Theses of the PhD Dissertation

CHALLENGES OF ECONOMIC AND SOCIAL UPGRADING IN THE SEMI-PERIPHERAL ECONOMIES OF THE GLOBAL VALUE CHAINS: THE CASE OF THE HUNGARIAN GARMENT MANUFACTURING INDUSTRY

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1. Research history and objectives of the research

The fashion industry carries a highly significant weight in the global economy (Garcia-Ortega et al., 2023). The textile and garment industry requires relatively low entry barriers, and due to the intensified liberalization of the segment, it is one of the first and most globalized industries (Bonacich and Appelbaum, 2000; Dicken, 2015). The fashion industry has significantly contributed to global economic development after the Second World War (Bieńkowska, 2023). Otherwise, the importance of the fashion industry cannot only be measured by economic indicators, as the industry can be a very significant employer among female workers, ethnic minorities, migrant people with disabilities, and people from rural areas as well (Molnár, 2017).

In terms of garment manufacturing, Bulgaria, the Czech Republic, Latvia, Hungary, Poland, Romania, Slovakia, and Slovenia are among the most representative countries of this region (Faust 2005). Garment manufacturing firms in the Central-Eastern European (CEE) region are attractive to Western fashion brands because of their geographical and cultural proximity, existing production capacities, qualified workforce, low level of respect, and inadequate adherence to national labor rights regulation (Musiolek, 2004). In parallel with the delocalization tendencies and outsourcing production within the fashion industry from the 1950s, mainly Western European fashion production became a traditional, sunset industry. Next to Asia, the CEE region was a destination for labor-intensive processes. The CEE and Hungarian fashion industry is deeply integrated into the global value chains through the high rate of export and the dominant contract work as well, as most of the firms are working as subcontractors for well-known, mainly Western-European fashion brands.

The low-value-added assembly task, contract work is the dominant form of Hungarian garment manufacturing firms' operation, however, exceptions and different trajectories remain. However, no local firm could reach the level of buyers and represented only the high-value-added tasks. Within this stream of literature, I examine upgrading as the 'space' that is left for suppliers by power relations with lead firms and the market realities. That is crucial to how I define and examine upgrading. According to Lee and Gereffi (2015), we have to distinguish between economic and social upgrading. Under economic upgrading, we primarily mean that countries and firms moving to higher value activities in GVCs with improved technology, knowledge, and skills. Social upgrading refers to the process of improving the rights and entitlements of workers as social actors and enhancing the quality of their employment (Barrientos et al., 2011). The authors claim that governance structures – international, national, and both public, private, and social forms of governance – are a key determinant in upgrading the GVC framework. It also has to be taken into account that neither moving towards a different industry nor even upgrading necessarily means a less dependent position for the firm (Szalavetz, 2017).

Regarding the *scope of the research*, the topic of the doctoral dissertation is the challenges of economic and social upgrading within the semi-peripheral economies of the global value chains, and it is examined through the case of the Hungarian garment industry. The dissertation contributes to the theoretical and empirical observation of the upgrading concept and its barriers within the global value chains (GVC) literature. I selected a sector that is highly exposed to globalization and global value chains thus many constraints are present in economic upgrading. It also proposes a triangulated analysis of current spatial restructuring within the garment industry of Hungary and a framework for reshoring factors. The dissertation

has a special focus on the reshoring phenomenon that has enjoyed a vivid scholarly interest since the 2008 economic crisis. The COVID-19 pandemic also served as a trigger point for the rethinking of international trade and a reform of global sourcing practices and reshoring tendencies that target this region; however, later it proved to be rather insignificant.

While developing economies – newly entering the global value chains – have gained a wide academic interest after the Washington Consensus, the semi-periphery countries do not have the same base, outlook, and prospects. This creates a gap for the examination of the ones, who have been already participating. I examine the topic because the fashion industry has a huge, long-standing tradition in Central-Eastern European (CEE) countries, but it has been a neglected field for decades (from the regime change) from a scholarly and economic, industrial policy point of view as well. A few historians, such as Ildikó Simonovics and Tibor Valuch analyzed the local fashion scene during the state-socialist period. However, with a few exceptions, such as the work of Ernő Molnár (2017; 2021); Molnár et al. (2023), Magdolna Sass & Katalin Antalóczy (1998), and Adrian Smith, John Pickles and Robert Begg (2003; 2010; 2014), the CEE garment industry and the upgrading opportunities of that is an under-researched area.

