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GLOBAL VALUE CHAINS (GVCS) FROM A DEVELOPMENT PERSPECTIVE

SYNOPSIS

The current discourse on Global Value Chains by key proponents and also the WTO Secretariat is that developing countries should liberalise - in goods and services, and conclude a Trade Facilitation Agreement. Some have also suggested that any restrictions on exports should be eliminated (e.g. export taxes on raw materials). According to this discourse, these strategies would help developing countries more deeply integrate into GVCs as they can import more cheaply and thus export more competitively.

The picture on closer examination, however, is not so simple. Not all players can equally gain from their participation in GVCs. Developing countries could open up, and they could become more integrated, but the quality of their integration may not be of real benefit. The real question for developing countries is how they can deepen their production capacities, so that they can garner a bigger share of the value added. Engagement in GVCs can be useful. However, national and regional production chains offer more opportunities than global value chains organised by transnational corporations.

A discourse more suited to developing countries is that in order to be more gainfully linked to GVCs, the WTO should provide for flexibilities and policy space for developing countries in the use of trade and tariff policies for industrial and agricultural development as well as for regulation of services. Across the board liberalisation is not the answer. The S&D and Implementation agenda of the Doha Round should be completed. Developing countries should be cautious about making certain binding Trade Facilitation commitments as some of these commitments are administratively intensive, require infrastructure, skills and are not always suited to developing countries' needs e.g. expedited shipments to be released based on bank guarantees; rules on single window; authorised operators

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I. Summary

1. Global Value Chains (GVCs) are not a new concept. They have been a part of trade since colonisation when developing countries were the providers of the raw materials, sent to the developed countries for use in a variety of ways, including in their production of higher end goods.

2. It is true that today, these value chains are expanding, simply because of the expansion of transnational corporations across the globe. Lead firms, mostly based in developed countries, and some developing countries, use suppliers from all over the world to carry out their various functions. Developing countries however are differentially placed along global value chains. All are involved to some degree. Some have a share in higher value added sections of GVCs, but many do not.

3. The current discourse by key proponents and also the WTO Secretariat is that developing countries should liberalise - in goods and services; and conclude a Trade Facilitation Agreement. Some have also suggested that any restrictions on exports should be eliminated (e.g. export taxes on raw materials). According to this stream of thought, these strategies would help developing countries more deeply integrate into GVCs as they can import more cheaply and thus export more competitively.

4. The picture on closer examination, however, is not so simple. Not all players can equally gain from their participation in GVCs. It all depends on where a country is lined up in terms of:
    - technological capacities;
    - the depth of their manufacturing capacities;
    - how developed their services sectors are;
    - the size of their enterprises;
    - their managerial expertise;
    - their ability to meet the standards of the international markets to name only a few criteria.

5. Due to these and other limitations, developing countries could open up, and they could become more integrated, but the quality of their integration may not be of real benefit. As Rashmi Banga (UNCTAD 2013) notes in her paper 'Measuring

Value in Global Value Chains', countries may be linked to GVCs, but they may not be 'gainfully' linked to GVCs.

6. In today's GVCs, the value is captured in the design and conceptual stage of the value chain, as well as in the final sales and marketing end of the GVC (the so-called 'deepening' of the smile curve). However, this is not where most developing countries are located. They are generally located in the lower value manufacturing section of the GVC, and even then, this is true for some, not all developing countries.

7. Mere liberalisation will not upgrade countries' technological or services supply side capacities. Nor will a Trade Facilitation Agreement – expediting the entry of imports through a range of customs procedures (some which are very costly and administratively intensive) be a magic bullet in catapulting developing countries into competitiveness on the global scale. In sum there are no short cuts.

8. In any case, the central question for developing countries is not about doing anything it takes to enter GVCs.

9. <u>The real question for developing countries is how they can deepen their production capacities, so that they can garner a bigger share of the value added.</u>

10. To do so, the path of industrial development, agriculture and services development must be undertaken. We need

    - structural transformation in industry if we want our manufacturing capacities to move beyond being assembly lines;
    - increased production capacities in a range of services sectors; and
    - a more vibrant agricultural sector, especially in countries with large rural populations. The agricultural sector cannot be overlooked or bypassed if a large section of the population is engaged here and depends on the sector for employment. Just like jobs in manufacturing, people must be provided with fair prices / wages. This is critical to create domestic purchasing power, and fuel domestic demand and thus the demand for local industries.

