Making Global Value Chains (GVCs) Accessible to All

Progress Report

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Introduction

The 2013 OECD MCM Ministerial Statement [C/MIN(2013)16/FINAL] noted that "GVCs are a powerful driver of growth and productivity and support job creation" and called on the OECD "to do further analysis of the relationship between GVCs and jobs and income as well as how to make GVCs accessible to all." This mandate followed a similar one by the G20 under Mexico's Presidency in 2012. In response to the latter, the OECD in collaboration with the WTO and UNCTAD submitted a report to the G20 Leaders' meeting in Saint Petersburg, Russia, in September 2013, titled "Implications of Global value Chains for Trade, Investment, Development and Jobs." Annex 1 reproduces the main findings and policy highlights from this report.

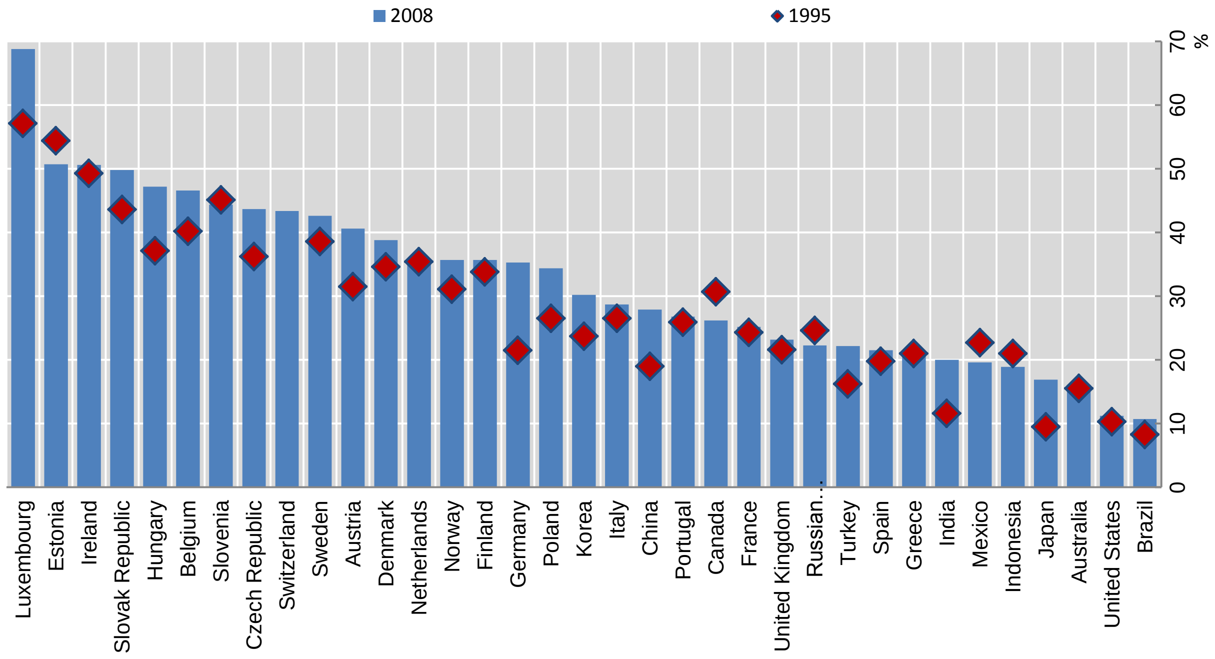
At the St. Petersburg G20 Summit, OECD, WTO and UNCTAD were asked to continue their research on the impact of GVCs, "particularly in relation to the influence of GVCs on trade, economic growth, development, job creation and distribution of value-added along GVCs." Since then, the World Bank Group has joined this collaboration.

This note reports on progress made since the 2013 MCM, and offers preliminary findings on the impact and policy implications of GVCs. Further work is currently on-going with the view to providing a final report to the G20 Australian Presidency prior to the July G20 Trade Ministers meeting in Sydney, Australia. The final Report will synthesise available evidence and highlight policy options, and recommendation that G20 Governments could consider in the short and medium term in support of their ambition to raise collective GDP growth by 2% above current levels. Thereafter, additional work will be undertaken to reflect new TiVA data, including linking it to other data sources and to the results of on-going work on furthering the integration of developing countries' firms into regional and global value chains, drawing from insights from across the OECD. The final Report, "Making Global Value Chains Accessible to All", will be presented to the 2015 MCM. In addition, further work on GVCs is being planned in the 2015-2016 PWB, including on Skills.