While Hungary plays a marginal role in the global garment sector and even on a national level, it enjoys a high export rate and can serve as a critical case for more socially sustainable garment production and exploitative working conditions along the low value-added assembly activity. It can allow learning about the potentials and constraints that suppliers and governments are facing in pursuing 'higher roads' of industrial upgrading. Its generalizability expands to not just the CEE region and other (semi-)peripheries, but widely and with caution to Southeast Asian countries as well, as those countries taking part in the same 'level' at the global supply chain, however they operate through different institutional and market conditions. The generalization of the dissertation's findings is further addressed at the conclusion.

The central research question of the dissertation is:

Why economic and social upgrading does not occur in a semi-peripheral economy?

The case to be explored is the garment manufacturing industry in Hungary.

Then this central research question is divided into three sub-questions:

1) How do recent spatial production network dynamics (both reshoring and outsourcing) affect economic and social upgrading trajectories?
2) How has the creation of own-brand manufacturing (OBM) products taken place among Hungarian garment manufacturing firms after the regime change?
3) Can locally established fashion brands as buyers support the upgrading prospects of the garment manufacturing firms?

Hypotheses:

H1) As reshoring tendencies are characterized by non-economic variables as well, and not only cost-effectiveness/lowest manufacturing costs, it supports the upgrading trajectories of the semi-peripheral actors.

H2) As garment manufacturers heavily rely on contract work, that limits their OBM prospects due to a lack of financial capital and specialized skills (such as branding, design and retail).

H3) Local buyers do not contribute to the upgrading prospects of garment manufacturers, due to their small market presence.

First, as globalization was 'caused' by economic variables, I examine how external shocks (especially, the former COVID-19 pandemic and the current Russia's aggression on Ukraine) affect those changes, especially reshoring tendencies and their relationship with upgrading, since the region is considered to be a main hub for reshoring (from Asia, to 'keep distance'). While the current trade war probably can redraw the sourcing map of the global fashion industry, these are not addressed in the dissertation in detail due to the lack of binding agreements and their changing nature. So, whether these external factors propose a new position and opportunity for the semi-periphery of the world economy, due to shorter and/or regionalized supply chains. Second, as functional upgrading enjoys a special scholarly interest within GVCs, own-brand manufacturing (OBM) is when a manufacturing firm starts to establish its brand and move towards contract work relations in a higher form, however, it comes with limitations. While many garment manufacturers have established their brands, no one could stick on the market and those firms conducted downgrading. Due to the limited amount of empirical research on that, I contribute to the examination of the topic, with a special focus on contract work relations. Third, I consider a buyer 'switch'. While foreign buyers govern global value chains, it is worth to examine that whether local fashion brands, as local buyers can contribute to the upgrading opportunities of the Hungarian garment manufacturing firms or not. The focus of these three sub-questions can give a detailed, comprehensive answer to the overall research question.

2. Methodology

The empirical part of the doctoral dissertation lies in a mixed methodology. Besides some quantitative elements, such as descriptive statistics, the work mainly relies on *qualitative research methods*, such as a) document analysis, both scientific and grey literature, b) interviews, c) and case studies. The work consists of three empirical chapters, related to 1) upgrading; 2) reshoring; and 3) case studies.

The empirical context of the upgrading chapter consists of three parts. The first one is related to interview findings from 4 unstructured interviews with experts on the topic. First, I have conducted structured interviews with written questions through the purposeful sampling method (Patton, 1990, 2015). The second part was done through a *media content analysis*, focusing on the social aspect of Hungarian garment manufacturing. To gain a picture of fashion brands' perception, regarding working conditions, I have conducted an online media analysis, focusing on content analysis of the most important articles, regarding working conditions among Hungarian garment manufacturers as we assume that brand reputation is formed by press coverage and scandalous reports, often fueled by the transnational activist networks or global civil society can enjoy a quite widespread, big reach through online and social media. The third part relies on interviews with Hungarian garment manufacturing firms. I have conducted 11 interviews with garment manufacturing firms on upgrading, both economic and social in March-April 2023.

