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Harnessing international production networks to foster inclusive growth and local productive capacities

Note by the UNCTAD secretariat

Executive summary

A combination of falling commodity prices, increasing financial market volatility and weak global demand has negatively affected growth performance in developing economies in recent years. Against this difficult background, high hopes have been placed in the trade and industrialization opportunities offered by international production networks. However, as documented in the *Trade and Development Report, 2016*: *Structural Transformation for Inclusive and Sustained Growth*, the evidence of a positive association between participation in global value chains and industrialization is weak.

This session of the expert meeting will discuss strategic approaches to link up to global value chains in order to upgrade local productive capacities and sustain an inclusive growth process. It will focus on the opportunities offered by regional value chains and South–South cooperation in this respect and discuss the role that industrial policy can play to turn integration and upgrading in global value chains into a driver of economic development. Particular attention will be devoted to the case of Southern Africa and lessons learned from other regions in the South.

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I. Introduction

1. The global economy has changed considerably since developed countries first industrialized and since the first tier of late industrializing economies of East Asia began their successful "catch-up". Today's global economy is a much more open and contested space, not only because of the many multilateral and bilateral trade and investment agreements, but also because of the full entry of former centrally planned economies into the global trading system. It is also a more crowded space, with a multitude of countries simultaneously engaged in efforts to realize the promise of export-led industrialization, thereby further increasing the global supply of less-skilled labour. On another level, however, it has become a more managed space, as a combination of large international firms with dominant market positions and advances in information and communications technologies have made it easier and cheaper to organize far-flung production networks, contributing to the rise of global value chains that account for a growing share of international trade, global gross domestic product and employment.

2. As a result of pressure from greater competition, contestability and control, production in many sectors has become more fragmented across multiple countries that link firms, workers, producers and consumers around the world. No longer are goods simply manufactured in one country and shipped to another for sale. Indeed, goods often go through many stages, crossing several geographic and organizational borders and adding components and value before they reach their final markets. This has markedly increased trade in intermediaries and vertical specialization (the import content of exports). Therefore, policymakers are increasingly turning to integration and upgrading in global value chains as a means of driving economic development, spurring structural transformation, generating employment and raising incomes.

3. Global value chains span across all sectors of the economy. However, for well-established reasons, building and upgrading manufacturing capacity remains an abiding goal of most developing countries.[1] Yet the external context for industrialization and industrial policy has changed significantly. The rise of global value chains, along with other external factors, such as the growing influence of financial markets in corporate governance, increasing market concentration, the rise of rent-seeking strategies, declining policy space, and shifting production and demand structures, have played a prominent role therein. In this changing environment, however, the main industrial development issue remains: how to use global market integration for learning, technology transfer and skill building to develop domestic productive capacities and ensure transformation to higher value adding activities. Furthermore, given the high levels of inequality and concentration of wealth in developed and developing economies alike, greater attention should be given to the capacity of this transformation process to deliver inclusive growth and a fair distribution of economic benefits.

4. In this context, the main objective of this session is to discuss the challenges and the opportunities faced by developing economies in the current global economic scenario. The Expert Meeting will discuss the following main points:

(a) Forms of international production integration that favour inclusive growth and local empowerment, with a focus on the Southern African region;

(b) The role that industrial policy can play to turn integration and upgrading in global value chains into a driver of economic development.

[1] UNCTAD, 2016, *Trade and Development Report, 2016*: *Structural Transformation for Inclusive and Sustained Growth* (United Nations publication, Sales No. E.16.II.D.5, New York and Geneva).

II. Global value chains, local capacities and inclusive growth

5. The world economy is weak. Stagnant global trade, low investment rates, decelerated productivity and heightened policy uncertainty have compounded one of the slowest recoveries from an economic crisis on record. Developing economies, which initially withstood the financial and economic turmoil of 2008–2009 much better than advanced economies, are now suffering the knock-on effects of a loss of economic momentum in the advanced economies. Against this difficult background, hopes have been placed in the trade and industrialization opportunities offered by global value chains coordinated by multinational enterprises through networks of affiliates, contractual partners or arm's-length suppliers.[2] The importance of these chains is reflected in the large volume of trade in intermediate goods, which amounted to 46 per cent of total merchandise trade in 2014.