TiVA, jobs, and activities of foreign affiliates

The OECD-WTO TiVA database has been complemented with two new sets of indicators. The first provides a complement to value-added flows by providing a jobs equivalent perspective, with, for example, first estimates of the number of jobs sustained by consumers in foreign markets. This indicator highlights interdependencies among economies in GVCs by showing how consumers in one country drive and sustain jobs in countries further up the value chain. As shown in Figure 1 below, between 10% and 70% of business sector workers in the countries for which data is available were dependent on global value chains in 2008, an increase compared to 1995 in most but not all countries. The percentage share in some large economies is smaller; nonetheless, in the United States, for example, in 2008 close to 11% of business sector workers or 10 million jobs were sustained by foreign final demand. These new data also point to the interconnectedness of labour markets and the potential of consumers in emerging markets to drive employment growth in other countries. For example, in the United States over a fifth of all jobs sustained by foreign demand in 2008 can be attributed to final consumers in East and Southeast Asia.

Figure 1. Jobs in the business sector sustained by foreign final demand, 1995 and 2008



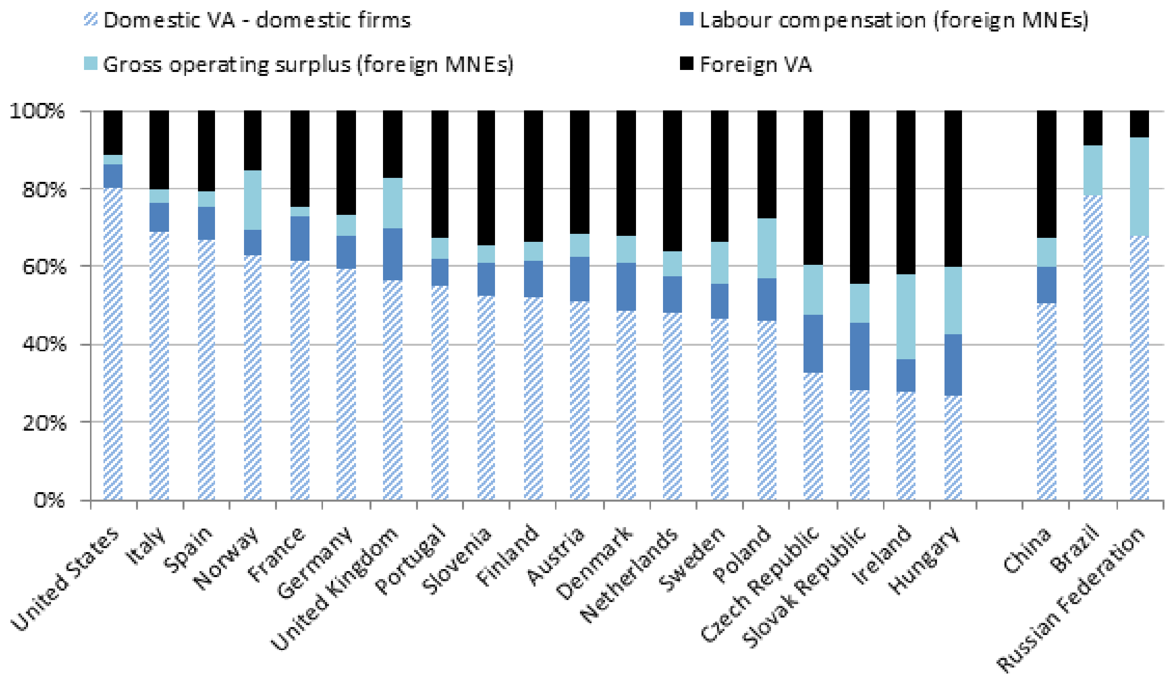
Note: Estimates are calculated on the basis of demand for goods and services at the "factory gate" and do not include the jobs sustained by distributors and providers of transport, logistics and insurance services that sell imported products to domestic consumers at the end of the value chain. These estimates capture those jobs sustained by foreign final demand and not necessarily the jobs sustained via investment channels.