The empirical context of upgrading
unstructured research interview with 4 experts (Appendix 1)
a media content analysis, based on 6 articles (Appendix 3)
structured interviews with 11 Hungarian garment manufacturing firms (Appendix 2)

Table 1: Applied research methods for the empirical examination of upgrading

The main purpose of the *empirical reshoring chapter* is a triangulated examination of reshoring within Hungarian garment manufacturing firms. The methodology relies on qualitative methods, such as a *structured written interview* among 11 Hungarian manufacturing firms, conducted in March-April 2023. The survey participants were chosen through Patton's (1990; 2015) purposeful sampling method. The author chose this method as well-established, owners/CEOs of local garment manufacturing firms have often built a trusted relationship, with their Western-European long-time buyers. They often have direct information on the buyer firms' strategy and values, that is not covered by official communication or press coverage. The author further conducted 13 in-depth, unstructured interviews with 11 experts from different fields between December 2019 and March 2024 with a deep knowledge of the local garment manufacturing segment.

The research is also based on written interviews with 3 Hungarian fashion firms on their sourcing practice done between December 2023 and March 2024 for the empirical observation of whether Hungarian garment brands, as local lead firms tend to reshore their manufacturing activity and why (not), for a better understanding of the Hungarian garment manufacturing firms' competitiveness from the viewpoint of buyer firms. In the cases of interviewees, the key informant approach (Kumar et al., 1993) was used to conduct interviews with people with their knowledge and roles.

Empirics on reshoring
survey among 11 Hungarian manufacturing firms (Appendix 4)
13 in-depth, unstructured interviews with 11 experts (Appendix 5)
written interviews with 3 Hungarian fashion firms (local buyers) (Appendix 6)

Table 1: Applied methods for the empirics on reshoring

The method of *case studies* offers the examination of early exploratory research on a new or under-researched area or phenomenon (McCutcheon & Meredith, 1993; Voss et al., 2002; Yin, 2008). Case studies represent a research strategy that focuses on understanding the dynamics present within single settings, and typically combine data collection methods, such as archives, interviews, questionnaires, and observations, where evidence can be quantitative, qualitative, or both (Eisenhardt, 1989). Case studies are a research method that offers unique advantages for exploring complex issues in real-life contexts. The main advantage of making case studies is their ability to provide an in-depth, detailed understanding of specific situations, processes, or phenomena, often revealing insights that other methods cannot capture. This method allows for multi-faceted, in-depth exploration of complex issues within their real-life settings, capturing the richness and complexity of actual situations (Cooper & Morgan, 2008; Crowe et al., 2011; Davey, 1990; MacNealy, 1997; Meyer, 2001), proved to be a valuable method for understanding situations marked by uncertainty, uniqueness, or value conflicts, and for analyzing what actions are practical and rational in specific contexts (Cooper and Morgan, 2008).

First, the different upgrading paths of former state-owned enterprises are shown through a *comparative most similar system's design (method of differences)*. For this empirical examination, I have identified 5 cases in which I have extensively observed the different upgrading trajectories of former state-owned garment manufacturing firms' successors. I facilitated the form of firm-level case studies as we can assume that all Hungarian garment manufacturing firms face relatively the same world, regional, and macroeconomic conditions, pointing out the examination of the microenvironment to spot firm-based difference(s) that explain different outcomes. So, I apply the most similar system's design during this empirical part, to examine which independent variable is responsible for different outcomes in similar cases. The identification of the independent variables is based on:

1) the synthesis of the existing empirical research on the region (Central-Eastern Europe as the semi-periphery of the world economy),

2) unstructured former background interviews with industry experts to gain new insights.

Second, the former own-brand manufacturing (OBM) experiences are shown with the *descriptive single case study* of the former PHARE program (1990-1996). The program was aimed at promoting own-brand manufacturing among Hungarian garment manufacturers in the European market. I assume that findings, generated from that case can suggest a considerable basis for the later prospects as well. This sub-chapter is based on document analysis (Arcanum database and Google search engine for relevant documents and interviews) and oral history conversation with 5 PHARE participants (two fashion designers, who were involved in the program from the beginning till the end and have designed collections for 3-3 garment manufacturers, one owner-CEO of a former Hungarian garment manufacturing firm group, who became an accredited PHARE-expert in Brussels later; one coordinator from the Hungarian

Fashion Institute; and a participant CEO). I have also conducted a pair interview with the designers, which can be considered as a *focus group interview*.