11. Failure to engage in structural transformation and deepening of production capacities could mean that countries get caught in i) supplying raw materials ii) being sites for low value added manufacturing tasks.

12. Very often, the domestic or regional markets offer better opportunities for having a larger share of the value added.

13. A discourse more suited to developing countries is that in order to be more gainfully linked to GVCs, the WTO rules and negotiations should provide for

- flexibilities for developing countries - the S&D and Implementation agenda of the Doha Round should be completed. The Implementation and S&D agenda in the Doha Round raised many issues that would support developing countries' industrial development eg. TRIMS issues; meaningful review of GATT Article XVIII (governmental assistance to economic development); strengthening Article XXXVIIIC on infant industry; TRIPS and technology transfer for LDCs etc.

- developing countries' use of trade and tariff policies for industrial and agricultural development. Trade policies must be used strategically to support industrial development of key sectors, and should be approached dynamically, changing over time as some industries mature, and new ones develop. Across the board liberalisation will not help.

- policy space in the regulation of services sectors in a way that encourages domestic investments and expansion in production capacities in services. Across the board liberalisation is not the answer if domestic services sectors are to be nurtured and grown. Trade and regulatory policies around services will have to be devised in step with the development of the domestic services sectors.

- caution in relation to binding Trade Facilitation commitments since these commitments would be administratively intensive; require infrastructure; skills; and are not always suited to developing countries' needs e.g. expedited shipments to be released based on bank guarantees; rules on single window; authorised operators.

II. Introduction

14. Today's discourse on Global Value Chains, propagated mainly by developed countries and also the WTO Secretariat seems to be stating the following:

- Global value chains offer new opportunities to developing countries. For developing countries to get a bigger part of GVCs, they should liberalise their borders since products are 'Made in the World'. Tariffs on goods should therefore be eliminated or reduced considerably.
- Trade in services should be liberalised. This is because services now play a major role in the value chain. According to the proponents, all the following services are important – logistics, distribution, telecommunications, business, financial services etc. Countries should therefore liberalise these and other services sectors for their own benefit.
- A Trade Facilitation agreement should be concluded in order to facilitate trade and lower trade costs.
- There should not be export restrictions, for example, export taxes put on raw materials since this would increase the production costs for all and prevent the smooth functioning of the GVC.

15. This paper will give an overview of developing countries' experiences of GVCs and illustrate that in fact, other strategies than the above are needed if developing countries are to grow beyond mainly supplying raw materials or being factor economies providing assembly lines.

III. The Discourse on GVCs

16. The following is an excerpt of a speech by WTO's Pascal Lamy on this matter (underline and bold texts are additions):

> 'International trade data in value added reveal the importance of services, show that <u>blocking imports can hurt a country's own exports</u>, cast trade imbalances in a new light and allow <u>a focus on job creation</u>, WTO Director-General Pascal Lamy told the Economic Development Foundation (IKV) and the Economic Policy Research Foundation of Turkey (TEPAV) in Istanbul on 14 March 2013.
>
> By virtue of being global, these chains lead to the very same goods or services being produced in multiple geographical locations. <u>It is not only finished products or finished services that cross territorial boundaries, but the vast majority of trade is</u>

actually in intermediate products and services; i.e. components. As these components travel into one country, and out another, to finally form a finished product, what producers are telling trade policy makers is that trade barriers, whether at the border or behind borders, are having a far worse impact than ever before. They disrupt entire supply chains. A country's imports, in today's world, are at once its exports…

It is therefore not surprising that the share of services more than doubles when trade is measured in value-added terms. The figures for 2008, immediately before the global economic crisis, show a rise from 23% of total trade, measured in the traditional way, to 45% if one incorporates value-addition. According to our new figures, services are thus the chief contributors to global trade, while the manufacturing industry's share of international trade falls (from 65% to 37%). So the first lesson for trade negotiators is that they must pay much greater attention to services trade, and to removing the barriers that obstruct it **(i.e. liberalise services).**

