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Connecting to Global Value Chains

Trade and the Post-2015 Development Agenda

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Evidence has shown that in certain sectors, developing countries are actually more integrated into global value chains than developed countries. The garments and textile industry in Asia provides an unparalleled example. Unfortunately, however, developing countries tend to remain locked into relatively low value added activities. This Briefing Paper looks firstly at how developing countries can begin to increasingly participate in more remunerative links in value chains, and how this can tie in with the post-2015 development agenda by ensuring that the benefits of global value chains are more evenly spread both within and across countries.

Background

While the newly adopted Sustainable Development Goals (SDGs) have elicited much hope, it is important to look at how much progress we have made under the previous structure. The Millennium Development Goals (MDGs-adopted in 2000) succeeded in bringing together various stakeholders from across the political and academic spectrum in the fight against global poverty and in the 15 years, the global community saw tremendous progress: global poverty continues to decline, more children than ever are attending primary school, infant mortality dropped dramatically, access to potable water greatly expanded, and targeted investments in fighting malaria, AIDS and tuberculosis have saved millions.

However, in spite of these successes, the inability to fully achieve these goals has left nearly one billion hungry and poverty still rampant – severely undermining the achievement of the MDGs. The global community can no longer afford to focus on and celebrate aggregates. In light of the work on the post-2015 Development Agenda how can we ensure that continued globalisation helps build sustainable and inclusive development?

Globalisation as the process of international economic integration has been underway for centuries. However, the sheer pace and scale of globalisation we are experiencing today has never been seen before. Although the current phase of unprecedented globalisation has attracted much attention in recent years, it can be traced back to as early as the 1950s. While major technological advancements, more open economic policies and trade liberalisation have traditionally been the driving force behind the spread of globalisation over the past 200 years, there are three specific features that clearly distinguish the current phase within which we find ourselves today.

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First, growth in trade has been accelerating at an unprecedented rate due to the recent boost the global economy has seen in foreign direct investment (FDI). Second, while manufacturing still accounts for a large portion of trade, services and FDI are increasingly becoming more prominent components of trade. And the third, and perhaps most prolific feature of this phase, has been the proliferation of global value chains (GVCs). It is no longer only finished products or services that cross borders but the vast majority of trade is actually now in intermediate products and services that are merely components of eventual final products.

Integration into GVCs

There are three processes that lie at the core of GVC development: importing, exporting and FDI. While the liberalisation of trade and investment policies over the years has facilitated the creation of the backward and forward linkages that play a key role in the uptake of GVCs, multinationals have played a key role in facilitating this process.

> ***Through increased trade and investment, GVCs have become an important link in facilitating the trade activities of smaller businesses – enhancing the possibilities for countries to defy their traditional comparative advantages and access new types of production to upgrade towards higher value added activities.***

There are two key drivers that play a role in multinational's production location choices: i) great country differences in the cost of input factors, competitiveness drivers, social and environmental conditions; and ii) the geographic and cultural proximity to the final consumer. The first has played a key role for developing countries.

Differences in the cost of input factors provided by developing countries have allowed GVCs to enhance the possibilities for countries to defy their traditional comparative advantages and access new types of production process to upgrade towards higher value added activities – simultaneously creating opportunities for smaller businesses as countries no longer need to develop vertically integrated industries to participate in global trade.

Given that it is now enough to develop capacities in specific links of the value chain, small and medium-size enterprises (SMEs) can have access to global markets through inclusion into GVCs as providers of intermediate goods or services, which is against the idea that trade and GVCs only benefit large multinational firms. This is particularly important given the significant role that SMEs play in developing countries particularly in employment generation.

However, trade and participation in GVCs are intermediary objectives. The central question is: how much value is captured by the country in terms of jobs, income, technology diffusion and sustainable development? To what extent can the private sector play a strategic role in advancing the development agenda of developing countries through GVCs?

