market |
|----------|-----------------|-----------------|---------------|
| Spinning |                 |                 |               |

### Weaving Department

**W1.** Source of Yarn:       In-house  
                                   Locally Sourced      Suppliers: .....  
                                   Imported;              Countries: .....

<sup>42</sup> Installed capacity is the output that would have been produced if all the installed machines on the floor were working

<sup>43</sup> Available capacity is the output that would have been produced if all the machines in working condition were running

<sup>44</sup> Achievable capacity is the output that would have been produced if all running machines were being used optimally

<sup>45</sup> Actual production is the output actually produced by the running machines.

Amount sourced in-house \_\_\_\_\_ Tons  
 Amount sourced locally \_\_\_\_\_ Tons; Price: \_\_\_\_\_ Tsh/Ton  
 Amount imported (If any) \_\_\_\_\_ Tons Price: \_\_\_\_\_ USD/Ton

**W2.** Reasons for importation: Quality []; Availability []; Price [];  
 Other reasons \_\_\_\_\_

**W3.** Number of weaving looms you are having \_\_\_\_\_

Type of weaving looms: Air Jet []; Water Jet Looms []; Shuttle Looms [];  
 Rapier Loom []; Projectile Loom []

**W4.** What is the main machinery used for weaving, its age and source?

Machinery:

Age: >20 years []; 10-20 years []; 5-10 years []; <5 years []

Specify: \_\_\_\_\_ years

Source:

Are different machinery used for different end markets?

Yes []; No []

If yes, please specify: .....

**W5.** Installed<sup>46</sup> weaving capacity \_\_\_\_\_ Mil Linear Meters

| Available capacity <sup>47</sup> | Achievable capacity <sup>48</sup> | Actual production <sup>49</sup> in 2018 | Production target in 2018 | Production target by 2019 |
|----------------------------------|-----------------------------------|---|---------------------------|---------------------------|
|                                  |                                   |   |                           |                           |

Main constraints to full weaving capacity utilisation: \_\_\_\_\_

**W6.** Total number of operatives in the weaving department \_\_\_\_\_

Of these, how many are:

|                | Local | Expatriate |
|----------------|-------|------------|
| Direct workers |       |            |
| Supervisors    |       |            |
| Managers       |       |            |

Which of these positions are you planning to hire for in 2019, and how many?  
 \_\_\_\_\_

<sup>46</sup> Installed capacity is the output that would have been produced if all the installed machines on the floor were working  
<sup>47</sup> Available capacity is the output that would have been produced if all the machines in working condition were running  
<sup>48</sup> Achievable capacity is the output that would have been produced if all running machines were being used optimally  
<sup>49</sup> Actual production is the output actually produced by the running machines.

**W7.** Has the firm recently started or stopped weaving for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)?

Recent changes:

Planned changes:

Explanation:

**W8.** How difficult, in terms of firm capabilities required, is it for a textiles/apparel firm operating in Tanzania (not yours specifically) to be competitive in weaving to supply fabric to production lines serving each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).

| Function | Domestic market | Regional market | Global market |
|----------|-----------------|-----------------|---------------|
| Weaving  |                 |                 |               |

### Knitting Department

**K1. Source of Yarn:**  In-house  
 Locally Sourced Suppliers: .....

Imported Countries: .....

Amount sourced in-house \_\_\_\_\_ Tons

Amount sourced locally \_\_\_\_\_ Tons; Price: \_\_\_\_\_ Tsh/Ton

Amount imported (If any) \_\_\_\_\_ Tons Price: \_\_\_\_\_ USD/Ton

**K2. Types of knit fabric:**  Plain Knit;  Double Knit;  Single Knit Jersey;

Double Knit Jersey;  Pique;  Interlock;

Rib;  Tricot;  Raschel

Other (Specify)

**K3. Gauges:** \_\_\_\_\_

**K4. What is the main machinery used for knitting, its age and source?**

Machinery:

Age: >20 years ; 10-20 years ; 5-10 years ; <5 years

Specify: \_\_\_\_\_ years

Source:

Are different machinery used for different end markets?

Yes []; No []

If yes, please specify: .....

**K5. Installed<sup>50</sup> Knitting capacity \_\_\_\_\_ Tons**

| Available capacity <sup>51</sup> | Achievable capacity <sup>52</sup> | Actual production <sup>53</sup> in 2018 | Production target in 2018 | Production target by 2019 |
|----------------------------------|-----------------------------------|---|---------------------------|---------------------------|
|                                  |                                   |   |                           |                           |

*Main constraints to full knitting capacity utilisation:*

\_\_\_\_\_

**K6. Total number of operatives in the knitting department \_\_\_\_\_**

*Of these, how many are:*

|                | Local | Expatriate |
|----------------|-------|------------|
| Direct workers |       |            |
| Supervisors    |       |            |
| Managers       |       |            |

*Which of these positions are you planning to hire for in 2019, and how many?*

\_\_\_\_\_

**K7. Has the firm recently started or stopped knitting for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)?**

*Recent changes:*

\_\_\_\_\_

*Planned changes:*

\_\_\_\_\_

*Explanation:*

\_\_\_\_\_

**K8. How difficult, in terms of firm capabilities required, is it for a textiles/apparel firm operating in Tanzania (not yours specifically) to be competitive in knitting to supply fabric to production lines serving each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).**

| Function | Domestic market | Regional market | Global market |
|----------|-----------------|-----------------|---------------|
| Knitting |                 |                 |               |

### **Sewing Department**

<sup>50</sup> Installed capacity is the output that would have been produced if all the installed machines on the floor were working

<sup>51</sup> Available capacity is the output that would have been produced if all the machines in working condition were running

<sup>52</sup> Achievable capacity is the output that would have been produced if all running machines were being used optimally

<sup>53</sup> Actual production is the output actually produced by the running machines.

**S1. What is your production basis:**

- Cut, make and trim/print (CMT/CMP)
- Full package/FOB
- Original design manufacturer (ODM)
- Own brand manufacturer (OBM)
- Vertically integrated

Is there variation by end market? If so, specify for...

Domestic market:

Regional market:

Global market:

**S2. What is the nature of buyers and buyer links in each end market?**

Nature of buyers (government, retailer, brand, etc.)

