Aid for trade and Global Value Chains

Issues for South Asia

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Global value chains (GVCs) are not a new phenomenon, nor are donors' interests in GVCs. Their interests in GVCs started in the late 1990s when researchers and policymakers were seeking to better understand the implications of the proliferation of GVCs for producers and labourers, predominantly in developing countries. The ramifications of the global financial crisis, the emergence of which has been linked to the proliferation of GVCs and ensuing developments in developed countries—notably the United States—have helped renew donors' interests in GVCs in the context of global rebalancing in a post-crisis world.[1] This policy brief discusses some of the motivations behind renewed interests in GVCs, and the opportunities that this may present for South Asian countries, as well as some of the expectations that should be managed.

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Growing prominence of GVCs and South Asia

The GVC approach to analysing trading relations is rooted in world systems theory. Wallerstein (1974) developed a core-periphery model in which Northern industrialized nations are located at the core and developing Southern nations around the periphery, and are linked together through global commodity chains (GCCs).[2] The approach was inherently sociological, as indicated by the inclusion of notions of power. Later, the GCC literature moved the world systems theory discourse from macro to meso and micro levels by focusing on the organization of industries and firms within a more integrated global economy. The GVC literature extended the GCC literature beyond its focus on homogenous goods by recognizing increasingly differentiated products (for example, as indicated by labels and standards). It is this latter development which shifted the emphasis of the discourse from general descriptive analysis of how firms are organized, in a static sense, to better understanding the creation of value, which may be conditioned by local as well as global economic processes.

In the handbook developed by Kaplinsky and Morris (2001), a value chain is defined as "the full range of activities which are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use".[3] GVCs are defined the same way, but with activities spread across countries.

The GVC literature became prominent during the 1990s when product- and sector-specific studies—motivated by the need to better understand how producers engaged in the most recent process of globalization and its implications for the development of productive capacity and capabilities—were published. The GVC approach continues to develop both conceptually (for example, by giving increased recognition to production networks) and empirically (for example, by employing more robust research methods, such as survey design). For instance, a major research consortium titled "Capturing the Gains", based at Manchester University, has conducted cross-country studies across Asia, Latin America, and sub-Saharan Africa employing the same methodology, thus facilitating comparative analysis.[4] Results have shown that upgrading processes by producers within GVCs are multifaceted, complex, and involve changes in business strategy, production structure and technology, policy, and the organization of markets.[5] Moreover, GVC analysis has tended to see "upgrading" as a continuum that begins with "process upgrading" (for example, a producer introduces more superior technology to increase efficiency), then moves on to "product upgrading" (whereby the quality of the product is upgraded by using higher quality material or through reduced human error), and then on to "functional upgrading" (where, for example, a clothing producer begins to source its own material for production and supplies to end markets directly). Subsequently, the process of upgrading proceeds to inter-sectoral upgrading (when the clothing producer begins to also produce, for instance, shoes and then motorcycle parts—moving across sectors of the manufacturing industry). Table 1 presents the traditional view of the GVC upgradation process.

Table 1 GVC upgradation process

Process upgrading	Transforming inputs into outputs more efficiently by re-organizing the production system or introducing superior technology. For example, through irrigating land, using pesticides or mechanical picking.
Product upgrading	Moving into more sophisticated product lines (which can be defined as increasing unit values), through, for example, introducing better quality seed, or minimizing crop contamination or disease.
Functional upgrading	Acquiring new functions in the chain (or abandoning existing functions) to increase the overall skill content of activities; such as the transition from OEM (original equipment manufacture) to ODM (own design manufacture) to OBM (own brand manufacture). Or, becoming a full package supplier, taking the responsibility for sourcing inputs as well as directly supplying buyers of lead firms.
Inter-sectoral upgrading	Using the knowledge acquired in particular chain functions to move into different sectors.

Source: Adapted from Humphrey and Schmitz (2004)[6]

The trajectory referred to in Table 1, which is considered to be a vertical one, is heavily influenced by the experience of the Newly Industrialized Countries (NICs) in East Asia, that moved from "original equipment assembling" to "own brand manufacturing". However, what was possible at that time in that region[7], within particular value chains, and accessing particular markets, may not necessarily be a completely replicable approach for South Asian countries.[8] There may be some ingredients that can be borrowed from the successful harnessing of GVCs for development by Asian NICs, which we discuss below with reference to the integration of Bangladesh into the textiles and clothing GVC. There may also be new opportunities for South Asian countries to engage in more dynamic forms of trade emanating from NICs.

GVCs and LDCs' export competitiveness

The degree of fragmentation of global production that has taken place in recent years has now led to widespread recognition that global trade increasingly involves different countries specializing in particular tasks, and hence exporting more intermediate goods rather than final ones. Hence, production of a final good (or a service) can take place across several firms located in different countries, with each firm undertaking—or specializing in—what is better described as "a task" in the overall process.[9] Much attention in the GVC literature has been given to the link between these shifts in the pattern of global trade and qualitative changes in the governance structures of GVCs.