The second lesson is that in shooting down your imports, you may actually be firing at your exports. They are progressively becoming very much the same. Today almost 60% of trade in goods is in intermediates and the average import content of exports is around 40%. In other words, to export, a country must import too. I am convinced that the new statistics we published will allow a better appreciation of this global interdependence, which in its turn will foster a more cooperative — and less mercantilist — approach to trade negotiations…' **(i.e. eliminate Tariffs in Goods).**

Source: 'In value chains, "what cannot be counted does not count": Lamy addresses Turkish think tank, 14 March 2013,
http://www.wto.org/english/news_e/sppl_e/sppl270_e.htm

IV. What are the interests behind the GVC Discourse?

17. The GVC discourse is about facilitating the operations of global Transnational Corporations. This explains the interests of key corporate players such as the US Coalition of Services Industries (see paper by Faisel Ismail 2012).

18. It <u>suggests a far reaching menu for negotiations that bypass</u>

- the areas of 'balance' developing countries want to see in the current Doha round (e.g. Agriculture subsidies)
- the fact that the Singapore issues have been rejected and to put it back on the agenda (e.g. investment liberalisation).
- or even Special and Differential Treatment when cutting tariffs,

19. The GVC discourse <u>encourages explicitly or implicitly</u>

- Tariff liberalisation
- Investment liberalisation
- Far reaching services liberation (logistics, distribution, telecoms, business, finance)
- No capital controls
- And even attempts to say that export restrictions are bad (latest OECD study) – i.e. it wants the free flow of raw materials exports
- Plurilateral approaches if the multilateral approach to trade opening is too slow (Ismail)

20. In its discourse, it

- Hides the interests behind its agenda (i.e. the TNCs) and presents it as a neutral agenda that is good for all countries and players. Those having difficulties (e.g. LDCs) should simply be supported to enter GVCs. I.e., it does not reveal the fact that power is differently distributed along the GVC and there are real and structural barriers facing the small players (eg. lack of access to new technologies; difficulties to provide economies of scale etc).

- With the financial and economic crisis, trade liberalisation has been discredited. It attempts to enact the same skit, but in different clothing.

- An attempt to bypass the stalemated areas of interests of most developing countries in the Doha Round and find a quick way to move on to issues mainly of interest to the bigger players (e.g. NAMA, services, investment).

- It makes the false assumption that the market is self-regulating, which is far from the case. Ismail also notes that its analysis of globalisation *'is divorced from the experiences of the majority of people in the world suffering the effects of a continuing economic and social crisis reflected in: rising unemployment, inequality and poverty'.*

V. How much of the value added in GVCs are in the hands of developing countries?

21. Using the OECD-WTO database on Trade in value Added (May 2013), UNCTAD provides a breakdown of the distribution of the global value added:

    - 67% accrue to OECD countries
    - 8% for Newly Industralised Countries I (NICs I – Singapore, Hong Kong, Taiwan, Korea)
    - 3% for Newly Industrialised Countries (NICs II – Malaysia, Thailand, Philippines)
    - 9% for China
    - 5% for the other BRICs (India, South Africa, Brazil, Russia)
    - 8% All LDCs and other developing countries
      (Banga R, UNCTAD 2013 'Measuring Value in Global Value Chains').

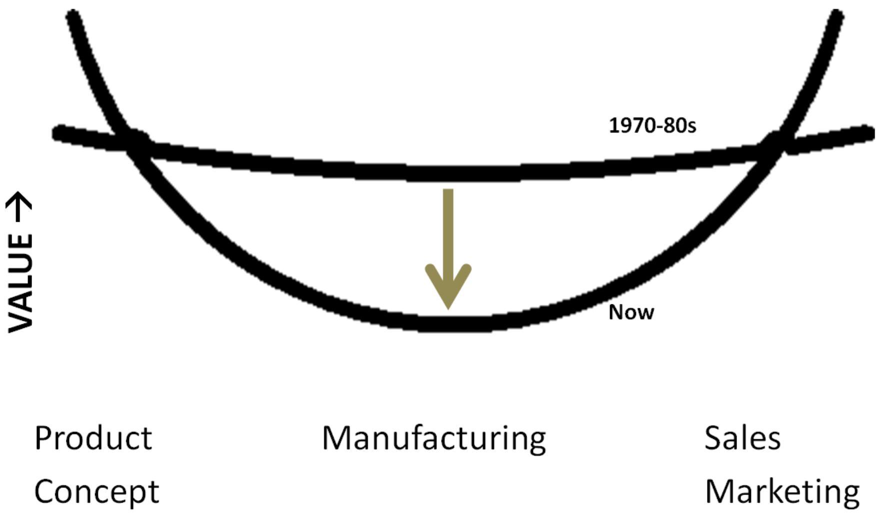
VI. Developing Countries' Experiences of GVCs?