6. From their modest start, mostly in the clothing industry in the late 1960s, exchanges within international production networks have now spread to many other industries. In recent years, however, outsourcing and producer-driven value chains have tended to concentrate especially in capital- and technology-intensive industries such as automobiles, electronics and machinery. The underlying rationale for this reorientation is that intangible activities (research and development, design, marketing and branding) are less prone to competition, as they are based on unique resources and capabilities that other firms find difficult to acquire – they are therefore sources of superior returns.[3] With regard to finances, outsourcing creates higher profits, and because there is less need for reinvestment in production capacity, those profits are increasingly devoted to returning shareholder value. This dynamic is becoming more and more prevalent in an era characterized by high profitability, low investments and an emphasis on turning profits into cash returns.[4]

7. Global value chains are often considered to be an inevitable outcome of technological changes and a natural evolution of the global trading system; as such they are presented as a promising basis for further trade and investment liberalization.[5] From a development perspective, global value chains are often viewed as presenting an attainable first step on the industrialization ladder and offering a more balanced integration into the global trading system. Rather than having to develop an entire product or break into a highly competitive market on their own, countries can specialize in specific tasks or components of a multitude of value chains, starting at the relatively accessible bottom. However, the association between participation in global value chains and development is not necessarily a straightforward one. The evidence presented in the 2016 edition of the UNCTAD *Trade and Development Report*,[6] for example, shows that when increases in the foreign value added of exports occurs in a larger context of greater production and exports of manufactures – as in much of the Asian region, for instance – participation in global value chains can complement industrialization and structural change. However, when such an increase reflects a reduction of domestic sourcing in a context of weak export performance of manufactures, participation in global value chains may even delay structural transformation, as in the case of many developing economies in Africa and Latin America.

[2] UNCTAD, 2013, *World Investment Report 2013: Global Value Chains – Investment and Trade for Development* (United Nations publication, Sales No. E.13.II.D.5, New York and Geneva); UNCTAD, 2015, *Global Value Chains and South–South Trade* (United Nations publication, New York and Geneva)

[3] R Kaplinsky, 2005, *Globalization, Poverty and Inequality: Between a Rock and a Hard Place* (Polity Press, Cambridge, United Kingdom of Great Britain and Northern Ireland.

[4] W Milberg and D Winkler, 2013, *Outsourcing Economics: Global Value Chains in Capitalist Development* (Cambridge University Press, New York).

[5] Organization for Economic Cooperation and Development, 2013, Interconnected economies: Benefiting from global value chains – Synthesis Report (Paris); World Trade Organization, Fung Global Institute and Nanyang Technological University, 2013, *Global Value Chains in a Changing World* (World Trade Organization, Geneva).

[6] UNCTAD, 2016.

8. Claims concerning how global value chains can strengthen productivity and contribute to economic growth are largely based on conventional trade models[7] and often assume that the package of assets and skills associated with foreign direct investment (FDI) automatically spill over into the local economy; however, empirical evidence to support this view is limited.[8] Furthermore, from a development perspective, the particularities of global value chain structures and the consequent distribution of power along the value chain require a more specific analysis. This was already clear to development economists such as Paul Streeten in the 1970s, when the emergence of such chains first became apparent:

> In one sense, the doctrine of comparative advantage seems to be vindicated, though in a manner quite different from that normally envisaged. It is foreign, not domestic, capital, know-how and management that are highly mobile internationally and that are combined with plentiful, immobile, domestic, semi-skilled labour. Specialization between countries is not by commodities according to relative factor endowments, but by factors of production: the poor countries specializing in low-skilled labour, leaving the rewards for capital, management and know-how to the foreign owners of these scarce but internationally mobile factors. The situation is equivalent to one in which labour itself rather than the product of labour is exported. For the surplus of the product of labour over the wage … accrues abroad... .
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> Since the firms operate in oligopolistic and oligopsonistic markets, cost advantages are not necessarily passed on to consumers in lower prices or to workers in higher wages, and the profits then accrue to the parent firms. The continued operation of this type of international specialization depends upon the continuation of substantial wage differentials… .[9]

9. As mentioned above, global value chains lower barriers to entry at the bottom of the value chain, making it easier today for developing countries to break into global exports of manufactures. However, the conditions that ease access can also act as barriers to upgrading, since more accessible parts of the value chain are associated with few forward and backward linkages, limited institutional development and little possibility for diffusion of knowledge externalities in the wider economy. Indeed, technological upgrading can be more difficult for economies that are used by transnational corporations primarily as bases for exports to third markets than for economies in which FDI is of the market-seeking and tariff-jumping type. Since the latter form of FDI is more dependent on the domestic economy, it gives host country Governments greater bargaining power for using FDI selectively to ensure that it will create spillovers and linkages with domestic industry in the context of a broader industrialization strategy. Most examples of successful use of FDI in industrialization and technological progress are from countries that have exploited this advantage effectively.

