

4.

LDC graduation and global value chain participation

As Asian graduating LDCs seem to have become stuck in the low-value manufacturing segments of T&C global value chains, the loss of trade preference would put serious pressure on their competitiveness and export prospects. As Asia has become a global centre for textiles and clothing production, LDC-related duty-free schemes and preferential trade agreements have facilitated the connection to international and regional T&C production networks. However, graduating Asian LDCs have mainly specialized in labour-intensive activities such as CMT operations, which have the least value-added content compared with other parts of the value chain – i.e. they are at the bottom of the so-called ‘smiley-curve’. In contrast, high value-added activities such as design, marketing and retail are undertaken by global big brands or importers in developed countries.

With a very low backward integration and with no sophisticated textile nor fibre production in place, most Asian LDCs have remained mainly garment manufacturing countries. The graduating LDCs remain at the manufacturing stage where least value is being created. In contrast, the most important value-adding stages are the intangible

services at the pre-production (left side of the ‘smiley-curve’) and post-production (right side of the ‘smiley-curve’) stages that are managed by international brands and retailers (the lead firms).

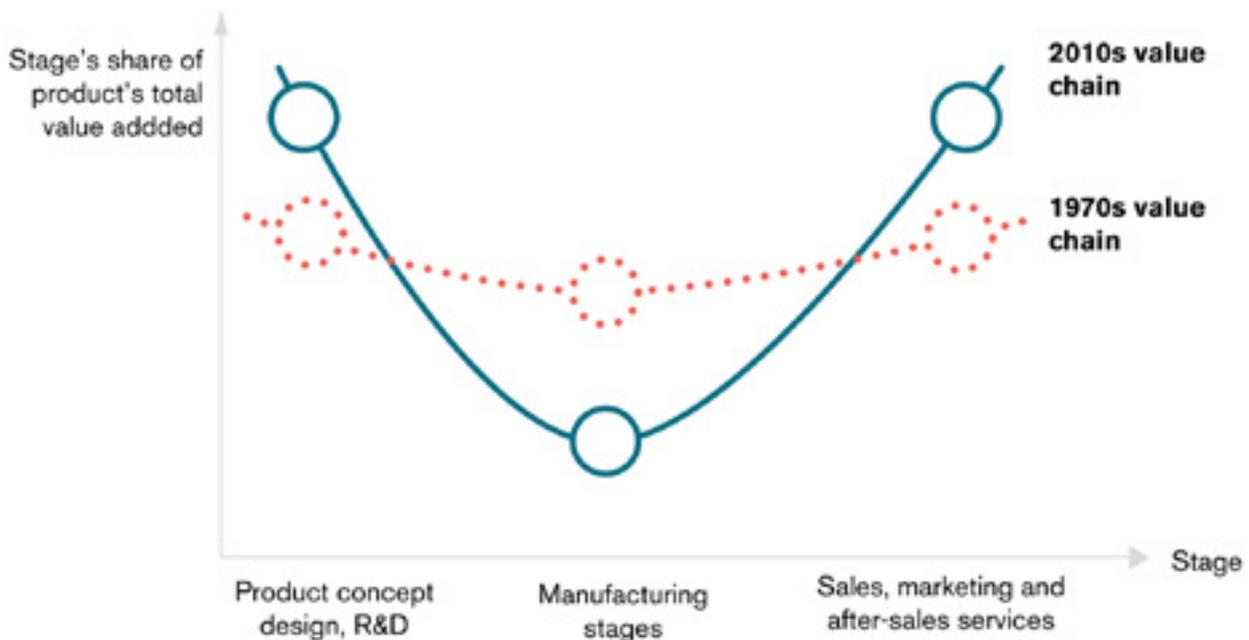
Over the years, the ‘smiley-curve’ has become increasingly steeper, reflecting a declining share of value addition in assembly tasks. Moreover, opportunities for upgrading and linkage development remain relatively circumscribed in graduating LDCs, given the nature of the value chain and their limited engagement in textile or fibre production. Hence, performing only CMT operations is not a desirable and sustainable option for graduating LDCs. While productivity, lean processes and social and environmental compliance on the factory floor are necessary to consolidate the existing client base and to lay the foundation for starting to move up the value chain, they are not sufficient to grow and to achieve the employment targets envisaged by the respective governments (Baldwin, 2012; Cosby, 2017; Knappe, 2019), as shown in Figure 12. Only relying on the low-value added simple manufacturing stage makes countries vulnerable and subject to strong pressures for lower prices. In this circumstance, losing any trade preference could jeopardize their export and business prospects.

The buyer-supplier relationship in textile and clothing GVCs is generally very fragile, and is vulnerable to the vagaries of consumer demand, especially in the fast fashion market segment. The “footloose” nature of lead firms’ demand heightens competitive pressure between economies, and textile and clothing GVCs tend to continuously reconfigure in response to changes in conditions and production costs (De Backer and Miroudot, 2013). Any disruption in their operations may have severe repercussions on several points along GVCs. Such fragility was exposed by the COVID-19 pandemic, with fashion industry profits contracting 93 per cent in 2020 (McKinsey Institute, 2021). In line with the buyer-driven nature of textile and clothing GVCs, many lead firms reacted to falling consumer demand by seeking to reduce or cancel orders and requesting longer payment terms and discounts from factories (ECCHR and ILAW, 2021). In addition, most refused to financially support their

suppliers during the crisis. Such practices have uncovered the power imbalances in T&C GVCs. It is estimated that approximately US\$ 1.6 billion of workers’ wages were lost because of order cancellations or renegotiations from international buyers in the European Union and the United States between April and June 2020 (Anner and Foxvog, 2020).

Preparing for graduation therefore presents an opportunity to develop economic strategies that tackle challenges around the loss of preferential trade treatment with the aim of encouraging and facilitating structural change and economic diversification. Furthermore, the COVID-19 pandemic has severely hit graduating LDCs’ economies and created exceptionally dire conditions for transition towards graduation. Graduating LDCs will hence need dedicated support throughout the whole process.

Figure 12: The GVC ‘smiley-curve’ in the 1970s and 2010s



Source: Cosbey, A. (2017), *Climate policies, economic diversification and trade for UNCTAD Ad Hoc Expert Group Meeting*.