Domestic market:

Regional market:

Global market:

Buyer links:

- Domestic market: Direct ; or indirect, e.g. subcontractor
- Regional market: Direct ; or indirect, e.g. subcontractor
- Global market: Direct ; or indirect, e.g. subcontractor

**S3. How difficult, in terms of firm capabilities required, is it for a firm operating in Tanzania (not yours specifically) to establish and maintain direct links to buyers in each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).**

| Function           | Domestic market | Regional market | Global market |
|--------------------|-----------------|-----------------|---------------|
| Direct buyer links |                 |                 |               |

**S4. Does the firm have a pricing department? YES or NO**

If yes: For which products? \_\_\_\_\_  
 Share of total sales? \_\_\_\_\_  
 For which end markets? \_\_\_\_\_

How are prices agreed/negotiated with buyers in each end market?

What are the payment terms/conditions (eg proportion paid in advance/on receipt of goods); are there ever delays/problems with payment?

---

**S5.** Annual Fabric consumption \_\_\_\_\_ Million Square Meter/Tons

**S6.** Source of fabric:             In-house  
     Locally Sourced      Suppliers: \_\_\_\_\_  
     Imported                      Countries: \_\_\_\_\_

Amount sourced in-house \_\_\_\_\_ Million Square Meter/Tons

Amount sourced locally \_\_\_\_\_ Million Square Meter/Tons; Price: \_\_\_\_\_ Tsh/unit

Amount imported \_\_\_\_\_ Million Square Meter/Tons; Price: \_\_\_\_\_ USD/unit

**S7.** Does the firm have an input sourcing department/capability in Tanzania? Yes ; No

If yes: How many staff are dedicated to sourcing (FTE)? \_\_\_\_\_

Which inputs are actively sourced? \_\_\_\_\_

From which markets? \_\_\_\_\_

For which products? \_\_\_\_\_

Share of total sales? \_\_\_\_\_ %

For which end markets? \_\_\_\_\_

**S8.** How difficult, in terms of firm capabilities required, is it for a firm operating in Tanzania (not yours specifically) to be competitive in sourcing inputs (from anywhere) to make products for sale in each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).

| Function       | Domestic market | Regional market | Global market |
|----------------|-----------------|-----------------|---------------|
| Input sourcing |                 |                 |               |

**S9.** Reasons for importation: Quality ; Availability ; Price   
 Other reasons \_\_\_\_\_

**S10.** Number of sewing machines \_\_\_\_\_ Number of machinist \_\_\_\_\_

**S11.** What is the main machinery used for sewing, its age and source?

Machinery:

Age: >20 years ; 10-20 years ; 5-10 years ; <5 years

Source:

Are different machinery used for different end markets?

Yes ; No

If yes, please specify: .....

**S12.** Installed<sup>54</sup> production capacity \_\_\_\_\_ Million Square Meter Equivalent (SME)

| Available capacity <sup>55</sup> | Achievable capacity <sup>56</sup> | Actual production <sup>57</sup> in 2018 | Production target in 2018 | Production target by 2019 |
|----------------------------------|-----------------------------------|---|---------------------------|---------------------------|
|                                  |                                   |   |                           |                           |

Garment Sewing Data \_\_\_\_\_ (garment per minutes produced)

Main constraints to full sewing capacity utilisation:

.....

**S13.** Total number of operatives in the sewing department \_\_\_\_\_

Of these, how many are:

|                | Local | Expatriate |
|----------------|-------|------------|
| Direct workers |       |            |
| Supervisors    |       |            |
| Managers       |       |            |

Which of these positions are you planning to hire for in 2019, and how many?

\_\_\_\_\_

For each position, what are the key skills someone needs to perform the job well? Which ones are lacking? What plans does the company have for bridging those gaps?

| Position                | Key Skills profiles | Which skills are lacking? | Company's skills plan for bridging gaps |
|-------------------------|---------------------|---------------------------|---|
| Sewing machine operator |                     |                           |   |
|                         |                     |                           |   |
|                         |                     |                           |   |
| Line supervisor         |                     |                           |   |
|                         |                     |                           |   |
|                         |                     |                           |   |
| Production manager      |                     |                           |   |
|                         |                     |                           |   |
|                         |                     |                           |   |
| Other                   |                     |                           |   |

<sup>54</sup> Installed capacity is the output that would have been produced if all the installed machines on the floor were working

<sup>55</sup> Available capacity is the output that would have been produced if all the machines in working condition were running

<sup>56</sup> Achievable capacity is the output that would have been produced if all running machines were being used optimally

<sup>57</sup> Actual production is the output actually produced by the running machines.

|            |  |  |  |
|------------|--|--|--|
| management |  |  |  |
|            |  |  |  |

**S14.** What do you think are the best ways that the SDL can be spent, to improve skills in the sector? This can be through VETA or other channels/institutions.

Top choices:

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

**S15.** Has the firm recently started or stopped sewing for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)? Also consider if the nature of buyer link, sourcing decisions or pricing capability has/will change

Recent changes: \_\_\_\_\_

Planned changes: \_\_\_\_\_

Explanation: \_\_\_\_\_

**Processing/Finishing Department (Dyeing, Printing, Packing)**

**P1. Source of fabric:**       In-house  
     Locally Sourced      Suppliers: \_\_\_\_\_  
     Imported                      Countries: \_\_\_\_\_

Amount sourced in-house \_\_\_\_\_ Million Square Meter/Tons

Amount sourced locally \_\_\_\_\_ Million Square Meter/Tons; Price: \_\_\_\_\_ Tsh/unit

Amount imported \_\_\_\_\_ Million Square Meter/Tons; Price: \_\_\_\_\_ USD/unit

**P2. Is your factory dyeing?**      Yes ;      No   
 Dyeing methods:      Direct Dyeing ;      Yarn Dyeing ;      Piece Dyeing ;  
    Garment Dyeing ;      Other \_\_\_\_\_

Select types of yarn dyeing methods if any:

Skein (Hank) Dyeing ;      Package Dyeing ;      Warp Beam Dyeing

Other (specify) \_\_\_\_\_

**P3. Is the factory printing?**      Yes ;      No

Printing methods:

Screen Printing []; Roller Printing []; Heat Transfer Printing [];  
 Digital Printing []; Ink-Jet Printing []; Other \_\_\_\_\_ []

**P4.** Installed<sup>58</sup> total Processing/finishing capacity \_\_\_\_\_

| Available capacity <sup>59</sup> | Achievable capacity <sup>60</sup> | Actual production <sup>61</sup> in 2018 | Production target in 2018 | Production target by 2019 |
|----------------------------------|-----------------------------------|---|---------------------------|---------------------------|
|                                  |                                   |   |                           |                           |

Main constraints to full processing/finishing capacity utilisation:

---

**P5.** What is the main machinery used for processing/finishing, its age and source? If different machinery is used for different end markets, specify.