Source: OECD Science, Technology and Industry Scoreboard 2013, based on OECD, Inter-Country Input-Output/Trade-in-Value-Added (ICIO/TiVA) database.

Second, OECD data on Activities of Multinational Enterprises (AMNE) have been linked with TiVA data in order to produce estimates of the share of exported value-added that can be attributed to foreign affiliates. For any given industry's exports therefore, it is now possible to identify : (i) the share of foreign value added (imports of intermediate inputs); (ii) the share of domestic value-added created by domestically owned firms; and (iii) the share of domestic value-added generated by foreign-owned firms. The domestic value added generated by foreign affiliates benefits the host economy, since part of it is paid out as labour income and hence largely stays in the host country. But a part of the residual may leave the host economy in the form of repatriated profits, dividends and interest payments.

Preliminary estimates indicate that a significant share of the domestic value-added in exports is created through the activities of foreign affiliates, from 8% in the United States to 30% in Hungary (Figure 2). A large part of this value added accrues to owners of domestic production factors, in particular through labour income.

Figure 2. The contribution of foreign affiliates to domestic value added in exports, 2009



Notes: 1. Results are calculated by linking the OECD/WTO TiVA (Trade in Value Added) database and the OECD AMNE (Activities of Multinational Enterprises) database for OECD economies; For China, Brazil and Russia, the OECD/TiVA database is linked with the ORBIS database (privately owned by Bureau Van Dijck)

2. Data for Brazil and Russia do not allow for a distinction between labour compensation and gross operating surplus in the domestic value added of foreign MNEs

3. Results only take into account the effects of inward investment, i.e. the domestic value created by foreign affiliates in host countries; the results do not capture the contribution of domestic MNEs through its foreign affiliates abroad (i.e. outward investment, part of which will be reflected within the foreign VA figures shown above).

Source: OECD-WTO TiVA database and OECD AMNE database.

Looking ahead, the OECD-WTO TiVA database should be updated to include data for 2010, with possibly a projection for 2011, by the end of this year. Three additional countries, i.e. Colombia, Costa Rica and Croatia, are also being added and the list of industries extended. The feasibility of undertaking further work on value-added by enterprise size, to isolate the contribution of small firms versus large companies, is also being explored.

GVCs, growth and development

Not all firms and countries are equally involved in GVCs. Some countries participate in many, either as the host country to lead firms or as suppliers of very specific tasks, while others participate very little. These varying degrees of connectedness are determined by many considerations, some of which are fixed (such as a country's geographic location and resource endowment), while others can be influenced by public policy (such as a country's human capital, physical infrastructure, and overall investment climate). Participation of SMEs in GVCs is especially important in the developing world, where smaller firms can represent as much as 80-90% of total employment. Yet in ASEAN, for example, the share of SMEs participating in GVCs is estimated to vary between 6% and 46%, depending on the country.[1]

Public sector views (Figure 3) on barriers to firms participating in GVCs can be very different than private sector views. Supplier firms in developing countries tend to be more concerned about access to finance, infrastructure limitations, and regulatory uncertainty (Figure 4); lead firms in GVCs see trade facilitation and standards compliance as more important constraints. Clearly, improving participation and upgrading in GVCs is a matter of perspective as well as place.