22. The difficulties developing countries have been grappling with in relation to GVCs include the following:

    - Since the 1970s, developing countries have already noted their disproportionate share in value chains as raw material exporters. The discourse since the time of Prebisch has been to increase developing countries' value added.

- In the 'Deepening Smile' curve, developing countries are mostly in the low value manufacturing part of the chain, as opposed to producing the concept, being the technology holders, designers, being in sales or marketing, where the value added is much greater. Lead firms tend to outsource the lower value added activities (e.g. final assembly) and retain higher value added areas e.g. R&D, IP, design, distribution (UNCTAD 2011).

Deepening Smile Curve (Baldwin, R July 2012)

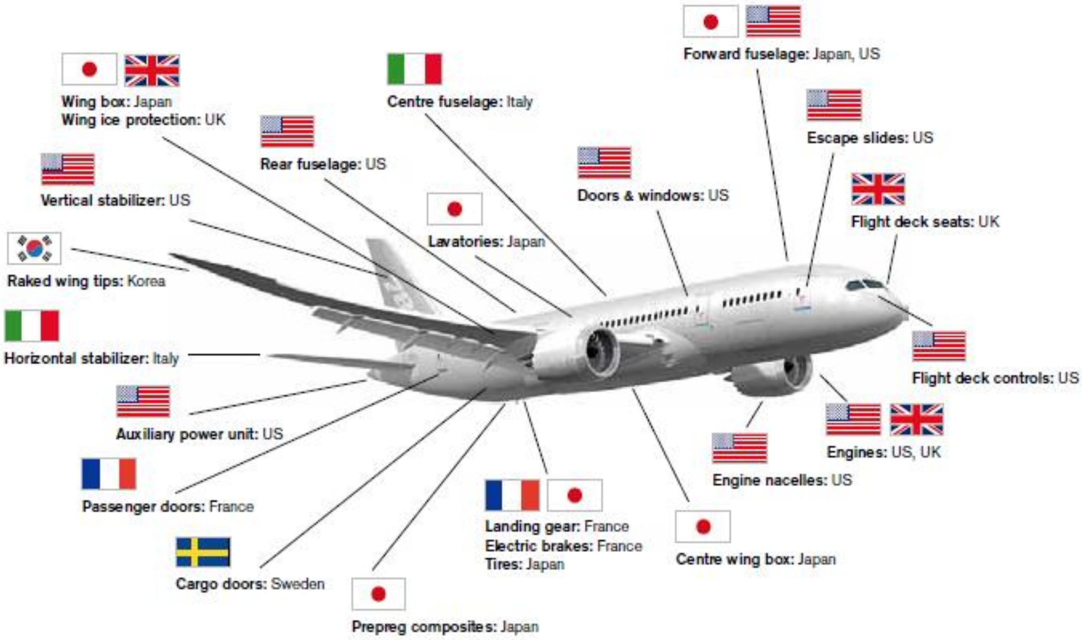


Source: adapted from Richard Baldwin, 2012 'Global Supply Chains: Why They Emerged, Why They Matter, and Where They are Going'.