Machinery:

Age: >20 years []; 10-20 years []; 5-10 years []; <5 years []

Specify: \_\_\_\_\_ years

Source:

Are different machinery used for different end markets?

Yes []; No []

If yes, please specify: .....

**P6.** Total number of operatives in the processing/finishing department \_\_\_\_\_

Of these, how many are:

|                | Local | Expatriate |
|----------------|-------|------------|
| Direct workers |       |            |
| Supervisors    |       |            |
| Managers       |       |            |

Which of these positions are you planning to hire for in 2019, and how many?

---

**P7.** Finishing processes detail (mostly associated with fabric production)

| Process  | Does the firm carry out the process? Y/N | Proportion of fabric treated | Source of input (e.g. dye, bleach) | For which end markets? |
|----------|--|------------------------------|------------------------------------|------------------------|
| Desizing |  |                              |                                    |                        |
| Scouring |  |                              |                                    |                        |

<sup>58</sup> Installed capacity is the output that would have been produced if all the installed machines on the floor were working

<sup>59</sup> Available capacity is the output that would have been produced if all the machines in working condition were running

<sup>60</sup> Achievable capacity is the output that would have been produced if all running machines were being used optimally

<sup>61</sup> Actual production is the output actually produced by the running machines

|                         |  |  |  |  |
|-------------------------|--|--|--|--|
| Bleaching               |  |  |  |  |
| Mercerising             |  |  |  |  |
| Singeing                |  |  |  |  |
| Raising                 |  |  |  |  |
| Calendaring             |  |  |  |  |
| Shrinking (Sanforizing) |  |  |  |  |
| Dyeing                  |  |  |  |  |
| Printing                |  |  |  |  |

**P8.** How difficult, in terms of firm capabilities required, is it for a textiles/apparel firm operating in Tanzania (not yours specifically) to be competitive in carrying out the above fabric processing/finishing operations serving each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).

| Function                    | Domestic market | Regional market | Global market |
|-----------------------------|-----------------|-----------------|---------------|
| Fabric finishing/processing |                 |                 |               |

If there are important differences by type of operation, specify:

---

**P9.** Finishing processes detail (mostly associated with apparel)

| Process                        | Does the firm carry out the process? Y/N | Proportion of apparel covered | Source of input (e.g. labels, packaging materials) | For which end markets? |
|--------------------------------|--|-------------------------------|--|------------------------|
| Embroidery                     |  |                               |  |                        |
| Washing                        |  |                               |  |                        |
| Thread removal/trimming        |  |                               |  |                        |
| Ironing or pressing            |  |                               |  |                        |
| Measurements check             |  |                               |  |                        |
| Quality inspection             |  |                               |  |                        |
| Folding                        |  |                               |  |                        |
| Label attaching                |  |                               |  |                        |
| Hang tag and barcode attaching |  |                               |  |                        |
| Poly packing and packaging     |  |                               |  |                        |
| Loading onto export carriers   |  |                               |  |                        |

**P10.** How difficult, in terms of firm capabilities required, is it for a textiles/apparel firm operating in Tanzania (not yours specifically) to be competitive in carrying out the above apparel finishing processes serving each end market? 1: very easy (i.e. very low capabilities required); 2: quite easy; 3: medium; 4: quite hard; 5: very hard (i.e. very high capabilities required).

| Function          | Domestic market | Regional market | Global market |
|-------------------|-----------------|-----------------|---------------|
| Apparel finishing |                 |                 |               |

If there are important differences by type of operation, specify:

---

**P11.** Has the firm recently started or stopped any of the above finishing/processing operations (for fabric or apparel) for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)?

Recent changes:

---

Planned changes:

---

Explanation:

---

**Other functions (design, sampling, branding, marketing, distribution)**

**F1.** Does the firm design any of its own products? Yes []; No []

If yes: Which software used? \_\_\_\_\_

Number of (apparel) designers employed? \_\_\_\_\_

Designers' training (type, level)? \_\_\_\_\_

**F2.** Does the firm make its own samples for any products? Yes []; No []

**F3.** Does the firm have its own branding for any products? Yes []; No []

**F4.** Does the firm have a marketing department? Yes []; No []

**F5.** Does the firm engage directly in the wholesale or retail distribution of its products?

Yes []; No []

If yes: Wholesale or retail basis? \_\_\_\_\_

Via own stores or those of others? \_\_\_\_\_

In which countries, regions and cities? \_\_\_\_\_

**F5.** For these functions, please complete the following table:

| Function | For which products? | Share of total sales? | For which end markets? | Nature of buyer & relationship duration | Buyer requirements |
|----------|---------------------|-----------------------|------------------------|---|--------------------|
|          |                     |                       |                        |   |                    |

|                     |  |  |  |  |  |
|---------------------|--|--|--|--|--|
| <i>Design</i>       |  |  |  |  |  |
| <i>Sampling</i>     |  |  |  |  |  |
| <i>Branding</i>     |  |  |  |  |  |
| <i>Marketing</i>    |  |  |  |  |  |
| <i>Distribution</i> |  |  |  |  |  |

**F6.** Has the firm recently started or stopped any of the above functions (design, sampling, branding, or distribution) for any end market, are any changes planned, and why/why not (with reference to firm's internal capabilities and constraints)?