10. Developing economies with limited productive capacities can therefore remain trapped in, and competing for, the lowest value adding activities at the bottom of value chains, which can ultimately result in thin industrialization and slow economic growth.[10] These activities are also detrimental from a dynamic perspective, since they do not generate those local productive capacities that are essential to meaningful development.

11. Participation in global value chains also carries the additional risk of leading to specialization in only a narrow strand of production with a concomitantly narrow technological base and overdependence on multinational enterprises for access to global value chains.[11] Such shallow integration also manifests itself in asymmetrical power relations between lead firms and suppliers and in weak bargaining positions for developing

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[7] See Organization for Economic Cooperation and Development, 2013.

[8] See D Winkler and T Farole, 2015, Global value chain integration and productivity: Evidence from enterprise surveys in Namibia, South Africa and Swaziland, Working Paper 102986, World Bank.

[9] P Streeten, 1993, The multinational enterprise and the theory of development policy, in S Lall, ed., *United Nations Library on Transnational Corporations: Transnational Corporations and Economic Development*, vol. 3 (Routledge, London and New York).

[10] G Gereffi, 2014, Global value chains in a post-Washington Consensus world, *Review of International Political Economy*, 21(1):9−37; UNCTAD, 2014, *Trade and Development Report, 2014: Global Governance and Policy Space for Development* (United Nations publication, Sales No. E.14.II.D.4, New York and Geneva).

[11] Organization for Economic Development and Cooperation, 2013.

countries. For example, the experiences of Mexico and Central American countries as assembly manufacturers have been likened to the creation of an enclave economy, with few domestic linkages.[12] The same can be said about the electronics and automotive industries in Eastern and Central Europe[13] and the electronics sector in Central America.[14] In these cases, there has been significant internal upgrading within multinational enterprise affiliates, but with few spillovers to local economies in the form of productivity improvements and imitation by domestic firms, partly due to limited linkages of multinational enterprises with local firms and labour markets. Moving up the chain into more capital-intensive or higher value added production is particularly challenging in such an environment, because it necessitates relationships with lead firms at the top that are ultimately focused on maintaining their profitability and flexibility. Indeed, these firms sometimes intentionally use global value chains to induce and intensify competition among suppliers and countries for their own benefit.[15]

12. Furthermore, global value chains appear to contribute to the worrisome trend of income inequality of the last decades, both in advanced[16] and developing countries.[17] As shown by Timmer et al., a bifurcation can be seen in the factor content of global value chains with increasing capital and high-skilled labour income shares matched by declining shares of medium-skilled labour, and in particular, of low-skilled labour.[18] According to estimates derived from the World Input-Output Database, high-skilled labour and capital captured 55 per cent of the value of manufactures in 1995, increasing to 63 per cent in 2008.

13. An alternative may lie in turning more towards regional markets in the South. East Asian economies, particularly China – despite its global reach in terms of exports and imports – the Republic of Korea, Singapore and Taiwan Province of China, have long recognized the importance of the East Asian regional production network. Furthermore, in response to the collapse in trade after the financial crisis of 2007–2008, a number of developing country suppliers in other world regions shifted their end markets from North to South in an effort to regionalize their supply chains. For instance, South African clothing manufacturers moved into other countries in sub-Saharan Africa such as Lesotho and Swaziland, leading to an expansion of the regional value chain led by South African retailers.[19]

14. Regional value chains can be instrumental in increasing value added in developing regions. Given the size, capacities and capabilities of many developing countries, a local industrial strategy might quickly reach its limits. This can be overcome by adopting a regional perspective, as different complementary advantages in the region could be leveraged, and economies of scale, vertical integration and horizontal specialization promoted. This is particularly important for smaller countries, which consider regional

[12] UNCTAD, 2002, *Trade and Development Report, 2002* (United Nations publication, Sales No. E.02.II.D.2, New York and Geneva).

