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Global Value Chain Policy Series

Introduction

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What are global value chains?

Global value chains (GVCs) have been an important feature of the trade and investment landscape for a few decades and have changed the way firms design, produce and distribute goods and services. GVC trade is thought to make up 60%-67% of global trade in value-added terms.[1] Services like research and design, engineering and marketing, whether outsourced or provided in-house, serve as important inputs in value chains. Transport, communications and logistics services act as vital links between the different points in the chain. In addition to supporting goods GVCs, services have fragmented to form GVCs in their own right.[2]

Technological advances have been essential to the emergence of GVCs and continue to affect their evolution. Falling transport costs, advances in information and communications technology (ICT) and developments such as containerization have made it easier to coordinate production processes over large distances and ship inputs, parts and components as required. This has made it feasible for firms to locate various stages of their production process in different countries. The lowering of barriers to the movement of goods, services, investment and personnel through free trade agreements has also been critical.

Multinational enterprises (MNEs) are key players in GVCs, operating as lead firms across borders using independent suppliers, foreign subsidiaries or strategic partnerships. Even where the relationship between the lead firm and the supplier is not one of ownership, the degree of coordination between them is very high.[3] Lead firms set private standards[4] that need to be met by suppliers of goods and services throughout the value chain. These govern economic considerations like timing, quality and cost of inputs, but increasingly also environmental and social concerns like CO_2 emissions and working conditions.[5] Small and medium-sized enterprises (SMEs) are also vital contributors to GVCs as suppliers of goods and services. In addition, they make up the vast majority of firms in most countries, provide employment, generate growth and exports and help tackle poverty.[6]

Recognizing the profound ways in which GVCs are changing the global economy, societies and the environment, the World Economic Forum has launched the Global Value Chain Policy Series. The aim of the series is to stimulate cross-policy discussion and thinking about GVCs and collect ideas from researchers and practitioners on how to help them contribute towards development, sustainability and inclusiveness.

Box 1: The basics

A **global value chain** (GVC) is the full range of activities undertaken to bring a product or service from its conception to its end use, distributed across international borders.

Traditional ways of measuring trade focus on **gross** flows of goods and services from one country to another. However, this doesn't present an accurate picture of how much each country is actually contributing to the production of the good or service. To better understand GVCs, it is necessary to break down gross exports or imports into their **value-added** components. Consider the example of China exporting laptops to the United States. How much of the value of the finished laptop came from firms in China (domestic value added)? Which other countries contributed inputs, such as the display, memory chips and engineering services, and how much did they each contribute (foreign value added)? Looking only at the value of finished laptop exports from China to the US overstates China's contribution to the production process.

Source: Foreign Affairs and International Trade Canada, *Canada's State of Trade: Trade and Investment Update - 2011*, 2011, p. 86, adapted from Duke University Global Value Chains Initiative, "Concept & Tools", https://globalvaluechains.org/concept-tools

How can GVCs contribute to, or impede, development, sustainability and inclusiveness?

Certain longstanding ideas regarding the positive and negative contributions of trade continue to apply to GVCs: they allow economic efficiencies through comparative advantage, scale and competition, yet create adjustment costs for disrupted workers. Nonetheless, the effects of GVC trade may differ in some respects from non-GVC trade, as may the strategies for maximizing benefits.

Development

Before GVCs were widespread, the typical development trajectory consisted of countries building production and export capabilities in an entire industry to produce a finished product. This could involve massive investments in research and development, protecting the relevant domestic industry from import competition or choosing national champions to support. This was how Japan, for example, became a world leader in automobiles and the Republic of Korea developed its ICT hardware industry.

The advent of GVCs has provided an alternative route to industrialization and economic development. GVCs allow developing countries to specialize in specific tasks and plug into international production networks, rather than develop entire industries. Participating in GVCs has helped some countries connect to new markets, better integrate with the global economy, diversify exports, improve technology and productivity and create jobs. However, many have been left out. The shares of least-developed countries (LDCs) in world exports of merchandise and commercial services were 0.94% and 0.7% respectively in 2016.[7] Countries in Africa and Latin America do not have the advantages that proximity to major hubs in North America, Europe and East Asia[8] brings.

In any case, simply joining GVCs does not guarantee sustainable development.[9] Developing country firms aim to upgrade; that is, move into higher value-added tasks to better capture the gains of participation. Lasting linkages between MNEs and the local economy and actors help boost development impacts.[10]

Sustainability

Globalization has afforded MNEs significant mobility and flexibility in arranging their international operations. This presents the opportunity for regulatory arbitrage between national jurisdictions and prompts a race to the bottom when it comes to environmental and social standards. However, GVCs do offer an opportunity to shift industries into a more sustainable trajectory. By influencing a limited number of MNEs, tangible progress can be made. This is, in large part, because these players set standards that their various suppliers and partners are required to meet.

While some global brands have made the point that it is not possible for them to accurately verify and track the sustainability of all their suppliers, consumers in advanced economies have demanded more transparency. Investors have also played an effective role in shaping corporate behaviour in this regard. Consequently, a number of initiatives are attempting to better map various tiers of suppliers and measure the overall sustainability of the product and its entire production process.