Figure 3. Barriers firms face in entering value chains – Public sector views

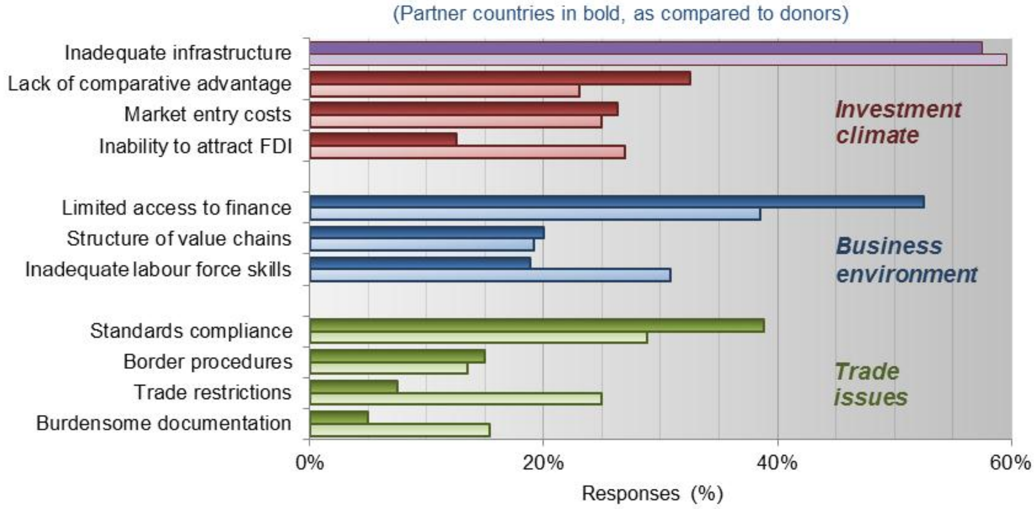
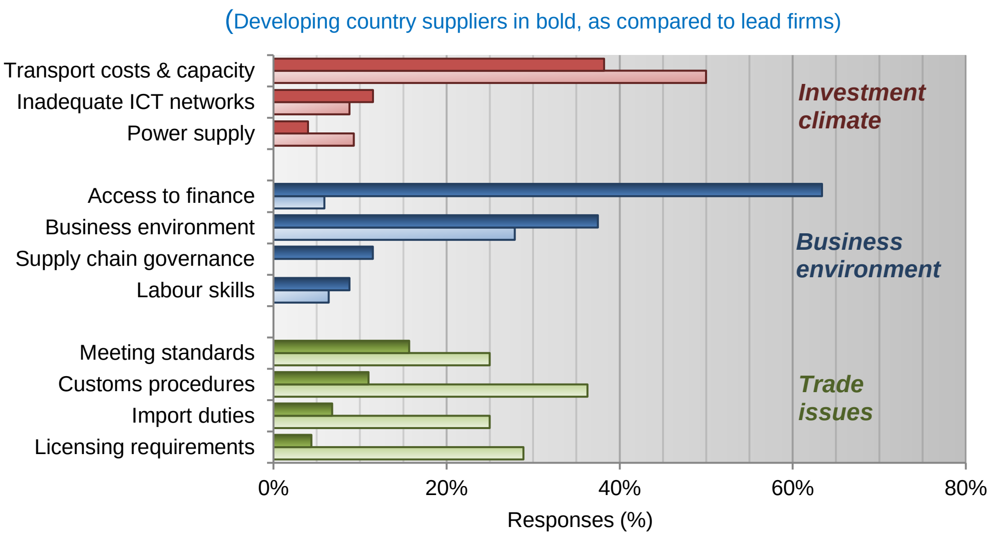


Figure 4. Barriers Firms Face in Entering Value Chains – Private Sector Views



Source: OECD-WTO Aid-for-Trade Questionnaire 2013

1. Wignaraga, Ganeshan (2013),"Can SMEs Participate in Global Networks? Evidence from ASEAN," In Elms, Deborah K. and Patrick Low, eds. (2013), *Global Value Chains in a Changing World*. Geneva, WTO Publications for Fung Global Institute, Nanyang Technological University and the World Trade Organization.

A wide array of additional work is underway on the link between GVCs, growth and development. This work is being conducted both on a regional basis (for example, to estimate the participation of African and Asian economies in GVCs and the implications for growth prospects, or to explore opportunities and impediments for Southeast Asian countries and firms to upgrade in GVCs) and on a thematic basis (for example, to clarify the links between value added trade, productivity performance, innovation, jobs, inequality and skills).