Third, the current OBM prospects are discussed through 9 interviews with garment manufacturing firms with their brands, following the purposeful sampling approach. This section puts a special focus on reliance on contract work. Through direct empirical observation, extensive media analysis, and background interviews, I have conducted 9 written interviews with garment manufacturing firms between December 2023 and March 2024, engaged in OBM.

Fourth, a sub-chapter on the local fashion brands' contribution to the upgrading prospects of manufacturers will follow. This sub-chapter contains an *ideal types categorization* first, to give an extensive overview of Hungarian fashion brands, and then, firms-based interviews will be followed. Based on exploratory research design, combining desk research and interview-based research with industry insiders and experts on the Hungarian garment market, and on extensive media analysis, I have created three main ideal types of brands: Designers, Manufacturers, and Retailers through an inductive approach. As the ideal types categorization had to serve an exploratory function as well and there is a lack of literature on local lead firms' contribution to upgrading, the current research design could not sufficiently answer the third sub-question of the dissertation (*Can locally established fashion brands as buyer support the upgrading prospects of the garment manufacturing firms?*). While I was working on the ideal types categorization, the interview findings raised the importance of examining whether is it better to work together and conduct assembly for Hungarian fashion brands or international lead firms, from both economic and social upgrading points of view.

<table>
<tr><th colspan="4">Case study selection</th></tr>
<tr><th>Comparative most similar case studies design (5 cases)</th><th>PHARE</th><th>OBM</th><th>Local buyer contribution to upgrading</th></tr>
<tr><td>media content analysis – 147 articles (included in the references)</td><td>document analysis
- Arcanum sources
- Google search for relevant documents
- documents, provided by the interviewees</td><td rowspan="3">9 semi-structured interviews with ‘brand-builder’ garment manufacturers (Appendix 8)</td><td>ideal type categorization</td></tr>
<tr><td>OPTEN database</td><td rowspan="2">oral history conversation with 5 participants (Appendix 7)</td><td>semi-structured research interview with 34 Hungarian fashion brands (local buyers) (Appendix 10)</td></tr>
<tr><td>research interviews (Appendix 11)</td><td>research interview with 4 manufacturers (Appendix 12)</td></tr>
</table>

Table 2: Overview of the case studies’ applied methods

I additionally use *descriptive statistics*, such as industry trade and employment statistics from databases, such as OECD – TiVA, the Hungarian Central Statistical Office, UN COMTRADE, Eurostat and OPTEN, and STATA database, for the analysis of the comparative case studies.

3. Results

The doctoral dissertation seeks to examine the challenges of economic and social upgrading in the garment industry in a semi-peripheral economy, through the garment manufacturing industry in Hungary. To address these questions, the dissertation built up three hypotheses.

H1) As reshoring tendencies are characterized by non-economic variables as well, and not only cost-effectiveness/lowest manufacturing costs, it supports the upgrading trajectories of the semi-peripheral actors.

H2) As garment manufacturers heavily rely on contract work, that limits their OBM prospects due to a lack of financial capital and specialized skills (such as branding, design and retail).

H3) Local buyers do not contribute to the upgrading prospects of garment manufacturers, due to their small market presence.

Based on the findings, H1 proved to be rejected, H2 was confirmed and H3 proved to be partially confirmed.

