WORLD INVESTMENT REPORT 2013

Global Value Chains: Investment and Trade for Development

UNCTAD
Division on Investment and Enterprise

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Ralf Peters, Division on International Trade
Trade is increasingly driven by global value chains (GVCs), leading to a significant amount of double counting.

Value added in global trade, 2010 (Trillions of dollars)

- Global gross exports: ~19
- "Double counting" (foreign value added in exports): ~5 (28% of ~19)
- Value added in trade: ~14
The contribution of GVCs to the economy can be significant.

Domestic value added in trade as a share of GDP, by region, 2010
(Per cent)

Global

**Developed Economies**
- EU: 26%
- United States: 24%
- Japan: 25%

**Developing Economies**
- Africa: 24%
- Asia: 25%
- East and South - East Asia: 37%
- South Asia: 30%
- West Asia: 30%
- Latin America and Caribbean: 22%
- Central America: 22%
- Caribbean: 27%
- South America: 14%

**Transition Economies**
- Least Developed Countries: 26%

**Memorandum item:**
- Developing country average: 20%
GVCs are typically coordinated by TNCs

Global gross trade (export of goods and services), by type of TNC involvement, 2010
(Trillions of dollars)

- Global trade in goods and services: ~19
- Non-TNC trade: ~4
- All TNC-related trade: ~15
- Intra-firm trade: ~6.3
- NEM-generated trade, selected industries: ~2.4
- TNC arm's length trade: ~6.3

TNC-related trade: ~80%
The presence of TNCs drives GVC participation
Correlation between inward FDI stock and GVC participation, 187 countries, 1990 – 2010
FDI shapes patterns of value added in trade

Key value added trade indicators (median values), by quartile of FDI stock relative to GDP, 2010

<table>
<thead>
<tr>
<th>Quartile</th>
<th>Foreign value added in export</th>
<th>Value added contribution of trade to GDP</th>
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<tbody>
<tr>
<td>1st quartile</td>
<td>34%</td>
<td>37%</td>
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<tr>
<td>(Countries with high FDI stock relative to GDP)</td>
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<tr>
<td>2nd quartile</td>
<td>24%</td>
<td>30%</td>
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<td>3rd quartile</td>
<td>17%</td>
<td>24%</td>
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<tr>
<td>4th quartile</td>
<td>18%</td>
<td>21%</td>
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<tr>
<td>(Countries with low FDI stock relative to GDP)</td>
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Thank You!

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Longer term, the ideal development path involves not just participation but also domestic value added creation.

GDP per capita growth rates for countries with high/low growth in GVC participation, and high/low growth in domestic value added share, 1990-2010

- Median GDP per capita growth rates: 
  - High GVC participation growth rate:
    - Low Growth of the domestic value added component of exports: +0.7%
    - High Growth of the domestic value added component of exports: +3.4%
    - Low Growth of the domestic value added component of exports: +1.2%
    - High Growth of the domestic value added component of exports: +2.2%

\[ + n.n\% = \text{median GDP per capita growth rates} \]
A number of factors and conditions may facilitate ‘climbing’ the GVC development ladder

GVC development stages

**Upgrading**
(Focus on functional and chain upgrading)
- Move to (or expand to) higher value segments in GVCs
- Move to (or expand to) more technologically sophisticated and higher value GVCs

**Upgrading**
(Focus on product and process upgrading)
- Increase productivity and value added produced within existing GVC segments

**Integrating**
- Enter (increase relative importance of) more fragmented GVCs
- Increase exports of intermediate goods and services

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### (i) Participation/ value creation archetypal moves

#### Resource-based
- **Value creation**
- **Participation**

#### Low-tech manufacturing, basic services
- **Value creation**
- **Participation**

#### Mid-level manufacturing and services
- **Value creation**
- **Participation**

#### Sophisticated manufacturing and services
- **Value creation**
- **Participation**

#### Knowledge-based services
- **Value creation**
- **Participation**

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### (ii) Share of exports by level of technological sophistication

- **Resource-based**
- **Low-tech manufacturing, basic services**
- **Mid-level manufacturing and services**
- **Sophisticated manufacturing and services**
- **Knowledge-based services**

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**Facilitating factors and conditions**

- **Upgrading**
  - Effective national innovation system, R&D policies, and intellectual property rules
  - Presence of TNCs capable of GVC coordination and a domestic and international supplier base
  - Pool of highly trained workers

- **Integrating**
  - Presence of domestic supplier base fully integrated in multiple GVCs (reduced reliance on individual GVCs)
  - Absorptive capacities at higher technology levels, capacity to engage in R&D activities
  - Pool of relatively low-cost skilled workers

- **Upgrading**
  - Availability and absorptive capacities of domestic supplier firms and partners
  - Reliable basic infrastructure services (utilities and telecommunications)
  - Pool of relatively low-cost semi-skilled workers

- **Integrating**
  - Conducive investment and trading environment
  - Basic infrastructure provision
  - Pool of relatively low-cost workers

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**Value creation Participation**

(i) Participation/ value creation archetypal moves

(ii) Share of exports by level of technological sophistication
The contribution of GVCs to development can be significant, however participation in GVCs also involves risks

- Value added trade contributes nearly 30 per cent to developing countries’ GDP on average
- There is a positive correlation between participation in GVCs and growth rates of GDP per capita
- GVCs have a direct economic impact on value added, jobs and income
- Participation in GVCs can help countries’ acquisition and dissemination of technologies and skills, and spread international best practices, including on social and environmental issues, e.g. through the use of CSR standards
- GVCs can also be an important avenue for developing countries to build productive capacity, opening up opportunities for longer-term industrial upgrading