[13] L Plank and C Staritz, 2013, "Precarious upgrading" in electronics global production networks in Central and Eastern Europe: The cases of Hungary and Romania, Working Paper No. 31, Capturing the Gains.

[14] E Paus, 2014, Industrial development strategies in Costa Rica: When structural change and domestic capability accumulation diverge, in JM Salazar-Xirinachs, I Nübler and R Kozul-Wright, eds., *Transforming Economies: Making Industrial Policy Work for Growth, Jobs and Development* (International Labour Office, Geneva), pp. 181−211.

[15] R Phillips and J Henderson, 2009, Global production networks and industrial upgrading: Negative lessons from Malaysian electronics, *Austrian Journal of Development Studies*, 25(2):38−61.

[16] P Temin, 2017, *The Vanishing Middle Class: Prejudice and Power in a Dual Economy* (Massachusetts Institute of Technology Press, Cambridge, Massachusetts, United States).

[17] UNCTAD, 2016; D Baker, 2015, The upward redistribution of income: Are rents the story? Centre for Economic and Policy Research Working Paper; J Dedrick, KL Kraemer and G Linden, 2010, Who profits from innovation in global value chains? A study of the iPod and notebook PCs, *Industrial and Corporate Change*, 19(1):81–116.

[18] MP Timmer, B Los, R Stehrer and GJ de Vries, 2013, Fragmentation, incomes and jobs: An analysis of European competitiveness, *Economic Policy*, 28(76):613–661.

[19] Gereffi, 2014.

connections crucial in complementing their own capacities in the face of supply-side constraints.

15. Regional value chains are characterized by end products being exported by a country within a region, more often to a regional partner, and with many high value adding activities undertaken within a region. Therefore, regional value chains can significantly contribute to the creation of value at the local level and offer more opportunities to participate, gain experience and build the local capacities needed to compete globally, and in turn serve as stepping stones to global value chains.[20] Regional markets might also exhibit better upgrading potentials, particularly in terms of functional upgrading, including design, marketing, branding and distribution. Regional value chains, however, are by far less developed than global value chains – recent data suggest that, outside Eastern and Southeastern Asia, the gap between the two has been widening rather than shrinking.[21] Understanding the new markets and the investment and sourcing policies of lead firms and buyers selling in these markets will be key to fostering the expansion of regional value chains.

III. Focusing on value addition in Southern Africa

16. New markets and regional value chains are also becoming increasingly important for African policymakers. Over the past two decades, the shares of Africa's exports to its traditional trading partners – the European Union and the United States of America – declined. The European Union was the destination for 50 per cent of Africa's exports in 1995, compared with 36 per cent in 2013. With regard to the United States, this percentage dropped from 15 per cent to 9 per cent over the same period. In contrast, China emerged as Africa's largest single trading partner, absorbing 16 per cent of Africa's exports in 2013. Developing countries as a whole now account for 46 per cent of Africa's merchandise exports and 53 per cent of its imports, up from 27 per cent and 34 per cent respectively, only 15 years earlier.[22]

17. However, geographical diversification of Africa's trade partners has not been accompanied by diversification of its exported products: primary commodities still accounted for 77 per cent of the continent's merchandise exports between 2000 and 2013. Partly as a result of the commodity price boom in the early 2000s, the manufacturing sector continued a decline that began in the 1990s; its share of Africa's exports decreased from 26 per cent in 1995 to 21 per cent in 2004 and to 18 per cent in 2014.[23]

18. In this context, intra-African trade and regional production networks can be instrumental in increasing the industrial content of Africa's exports and ultimately foster structural transformation in the region. Unlike extraregional trade, intraregional trade in Africa, although limited in size, revolves around exports of manufactured and more sophisticated goods such as construction materials and food processing.[24] Indeed, in 2013, about two thirds of intra-African trade was in manufactured goods.[25] However, intra-African trade has grown modestly over the past decade, remaining significantly below the share of exports directed towards more developed regions, such as developing Asia and Europe, and Latin America.

[20] UNCTAD, 2015.

[21] B Los, MP Timmer and G de Vries, 2015, How global are global value chains? A new approach to measure international fragmentation, *Journal of Regional Science*, 55(1):66–92.

[22] Economic Commission for Africa, 2015, *Economic Report on Africa 2015: Industrializing through Trade* (United Nations publication, Sales No. E.15.II.K.2, Addis Ababa).