Inclusiveness

Trade and globalization have done much to lift global average incomes and reduce inequalities between countries.[11] At the national level, results are more mixed. The share of labour compensation in GDP is one potential indicator of inclusiveness in terms of income distribution. When this measure falls, it indicates that wages are not increasing in line with increases in productivity and workers are not benefiting proportionally from economic growth. This has been the case in some advanced economies, though it is more nuanced in developing economies. Technological progress, coupled with offshoring through GVCs, has brought many gains but has also led to structural unemployment in some cases.[12]

The process of adjustment for disrupted workers can take many years, with disadvantages accruing across generations.[13] Domestic efforts to provide a social safety net depend on the ability of governments to raise tax revenues. Unfortunately, GVCs have also exacerbated tax avoidance by MNEs and tax competition between jurisdictions seeking to attract foreign direct investment (FDI).

Also relevant to the inclusiveness of GVCs are the opportunities and outcomes they provide for SMEs and women. SMEs are key participants in GVCs but face constraints in importing inputs (they have a lower share of foreign value added in their exports than large firms),[14] accessing trade and supply chain finance,[15] meeting private product and process standards and navigating sustainability certification schemes. Meanwhile, research in select value chains shows that women in developing countries tend to be concentrated in lower-level stages and rarely in management. When attempting to move to higher value-added activities, access to land rights, finance and market information and family-related responsibilities were found to be constraints.[16]

What do GVCs mean for policy?

Thinking in terms of value chains instead of industries could discourage trade policies that are ultimately self-harming. Attempts to protect a particular domestic industry may disrupt other successful firms in the value chain. Baldwin describes this approach as akin to putting up a wall in the middle of a factory to keep jobs on one side safe; the factory as a whole becomes less competitive.[17] Beyond trade, a number of policy areas are relevant to ensuring the smooth functioning of GVCs, creating the enabling environment to attract crucial FDI, developing talent, improving services productivity, fostering innovation, ensuring that the gains are more equitably distributed and preparing for macro-economic shocks.

Some polices or processes disproportionately affect GVC, as opposed to non-GVC, trade. For instance, complicated or slow border procedures have a "cascading" effect in the GVC context, as parts and components cross borders multiple times.[18]

For GVC participation to reap development benefits and distribute gains more equitably, pure trade policies and instruments are insufficient. Accompanying economic policies and strategies that help build local ecosystems, networks and institutions are vital. This includes encouraging linkages between the foreign investor and local firms, workers and universities.

With tasks spread globally, outcomes depend on the orchestration and incentivization of many actors. A better understanding is needed of why some countries have succeeded in translating GVC participation into inclusive and sustainable growth and development while others have failed.[19]

Global Value Chain Policy Series

The GVC Policy Series looks at GVCs through different lenses, explaining the state of play, laying out relevant questions and offering solutions where they exist. It opens with five papers which are briefly described below. The initial papers tackle a mix of objectives (environmental sustainability), economic activities (investment and services) and policy levers (competition and taxation). The papers are not meant to be comprehensive – rather they provide a common basis for dialogue on potential multistakeholder partnerships addressing the issues raised.

Environment

This paper examines two questions that arise at the intersection of environmental sustainability and GVCs. The first relates to trade and other barriers to the smooth functioning of environmental goods and services value chains. The development, production and distribution of these products are vital for a sustainable, low-carbon future, but differences over definitions, protectionism and regulatory uncertainty pose challenges. The second question relates to how value-chain actors can be encouraged to improve sustainability outcomes throughout the value chain, particularly through sustainability standards and public-private initiatives.

Investment

Given the important role of MNEs, attracting FDI is a key concern for countries keen to join GVCs. This paper explains why increasing the foreign services share of gross exports, implementing trade facilitation measures and signing on to deep trade agreements, particularly with neighbouring countries, can be beneficial. It also highlights some practical constraints that MNEs face in host countries with respect to access to hard currency, infrastructure and on-the-ground services gaps and corruption. Local firms and SMEs also suffer as a result of corruption, complex processes and poor infrastructure.

Services

With new data revealing the extent of services' contribution to GVCs, there has been greater policy interest in what drives services competitiveness. This paper traces the story of the evolving role of services in the global economy and how new technologies will impact services business models. It also highlights the opportunities services sectors provide for SME participation, economic development, gender equality and environmental sustainability.

Competition

Anti-competitive behaviour can affect the smooth functioning of GVCs in different ways and at various stages. The international nature of value chains, MNE operations and the digital economy is at odds with nationally administered competition law. While acknowledging that competition law may be a blunt instrument to achieve some public purpose or equity objectives, the paper makes specific recommendations for the design and enforcement of competition law in the GVC context.

Taxation

This paper highlights the disconnect between the modern global economy and an outdated international tax framework and provides some suggestions for how tax policy could better promote sustainable and inclusive GVCs. The authors explain that, in theory, MNEs have a greater ability to avoid taxation on their residual profits in the context of GVCs, or even to deflate source-country profits while inflating GVC-produced residual profits (whether or not in compliance with the Transfer Pricing Guidelines of the Organisation of Economic Co-operation and Development, OECD). However, there is a risk that uncoordinated and unilateral over-implementation of anti-Base Erosion Profit Shifting (BEPS) measures could be detrimental to the operation of GVCs. Consistency and cooperation are required.

The GVC Policy Series aims to highlight some key questions which will need to be examined in more depth in the context of specific value chains, regions or public-private initiatives. A unifying theme in these papers is the need for coherence – be it among different policy instruments, various jurisdictions or public and private initiatives.

Endnotes

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