The Financial Express
Monday, 28 December 2020 | Today's FE | e-Paper

Balancing global and regional value chains for RMG industry

Mustafa K Mujeri | Published: December 25, 2020 21:02:37 | Updated: December 25, 2020 21:31:13

As the Covid-19 pandemic ravages global production and trade linkages, the policy makers are increasingly exploring the possibilities of shifting more towards regional value chains (RVCs) from global value chains (GVCs) as pathways to sustaining export growth. Bangladesh's RMG and apparel sector is one of the country's biggest growth drivers with a global apparel market share of 6.8 per cent in 2019. The sector accounts for about 84 per cent of the country's total exports and employs nearly 4 million people of which 61 per cent are women.

The country's RMG and apparel industry has seen a devastating impact of Covid-19. Cancelled orders, unsold stock and declining demand have led the sector to struggle for sustaining its past successes at expected levels. Bangladesh's close competitor in the RMG market is Vietnam which had 6.2 per cent of the global market share in 2019; and Vietnam managed to achieve strong export growth since the late-2019. Vietnam has also shown better performance than Bangladesh in containing the Covid-19 pandemic and is currently threatening rather successfully to capture Bangladesh's position as the 2nd largest exporter of RMG after China.

Vietnam has also entered into a free trade agreement (FTA) with the EU in August 2020 which is the most comprehensive agreement that EU has ever concluded with a developing country. At present, only 42 per cent of Vietnamese exports to the EU enjoy zero tariffs under the GSP. It will be almost 99 per cent elimination of duties after the FTA. The EU is also a major export destination for Bangladesh's RMG. Bangladesh is yet to negotiate a similar FTA or bilateral trade agreements once the GSPs are removed. Vietnam's RMG export basket is also more diversified with relatively higher value-added products than Bangladesh; and per hour labour productivity per worker is 19 per cent higher in 2016--USD 4.09 in Vietnam compared with USD 3.45 in Bangladesh as estimated by the Asian Productivity Organisation (APO). It is more likely that Vietnam still holds this advantage although the labour cost is lower in Bangladesh. It is therefore high time for Bangladesh's RMG sector to regain its position of power and adopt a sustainable pathway for going forward.

Along with sustained low labour costs, Bangladesh's big advantage is its leadership in LEED (Leadership in Energy and Environmental Design) certified green RMG with 91 LEED-certified factories in Bangladesh, which is higher than in any other country. Of the 10 highest rated LEED-certified factories in the world, six are located in Bangladesh. These give a preference on the part of the foreign buyers and investors for importing RMG from Bangladesh and treat the country as a lucrative destination for FDI. On the other hand, some critical constraints for Bangladesh are that the country does not have a diverse range of export destinations and possesses a low product range of RMG and low labour productivity.

At present, the urgent need for Bangladesh is to secure FTAs or bilateral trade deals to expand the access of its RMG to multiple destination markets. China has announced a tariff exemption for 97 per cent of Bangladesh's products in July 2020 which provides an excellent opportunity to benefit from trading with China and adopt more advanced production processes and technology from China to move up in the ladder of global RMG market. The key for Bangladesh will be to take the advantage of being a world leader in Green RMG to add higher value to its RMG products. In particular, Bangladesh's RMG sector will have to provide more attention towards maintaining factory standards and labour welfare regulations to overcome the disruptions in the post Covid-19 world.

Since its beginning, Bangladesh's RMG exports are led by the GVC-led production and distribution channels. The process has been characterised by cross-border fragmentation of production processes, which entails specialisation in a narrower range of tasks by domestic firms organised within the global production networks. With limited productive capacities, integrating with GVCs has provided wider trade opportunities for Bangladesh's domestic RMG industry to gain access to new markets through specialising in a single or limited number of tasks in the production chain.

The typical feature of the GVC-oriented RMG is that the firms in Bangladesh focus mainly on manufacturing (processing) activities, while research and design (R&D) for product development is provided by the global brands or importers in the developed country markets, raw materials are sourced from a cheaper source in another country, and marketing and after sales services are provided by the providers in countries where the consumers are located (this is called the 'smile curve' process). The issue for Bangladesh is that the manufacturing stage in the smile curve generates very little value in proportion to the retail prices paid by the consumers of the RMG products.

With a huge advantage in terms of cheap labour, Bangladesh is mostly involved in two low-value stages of cut, make and trim (CMT) and original equipment manufacturing (OEM)/free on board (FOB). In short, most of Bangladesh's RMG export does not fall under the high-value added models, such as original design manufacturing (ODM) and original brand manufacturing (OBM). Thus, Bangladesh is mostly known as a source of low-cost garment items in bulk rather than a source of relatively high-priced garment products sold by the global brands.