GVCs and Developing Countries

As the global economy has begun to structure itself around GVCs over the past couple of decades , the high level of trade has created an unprecedented level of inter-dependency among countries that are engaged at different stages of supply chains. This has created tremendous opportunities for developing countries to benefit from the international fragmentation of production process, and allow them to specialise in specific areas of a value chain. Not only are they gaining from the lowered price of production, but also from the breaking up of cumbersome production process into specialised integrated units leading to the optimal utilisation of resources that tend to be sparse in different economies.

This new structure of production processes has significantly reduced the costs for developing countries and emerging economies to reach out and become a part of the global market. Localising an increased share of value added along a specific supply chain can play a significant role in a nation's development and diversification process. However, while the participation rate of developing countries in GVCs has increased from 20 per cent in 1990 to over 40 per cent today, in spite of this gradual growth, developing countries continue to lag behind in development statistics. Why is this?

Historically, developing countries have had a comparative advantage in the export of raw materials. Therefore, the domestic value added content of their exports constitute a large component of their exports. The nature of these exports tends to place them at the lower income-generating end of GVCs. As a result, one of today's most salient concerns pertains not only to how developing countries can enter into GVCs but, more specifically, how developing countries can systematically upgrade their involvement in GVCs.

While developed countries have a higher share of foreign value added exports than the global average, developing countries have a much higher share of domestic value added in trade because they have a comparative advantage in the export of raw materials primarily due to the abundance of natural resources and low skilled workers (See Figure 1).

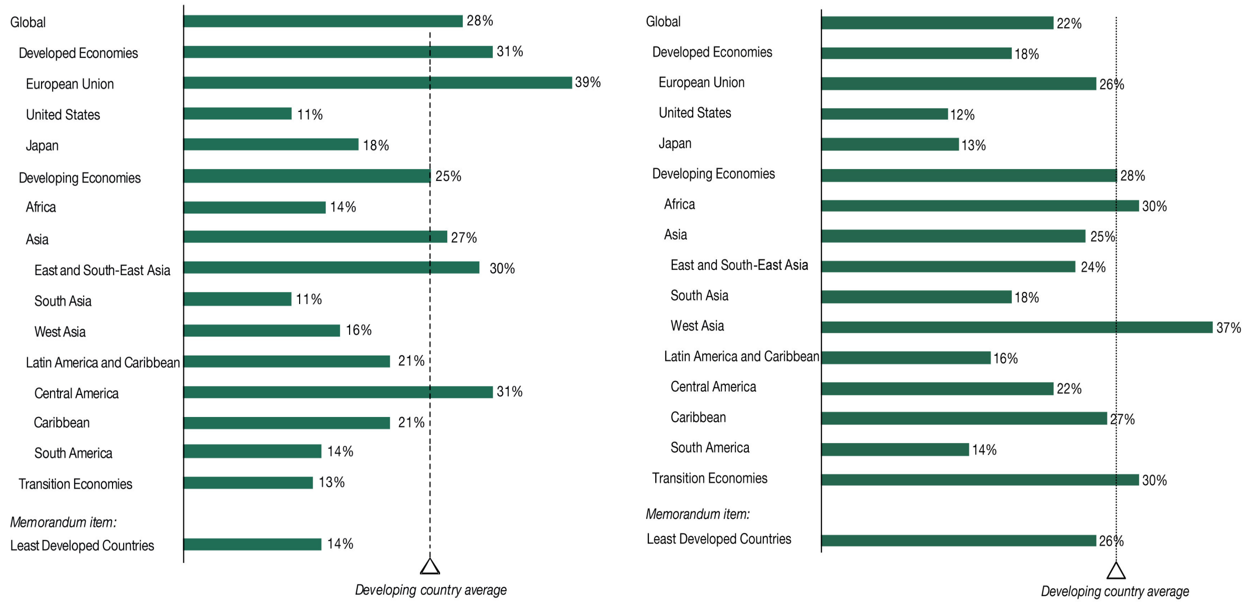
Many developing countries depend completely on the export of raw materials for employment, but since raw materials are predominantly the first stage in the value chain, the value added to the country from export of these commodities are minimal as compared to the value added to the countries in the later part of the chain.

