SUPPORTING ECONOMIC TRANSFORMATION

TRADE, GLOBAL VALUE CHAINS AND ECONOMIC TRANSFORMATION

MEETING REPORT

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Leah Worrall

Present – Dirk Willem te Velde (ODI), Marie-Agnes Jouanjean (ODI), Alexander Plekhanov (EBRD), Ganesh Wignaraja (ADB), Julian Thompson (Christian Aid), Becky (Christian Aid), Johnny Richards (DFID), Lila Caballero (ActionAid), Luc Timmermans (Belgian Development Cooperation), Jayyad K. Malik, Leah Worrall (ODI)

INTRODUCTION BY DIRK WILLEM TE VELDE

- Introduction to the SET programme, a DFID funded accountable grant on supporting economic transformation
- Defines economic transformation as moving labour and other resources from lower productivity to higher productivity activities

PRESENTATION BY GANESHAN WIGNARAJA

- Presents an overview of a recent ADB book (output of the recent ADBI/CTEI conference in Geneva, March 2013) with 13 chapters covering different issues in trade
- Economic transformation as measured at both levels of (a) aggregate data and (b) firm-level data and evidence on market entry, as well as (c) value added of trade
- Conclusion and key motivation of the book is that the Doha deadlock and mega-regionals will transform world trade governance. The current system is broken and hence there will be (and need to be) significant shifts in the future. How Asia thinks and acts on these issues will likely influence the world economy

UKaid from the British people

- Lessons from Asia's development experience include pursuing market-friendly trade and industrial policies to develop supply chain side; improving surveillance of non-tariff measures; consolidating trade agreements into a large region-wide one; using more accurate data to measure value-added and participants in supply chain trade (e.g. SMEs) provide empirical insights for policy development; better coherence between Asia's regional trade rules and global trade governance
- East Asia accounts for 50% of the global share of production network trade, with other regions accounting for the remaining 50% (UN Comtrade data)
- But which firms are accessing global value chains versus those that are not? Using World Bank enterprise data analysed the characteristics of firms (SMEs) in Malaysia, Thailand, Philippines, Indonesia and Vietnam to examine characteristics of firms in supply chain trade. The main findings are that supply chain trade benefits from firm size heterogeneity, however smaller firms are at a disadvantage in terms of technological capabilities, skills, access to credit and foreign ownership. Overall, 37% of firms are in value chain trade, and large firms dominate, participation of small firms varies across economies. Beyond size, there are other important determinants in access to value chain trade
- There has been a proliferation of FTAs globally, Asia is catching up with increases in the number of FTAs, and shifting to multi-track trade policy. One of the chapters examines these policy challenges (in increasing depth of FTAs, use of FTA tariffs, etc.) by a review of the literature. Evidence on proportion of export value with FTA preferences reveals that if you go into an agreement, firms are going to use it. A key conclusion is that the WTO should have an agenda on FTAs
- Trade in value-added measures international trade as a flow of values rather than of products. Value added can be misleading, using the example of iPhones a large proportion of value added is in the US, however employing traditional statistics reveals the opposite conclusion with the majority of components to make up an iPhone coming from China
- Value added can provide a more realistic view of bilateral trade in the light of international production sharing; to avoid multiple counting of trade flows when goods are transferred across borders; univocally identify the origins of values, which helps to design regional trade agreements (FTA, EPA). However in terms of economic transformation, is it capturing an accurate picture?

PRESENTATION BY ALEXANDER PLEKHANOV

- An EBRD report from last year used the World Bank enterprise surveys, including a detailed innovation model and interviews with stakeholders (e.g. what did firms do?) – they found that 35.2 % of cases there was product innovation, 4.9% of cases with process innovation, 23.7% with marketing innovation, 0.5% with organisational innovation and 27.4% cases where no evidence of was found (in 8% cases there was not enough information)
- The main findings were that a small percentage of firms innovate relative to the international market, however firms participating in global value chains (exporters) innovate more, also foreign firms are more likely to innovate. Foreign firms not only do more innovation, but also invest more in-house research and development and acquisition of external knowledge. Exporters innovate more due to increased customer base spreading costs of innovation investment
- Presented the example of domestic research and development by a GVC firm: Ford Otosan, Turkey. JV was set up in 1959, and is now listed; there has been a move from focus on pure assembly to local R&D; the largest private R&D centre in Turkey has 1,300 engineers; developed a project to develop new heavy truck engine meeting EU standards, in cooperation with local suppliers and more than a dozen universities
- Innovate firms are also more sensitive to the business environment and encounter greater constraints when compared with non-innovative firms, particularly in terms of corruption, finance and skills constraints