Preliminary policy implications

For trade…

- The way that trade policy is conceived requires adjustment; it is necessary to value imports as well as exports, to reduce time delays as well as tariffs, and to look “behind the border” at regulatory measures as well as “at the border” measures.
- While tariffs are no longer as important in most channels of trade as they once were, the structure of GVCs can multiply the effects of even low-level rates of duty.
- Policies that artificially aim to increase the domestic content of production, such as local content requirements, forced technology transfer, or restrictions on exports of raw materials are likely to fail. Such policies often shift resources to less productive activities, prevent local producers from outsourcing and gaining access to the most efficient inputs, distort competition, and discourage knowledge spill-overs on both the import and export side.
- Multilateral market opening is preferred, as barriers between third countries, upstream or downstream, can matter as much as barriers put in place by direct trade partners.
- Trade facilitation helps countries participate in GVCs by cutting costs, avoiding unnecessary delays, and reducing uncertainty. The potential reduction in trade costs of fully implementing the WTO Agreement on Trade Facilitation that was concluded in Bali in December 2013 is as high as 14% for some developing countries (slightly lower than the 16% estimate had all items under negotiation been agreed).
- GVCs are particularly sensitive to the quality and efficiency of services, accounting for over half of the value added in the exports of many OECD countries and over 30% in China. Services support the efficient functioning of GVCs and value creation, by enabling firms to differentiate their products to specific customer needs.
- Improving logistics services, in particular, **is** essential to effective GVC participation. High-quality logistics affect trade even more than distance or transport costs; every extra day needed to ready goods for export and import reduces trade flows by around 4%.
- International regulatory cooperation, including via mutual recognition agreements, can help mitigate compliance costs that arise as a result of unnecessarily complex or heterogonous regulations, enhancing the ability of firms, in particular SMEs, to participate in GVCs.

For growth…

- The link between trade-related participation in GVCs and economic growth is through the gains to firms from specialisation and productivity gains related to both imports and exports (access to intermediate inputs, new technology and markets as well as knowledge spill-overs).

- This is equally the case for investment, where the nature of the interaction between foreign firms and domestic producers can explain more of the potential productivity spill-overs than the level of FDI.
- Integration into GVCs should be only one part of a broader pro-growth agenda. A well-crafted package of macroeconomic and structural policies, including innovation policies, is also required to stimulate growth, and the precise shape of these policies depends significantly on the specific situation in a given country.

For jobs…

- The strong increase in the value-added created within GVCs as a share of world GDP means that a high share of employment now relies on foreign final demand and the smooth functioning of GVCs.
- Offshoring and outsourcing enhance the productivity and competitiveness of firms within GVCs by providing access to lower cost, differentiated, and better quality inputs. Employment will decline in less competitive sectors but this will be offset by job growth in more competitive parts of the economy. The jobs potentially displaced by new trade and investment opening are dwarfed by the jobs already depending on the operations of established foreign affiliates and on foreign demand in GVCs.
- Policy needs to protect workers, not jobs, including against the loss of jobs as a consequence of trade policy reversals and "beggar thy neighbour" policies. Changes in the composition of jobs are best addressed by effective education and skills policies, and by well-designed labour market and social policies.
- An open investment regime is beneficial to the domestic economy, even when foreign affiliates of MNEs represent a very large share of exports. Recent OECD analysis highlights that more than half of the contribution of foreign affiliates to domestic value-added is through labour income (that stays in the domestic economy).
- Differences across countries in the share of the gross operating surplus of foreign-owned firms leaving the host economy are affected by tax regimes and the tax strategies of firms. Current international efforts to address "base erosion and profit shifting" could affect the share of the gross operating surplus of foreign firms leaving some economies.

For development…

- Strong social, environmental, and governance frameworks and policies are pre-requisite to maximising the positive impact of GVC activities and minimising risks in all countries, especially in developing economies.
- GVCs require sound public institutions that enforce contracts, adequately secure property rights and investor protection, ensure an impartial judiciary, and reduce corruption.
- In many less developed economies, there is often a particular need to improve supply side capacity through strategic investments in people (health, education, skills) as well as in physical infrastructure, including information and communication networks.
- Countries should ensure that GVC participants observe international core labour standards, including establishment and enforcement of occupational health, safety, and environmental standards and related capacity-building for compliance.
- For firms to upgrade in GVCs, countries should develop an efficient innovation system that facilitates investments in knowledge and fosters technology dissemination, skills upgrading and entrepreneurship.