Recent changes:

Planned changes:

Explanation:

### 10.2.2. Firm survey – Kenya

#### 1. Basic Details

|                     |  |
|---------------------|--|
| Company Name        |  |
| Name                |  |
| Position            |  |
| Telephone           |  |
| Email               |  |
| Institution Website |  |

#### 2. Current capacities

|  |                              |
|--|------------------------------|
| Local Ownership Stake %                        |                              |
| Foreign Ownership Stake %                      |                              |
| Products with share of sales (%)               |                              |
| Export Destinations by product:                |                              |
| Year of entry to each export market            |                              |
| Share of domestic, regional and global sales   | D: ___ %, R: ___ %, G: ___ % |
| Number and nature of buyers                    |                              |
| Buyer links (direct/indirect)                  |                              |
| Lead time (days)                               |                              |
| Annual Production capacity (No of Pieces)      |                              |
| Current Utilisation (%)                        |                              |
| Minimum order quantity                         |                              |
| Number of Employed                             |                              |
| Certification (quality, safety, environmental) |                              |
| Productivity/KPI measure                       |                              |
| Machine cost                                   |                              |

### 3. Value chain functions

| Production basis                    | Local market | Regional market | Global market |
|-------------------------------------|--------------|-----------------|---------------|
| Cut, make and trim/ print (CMT/CMP) |              |                 |               |
| Full package/FOB                    |              |                 |               |
| Original design manufacturer (ODM)  |              |                 |               |
| Own brand manufacturer (OBM)        |              |                 |               |
| Vertically integrated               |              |                 |               |

| Function  | Production capacity | 2018 production | % used as input | % sold locally | % exported | Export destinations |
|-----------|---------------------|-----------------|-----------------|----------------|------------|---------------------|
| Spinning  |                     |                 |                 |                |            |                     |
| Weaving   |                     |                 |                 |                |            |                     |
| Knitting  |                     |                 |                 |                |            |                     |
| Sewing    |                     |                 |                 |                |            |                     |
| Finishing |                     |                 |                 |                |            |                     |

#### Finishing processes

| Fabric processes        | Yes/no | Apparel processes              | Yes/no |
|-------------------------|--------|--------------------------------|--------|
| Desizing                |        | Embroidery                     |        |
| Scouring                |        | Washing                        |        |
| Bleaching               |        | Thread removal/ trimming       |        |
| Mercerising             |        | Ironing or pressing            |        |
| Singeing                |        | Measurements check             |        |
| Raising                 |        | Quality inspection             |        |
| Calendaring             |        | Folding                        |        |
| Shrinking (Sanforizing) |        | Label attaching                |        |
| Dyeing                  |        | Hang tag and barcode attaching |        |
| Printing                |        | Poly packing and packaging     |        |
| Washing                 |        | Loading onto export carriers   |        |

#### Other functions

| Function       | Y/N | Products | End markets | Share of sales (%) |
|----------------|-----|----------|-------------|--------------------|
| Design         |     |          |             |                    |
| Input sourcing |     |          |             |                    |
| Sampling       |     |          |             |                    |
| Branding       |     |          |             |                    |
| Marketing      |     |          |             |                    |
| Distribution   |     |          |             |                    |

### 4. Raw Materials:

| Raw Material | Country of Origin | Quantity (KG/Mt./Pc) | Cost per KG/Mt./Pc | Import duties, VAT etc. paid (%) |
|--------------|-------------------|----------------------|--------------------|----------------------------------|
| Fabrics      |                   |                      |                    |                                  |
| Accessories  |                   |                      |                    |                                  |
| Yarn         |                   |                      |                    |                                  |

|        |  |  |  |  |
|--------|--|--|--|--|
| Cotton |  |  |  |  |
| Other  |  |  |  |  |

a) To what extent are your key inputs available in the region? At what prices?

---



---

b) Are any exemptions held for import duties/taxes?  EPZ,  SEZ,  Duty remission

c) How does the EAC CET system of applied tariffs, stays of application and duty remissions impact the firm's competitiveness?

---



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#### 5. Level of technology

| Area                   | Specific Technologies | Quantities | Age & source |
|------------------------|-----------------------|------------|--------------|
| Spinning               |                       |            |              |
| Weaving                |                       |            |              |
| Knitting               |                       |            |              |
| Cutting                |                       |            |              |
| Stitching              |                       |            |              |
| Finishing ( Dry & Wet) |                       |            |              |
| Packaging              |                       |            |              |

#### 6. Labor scenario

a) Number of Employees

---

b) %age Female

---

c) Average monthly Wages (KES, net, per month)

---

d) Labor turnover (% leaving in 2018)

---

e) Details of Training programs, if any

---

f) Duration of on-the-job training

---

g) Any benefits provided

---

h) Issues (unavailability, absenteeism, low productivity)

---

i) Any measures you want to introduce to mitigate the above

---

## 7. Factor Costs

|                                      | Source | Cost | Related issues |
|--------------------------------------|--------|------|----------------|
| Power Per kWh                        |        |      |                |
| Water Per CuSec                      |        |      |                |
| Fuel Per Ltr                         |        |      |                |
| Financing for Capex                  |        |      |                |
| Finance Cost for Opex                |        |      |                |
| Rental per SQM                       |        |      |                |
| Work Permits (USD Annual)            |        |      |                |
| Specific Licenses for start-up       |        |      |                |
| Specific Licenses for recurring      |        |      |                |
| Logistics-Road Per 40 foot Container |        |      |                |
| Logistics-Road Per 40 foot Container |        |      |                |
| Port Charges – Import per 40 foot    |        |      |                |
| Port Charges – Export Per 40 foot    |        |      |                |

## 8. Buyers

- a) How demanding, in terms of the firm capabilities required to meet the demands, are domestic (D), regional (R) and global (G) buyers on the following measures? Please rank buyers (1-3) on each measure, where 1 is most demanding, and give an explanation.

| Measure                 | D | R | G | Explanation |
|-------------------------|---|---|---|-------------|
| Tolerance to defects    |   |   |   |             |
| Product quality         |   |   |   |             |
| Price                   |   |   |   |             |
| Lead times              |   |   |   |             |
| Order size              |   |   |   |             |
| Labour/safety standards |   |   |   |             |
| Environmental standards |   |   |   |             |
| Other measure (specify) |   |   |   |             |

- b) How often are you unable to fulfil buyer orders as planned due to production problems (number of not on-time/in-full orders in 2018), and what are the main issues?

\_\_\_\_\_

\_\_\_\_\_

- c) How have the demands of buyers changed in recent years? Any difference by origin?

\_\_\_\_\_

\_\_\_\_\_

- d) How has the firm upgraded its skills, technology, processes etc. to meet buyer demands?

\_\_\_\_\_

\_\_\_\_\_

- e) What support has been received from buyers, government etc. to upgrade?