Because of the consolidation of marketing and retailing nodes of GVCs in developed country markets, there has been considerable debate regarding the best means of engagement with more hierarchical governance structures. Commonly, large oligopolistic lead firms from industrialized countries enjoy greater economic power within their value chains, and are able, therefore, to capture most of the value created in the chain. That is because buyer-supplier contracts are negotiated and a lead firm with a multitude of potential suppliers will be in a very strong position to dictate the terms of the supply contract.[10]

The recent debate as to how producers engage in this type of trade highlights the tension between the potential for firms to achieve rapid process upgrading at a point in time and the potential to upgrade over time; the latter being potentially more difficult. There are circumstances when smaller and poorer producers and farmers may be excluded rather than included in high value hierarchical GVCs. But better organization of producers can help to reduce diseconomies of scale which may result if goods are sourced from many small individual producers. It may also help to overcome coordination failures.[11]

Although there are inevitable challenges, increasing fragmentation of global production does create new trade opportunities, including for South Asian countries. For example, movement into the modern export sector and the production of high value agriculture commodities and ready-made garments (RMG) has been driven by the increasing integration of LDCs into global GVCs.[12] However, the role of formal trade policy in creating these opportunities should not be overlooked. Preferential market access into developed-country markets has often provided a form of locational advantage to attract investment, and increased outsourcing and/or relocation of production from one country to another. For example, Bangladesh developed its textiles and clothing industry by attracting

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East Asian manufacturers seeking to benefit from its market access entitlements in developed country markets. However, the process of relocation, particularly by South Korean firms (notably Daewoo), was approached strategically and made contingent upon the formation of joint ventures with local industry and firms. The low level of foreign ownership in the industry, however, is not only a result of government intervention that sought to promote the creation of joint ventures with East Asian investors, but also due to the way in which the clothing industry is organized globally, with outsourcing taking place where domestic capabilities already exist and offshoring where they don't.[13]

Although a substantial portion of the accessories used in the ready-made garment industry in Bangladesh is produced domestically, some regional sourcing does take place, with Pakistan and India supplying inputs such as cotton, and knitted or crocheted fabric. Thus, some intra-regional trade has also been spurred by participation of Bangladesh in the GVC.

Through the negotiation of external governance structures which has facilitated upgrading processes, Bangladesh has been able to build on existing domestic capabilities and obtain a more secure supplier position. In many respects, the garment value chain in Bangladesh appears to exhibit more producer-driven tendencies, in terms of being less footloose and with an ability to exert control over backward and forward linkages.[14] Bangladesh has been able to build on its industrial capabilities over time, move up the garment value chain and obtain a more secure position as a second-tier garment supplier, or package contractor. Today, Bangladesh has become a preferred, rather than a marginal supplier.[15]

Therefore, South Asian countries should give greater consideration to how the external and internal governance structures of this type of trade interact and affect trade patterns, as well as influence development outcomes over time. They should also delve into how governments can be better assisted in performing this role, including through the provision of Aid for Trade.

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Benefits and risks of participating in GVCs

Because producers need to forge links with retailers and develop contractual relations so as to reach end markets and meet product specifications, the relative position of producers within GVCs and the types of entry barriers that exist may be linked to specific types of economic rent. Some of these types of rents may be directly under the control of government (for example, securing preferential market access overseas) but others may not (for example, securing access to a private auction house for agricultural products). The benefits as well as costs for producers participating in one type of value chain compared to another are essentially contingent on how the integration process of producers into the GVCs are managed.

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Services such as logistics and transportation are integral to integrate South Asian countries into regional and global value chains.

Strengthening the bargaining position of producers relative to powerful actors operating within GVCs may require more direct, as opposed to facilitative, government interventions, including in relation to the use of industrial policy. Merely facilitating trade is not the same as integrating trade in a country's development strategy. For instance, securing a contract with firms may be underpinned by the creation of joint ventures between firms located overseas, and deeper trading relations, both of which can improve access to technology (hard and soft), facilitate knowledge transfer, among others, and formulate part of an upgrading strategy for the entire economy. That is, interventions cannot be solely limited to correcting market failures, but may be required to help create markets and bolster the position of domestic producers within particular types of GVCs.

Since the upgrading processes within GVCs do not occur automatically, lead firms can be encouraged or required to actively engage with their suppliers which could facilitate technology, knowledge and skill transfer into the domestic market. More importantly, skill formation needs to become institutionalized so that lead firms can subsequently adopt a more hands-off role as producers' capabilities develop.