- Financial system development can alleviate cash constraints and facilitate GVC participation. By lowering the cost of trade, well-functioning financial systems can increase the number of potential trading partners and the volume of trade.
- The role of services in GVCs highlights the importance of efficient services sectors in all countries, including developing countries. If established firms or potential new entrants cannot find the services supporting their activities in the local economy, they can be expected either to rely on cross-border provision (when feasible) or to establish in another country. This would slow development and growth.
- Policies that artificially increase the participation of firms in GVCs through direct government incentives for specific activities and disincentives for other activities ignore the interconnected nature of production in GVCs and the need for competition and openness. Linking with lead firms and fostering the capabilities of domestic firms can be a more solid foundation to build on for many small and innovative firms.

Next steps

The preceding analysis reviewed the multiplicity of factors that affect competitiveness, participation and upgrading in GVCs. These factors speak to the need for countries to take a multi-pronged yet concerted approach that cuts across different policy domains. No one field of public policy or firm behaviour can offer the "silver bullet" for a country or firm, as eliminating barriers in a single area may be insufficient to trigger investment or scaling up of existing activities if other policies or shortcomings continue to weigh down supply chains with significant costs. In the same token, no one recipe offers the "silver bullet" for all countries.

Some countries participate in many and varied GVCs, either as the host country to lead firms or as supplier of very specific tasks, while others have experienced little GVC penetration. Even in the case where a country had managed to integrate into GVCs, this alone does not necessarily translate into positive development gains. The challenge here is not only a matter of how to link to global and regional value chains, but how to do so in a way that brings sustainable welfare gains to the entire economy.

It is for these reasons that the OECD is currently reviewing region and country-specific experiences in GVCs. The main objective is to strengthen comprehensive structural policy reforms targeted to the specific situation and prospects in individual countries. The analysis will take into account countries' size, level of development, endowments, economic structure and geographical characteristics. Further work is also being undertaken to explore the implications of GVCs for jobs, skills and innovation, and to further strengthen and elaborate the evidence base for analysis of GVCs, notably the OECD-WTO TiVA database.

International cooperation in support of resilient economies and inclusive societies could be enhanced through improved transparency, information exchange, and a commitment to open trade and investment and structural reform more generally.

Annex 1

Highlights from the OECD-WTO-UNCTAD report to the Saint Petersburg Summit, September 2013
Implications of Global Value Chains for Trade, Investment, Development and Jobs

- Global value chains (GVCs) account for an increasing share of world income, reflecting a high degree of economic interdependence amongst nations.
- All countries have increased income associated with their participation in GVCs, in particular major emerging economies.
- The income from trade flows within GVCs has doubled between 1995 and 2009: for China it has increased six-fold, India five-fold and Brazil three-fold.
- Income growth means more job growth: in Germany jobs associated with GVCs have doubled to about 10 million jobs between 1995 and 2008.
- Trade facilitating measures are vital to successful participation in GVCs; trade cost reductions from practical and relatively inexpensive actions could be as high as 16% for some developing countries.
- The role of efficient and competitive services sectors is also crucial: services account for 42% of exports (in value added terms) from G20 economies and more than 50% for some countries.
- GVCs strengthen the case for multilateral market opening, as barriers between third countries, including various non-tariff measures, upstream or downstream can matter as much as barriers put in place by direct trade partners.
- Open, transparent and predictable trade and investment policies need a range of flanking policies to ensure benefits from GVCs are inclusive and widespread. In some less developed economies there remains much work to be done to address specific obstacles to effective participation in GVCs.
- Overcoming obstacles to GVC participation can pay big dividends; developing economies with the fastest growing GVC participation have GDP per capita growth rates 2% above average.
- Multinational Enterprise (MNE) coordinated GVCs account for 80% of global trade. But it is also estimated that the contribution of local firms is very significant (in the range of 40-50% of export value added).
- GVCs can be an important avenue for developing countries to build productive capacity where local firms can capture a significant share of the value added: but technology dissemination, skill building and upgrading are not automatic and require significant investment.
- Individual countries will want to carefully weigh the costs and benefits of proactive policies, carefully tailored to the country's specific situation and coherent with its overall development strategy.