**9. Supply Chain**

|                | Type | Source or Destination | Mode of transportation | Time taken | Cost involved | Related issues |
|----------------|------|-----------------------|------------------------|------------|---------------|----------------|
| Raw material   |      |                       |                        |            |               |                |
|                |      |                       |                        |            |               |                |
| Finished goods |      |                       |                        |            |               |                |
|                |      |                       |                        |            |               |                |
|                |      |                       |                        |            |               |                |

**10. Other**

| Investments / Expansions in the last 2 years? | Amount         | Impact on Employment / Efficiencies |
|---|----------------|-------------------------------------|
|   |                |                                     |
|   |                |                                     |
| Destination Port                              | Number of Days | Cost (per container or Kg)          |
|   |                |                                     |
|   |                |                                     |

Recent changes to mix of products, markets and value chain functions:

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**11. Future Plans to increase Investments /exports in Textiles & Apparel, specify products, markets and value chain functions**

|   |
|---|
| Short Term Plans / activities (2020 - 2025) |
|   |
| Long Term Plans / activities (2025 - 2030)  |
|   |

**12. Challenges, Policies & Recommendations**

| Issue             | Challenge | Recommendation |
|-------------------|-----------|----------------|
| Space             |           |                |
| Cost of Finance   |           |                |
| Workforce         |           |                |
| Skills            |           |                |
| Labour regulation |           |                |
| Electricity       |           |                |

|                           |  |  |
|---------------------------|--|--|
| Raw materials             |  |  |
| Infrastructure            |  |  |
| Customs clearance         |  |  |
| Import undervaluation     |  |  |
| Used clothing imports     |  |  |
| Taxes                     |  |  |
| Administrative procedures |  |  |
| Industry association(s)   |  |  |
| Other                     |  |  |

Do you view regional markets for inputs or outputs as potentially important for your future strategy? Why/why not? How could regional integration policies (e.g. the EAC, COMESA, AfCFTA, infrastructure cooperation, etc.) be better designed to promote expansion and upgrading?

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### 10.2.3 Interview guide – policy issues

*NB: Not all questions were asked to all respondents, actual questions asked to each interviewee depended on their current and past roles and institutions*

|   |  |
|---|--|
| <b>Respondent name</b>                              |  |
| <b>Contact number and email address</b>             |  |
| <b>Current role, institution &amp; time in post</b> |  |
| <b>Previous roles and institutions</b>              |  |

#### **National policy**

**P1.** For you, what are the most important national trade and industrial policies affecting the sector, and how does the current policy stance impact the sector’s competitiveness and growth prospects?

Rating system:

- 0: no impact
- 1: very negatively
- 2: quite negatively
- 3: neutral overall
- 4: quite positively
- 5: very positively

| Policy | Rating | Explanation |
|--------|--------|-------------|
|--------|--------|-------------|

|  |  |                       |
|--|--|-----------------------|
| <i>EPZ/SEZs – tax and other benefits</i>   |  |                       |
| <i>EPZ/SEZs – Compliance requirements</i>  |  |                       |
| <i>Other investment incentives (e.g. IPA, specify: _____)</i>                        |  |                       |
| <i>Electricity – cost</i>  |  | <i>(\$/kWh: ____)</i> |
| <i>Electricity - reliability</i>   |  |                       |
| <i>Infrastructure quality</i>  |  |                       |
| <i>Customs clearance: speed and reliability</i>                                      |  |                       |
| <i>Access to foreign exchange</i>  |  |                       |
| <i>Adequacy of skills training from public/private providers</i>                     |  |                       |
| <i>Supply of skilled workers</i>   |  |                       |
| <i>Labour market regulation and enforcement</i>                                      |  |                       |
| <i>Access to and affordability of finance</i>  |  |                       |
| <i>Research and technology institutions</i>  |  |                       |
| <i>Misclassification of new clothes as second hand; under declaration of imports</i> |  |                       |
| <i>Other (e.g. fiscal policy, specify: _____)</i>                                    |  |                       |

**P2.** *In [Tanzania/Kenya]’s official vision for the T&A sector, what are the relative roles of regional markets (e.g. EAC, SADC, COMESA, AfCFTA) and global markets for both inputs and outputs? What have been the key successes and problems in implementation of national industrial policies related to T&A?*

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**P3.** *Undervaluation of imports*

- a. The undervaluation of imported fabric and garments, and the resulting unfair competition, has been identified as a key threat to the domestic industry. Why is this happening and what can be done about it?*

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**P4.** *Immigration rules – employment of expatriates*

- a. Immigration rules balance the needs of industry for foreign expertise in the short term with incentives to train locals to replace expatriates in the medium to long-term. How do current policies achieve this?*

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**P5. Tax rules - VAT**

- a. *Is VAT due on both domestically produced and imported cotton? In each case, can a refund can be claimed if the final products are exported? Such VAT refunds can be severely delayed – why is that? Is there a unit responsible for resolving such issues?*

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- b. *Is it correct that VAT is due on imports of machinery and spare parts? Can any refund be claimed in case of production for export markets?*

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- c. *Is VAT due on electricity for industrial use? What % rate?*

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**P6. EPZs – VAT due**

- a. *Firms in EPZs report being required to pay VAT on production inputs such as sewing needles, protective equipment and security services since these are not categorised as raw materials. How are decisions made about categorisation of production inputs as raw materials or other?*

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- b. *What challenges does EPZA face in supporting T&A firms (e.g. on electricity provision, customs procedures, etc.)*

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**P7. Access to finance**

- a. *Do any institutions provide **working capital**/commodity financing at below commercial rates to textile manufacturers, e.g. to buy the cotton they need for the year ahead?*

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- b. *Can those or other institutions provide financing at below commercial rates for **capital investment** by textile and garment manufacturers in support of their expansion plans?*

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**P8. Technology institutions**

- a. What services do national technology institutions offer to textile and garment manufacturers?

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**P9. Anti-dumping**

- a. Does Tanzania/Kenya intend to establish a national authority with the competence to conduct anti-dumping investigations? Is there any national legislation or regulations governing anti-dumping measures, currently or in the pipeline?

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**P10. Industry association**

- b. How often do industry associations hold meetings? How are they initiated and organised? Who sets an agenda, sends invitations, takes minutes etc.? How are actions followed up and monitored?

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- P11.** How do political issues at the national, regional and international levels affect the business climate/ policymaking in the sector and what impact is there on investment in upgrading?

Domestic political issues:

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Regional political issues (e.g. Tensions between Kenya and Tanzania):

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Global political issues:

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**Regional policy**

- P12.** What are the most important regional trade and industrial policies affecting the sector, and how does the current policy stance impact the sector's competitiveness and growth prospects?