PRESENTATION BY MARIE-AGNES JOUANJEAN

- There is a wide diversity of firms within GVCs. Firms use different types of global value chains and different ways of participating in GVCs. Trade in value added has been helpful in disentangling data issues related to these, however given the diversity it remains difficult to compare indicators
- What types of GVC can support economic transformation more effectively? Evidence shows that countries often trade more with neighbours, hence regional trade is very important. However Africa presents an exception. It's formal trade is very much outward oriented with major trade partner is Europe. Many countries, including in Africa, are in fact connected to GVCs rather than regional value chains. However, looking at inter-african trade shows that African countries trade is more diversified regionally than globally.
- Value addition is an important measure, in particular in terms of sophistication and upgrading, however the scale of the production is as important as well as creating a high number of jobs.
- Recent evidence from Rodrik suggests that de-industrialisation is occurring much sooner in Africa. New firms are at disadvantage in accessing GVCs, often at lower levels of sophistication and competitiveness. But is the leapfrogging an advantage for economic development or a disadvantage as, in the Rodrick framework, it could further increase the pace of low skilled deindustrialisation.
- From this perspective, should countries also focus developing domestic trade networks, thereby supporting increased sophistication and upgrade in value chain rather than focusing solely on entering GVCs? Should the focus be on improving infrastructure and networks in regional value chains in Africa to support economic transformation? GVC participation is not only about having firms directly interring GVCs and export. Smaller domestic firms can indirectly participate by supporting and providing inputs to GVC firms? Ultimately, what are the strategies to allow firms to integrate GVCs both directly and indirectly?

DISCUSSIONS

- Dirk Willem – we should focus discussions around (1) data issues, (2) link between GVCs and firm (or country) performance, (3) types of heterogeneity in GVCs, (4) trade and general policy implications
- Lila – there is also the issue of policy space. Christian Aid are working in Bangladesh, Uganda and Vietnam and evidence points towards the need to provide the government with space for effective policies in accessing domestic, regional or global value chains and create jobs. There is a need to initially focus on domestic trade, and promote diversification away from garments, including into light engineering and electronics sectors. Another point is on how strong domestic trickle down effects will be for technology and innovation
- Ganesh – there is a question here of causality – gains aren't necessarily experienced from presence in the export market, but rather in building capacity to enhance competitiveness (before you enter either GVCs or domestic markets). In terms of job creation, are good-quality jobs being created or is the focus on competitiveness and hence lower-quality jobs (e.g. East Asia example)? Africa trade development strategy needs to focus on effective policy and identifying indicators (beyond firm size) to enhance firm access to international markets
- Dirk Willem – work by John Page outlines that some level of international competition is required to generate high-quality firms domestically; relaying on the domestic market may appear to be important in nurturing domestic industry initially, but in the long-run this will not work
- Alexander – EBRD has encountered problems with lengthy surveys for survey participation. The causality between skill and innovation runs both ways, which has implications in terms of policy. It is difficult to equate opening up now compared with successful examples from the past, as the international environment has changed. It is important to leverage competitive gains from domestic markets, and often linkages/infrastructure investments are required to improve connectivity.

Mauritius provides a successful example in textiles, tourism, sugar, having employed a combination of openness and leveraging important preferential agreements

- Dirk Willem – can you discuss more on the focus of EBRD on transition rather than job creation
- Alexander – innovation is more prevalent in higher tech sectors, however the impact on productivity is higher for innovation in lower tech sectors. The latter is about increasing efficiency and shedding labour in the short-term, however if the labour is reallocated effectively then the impact will not be too negative in the longer-term
- Dirk Willem – innovative firms create more jobs in the longer-term, however in the short-term innovations can also lead to labour shedding
- Marie-Agnes Jouanjean – Mauritius used FDI as well as private sector money to invest in knowledge and skills development
- Ganesh – important not to over-emphasise the Mauritius case given low population levels and the role of preferences in its transformation process, removing these preferences questions the level of transformation. In Africa, you need to start with a framework on factor endowments (land and labour), what are the opportunities that arise from these? Value chain access requires a very high level of sophistication in management across several countries, what does this mean for Africa in terms of management and do firms have the capability for this? Trade and investment regimes are important. The use of domestic protectionist trade policy has declined. In terms of policy priorities, countries need to build capabilities, logistics and then human capital, as well as a predictable investment environment. For industrial policy the problem is that government capacity is often not there, therefore you need open investment regime, to attract international investment from natural and labour endowments. Eventually, there will be spill-over in terms of job creation in certain countries
- Dirk Willem – what is the role of donors in domestic reforms?
- Jonny – GVCs are a means but not necessarily the end, there is a need to focus instead more broadly on trade policy. DFID works in domestic climate reform and investment in growth and economic transformation. How can you ensure this work feeds directly into supply chain development, or encourages governments to do so? A better understanding on the use of preferences would be useful. Trade negotiations and WTO can often be seen as a wish list for preferences, rather than adopting a value addition approach. From a DFID perspective, more needs to be done to understand low-income countries access to GVCs, where current negotiations still focused exclusively on preferences
- Ganesh – business support for SMEs is important, rather than government support who don't have required capacity. For example, business support services who provide training for firms, which afterwards recoup the costs of training. These services can be subsidised, for example by Governments. Often, first generation entrepreneurs don't do well as second generation entrepreneurs, particularly if the younger generation has received education or work experience abroad. If females are the ones who are educated or work abroad there will also be a significant gender impact
- Dirk Willem – demonstration projects are also important in providing good examples in an economy
- Ganesh – demonstration projects are important for domestic industry development. You need to also think about the role of skills, effective institutions, and trade costs. Different regions will generate different implications, especially in terms of policy sequencing. Geography and neighbour effects matter