Pascal Lamy’s crisp message for Bangladesh

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When Pascal Lamy, the head of the World Trade Organisation (WTO),

speaks out on trade issues, he is heard. He is not known to beat around the bush. His analyses as well as his messages come out crisp and clear, even when he speaks without a written draft. He is an outspoken promoter of greater trade openness – as he should be – but understands the limits of his mission to break down trade barriers through the operations of a global institution — WTO — which must take “decisions by consensus”. Yet, from his vantage point and by dint of his deep insights from history and global experience with progress and pitfalls of multilateralism, he can articulate a few policy prescriptions for developing countries like Bangladesh that should draw the attention of policymakers.

He is no friend of protectionism, particularly of the kind that lasts forever. That was clear from his address last week to business leaders and economists in Dhaka. For economies engaged in protectionism ad infinitum, he equated that approach to shooting oneself in the foot. But he was truly upbeat about Bangladesh’s performance and prospects in the export of readymade garments. Trade has been an engine of growth, job creation, and poverty reduction for Bangladesh. He stressed the importance of seizing export opportunities that are being created through the global trading system while relying on the competitive cost advantage that stems from abundant supply of low cost labour. He agrees that, for the next decade or so, Bangladesh’s comparative advantage will continue to be in labour intensive production. But that is neither a hindrance to export-oriented growth nor does it limit the scope for export diversification.

We are aware of the China opportunity that beckons us. Chinese factory workers have been receiving wages that are three to four times what a Bangladeshi factory worker receives.

Even those wages have been rising sharply in the recent past making China uncompetitive in cheap export products ranging from clothing to toys to consumer electronics. That is a boon for Bangladesh if it could only get its act together to attract the investors who are scurrying to find alternative berths for their investments. But that window is fast closing as competition heats up from countries like Indonesia, Vietnam, and India.

But Pascal Lamy had an additional opening to offer, one that stems from what is being described as the fragmentation of global production or value chains. The new phenomenon, "Made in the World", reflects global integration of two hitherto apparently dichotomous activities: production and trade. Greater trade openness, coupled with advancement in information technology and lower transportation costs, has made it possible to break up the production process into vertically separate stages that could then be carried out in different countries in accordance with their comparative advantage in a particular production stage. What it means is that a country like Bangladesh need not have to invest in machinery and equipment required for the fabrication of an entire product; rather it can specialize in any stage of the production process that fits in with its available capital, skills and labor cost advantage. What Mr. Lamy was hinting at was that a capital scarce country need not have to wait to accumulate enormous amount of capital to take advantage of growth opportunities through trade. Limited capital, combined with low cost unskilled labour, could be sufficient for engaging in a part of the production process. Isn't this exactly what happened in the case of readymade garments (RMG)? In the 1970s and 1980s, Bangladesh produced neither cotton nor export quality fabrics nor yarn, all of which had to be imported. Yet, suppliers were willing to offer inputs on credit (through back-to-back letters of credit or LCs) guaranteed against export proceeds. Bangladesh's labour cost advantage lay in the last stage of processing – what is now euphemistically described as C&M (cutting and making). But make no mistake. Such an activity is only possible within a framework of trade openness that ensures a seamless import regime with world-priced (duty-free) inputs. RMG was the beneficiary of that kind of trade regime. Not surprisingly, it flourished.

But RMG is a final product, and Bangladesh did participate in and take advantage of the global value chain in clothing, only at the end stage. This need not always be the case, if we grasp the corollary that stems from Mr. Lamy's message. He talked at length about the emergence of trade in intermediate goods. Specializing in any stage of fabrication of the final product implies specializing in an intermediate product that actually forms part of the final product. The intermediate product is exported to the country where the final product is assembled. This entire process is described as “trade in tasks”. His ideas are based on joint research done by WTO with the Japanese think tank, Institute of Developing Economies-Japan External Trade Organisation (IDE-JETRO), which resulted in the report, “Trade Patterns and Global Value Chains in East Asia”. The report confirms that there is a surge in global trade in intermediate goods stemming from the fragmentation of production. In 2009, trade in intermediate goods was the most dynamic sector of international trade, representing more than 50 per cent of non-fuel world merchandise trade. This is basically trade in parts, components and accessories. The key message of the report? “Specialisation is no longer based on the overall balance of comparative advantage of countries in producing a final good, but on comparative advantage in “tasks” that countries complete at steps along the global value chain”.

In East Asia alone, the share of intermediate goods trade is a whopping 75%, which exemplifies a spoke and hub relationship between the world’s super assembler, China, and the Association of South East Asian Nations (ASEAN) member-countries. The recent floods in Thailand demonstrated how integrated Thailand was in the global supply chains. The floods caused disruption in the trade in automobiles, car parts, and computer disk drives that was more severe than what was caused by the economic crisis of 2008.

That brings us to the problem in Bangladesh. Where do we stand in the matter of intermediate goods production and the seamlessness of the import regime? It is time to realize that our trade policy is geared to protecting a plethora of final consumer goods at the expense of intermediate goods. Tariff escalation from intermediate (12%) to final goods (55%+) gives the clear message that it is more profitable to produce and sell final consumer goods in the domestic market. Consequently, there is virtually little growth of intermediate goods industry except those related to the RMG sector. While Mr. Lamy’s prescription is worth heeding, the only way that we can take advantage of global value chains preceding the final stage of processing is through joint ventures and foreign direct investment (FDI) that brings not just capital, but market links, coupled with technology, management and marketing skills. That way, we skip the stage of import substituting domestic production of intermediate goods, and head straight for the export market.

Lets face it. Outside the RMG production structure, we are nowhere near the global value chain in other products. Partly, the entry barriers are the creation of our own policy. Partly, it comes from a lack of information or understanding about the opportunities being created by the new global trade and production architecture. We might be missing a fertile ground for the sprouting of small and medium enterprises (SMEs) linked to the global value chain.

It is time to get things right. In its articulation of a strategy for higher manufacturing growth, the country’s Sixth Five year Plan (2011-15) has indeed made the case for seizing opportunities created by global value chains and fragmentation of production. Now, in the implementation phase, Pascal Lamy’s message for Bangladesh ought to be heeded, and, better still, acted on.

At the end of the day, we cannot afford to miss any opportunity to generate higher growth, create more jobs, and reduce poverty.

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