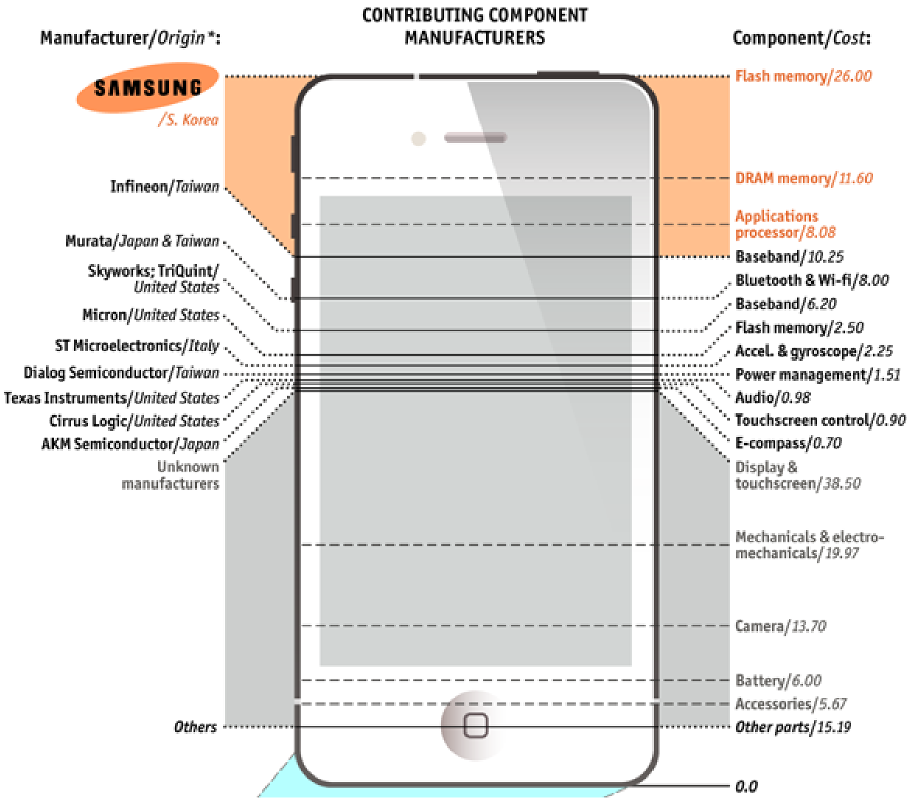
23. According to Derick, Kraemer and Linden 2009, case studies for China shows that for Apple iPod, only USD 4 out of the total value of USD 150 is attributed to producers located in China. Most of the value accrues to US, Japan and Korea.

24. Most developing countries are not the source of lead firms, outside of a few Asian (newly industrialised) countries (the NICs). At best, developing countries are 2nd or more commonly even third or fourth tier suppliers. They have real difficulties in getting into GVCs (apart from providing the raw materials) and moving up the GVC chain.

25. A quick look at the Boeing shows that the components come from the OECD countries (including Korea), but principally US, UK, Japan, France, Sweden, Italy.



26. Components for Samsung phones are mainly sourced from US, Taiwan, Korea, Italy and Japan.



27. UNCTAD examples of developing countries SMEs' experiences in GVCs illustrates this:

- Microsoft and Egypt – Egyptian firms translate software products of leading brands into Arabic, provide support package to users, run call centers. They have branched into software development in the Middle East.

- IBM and Vietnam – Firms provide IBM software services to clients – banks, enterprises, the government. Others distribute software.

28. UNCTAD concludes that: *'Participating in the TNC's GVC enhances the prestige and credibility of the SMEs making it easier for them to expand. It also makes continuous upgrading easier as they have access to the TNC's technical staff and training… However, since they are selling or adapting established products and services, genuine innovation is still in its infancy'.* (UNCTAD 2010; p. 13)

29. In the case of Toyota in South Africa and Volkswagen in Mexico, a few companies became first tier suppliers in these countries to the TNCs, however UNCTAD notes that *'many independent local suppliers have not managed to either link with global sourcing partners or upgrade their own capabilities…'. 'In Mexico, for instance, among the local suppliers interviewed no local SME in the second- and third-tiers has been able to leverage its link to GVCs as a springboard for its own internationalization.'* (UNCTAD 2010; p. 11)

30. Countries can export more, but they may not be 'gainfully linked' into the GVCs. The domestic content of their exports may not be increasing and instead the foreign value added content of their exports is increasing. In the latest UNCTAD analysis on value added, the US is the country with the highest increase in the domestic value-added content in its exports from 2005 - 2009. Even Korea and Germany illustrate increasing exports, but falling domestic value-added in exports between 2005 and 2009. The paper's conclusion is that *'Country experiences therefore show that linking into GVCs may not bring gains automatically. In fact, it makes aiming for trade-led growth more questionable'* (Banga R UNCTAD 2013).