Thus, the key for Bangladesh in RMG upgrading is to move up the GVCs through developing product and process upgradation capabilities. Product upgrading involves producing high value garment items by moving into higher segments of the value chain, while process upgrading requires advancing production methods using better and modern technologies and more skilled labour force. Although Bangladesh has made a beginning, still it needs to go a long way in both upgradation processes.

Further, the impending graduation from the LDC status, which represents a major development transition for Bangladesh, also gives rise to concerns about the adverse implications of the loss of access to various support measures on RMG export such as duty-free market access and relaxed rules of origin (ROO) provisions in the EU. Bangladesh's RMG industry needs to go for industrial upgradation within GVCs including automation and deepening of capital-intensive techniques for promoting export competitiveness of its products.

It is true that the GVCs are making important contributions to the growth of the export-oriented RMG in Bangladesh since the 1980s including rapid expansion of women employment in the industry. On the other hand, the role of RVCs has been rather limited--the strength of which lies in supporting higher-value activities, such as design and branding. At present, the heightened uncertainty unfolding in the GVCs due to recent trade wars and the Covid-19 pandemic has forced several stakeholders to give a new look at RVCs as complementary drivers of RMG. In this context, the major route is to strengthen intra-regional trade and RVCs for which designing of optimal regional policies is the key to move forward.

In Bangladesh, no serious study is available in the textiles and apparel sector on the value chain directionality of firms - their orientation to different value chains - and how these affect upgrading opportunities and outcomes. Further, only limited knowledge exists on the impact of industrial and trade policies on firms' incentives to capitalise strategically on the benefits created by different types of value chains. Available evidence from other countries suggests that various types of value chain offer distinct opportunities for upgrading, job creation, and development of backward linkages to domestic and/or regional suppliers.

In general, GVC-oriented RMG make the greatest contribution to current job creation and export growth. But the focus is mostly on a narrow range of lower-value products. On the other hand, the RVC-oriented RMG are likely to be more involved in a wider range of product categories and related activities, including vertical integration to the textiles sector producing own yarn and fabric inputs and higher-value activities involving design and branding. These RMG are also more likely to source inputs from the regional markets.

Over the years, Bangladesh's RMG have experienced significant economic and social upgrading; but weak linkages with the RVCs still preclude the industry to avail the full advantages of these regional networks as stepping stones to more demanding but lucrative global markets. A successful RVC-oriented RMG firm can build its capabilities, to begin with, as an own-brand manufacturer in the domestic market, then learn to export by serving the regional market, before meeting the tough requirements and competition of the global market.

In practice, all RMG firms undergo process upgrading, but GVC-oriented firms remain closest to the technological frontier. The reasons are manifold. The high degree of process upgrading (and low level of functional upgrading) by GVC firms is partly due to its nature of ownership. Most of the GVC-oriented firms are either foreign-owned or under foreign-partnerships where higher value activities are reserved for their overseas parent companies.

In terms of policy, rents allocated through multi-scalar industrial and trade policies (e.g. removal of tariffs under regional trade agreements) both at the regional and global levels can be critical for RVC-oriented RMG. For the RMG industry, Bangladesh needs to carefully assess the implications for the design of ROO and similar initiatives such as whether to opt for double transformation requirements or the more relaxed single transformation rules allowing manufacture from imported inputs. Often, the more relaxed single transformation rules favouring regional RMG export might result in backward linkage effects (e.g. more new investments in textiles). The relaxed single transformation rules of origin can allow Bangladesh's RMG manufacturers to import their inputs but still benefit from the duty-free market access to the major importing countries.

With the graduation of Bangladesh from the LDC status in the near future, it is high time for the GVC-oriented RMG firms to reconsider their business models since the uncertainty over the future course may reduce incentives for new investments and the investors may prefer to wait for policy stability. A key concern for the policymakers will be to secure the continuity of market access in the developed countries without exposing the domestic RMG producers to additional competition.

At the present level of development of the country's RMG industry, the value chain directionality matters for Bangladesh. Although GVC-oriented firms have made the largest contribution to the growth of RMG industry in the past, global experience suggests that the RVC-oriented RMG firms perform a wider range of higher-value activities, have greater incentives to move towards high value products, procure more inputs locally, and have a tendency to engage more in end-market upgrading. The key for Bangladesh's policy will be to redefine the country's multi-scalar industrial and trade policies to strategically combine the benefits of both types of value chain.

Dr Mustafa K Mujeri is Executive Director, Institute for Inclusive Finance and Development (InM).

mujeri48@gmail.com