First, regarding how reshoring of manufacturing affects economic and social upgrading prospects of the examined case, I have found that reshoring does not automatically come with upgrading for garment manufacturing firms, as full-package or OEM production is not necessarily an improvement, rather a requirement from the lead firms. The reshoring chapter contributed to the empirical observation of reshoring through the case of Hungarian garment manufacturing. The research states that there is a tradeoff between the resilience of supply chains and the higher costs, associated with the reconfiguration of lead firms' strategies. The empirical results do not show a clear approach to whether the lead firms of the garment industry are more likely to invest in the resilience of their supply chains or follow the principle of cost-efficiency. While there are various strategies in terms of reshoring (or not), cost-efficiency and the reduced budget for manufacturing are still highly present among lead firms. Possibly due to the footloose nature of garment manufacturing, sourcing activities bounced back soon after the COVID-19 pandemic and showed that even if multiple risks have threatened the global value chains of the garment industry, these factors are manageable and do not bring fundamental change. While the firm survey showed significant reshoring and nearshoring experiences, expert interviews concluded contrary results, and the optimism of growing orders faded around the end, and after the pandemic. The research only showed the weakness of local garment manufacturing through the examination of local garment brands' approach towards reshoring, so no onshoring has occurred yet and even small firms are likely to offshore. Due to several limitations, such as the lack of local textile manufacturing, proper technological development, and local tax burdens, Hungarian garment manufacturing firms are not competitive and their position and current orders are under constant threat by neighboring countries, such as Romania, Serbia, and especially Turkey. While sustainability became a 'must have' in the strategy of lead firms, it rather serves as an official communication gesture than an actual reshoring factor.

I have experienced a purposeful limitation of entrepreneurship that is required for economic upgrading. It is seen that employers often practice some form of 'self-sabotage' or conscious stagnation, related to economic upgrading that would lead to job reduction: if they are well aware that they are single, big employers within the nearby towns and regions, their primary purpose regarding employment is to give any job as possible and they consciously block (or at least not moving towards) any improvement that would need less, more-skilled

employees. This way, employers sacrifice economic upgrading and emphasize the social one for job security and a high number of employees alongside the region. That can be also explained by the spatial/geographical location: the successors of former, huge garment factories are concentrated in chief towns of counties where those factories were the only, big employers.

However low value-added assembly activity (CMT) can provide a potential learning curve for the garment manufacturers as they have to comply with the quality requirements of the lead brand. The upper market segments of the fashion industry (premium, high-end, luxury labels) supposedly have higher requirements, than mass-market brands. As Yoruk (2002) has also highlighted: participation in GVCs through OPT relations provides short-cut organizational learning opportunities for CEE firms. This way, the spillover effect applies to this situation, but capital does not play an important role – through contract work, the manufacturer will be able to comply with higher and higher quality requirements. They can monetize that knowledge (quality requirements and planning of the work) that was gained through the collaboration in OBM as well.

Product upgrading is common among Hungarian garment manufacturers, and they can comply even with the highest and special requirements of the luxury and functional segment. But that does not lead to higher contract work fees and/or better appreciation. The different dimensions of functional upgrading (CMT, full-package manufacturing, and OBM) are parallelly existing and connected among the manufacturing companies. Functional upgrading is not linear in practice. The results are in line with former findings (Éltető et al., 2015).

Moving up within functional upgrading does not necessarily go together with revenue stability and predictability. Purposeful downgrading to CMT over OBM can be more stable and predictable work and income for manufacturers. This way, manufacturers can eliminate risks, related to OBM.

Intersectoral upgrading can serve as an escape route from the less and less profitable fashion industry, however, the dependency of the manufacturers is not automatically reduced in this case (Szalavetz, 2017).

The aging workforce is signed by numerous garment manufacturers and industry insiders as a major challenge for the future. It is interesting to examine (and can offer a possible future direction as well), that this insoluble ‘threat’ can propose a certain adaptation strategy. On one hand, the reduced number of workers can serve as a solid foundation for economic upgrading, when there is not such a big need for labor-intensive processes (higher value addition). On the other hand, the aging workforce also poses a challenge for the necessary training and education of workers as I suppose that younger workers tend to be more open to any training, and any form of investment would pay off in the long term. How can it be supported institutionally, at the industrial policy level?

The working conditions and the social upgrading are not related to a) the market segmentation of the buyers of the manufacturers as it is often implicitly indicated: garment manufacturers are not truly affected by the b) governance, related to the working conditions of the lead firms. It can happen in reality that garment manufacturers are working for fashion brands parallelly related to different market segmentation and 1) highly engaged in the working conditions of garment workers, employed in the companies connected to their supply chain and actively monitors that, 2) formally engaged in working conditions, 3) not engaged in the working conditions along their supply chain as well (Gulyás et al., 2018).

However shorter lead time, fast reaction, flexibility, and labor compliance are described as important factors in sourcing decisions (Plank and Staritz, 2014), the empirical findings show that these factors do not directly affect the (negotiation) position of garment manufacturers.

