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Participating in the Global Value Chain: How Low-Income Countries can Maximise the Potential Benefits

A Discussant Presentation

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Participating in Global Value Chains:
How Low-Income Countries Can Maximize Potential Benefits

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My presentation today is not intended to resolve issues or to dictate what should be the policies of LDC countries or companies. Rather, in keeping with the objectives of this Cordell Hull/SAIIA/World Bank/CPD project, I hope to:

(a) Generate discussion among the participants about your concern with the current process of trade negotiations and the LDC-related issues that you feel are being neglected, and

(b) Suggest some lines of thought by which you might react productively to the new patterns of trade negotiations and to the new patterns of trade itself.

This particular presentation will focus on that second objective, and will suggest how increased attention to global value chains (GVCs) can be advantageous to LDCs.

As a prelude to that discussion, I urge you to realize that negotiations centering on the facilitation of GVCs are already here – the Trans Pacific Partnership (TPP) is the prime example – and it is too late to put that toothpaste back in the tube.

Now of course TPP is not your negotiation. The LDCs (together with other developing and emerging economies) are not participating in the TPP initiative, which is led and shaped by the United States. However, if the TPP succeeds, it will have a major impact on your countries and industries in at least two ways:

First, it will establish (for the TPP participants) a variety of rules that will significantly affect trade flows and – more particularly – investment flows. Those new rules will affect your countries immediately, simply by being adopted by TPP members. But there is also a prospect – and indeed, this is a stated goal of the United States – that these rules may be multilateralized, either by accretion as more countries join TPP, by melding with other regional initiatives in a Free Trade Area of the Asia-Pacific, or by incorporation in future multilateral trade agreements.

These impacts will be particularly significant if, as many economists and trade experts believe, we are moving progressively toward a new way of conducting international trade. Increasingly, trade will be about the locations of various stages of production of goods and services. Market access will remain very important, but it will increasingly focus on access for intermediate products and services. These will be produced in a variety of countries, will move among those countries to be combined ultimately into the final, finished product or service sold

to the ultimate consumers. Let's now consider some of the consequences of that new GVC pattern of trade:

(a) Countries will be competing aggressively for the location of production for various stages of multinational companies' (MNCs') GVCs. This will extend to production of services as well as goods, intermediate products and raw materials.

(b) An aspect of that type of competition will be countries' development of their own businesses to make them attractive as suppliers of intermediate physical inputs and services. Upper-tier developing countries are already doing this in a big way, using a variety of subsidizing and facilitating techniques. Korea is an example.

(c) A second aspect – and this is not new, but has an increasing focus on intermediate GVC-related input production – is that countries are negotiating deals with MNCs to establish or increase in their country the production of goods and services relevant to the MNCs' global value chains. At present, other than low labor rates (and in some cases plentiful minerals, energy or crops), LDCs have real disadvantages in such negotiations, compared with more advanced countries.

(d) Mega-Regional Agreements (MRAs) like TPP can give their members significant advantages in attracting MNCs to locate GVC elements in their countries. One advantage is the freer flow among the MRA members of intermediate goods and services, resulting from the MRA's reduction of tariffs and other market access barriers. Equally if not more important, the TPP member countries will have established structural conditions – legal, regulatory, etc. – that significantly increase their attractiveness for foreign direct investment (FDI) compared to countries that do not create such conditions. These are things like protection of investment, protection of intellectual property rights, open government procurement, regulation of state-owned enterprises (SOEs), competition policy, regulation of employment and environment, non-restrictive rules of origin and harmonization of standards and/or (although this is much more difficult) regulatory regimes.

[Note: Many of these policy and structural questions are over issues that LDCs have in the past resisted including in trade negotiations; such opposition has been based in part on preventing impingement on LDC governments' "policy space" and in part on concerns over LDCs limited capacity for implementation. One may question, however, the extent to which such resistance remains appropriate when such policies create significant advantages in the game of attracting foreign direct investment (FDI) for countries who adopt such policies and structures, especially where this occurs on the part of a number of countries in a regional trade agreement.]