Need for improved data

There is a need for improved data collection on trade in GVCs. Recent initiatives such as the trade in value added (TVA) database created by the World Trade Organization (WTO) and the Organization for Economic Cooperation and Development (OECD) are laudable and have helped to debauch the hype regarding China's export surplus through a focus on net exports in intermediate goods trade. Nevertheless, there remains a paucity of data regarding those countries struggling the most to tap into more dynamic forms of trade and gain maximum benefits from their participation in GVC and commodity specialization. While data on India is available in the WTO-OECD TVA database, there is a lack of information on all other South Asian countries.

Additionally, there are conceptual issues regarding the WTO-OECD TVA database. Would an increase in trade in value added indicate firm-level upgrading? Also, the *World Investment Report* on GVCs by UNCTAD (2013) suggests that investment flows have been driven by top transnational corporations located in developing and transitional countries.[16] What does this shift mean in terms of different types of GVC governance? How governance structures influence the potential upgrading trajectories for firms and their labourers arguably deserves further attention.

Role of Aid for Trade for LDCs' participation in GVCS

Any approach to trade capacity building should start from a broad view of how a country is trying to change its trade, followed by an assessment of existing obstacles to it. In that respect, looking at the production chain, rather than the individual stages of production, is more helpful. Individual donors with their own priorities and expertise cannot be expected to provide comprehensive response to the needs identified, not to mention the legal responsibilities of many specialist agencies. But their priorities and modalities must adapt to the way production chains operate, and they need to coordinate with other donors to cover all types of trade needs. Since the value chain approach emphasizes the importance of relative power in chains, donors and governments must work together and take account of how aid flows may affect power relationships. Governments, therefore, need to better understand the nature of trading patterns that affect their domestic producers, and subsequently identify the steps necessary to better support them. Because the GVC methodology lends itself to clearly identifying and articulating these linkages, it can assist in identifying which policy levers are in place, and when it might be appropriate to pull them.

Additionally, it is important to realize that services such as logistics and transportation are integral to connect South Asian countries with external markets and to integrate them into both regional and global value chains. In fact, developing logistics and transportation systems may enable producers to subsequently obtain more functions within a given value chain, and to move towards becoming a full package supplier. Therefore, interventions to improve such services can assist South Asian firms upgrade their position within a given value chain by attracting more functions to be undertaken within the country, and indeed across the entire value chain. This is particularly important for landlocked South Asian countries.

There is growing evidence that the costs of trading are significant barriers for countries trying to increase their participation in world markets and integrate themselves into the global value chains, including in South Asia. Aid targeting these costs will have a significant effect on countries' ability to use trade and harness the opportunities arising from new types of GVCs in their development strategies. ■

Notes

1. Milberg, W., and D. Winkler. 2011. "Economic and Social Upgrading in Global Production Networks: Problems of Theory and Measurement." *International Labour Review* 150(3-4): 341–65.
2. Wallerstein, M. 1974. *The Modern World System: Capitalist Agriculture and the Origins of the European World Economy in the Sixteenth Century*. New York: Academic Press.
3. Kaplinsky, R., and M. Morris. 2001. "A Handbook for Value Chain Research." http://asiandrivers.open.ac.uk/documents/Value_chain_Handbook_RKMM_Nov_2001.pdf.
4. See "Capturing the Gains" project. http://www.capturingthegains.org/.
5. Bernhardt, T., and W. Milberg. 2011. "Economic and Social Upgrading in Global Value Chains: Analysis of Horticulture, Apparel, Tourism and Mobile Telephones." Capturing the Gains Working Paper 2011/06.
6. Humphrey, J., and H. Schmitz. 2004. "Chain Governance and Upgrading: Taking Stock." in *Local Enterprises in the Global Economy*, edited by H. Schmitz, 349–82. Cheltenham: Edward Elgar.
7. Kaplinsky and Morris (2001). Note 3.
8. However, some of the theoretical advancements of new growth theory were developed on the basis of the historical upgrading experience of the East Asian NICs such as learning and developing human capital, and are generally recognized as being particularly relevant for late industrializers.
9. See WTO-IDE. 2011. "Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks." http://www.ide.go.jp/English/Press/pdf/20110606_news.pdf.
10. Mayer, F., and W. Milberg. 2013. "Aid for Trade in a World of Global Value Chains: Chain Power, the Distribution of Rents and Implications for the Form of Aid." Working Paper. Sanford School of Public Policy, Duke University.
11. This includes whether or not non-farm facilities, such as storage and light processing, are also made available to associations of producers.
12. More broadly, it is a non-equity mode of production. See UNCTAD. 2011. *World Investment Report 2011: Non Equity Modes of Production and Development*. Geneva: United Nations Conference on Trade and Development.
13. Gereffi, G., and S. Frederick. 2010. The Global Apparel Value Chain, Trade and the Crisis: Challenges and Opportunities for Developing Countries. World Bank Policy Research Working Paper. Washington, D.C.: World Bank.
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15. Gereffi and Frederick (2010). Note 13.
16. UNCTAD. 2013. "Global Value Chains: Investment and Trade for Development." http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf.

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