31. The 'glass ceiling' faced by developing countries' SMEs include:

- Being technology savvy is critical – knowledge intensive products are critical to the cutting edge of manufacturing. Low-income countries tend to be involved in low-value added segments of chains and are in sectors where chains are shorter and less technologically intensive e.g. apparel and agriculture.

- Need medium to large enterprises for large-scale production
- Require investments to ensure timely shipments, high quality outputs
- Management expertise is necessary to meet complex GVC management issues
- Size of the domestic market matters – attracts foreign firms. Smaller developing countries have less leverage to create such a strong linkage with lead firms
- Meeting the standards required in the GVC is expensive and requires technological know-how

32. Developing countries also experience unstable contracts with lead firms who benefit from severe competition amongst identical suppliers. They select those meeting their short term requirements (UNCTAD 2011).

VII. What is Our Agenda? our Alternative Discourse

33. The **existing trade rules at the WTO remain imbalanced** in a range of areas – hence developing countries' attempts to put forward these concerns under the **Implementation Issues and S&D agenda in the Doha Round**. Fairer trade rules and Special and Differential Treatment would give developing countries' SMEs a better chance in participating in world trade.

34. Developing countries would therefore benefit from the satisfactory conclusion of the Doha Implementation Issues agenda, as well as the S&D issues agenda (going beyond the 28 Cancun items). Some areas (to name only a few) in this negotiating agenda include:

- Extension of TRIMS for countries demonstrating difficulties (can have local content requirements)
- Review GATT Article XVIII (Governmental Assistance to Economic Development) – we can take measures to control imports for BOP reasons, or promote establishment of an industry to raise standard of living of people
- Strengthening Article XXXVIIIC on infant industry to make it effective and operational

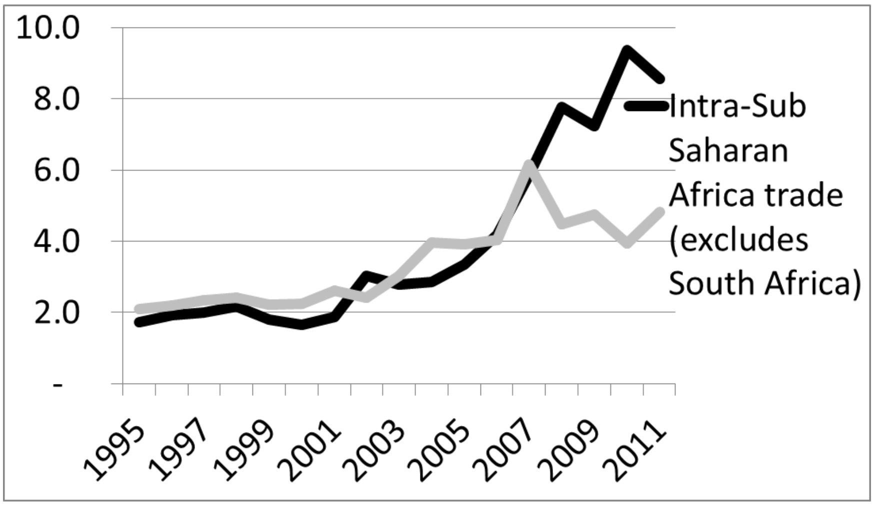
- SPS – Establishing Equivalence (expeditiously further implementation of Article 4 of SPS)
- Anti-dumping – simplified procedures for LDCs to take up Anti-dumping cases, changes to make it less easy for others to invoke cases against developing countries
- Subsidies agreement – subsidies for development, diversification, upgrading of infant industries should be non-actionable
- TRIPS – transition period for LDCs extended as long as they are LDCs, Technology transfer should be operationalised

35. In developing countries, **industrialisation, supporting agricultural production (especially of small farmers), and services development is critical**. This needs explicit government policies and they will not simply 'happen' through participation in the often low-end of GVCs (where most developing countries are). For industrialisation to take place, it is not across the board liberalisation that will be a help, but deliberate and dynamic tariff and government regulatory policies.