<u>The Potential Economic Benefits of Attracting GVC-Related FDI</u>

The effect of diverting GVC-related FDI to members of a trading bloc and away from non-member countries is arguably especially harmful to LDCs. The establishment by a MNC of production in a country – or the MNC contracting with an in-country company for supply of intermediate products or services – brings at least employment, foreign exchange, tax revenue and invested capital. Moreover, as discussed later in the presentation, a well-constructed

agreement with a foreign investor/MNC can also bring technology, worker training, assumption in part or in whole of infrastructure costs and supply contracts with domestic companies.

Moreover, an initial investment for production of a product or service at an early stage of the value chain may lead to expansion of the MNCs in-country involvement to higher aspects of the value chain, with resultant increase in many of the benefits discussed above.

What this implies is that GVC-related investments can have spin-offs that increase their benefits beyond those that flow from other forms of FDI or that inhere in purely domestic development projects. Moreover, properly understood, GVC investments lend themselves somewhat more readily to de facto partnerships between MNC and host country, in which the MNC may assume some of the costs that the host government might otherwise bear in developing similar production as a free-standing, non-GVC project. This sort of "you and we are partners together in this project" can help offset the inherent disadvantages that LDCs suffer in competing with more advanced countries for GVC-related FDI: less money (financing) to offer, less-educated or trained work force, better infrastructure (in various ways), etc.

Tools for Attracting Expansive GVC-Related FDI

The idea here is to construct a broad relationship-type of FDI deal with the MNC, with a structure and incentives that enhance the attractiveness of the investment in ways which will persuade the MNC to expand the scope of its in-country operation and/or to share costs that might otherwise by beyond the means of the host government. The variety of potential structures and incentives is too great to be addressed comprehensively here; so the following is exemplary, not comprehensive:

Structures. Domestic and regional connectivity initiatives have been discussed by other speakers here, and can be very useful. Export processing zones provide duty-free treatment of components and raw materials, to the extent they are incorporated in products (finished products or more advanced semi-finished products) that are exported. Public-private partnerships are attractive to the extent that they have broad scope and incorporate a complex of government-provided benefits (leased or transferred land, licenses/permits/concessions, tax breaks, loans, etc.), but they require serious attention to governance (see discussion below).

Incentives. LDC governments, in competition with governments in more advanced economies to attract GVC-related FDI, almost always have lesser financial resources to draw upon. Thus they usually cannot match the grants or loans offered by developed or emerging countries. This suggests that benefits are more likely to take the form of reductions in government-imposed charges (income taxes, property taxes, import duties on components or raw materials, license/permit fees, etc.). Provision of water, electric power and other utilities can be done at preferential rates. What all of these have in common is that they can convey quite substantial benefits at no out-of-pocket cost. To be sure, government revenues are less than would have been received from another project, but of course that can be justified on the basis that there would have been no revenues if the LDC government had not attracted the FDI by these incentives. Having said that, the providing of such "special deals" is very likely to attract political heat. Accordingly, it is important to be able to justify such concessions on the basis of

commitments by the foreign MNC (e.g., worker training, component supply contracts with domestic companies, assistance with infrastructure carts, etc.).

Structural Considerations. If TPP or other Mega-Regional Agreements come into effect and LDCs do not join them, they will find themselves in competition with MRA member countries that have agreed to structural reforms that make them more attractive to MNCs for GVCs, such as protection of investments and of intellectual property rights, open government procurement, rules for conduct of SOEs, etc. These are major considerations in MNC's selection of countries for GVC-related FDI. LDCs need to consider whether, despite their previous opposition to addressing such issues in trade negotiations, they need now to incorporate reforms in these areas in their domestic legislation in order to be competitive in the new universe of international competition for GVC-related FDI.

A Brief Word on the Responsibility of the WTO

The interrelationship of two major themes of this Roundtable poses a very serious question concerning the responsibility of the World Trade Organization. Those two themes are:

(a) The emergence of global value chains as the increasingly common, perhaps now or soon to be dominant, way of inducing trade, with the corollary that countries are now competing for GVC-related FDI, and

(b) The diversion of trade negotiations from multilateral to plurilaterals and MRAs, in which developing and emerging countries are not participating, and which will put participating nations at a significant advantage in the competition for GVC-related FDI.