- GDP contribution of GVCs can be limited if countries capture only a small share of the value added created in the chain
- Also, a large part of GVC value added in developing economies is generated by foreign affiliates of TNCs, which can lead to relatively low “value capture”, e.g. as a result of transfer pricing or income repatriation
- Technology dissemination, skill building and upgrading are not automatic. Developing countries face the risk of remaining locked into relatively low value added activities
- Environmental impacts and social effects, including on working conditions, occupational safety and health, and job security, can be negative
- The potential “footlooseness” of GVC activities and increased vulnerability to external shocks pose further risks
Countries need to make a strategic choice whether or not to promote GVCs

- Countries need to carefully weigh the pros and cons of GVC participation, and the costs and benefits of proactive policies to promote GVCs or GVC-led development strategies, in line with their specific situation and factor endowments.

- Some countries may decide not to promote GVC participation. Others may not have a choice: for the majority of smaller developing economies with limited resource endowments there is often little alternative to development strategies that incorporate a degree of participation in GVCs. The question for those countries is not so much *whether* to participate in GVCs, but *how*. In reality, most countries are already involved in GVCs one way or another.

- Promoting GVC participation requires targeting specific GVC segments, i.e. GVC promotion can be selective. Moreover, GVC participation is only one aspect of a country’s overall development strategy.
Policies matter to make GVCs work for development

A policy framework for GVCs and development

- Incorporating GVCs in industrial development policies
- Setting policy objectives along GVC development paths

- Creating and maintaining a conducive environment for trade and investment
- Putting in place infrastructural prerequisites for GVC participation

- Supporting enterprise development and enhancing the bargaining power of local firms
- Strengthening skills of the workforce

- Minimizing negative effects and risks associated with GVC participation through regulation, public and private standards
- Supporting local firms in complying with international standards

- Ensuring coherence between trade and investment policies
- Synergizing trade and investment promotion and facilitation
- Creating ‘Regional Industrial Development Compacts’
Regional trade and investment agreements could evolve into *regional industrial development compacts*.

*Regional industrial development compacts* for regional value chains.
The internationalization of state owned enterprises (SOEs) and sovereign wealth funds (SWFs) maintains pace

**Number of state owned TNCs** increased from 650 in 2010 to 845 in 2012

**FDI by SOEs** amounted to $145 billion in 2012, almost 11 per cent of global FDI, despite a contraction of 23% vs. 2011

**FDI by SWFs** doubled in 2012, reaching $20 billion

The **number of net M&A deals by private equity** remained at historically **high levels**, although value fell by 34%
Investments in offshore financial centres (OFCs) remain at historically high levels

Value and share of OFCs in global FDI flows, 1990 – 2012
(Billions of dollars and per cent)
However special purpose entities (SPEs) play an even larger role

Estimated investment flows to SPEs and OFCs, 2011
(Billions of dollars)

*Includes only flows to SPEs based in Hungary, Luxembourg and the Netherlands. UNCTAD does not include flows to SPEs in these countries in FDI statistics.
Global FDI income reached $1.5 trillion in 2011

Trend of FDI income by economic group, 2005 – 2011
(Billions of dollars)
Policymakers need to make sure that investment and trade policy measures work in the same direction.

### Trade policy measures affecting investment in GVCs

**Examples**
- Import tariffs, tariff escalation
- Non-tariff barriers: regulatory standards
- Trade facilitation (applying to both imports and exports)
- Export promotion (e.g. export finance, credit guarantees, trade fairs)

**Potential investment-related effects**
- Negative effect on export-oriented investment in operation that rely on imported content that is subject to the measure
- Positive effect on market-seeking or import substitution investment (barrier hopping)
- Positive effect on export-oriented investment by reducing the cost of multiple border crossings and through expedited exports
- Positive effect on market-seeking investment that benefits from facilitated imports

### Investment policy measures affecting trade in GVCs

**Examples**
- Investment promotion, in particular for export oriented FDI
- Investment facilitation (e.g. reduced registration and licensing procedures, access to land)

**Potential trade-related effects**
- Positive effect on exports, possibly with higher imported content, and at risk of distortive effects
- Negative effect on export competitiveness where they result in an increase of cost of production once incentives are phased out
- Positive effect on exports, possibly with higher imported content, where facilitation helps attract export-oriented (i.e. efficiency seeking) investment

**Extensive list of examples in WIR**
Export processing zones could evolve into centres of excellence for sustainable business

‘Sustainable export processing zones’

Rationale

- Respond to the **obligation** (inherent to the governmental or quasi-governmental nature of EPZs) to **protect human rights and promote environmental best practices**
- Enhance EPZs’ **ability to attract and retain investment** by providing social and environmental standards demanded by TNCs, also in view of the potential regulatory challenges deriving by WTO’s Agreement on Subsidies and Countervailing measures

Key elements

- Build a comprehensive **regulatory framework** and provide **infrastructure and services** to promote sustainable business practices **across multiple areas of sustainability**:
  - Responsible labour practices
  - Environmental sustainability policies
  - Employee occupational safety and health
  - Good governance: combatting corruption

Advantages for firms

- **Share the cost** of sustainability-related services, leading to economies of scale
- **Standardize and harmonize** CSR practices, leading also to a reduction in the number of on-site inspections
- Benefit from **reputational gains** deriving from positive “branding” of zones