Localising an increased share of value added along a specific supply chain can play a large role in a nation's development and diversification process

The Post-2015 Development Agenda and Climbing up the Value Chain

As globalisation has progressed, its impact on sustainable development has become a growing concern. Sustainable development has

Figure 1: Share of Foreign Value Added in Exports and Domestic Value in Trade as Share of GDP, by Region, 2010



Source: UNCTAD (2013), 'Global value chains and development', http://unctad.org/en/PublicationsLibrary/diae2013d1_en.pdf been defined as "when development meets present needs without compromising the ability of future generations to meet their needs."[1] In response to this looming challenge, during the 2012 United Nations Conference on Sustainable Development, a set of various thematic and cross-cutting issues articulated as the Sustainable Development Goals (SDGs) were launched and included in the MDGs. It was noted that these would converge with post-2015 development agenda.

One of the most distinguishing features of globalisation is that it invariably results in both winners and losers. The uneven distribution of the gains from participating in GVCs provides one such example. Developed countries usually gain more in trade than their developing country counterparts with the benefits of globalisation going to countries with more education, more skills, better infrastructure and more open economic policies.

While developed countries have a higher share of foreign value added exports than the global average, developing countries have a much higher share of domestic value added in trade because they have a comparative advantage in the export of raw materials primarily due to the abundance of natural resources and low skilled workers

Furthermore, as discussed earlier, the motivation behind most multinational companies shifting their production process to developing countries is generally to tap into the low wage labour in the region to reduce the cost of production. While this is beneficial to developing countries in their efforts to attract investment, at times it can impede the process of moving up the value chain as it is often in the interest of the multinational companies that the economy stays underdeveloped so that they can continue to reap the benefits of low wages.

This is further exacerbated by the fact that even the possible development benefits of GVCs such as technology dissemination, skill building and upgrading are not self-regulating, thereby further entrenching developing countries into relatively low value added activities. For a developing country to move up the value chain, the country has to provide infrastructure for development and education to enable labour to shift from unskilled to skilled; otherwise they suffer the risk of being trapped into low income generating activities and relatively low-value added trade at the bottom of the global value chain.

In fostering the inclusion of developing countries into the GVCs, efforts should also work to ensure that they address the economic, social and environmental dimensions of sustainable development and their inter-linkages. This can be done with adequate focus on the poverty reduction and the promotion of sustainable patterns of consumption and production, as well as protecting and managing natural resources, and ensuring equitable distribution of income to promote sustained inclusive growth.

Recommendations

In order to promote the role of GVCs in the attainment of the SDGs, there area number issues that need to be addressed. Firstly, GVCs cannot function properly in the absence of well-functioning markets for backbone services such as transport, logistics and telecommunications. GVCs are highly dependent on the existence of an open and competitive services sector. An emphasis on the strengthening of services is vital given their increasing share in manufactured exports.

Transport services particularly play a crucial role given that multinational companies tend to operate in countries where logistics costs are cheaper; highlighting the need to focus on trade facilitation. This is particularly important in light of the proliferation of mega regional trade agreements in whose negotiations developing countries have been largely excluded. These agreements have the potential to restrict the expansion of GVCs into developing countries with the member countries participating in them. In order to tackle this, developing countries will need to focus more on harmonising regulatory standards and implementing mutual recognition agreements in order to reduce the scope of non-tariff barriers.

Secondly, the development of human and institutional capacities is crucial to moving into higher value chains and engaging in more remunerative linkages in value chains. While the establishment of a strong workforce can be facilitated by increased investment in the areas of education, training, workforce development, institutional capacity can be facilitated by strong policies in technology, innovation and intellectual property rights regime.

Thirdly, building competitive advantages along GVCs needs partnerships with businesses; more specifically, buy-in from the private sector is essential in ensuring that trade-related assistance delivered by development partners delivers sustainable outcomes. The importance of galvanising private actors along the value chains in developing countries is becoming clearer and this can be undertaken by investing in the capacity and competitiveness of producers, traders and trade support institutions.

By addressing these three issues and embedding GVC policies within the broader development framework, particularly those aimed at supporting private sector development, the global community can work to ensure that benefits from globalisation is increasingly evenly distributed both within and across countries.

Endnote

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