Rating system:

- 0: no impact
- 1: very negatively
- 2: quite negatively
- 3: neutral overall
- 4: quite positively
- 5: very positively

| Policy | Rating | Explanation |
|--------|--------|-------------|
|--------|--------|-------------|

|  |  |  |
|--|--|--|
| <i>EAC CET: Applied tariff rates on imports (e.g. inputs &amp; competing products)</i> |  |  |
| <i>EAC: Stays of application on imports</i>  |  |  |
| <i>EAC: Duty remissions granted to firms</i>   |  |  |
| <i>EAC: CET review process (if ongoing) or outcome</i>                                 |  |  |
| <i>EAC FTA: assured market access for inputs</i>                                       |  |  |
| <i>EAC FTA: assured market access for outputs</i>                                      |  |  |
| <i>EAC NTBs: Restrictions on internal EAC trade in inputs or outputs</i>               |  |  |
| <i>EAC Rules of Origin</i>   |  |  |
| <i>EAC regional industrial policy</i>  |  |  |
| <i>Infrastructure/energy cooperation in East Africa (e.g. AfDB, gas pipeline)</i>      |  |  |
| <i>SADC assured duty free market access for inputs</i>                                 |  |  |
| <i>SADC assured duty free market access for outputs</i>                                |  |  |
| <i>SADC Rules of Origin</i>  |  |  |
| <i>SADC industrial policy initiatives</i>  |  |  |
| <i>COMESA assured duty free market access for inputs</i>                               |  |  |
| <i>COMESA assured duty free market access for outputs</i>                              |  |  |
| <i>COMESA Rules of Origin</i>  |  |  |
| <i>COMESA industrial policy initiatives</i>  |  |  |
| <i>Other regional policies (e.g. investment treaties, etc. - specify)</i>              |  |  |

**P13. EAC Duty Remission scheme (EAC Secretariat)**

- a. Sometimes duty on intermediate products/inputs is reduced by means of a (country-wide) stay of application, at others through a (company specific) duty remission. How is it decided which is granted, and what is the approval process for each? Do other countries have to agree?

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- b. Is it necessary for the first EAC Gazette of the year on 30<sup>th</sup> June to specify all products on which duty remission can be granted that year, or can duty remission later be

*granted on products that are not listed in the June Gazette? How is it decided each year which products may be eligible for duty remission – at industry request, or based on government policy/strategy? Must each country’s list be agreed by other members? Does each member approach the grant of duty remissions in the same way?*

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- c. *The duty remission regulations allow for manufacture for both home and export use. When is each used, and how is it decided in each case?*

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- d. *Why were duty remissions on similar textiles raw materials and equipment given for multiple countries in 2018-19, instead of granting it for the whole bloc? Was this due to Kenya’s withdrawal from a cross-EAC scheme? Would that have involved an EAC-wide stay of application, or what other mechanism, and would it have allowed duty free garment trade in the EAC? Why did Kenya withdraw from the cross-EAC scheme, and why did it not grant its manufacturers duty remissions?*

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- e. *Some companies prefer not to participate in the duty remission scheme due to delays in clearing imports and high storage costs, preferring to pay the duty. Is this an issue of regional policy or national (customs) policy/implementation?*

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- f. *Is there a central repository of all past EAC Gazettes which can be accessed by the sector? They are not all published online.*

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**P14.** *What are the priorities for [Tanzania/Kenya] in the ongoing negotiations to review the EAC Common External Tariff? How would these outcomes impact the T&A sector?*

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*How would the proposed elimination of stays of application affect [Tanzanian/Kenyan manufacturing, and in particular the T&A sector?*

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*How would the proposed four band tariff structure (i.e. an additional band of 5% for intermediate products such as yarn) affect the [Tanzanian/Kenyan] T&A sector?*

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**P15.** *Will the EAC agree to a ‘variable geometry’ approach allowing Kenya alone to implement the EPA with the EU?*

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**P16.** *Will the planned implementation of the African Continental Free Trade Agreement (AfCFTA) and the Tripartite Free Trade Agreement (TFTA) between COMESA, SADC and the EAC be positive overall for the [Tanzanian/Kenyan] textile and apparel sector? Consider the expanded market access for exporters, increased import competition in the domestic market, and increased competition in exporting to regional markets.*

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*Where are negotiations at on rules of origin for the AfCFTA and TFTA on woven fabrics, knitted fabrics, and garments? Are they likely to be single or double transformation? What is the position of [Tanzania/Kenya], the EAC, SADC and COMESA?*

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**P17.** *The EAC CET means members cannot in principle set their own tariffs or sign trade deals independently, but stays of application and duty remissions provide flexibility. Does the system allow [Tanzania/Kenya] to provide the necessary trade policy support to the manufacturing sector, and T&A in particular?*

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*For example, does the EAC framework allow the right balance to be struck between the needs of firms for affordable, quality inputs imported from outside the region and the objective of promoting domestic and regional value chains?*

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**P18.** *Trade agreements such as the EAC aim to expand duty-free market access for manufacturers, providing economies of scale and making new investments viable. Has this been evident in the [Tanzanian/Kenyan] T&A sector, and have new policies emerged as a result?*

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**P19.** Have the new political and institutional structures (e.g. the EAC Summit, Secretariat, Council of Ministers, etc.) created through regional cooperation under the EAC resulted in new kinds of policies towards the T&A sector?

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*Is the used clothing phase out an example of a new policy emerging because of regional cooperation?*

Yes;       No

Explanation:

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*Did you initially, and do you now, oppose or support the EAC used clothes phase-out? (Note that the improper classification of new clothes as used is addressed separately)*

*Initial position: opposed  or supported:*

Explanation:

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*Current position: oppose  or support:*

Explanation:

---

*Why did the policy emerge, and why was it not implemented?*

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*If it were implemented, how might it affect the prospects of the sector?*

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**P20.** Regional policy aims to promote regional value chains, i.e. regional sourcing of inputs and marketing of outputs. Do you see that objective as good for the sector's prospects?

Yes;       No

Explanation:

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*Is there a trade-off between regional value chain development and rapid growth in the sector?*

Yes;       No

Explanation:

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Are regional cooperation initiatives such as the EAC promoting the development of complementary productive structures across countries in the sector?