Furthermore, besides global industry challenges, the local political economy and lack of governmental appreciation, focus, and support (tax policy, adjuncts, lack of tenders, etc.) can still undermine any upgrading incentives of the local garment manufacturing firms. While garment manufacturing companies are positive regarding relocation tendencies, the costs of the segment seem to be a deciding factor in terms of the sustainability of future relocation activities and capacities. This led to the conclusion that upgrading possibilities are rather characterized by the national business environment and political economy, than the role in GVCs. This finding is in line with that GVC literature acknowledges the importance of states, however, there is little understanding of how they matter, from a policy perspective, as it is also advocated that lead firms might not be sufficiently committed or able to manage complex issues in their chains, particularly in the realm of social upgrading. However, it is also acknowledged, that the strategies of lead firms pose challenges for national policies and jurisdictions (De Marchi and Alford, 2022). As Lee & Gereffi (2015) emphasized, the ineffectiveness of private standards to achieve social upgrading has led to calls for synergistic governance through the collaboration of private, public, and social actors both on a global and local level.

Based on the analysis of the selective cases (comparative case studies), all of the selected cases have shown functional upgrading during the regime change and the time of privatization, as they were all offering their brand manufacturing (during the state-socialist period) that stopped with the ceasement of the COMECON market. However, all the cases have been formerly built on Western contract work relations, however, this proved to be not fully decisive in terms of the later upgrading and the survival of the firms. An interesting result is that those cases (Cases 2 and 4) who were specialized in menswear are now going into liquidation. There is a consensus that menswear is not so volatile, and way more stable as a market, compared to womenswear since there are not so fast changes in design trends. Even higher market segments are considered to be more ‘crisis-proof’, however as the analysis of the cases has shown: manufacturing firms, conducting even low-value added contract work or upgraded tasks, such as OEM or ODM cannot stay undisturbed by the financial circumstances, and sustained operation of buyer firms.

In general, relying on parallel buyers at the same time, and relying on different tasks could be beneficial since buyer firms (those who were considered as ‘reliable ones’) are also facing turbulent economic conditions and as many interviewees have shared, they have witnessed the bankruptcy of multiple buyers (and even owners), while manufacturing firms have survived and managed to sustained operation during the bankruptcy of their relative owners and buyers. This ‘in-built/in-house resiliency’ that may emerged from the often short-lived contract work relationships resulted in more proactive managerial strategies to sustain manufacturing.

As the cases showed, there is no clear strategy for sustaining the firm and upgrading strategies, while strategic intent matters, it can contribute to different outputs. As Cases 3 and 5 show: even moving towards OEM and being specialized in product development and organization of manufacturing, being higher value-added, the same tasks can offer entirely different profitability prospects, so the attitude of buyers/lead matters, pointing out to the importance of governance. As Cases 4 and 5 show, even moving towards high-quality products (product upgrading) does not ‘work out’ in every case. As Cases 3 and 5 show, functional downgrading can be even more profitable than upgrading.

Second, while several garment manufacturing firms have stepped into OBM, it does not allow them an upgrading, in terms of higher benefits, as the majority of the garment manufacturing firms are relying on contract work: this mode of operation increases their

dependency on the buyers. Furthermore, as Hungarian garment manufacturing firms mostly suffer from the lack of both financial and professional resources (that is needed for OBM), they further rely on low-value-added assembly work (CMT) that offers them faster returns (compared to OBM sales). As minimum wages increase companies lose their competitive advantage, and because of the seasonal rhythm of fashion it makes it difficult for companies to manage their decreasing margins. The growing lack of labor and the problem of aging employees have long posed challenges to the Hungarian fashion industry, as it grapples with the potential benefits of shorter supply chains and relocation tendencies.

Third, regarding the local buyers' contribution to the upgrading of Hungarian garment manufacturing firms, smaller fashion brands (regardless ideal type of export aspirant or premium) tend to rely on in-house garment manufacturing, while bigger ones tend to outsource manufacturing to foreign countries, on the criteria of cost-efficiency and specialized knowledge. Manufacturers even find collaboration with local buyers is even more challenging (compared to foreign ones), leading to the finding that local buyers do not contribute to the upgrading of Hungarian garment manufacturers.

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