[23] O Pesce, S Karingi, and I Gebretensaye, 2015, Trade growth prospects: An African perspective, in B Hoekman, ed., *The Global Trade Slowdown: A New Normal?* (Centre for Economic Policy Research Press, London).

[24] P Fortunato and G Valensisi, 2011, Regional trade integration and development opportunities: Some evidence from Africa, *Trade Negotiations Insights*, 10(6):8–9.

[25] Economic Commission for Africa, 2015.

19. If sustained with adequate policy measures, raising internal demand can in principle support an expansion of intraregional trade and production networks. Africa's urbanization and economic growth are underpinning fast-growing demand for goods and services in the region. This is evident in Southern Africa, where a sevenfold increase in the consumption of high-value processed foods is forecast by 2040.[26] High demand growth in the Southern Cone has also underpinned the development of regional value chains driven by apparel retail chains in South Africa,[27] supermarkets[28] and agroprocessing corporations.[29]

20. This represents a welcome novelty in the regional landscape, since domestic markets are too small to support significant industrial upgrading and scale economies in most Southern African countries. Industrial growth in Southern Africa has been lower than in the other parts of the continent since the early 2000s, averaging 4 per cent annually in 2000–2012. In particular, the manufacturing sector was underperforming, recording an average growth rate of about 1 per cent. Services are absorbing most of the jobs moving out of agriculture, leaving employment in industry stagnant at about 8.4 per cent. This hampers development prospects, as most services jobs are informal and display low productivity and wages.

21. Nevertheless, Southern African economies seem well placed for developing value chains at the regional level. As stated in the *Economic Report on Africa 2015* of the Economic Commission for Africa, Southern Africa, along with Eastern Africa, stands out in terms of integration and trade complementarity. Recognizing these peculiarities and the importance of regional productive integration as a means to revitalize the industrial sector and foster economic growth, the Southern African Development Community has recently launched a common industrial strategy. This strategy is aimed at promoting the development of an integrated industrial base within the Community through the exploitation of regional synergies in value added production and enhancement of export competitiveness, including through collaboration in the development of regional value chains with targeted interventions (Southern African Development Community Industrial Development Policy Framework).

IV. Using industrial policy to sustain inclusive growth

22. Today's policymakers can no longer expect export-led production and trade of manufactures that fuelled industrialization in the highly developed East Asian economies ("East Asian tigers") to produce similar outcomes. Indeed, as noted earlier, targeting the growth of export-oriented manufactures or increasing participation in global value chains linked to manufacturing offers neither automatic nor straightforward pathways to industrialization and development. This does not imply that countries should no longer seek export markets. Rather, a much more strategic approach is needed in which countries are more selective in their choices of processes, products and markets since both the composition of export-oriented manufactures – the more technologically intensive and sophisticated the better – and the share of domestic value added determine whether and to what extent exporting will induce structural change and productivity growth.[30]

[26] D Tschirley, S Haggblade and T Reardon, 2013, Africa's emerging food system transformation, White Paper, Global Centre for Food Systems Innovation.

[27] M Morris and C Staritz, 2014, Industrialization trajectories in Madagascar's export apparel industry: Ownership, embeddedness, markets and upgrading, *World Development*, vol. 56, pp. 243–257.

[28] R das Nair and S Chisoro, 2015, The expansion of regional supermarket chains: Changing models of retailing and the implications for local supplier capabilities in South Africa, Botswana, Zambia and Zimbabwe, United Nations University World Institute for Development Economics Research Working Paper 2015/114.

[29] P Ncube, S Roberts and T Zengeni, 2016, Development of the animal feed to poultry value chain across Botswana, South Africa, and Zimbabwe, United Nations University World Institute for Development Economics Research Working Paper 2016/2.

[30] P Fortunato and C Razo, 2014, Export sophistication, growth and the middle-income trap, in I Nübler, JM Salazar-Xirinachs and R Kozul-Wright, eds., *Transforming Economies: Making Industrial Policy Work for Growth, Jobs and Development*. (International Labour Office, Geneva), pp. 267–287.