Yes;       No

Explanation:

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For [Tanzanian/Kenyan] T&A firms, do regional value chains offer better or worse prospects for upgrading than global value chains?

Better;       Worse

Explanation:

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**P21.** How might regional cooperation help address the main challenges facing firms in the T&A sector (e.g. around power supply, skilled labour, production cost, import competition)?

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**P22.** How could regional policies be changed to make investment in upgrading and expansion more viable in the [Tanzanian/Kenyan] T&A sector?

Examples for consideration: (note trade-off between market access and national policy flexibility)

- Institutionalise national flexibilities of regional policies (e.g. possibility for transparent restriction of internal trade without recourse to NTBs)
- More secure market access at the regional level (e.g. eliminate national flexibilities – NTBs, stays of application, duty remission within the EAC)
- Strengthen industrial policy coordination at regional level (e.g. coordinate investment decisions to promote industrial convergence)
- Greater market access at the regional level through liberalisation: more and bigger FTAs, e.g. AfCFTA
- Greater responsiveness of regional policy to industry (e.g. strengthen EABC)

Discuss:

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**P23.** How does the external financing of the EAC Secretariat and East African infrastructure projects affect the priorities and agenda of East African integration?

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**International policy**

**P24.** What are the most important international trade agreements and rules for the sector, and how do they impact sector competitiveness?

Rating system:

- 0: no impact
- 1: very negatively
- 2: quite negatively
- 3: neutral overall
- 4: quite positively
- 5: very positively

| Policy  | Rating | Explanation |
|---|--------|-------------|
| AGOA: duty free market access to US market                        |        |             |
| AGOA: Rules of Origin ('special' third country fabric provisions) |        |             |
| EU EBA: duty free market access to EU market                      |        |             |
| EU EBA: Rules of Origin (single transformation)                   |        |             |
| EU Economic Partnership Agreement (EPA)                           |        |             |
| India's Duty-Free Tariff Preference Scheme                        |        |             |
| China's Duty Free Quota Free Scheme for LDCs                      |        |             |
| Bilateral investment treaties (specify key countries)             |        |             |
| WTO market access and MFN status (specify key countries)          |        |             |
| WTO agreements and flexibilities, e.g. SDT (specify)              |        |             |
| Other (specify)   |        |             |

**P25.** What impact do the key international trade agreements and rules have on regional integration and regional value chain development (i.e. regional trade in inputs and outputs)?

Specify key agreements:

---

Impact on regionalism?

(e.g. single transformation RoO and regional sourcing; AGOA duty preference advantage for non-cotton clothing and RVC development; trade off between AGOA access and EAC second hand clothing policy)

### 10.3. List of manufactured T&A products

| HS Code | Description  |
|---------|--|
| 5204    | Cotton sewing thread, whether or not put up for retail sale  |
| 5205    | Cotton yarn (other than sewing thread), containing 85 % or more by weight of cotton, not put up for retail sale  |
| 5206    | Cotton yarn (other than sewing thread), containing less than 85 % by weight of cotton, not put up for retail sale  |
| 5207    | Cotton yarn (other than sewing thread) put up for retail sale  |
| 5208    | Woven fabrics of cotton, containing 85 % or more by weight of cotton, weighing not more than 200 g/m <sup>2</sup>  |
| 5209    | Woven fabrics of cotton, containing 85 % or more by weight of cotton, weighing more than 200 g/m <sup>2</sup>  |
| 5210    | Woven fabrics of cotton, containing less than 85 % by weight of cotton, mixed mainly or solely with man-made fibres, weighing not more than 200 g/m <sup>2</sup>                 |
| 5211    | Woven fabrics of cotton, containing less than 85 % by weight of cotton, mixed mainly or solely with man-made fibres, weighing more than 200 g/m <sup>2</sup>                     |
| 5212    | Other woven fabrics of cotton  |
| 5401    | Sewing thread of man-made filaments, whether or not put up for retail sale   |
| 5402    | Synthetic filament yarn (other than sewing thread), not put up for retail sale, including synthetic monofilament of less than 67 decitex   |
| 5403    | Artificial filament yarn (other than sewing thread), not put up for retail sale, including artificial monofilament of less than 67 decitex                                       |
| 5406    | Man-made filament yarn (other than sewing thread), put up for retail sale  |
| 5407    | Woven fabrics of synthetic filament yarn, including woven fabrics obtained from materials of heading 54.04   |
| 5408    | Woven fabrics of artificial filament yarn, including woven fabrics obtained from materials of heading 54.05  |
| 5508    | Sewing thread of man-made staple fibres, whether or not put up for retail sale   |
| 5509    | Yarn (other than sewing thread) of synthetic staple fibres, not put up for retail sale   |
| 5510    | Yarn (other than sewing thread) of artificial staple fibres, not put up for retail sale  |
| 5511    | Yarn (other than sewing thread) of man-made staple fibres, put up for retail sale  |
| 5512    | Woven fabrics of synthetic staple fibres, containing 85 % or more by weight of synthetic staple fibres   |
| 5513    | Woven fabrics of synthetic staple fibres, containing less than 85 % by weight of such fibres, mixed mainly or solely with cotton, of a weight not exceeding 170 g/m <sup>2</sup> |
| 5514    | Woven fabrics of synthetic staple fibres, containing less than 85 % by weight of such fibres, mixed mainly or solely with cotton, of a weight exceeding 170 g/m <sup>2</sup>     |
| 5515    | Other woven fabrics of synthetic staple fibres   |
| 5516    | Woven fabrics of artificial staple fibres  |
| 5701    | Carpets and other textile floor coverings, knotted, whether or not made up   |
| 5702    | Carpets and other textile floor coverings, woven, not tufted or flocked, whether or not made up, including “Kelem”, “Schumacks”, “Karamanie” and similar hand-woven rugs         |
| 5703    | Carpets and other textile floor coverings, tufted, whether or not made up  |
| 5704    | Carpets and other textile floor coverings, of felt, not tufted or flocked, made up or not  |
| 5705    | Other carpets and other textile floor coverings, whether or not made up  |