I would argue strongly that the WTO, as guardian of the global trading system, has a responsibility to address and correct changes in that system that put the most vulnerable countries at a substantial, systemic disadvantage. I would therefore urge the LDC community, as a fairly urgent priority, to hold the WTO to its responsibility. Specifically, I would suggest four steps that the WTO should take:

First, the WTO should insist on transparency of the new MRA and plurilateral negotiating initiatives. As U.S. President Woodrow Wilson expressed the principle in his famous Fourteen Points: "Open covenants, openly arrived at." And on the basis of that transparency, the WTO should assess whether or not these initiatives are consistent, in letter and/or spirit, with the fundamental WTO principles of non-discrimination, development and trade liberalization.

Second, consistent with the stated position of the United States that it expects and desires that the TPP and TTIP will be open to accession by other countries, the WTO should supervise the terms and process for accession by developing countries to determine whether and to what extent the accession criteria should be such that, consistent with the principle of special and differential treatment, there would be special interim and processes for developing country accession, accompanied (as in the Trade Facilitation Agreement) by "aid for trade" to enable them to accede effectively and meaningfully.

Third, in the process now under way to devise a post-2015 "way forward" with respect to the DDA, the WTO should include the issues of multilateralization of MRAs and plurilaterals, as well as the accession and S&DT issues discussed above. An example of a logical provision to benefit LDCs in the GVC-based FDI context would be an amendment of the Agreement on Subsidies and Countervailing Measures to permit LDCs to provide certain types of subsidies in connection with the negotiation of GVC-based FDI agreements. The rationale would be that such subsidies could be provided where, and to the extent, necessary to offset the greater cost of locating the production in the LDC as opposed to locating it in a developed country. There was precedent for this in the Tokyo Round Subsidies Code, which contained a provision permitting subsidies given to offset the higher cost of establishing production in a high cost region (the so-called "regional development subsidies" provision).

[Note: It should not be assumed that the United States and EU will oppose the second and third measures listed above. Just as the TFA provisions facilitate trade flows and thus benefit both imports (i.e., foreign countries) and exports (i.e., the country implementing the behind the border measures), so the behind the border reforms contrived in TPP and TTIP benefit MNCs (including U.S. and EU MNCs) as well as the countries implementing those reforms. Accordingly, assisting LDCs to implement those structural measures would benefit the U.S. and EU as well as the LDCs and other implementing countries. Besides, the U.S. and EU, who have proclaimed the benefits of these "21st Century Agreements" may find it awkward to stand in the way of extending those benefits to LDCs.]

Fourth, the WTO should study and find ways to develop "codes of conduct" and "best practices" addressing the conduct in GVC-based FDI of both MNCs and host governments. In this regard, see the discussion below of the interrelated issues of corruption and governance.

A Brief Word on Governance, Corruption and Imbalance of Negotiating Capability

The negotiations between LDC governments and MNCs with respect to GVC-based FDI will in most cases involve substantial commercial undertakings, serious government policy issues and large amounts of money. In such negotiations, three considerations deserve serious attention:

Imbalance of Negotiating Capability. In most cases the MNC will be highly capable, experienced and sophisticated in the conduct of such negotiations. With respect, this will not always be the case with respect to the LDC government. At the risk of seeming to promote the use of my law firm's services (which is not my intention here), I strongly urge the LDC government to retain skilled lawyers, investment bankers, etc. to help conduct such negotiations. Folks like us may not seem inexpensive, but they are in my view indispensable.

Corruption. In every discussion I have ever had with MNC officers about GVC and FDI transactions with developing countries, concern about corruption has always been prominent. Chances of negotiating success on the part of the LDC are immensely enhanced by the existence and the demonstrated careful implementation of a good pre-existing compliance program.

Governance. Is absolutely essential in this type of project. Comprehensive advance planning about how the LDC government will implement the project and supervise the MNCs implementation is absolutely essential.

An excellent cautionary discussion of these interrelated issues, written in the contest of large public-private agricultural partnerships in Africa, is well worth reading:

> 188 OXFAM briefing Paper, Moral Hazard: "Mega" public-private partnerships in African agriculture, Oxfam_moral_hazard_ppp-agriculture-africa-01091-en_o.pdf