36. The GVC discourse on good and services liberalisation will make it difficult for developing countries to strategically use the opportunities of their own national and regional markets to jump-start their industrialisation process. This does not mean that developing countries should use high tariffs across the board, but that they should have the flexibility to raise or lower their tariffs over time according to the needs of their industries. The same applies in the services sectors – in order to grow their own services industries, government supports and regulations are important.

37. Rather than putting our sights only on the need to participate in global value chains, developing countries are already and can continue to create their own national and regional value chains. The reality is that for many developing countries, domestic and regional markets are very important and could offer more opportunities for value addition. For example, Africa is the primary market for Sub-Saharan Africa's processed goods, as compared to the EU or the US.

Table 1: Sub-Saharan Africa's Processed Goods Exports to Africa and to the EU



Source: UNCTADstat. Processed goods = Total - Primary commodities, precious stones and non-monetary gold (SITC 0 + 1 + 2 + 3 + 4 + 68 + 667+ 971)

38. For all that they say, developed countries continue to use protective policies to reinvigorate their industries and agriculture – agriculture subsidies; anti-dumping measures, quantitative restrictions and tariff rate quotas (in agriculture), subsidies (by the billions) to the auto and financial sectors during the crisis, government procurement policies. (US provided $65 billion in loans to GM and Chrysler in 2008; they also used 'voluntary' quotas on foreign cars imported into US markets, Pollin R 2010 'Industrial Policy and the Revival of US Manufacturing').

Protection by France of their VCRs

'As from October 1982, the French government required all imports of VCRs into France to obtain customs clearance at a small post located in Poitiers. Prompted by French concern about sharply rising VCR imports from Japan, all VCR imports henceforth were channelled through this customs bureau, staffed with only two inspectors. On 21 December 1982, Japan requested consultations with the EC, i.e. the Commission under GATT Article XXIII for nullification and impairment of the French import restrictive measure on VCRs . . . The reluctance <by the Commission> to challenge the measure in regard to Japanese imports became particularly apparent in January 1993, when the requirement for customs clearance ceased to apply for VCRs made in the EC. It continued, however, to apply to Japanese VCRs, including those that had been first imported through another Member State.'
Source: Nuesch S 2010 'Voluntary Export Restraints in WTO and EU Law' p. 53.

39. Trade facilitation is touted in the GVC discourse as a panacea. Developing countries in fact have already and can continue to take unilateral action to modernise their customs procedures. The need for a binding commitment at the WTO is questionable since these commitments are very expensive to implement, and the rules imposed are the customs procedures of developed countries and are thus suited primarily to their needs and economic interests.

40. As has been discussed, **TF could also increase imports by reducing trade costs, and this could have an impact on developing countries' SMEs** and in fact their access to their own national or regional value chains.

41. **Local content and the regulation of investors when entering a country is very important.** The GVC promotion of investment liberalisation must be viewed with tremendous caution. It is about allowing TNCs to come in and out and operate with the same advantages as local companies. This is likely to have a very detrimental impact on local firms that cannot compete and need governmental support. The concerns developing countries had raised at the Cancun Ministerial to drop the Singapore issues from the Doha Round remain the same today.

42. **In conclusion**, the GVC discourse, as noted by Faisel Ismail (2012), does not provide a framework for helping developing countries develop beyond their current comparative advantages. UNCTAD's latest analysis of the value added trade data also shows that more exports do not mean more value-added exports. Countries could be linked to GVCs but not 'gainfully' linked to GVCs.

43. The GVC discourse comes from the place of wanting to further ease the operations, movement and access of TNCs across global markets, with real dangers for developing countries' firms and industries. All developing countries do participate in GVCs to varying degrees. However, the priority for developing countries is the building of production capacities. In that context, in contrast to the GVC discourse of 'more liberalisation', the flexible and dynamic use of trade policy instruments (tariffs, government regulations) that support industrialisation, agricultural and services development, complemented by fairer trade rules are necessary.

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