|      |   |
|------|---|
| 5801 | Woven pile fabrics and chenille fabrics, other than fabrics of heading 58.02 or 58.06   |
| 5802 | Terry towelling and similar woven terry fabrics, other than narrow fabrics of heading 58.06; tufted textile fabrics, other than products of heading 57.03   |
| 5804 | Tulles and other net fabrics, not including woven, knitted or crocheted fabrics; lace in the piece, in strips or in motifs, other than fabrics of headings 60.02 to 60.06   |
| 5806 | Narrow woven fabrics, other than goods of heading 58.07; narrow fabrics consisting of warp without weft assembled by means of an adhesive (bolducs)   |
| 5807 | Labels, badges and similar articles of textile materials, in the piece, in strips or cut to shape or size, not embroidered  |
| 5808 | Braids in the piece; ornamental trimmings in the piece, without embroidery, other than knitted or crocheted; tassels, pompons and similar articles  |
| 5809 | Woven fabrics of metal thread and woven fabrics of metallised yarn of heading 56.05, of a kind used in apparel, as furnishing fabrics or for similar purposes, not elsewhere specified or included  |
| 5810 | Embroidery in the piece, in strips or in motifs   |
| 5901 | Textile fabrics coated with gum or amylaceous substances, of a kind used for the outer covers of books or the like; tracing cloth; prepared painting canvas; buckram and similar stiffened textile fabrics of a kind used for hat foundations |
| 5902 | Tyre cord fabric of high tenacity yarn of nylon or other polyamides, polyesters or viscose rayon  |
| 5903 | Textile fabrics impregnated, coated, covered or laminated with plastics, other than those of heading 59.02  |
| 5904 | Linoleum, whether or not cut to shape; floor coverings consisting of a coating or covering applied on a textile backing, whether or not cut to shape  |
| 5906 | Rubberised textile fabrics, other than those of heading 59.02   |
| 5907 | Textile fabrics otherwise impregnated, coated or covered; painted canvas being theatrical scenery, studio back-cloths or the like   |
| 5908 | Textile wicks, woven, plaited or knitted, for lamps, stoves, lighters, candles or the like; incandescent gas mantles and tubular knitted gas mantle fabric therefor, whether or not impregnated   |
| 5909 | Textile hosepiping and similar textile tubing, with or without lining, armour or accessories of other materials   |
| 5910 | Transmission or conveyor belts or belting, of textile material, whether or not impregnated, coated, covered or laminated with plastics, or reinforced with metal or other material  |
| 5911 | Textile products and articles, for technical uses, specified in Note 7 to this Chapter  |
| 6001 | Pile fabrics, including "long pile" fabrics and terry fabrics, knitted or crocheted   |
| 6002 | Knitted or crocheted fabrics of a width not exceeding 30 cm, containing by weight 5 % or more of elastomeric yarn or rubber thread, other than those of heading 60.01   |
| 6003 | Knitted or crocheted fabrics of a width not exceeding 30 cm, other than those of heading 60.01 or 60.02   |
| 6004 | Knitted or crocheted fabrics of a width exceeding 30 cm, containing by weight 5 % or more of elastomeric yarn or rubber thread, other than those of heading 60.01   |
| 6005 | Warp knit fabrics (including those made on galloon knitting machines), other than those of headings 60.01 to 60.04  |
| 6006 | Other knitted or crocheted fabrics  |
| 6101 | Men's or boys' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, knitted or crocheted, other than those of heading 61.03  |
| 6102 | Women's or girls' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, knitted or crocheted, other than those of heading 61.04   |
| 6103 | Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts (other than swimwear), knitted or crocheted  |

|      |  |
|------|--|
| 6104 | Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib & brace overalls, breeches & shorts (other than swimwear), knitted or crocheted                 |
| 6105 | Men's or boys' shirts, knitted or crocheted  |
| 6106 | Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted  |
| 6107 | Men's or boys' underpants, briefs, nightshirts, pyjamas, bathrobes, dressing gowns and similar articles, knitted or crocheted  |
| 6108 | Women's or girls' slips, petticoats, briefs, panties, nightdresses, pyjamas, negligees, bathrobes, dressing gowns and similar articles, knitted or crocheted   |
| 6109 | T-shirts, singlets and other vests, knitted or crocheted   |
| 6110 | Jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted   |
| 6111 | Babies' garments and clothing accessories, knitted or crocheted  |
| 6112 | Track suits, ski suits and swimwear, knitted or crocheted  |
| 6113 | Garments, made up of knitted or crocheted fabrics of heading 59.03, 59.06 or 59.07   |
| 6114 | Other garments, knitted or crocheted   |
| 6115 | Panty hose, tights, stockings, socks and other hosiery, including graduated compression hosiery (for example, stockings for varicose veins) and footwear without applied soles, knitted or crocheted |
| 6116 | Gloves, mittens and mitts, knitted or crocheted  |
| 6117 | Other made up clothing accessories, knitted or crocheted; knitted or crocheted parts of garments or of clothing accessories  |
| 6201 | Men's or boys' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, other than those of heading 62.03                             |
| 6202 | Women's or girls' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, other than those of heading 62.04                          |
| 6203 | Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts (other than swimwear)   |
| 6204 | Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts (other than swimwear)                                   |
| 6205 | Men's or boys' shirts  |
| 6206 | Women's or girls' blouses, shirts and shirt-blouses  |
| 6207 | Men's or boys' singlets and other vests, underpants, briefs, nightshirts, pyjamas, bathrobes, dressing gowns and similar articles  |
| 6208 | Women's or girls' singlets and other vests, slips, petticoats, briefs, panties, nightdresses, pyjamas, negligees, bathrobes, dressing gowns and similar articles                                     |
| 6209 | Babies' garments and clothing accessories  |
| 6210 | Garments, made up of fabrics of heading 56.02, 56.03, 59.03, 59.06 or 59.07  |
| 6211 | Track suits, ski suits and swimwear; other garments  |
| 6212 | Brassieres, girdles, corsets, braces, suspenders, garters and similar articles and parts thereof, whether or not knitted or crocheted  |
| 6213 | Handkerchiefs  |
| 6214 | Shawls, scarves, mufflers, mantillas, veils and the like   |
| 6215 | Ties, bow ties and cravats   |
| 6216 | Gloves, mittens and mitts  |
| 6217 | Other made up clothing accessories; parts of garments or of clothing accessories, other than those of heading 62.12  |
| 6301 | Blankets and travelling rugs   |
| 6302 | Bed linen, table linen, toilet linen and kitchen linen   |
| 6303 | Curtains (including drapes) and interior blinds; curtain or bed valances   |
| 6304 | Other furnishing articles, excluding those of heading 94.04.   |