23. The type of participation in global value chains is crucial in this respect. Countries that can develop productive capacities in sync with those needed by international production networks and position themselves at a relatively high level in the world distribution of tasks should be well placed to sustain a more inclusive growth process. However, from an industrial policy perspective, simply complying with the demands of lead firms in these chains is unlikely to facilitate the emergence of the kind of industrial base necessary for sustained growth and inclusive development. There is little evidence of technological and other spillovers from multinational enterprises in the absence of effective government bargaining and policy measures, even when greenfield investments have involved a fuller range of industrial activities, and evidence of upgrading within value chains is equally elusive. Therefore, a developmental State still has a critical role to play, especially in favouring the emergence of a vibrant industrial base, robust local markets and a dynamic enterprise sector.[31]

24. Accordingly, an active and comprehensive industrial policy framework will continue to employ subsidies and regulations to support domestic productive capacity, as well as State-owned financial institutions to mobilize and allocate savings in order to support long-term investment priorities, secure profitability, socialize risks and facilitate the internalization of new technologies. Such a policy framework will also use public sector procurement policies such as tendering and reverse auctions to support strategic sectors and the use of public investment to promote research and development and remove bottlenecks, especially in infrastructure and basic industries. It will develop competition rules and targeted policies to restrict market power, manage entry into key growth sectors, address coordination failures and regulate the ownership of productive assets, including intellectual property, to support investment and innovation and maximize learning spillovers. Furthermore, it will target measures to address regional inequalities, including tax incentives and support for appropriately qualified labour force through training and education programmes. The challenge, particularly given the constraints on more top-down policy mechanisms, will be to find the requisite mixture of effective public agencies to bargain with more footloose businesses and more decentralized State institutions capable of using an expanded range of support measures and instruments to build the clusters and linkages needed for an effective industrial diversification strategy.

25. Selection of the relevant sectors and industries for industrial policy support varies from country to country, according to their pre-existing areas of strengths and potential for upgrading, dynamic comparative advantage and, in the larger economies, creation of national champions that can become major players in international markets. In South America, Brazil, a country with a large industrial base, prioritizes sectors such as capital goods, electronics and pharmaceuticals. By comparison, Uruguay in recognition of the limitations imposed by its small domestic market, promotes sectors engaged in information and communications technology and biotechnology, as well as cultural and automotive industries within a broader framework of regional productive integration.

26. These new industrial policies are evolving over time, embodying some – but not all – characteristics of successful development strategies of the past, showing the ability to adapt both to international changes and to local conditions and circumstances. Trade and investment agreements at the bilateral, regional and multilateral levels have restricted policy space in some key areas,[32] while the slowdown in developed countries, and the possibility that they have entered a period of secular stagnation, is limiting possibilities of exporting to these economies. Accordingly, developing countries must design their industrial policies in this more constrained environment and respond to it by adopting innovative policies – or policy tools less subject to restrictions by international agreements – and by exploring new pathways for industrial development.

[31] R Kozul-Wright and P Fortunato, 2015, Sustaining industrial development in the South, *Development*, 58(4):463−472.

[32] UNCTAD, 2014.

27. Given the new constraints in the external environment, South–South cooperation is opening up new opportunities to bolster regional trade and productive integration in support of structural transformation. The East Asian experience has been a notable example of successful regional integration supporting rapid productive transformation.[33] Other developing regions have established many subregional trade agreements, but progress on the ground in the form of substantially larger intraregional trade flows and productive integration has been limited, due to insufficient support for productive capacity-building, lack of trade-related services (for example, insurance and trade finance), poor physical infrastructure, economic volatility and lack of policy coordination. Despite these obstacles, the South has demonstrated a renewed interest in regional trade agreements, given the lack of dynamism of the world economy and the difficulties this is creating for a continued expansion of world trade. South–South cooperation can bolster regional trade integration initiatives by helping overcome the obstacles that have hindered their development to date. It can also set up new financing mechanisms for trade and infrastructure development. Most importantly, it can support a more ambitious development agenda that focuses on productive capacity-building and structural transformation at the regional level.

28. Paying greater attention to expanding domestic markets is also key to meeting a more ambitious development agenda. Measures aimed at a more equal distribution of income by setting minimum wages, implementing direct taxation and developing welfare-enhancing programmes will be central to such a strategy. These measures, which will effectively lead to wage increases closer to average productivity gains, play a dual role: they help sustain aggregate demand and will trigger improvements in productivity through demand-driven technical progress. Greater public sector employment, along with active labour market policies aimed at both formal skills development and on-the-job training, will also be key to the success of any such strategy.

29. It is of critical importance to leverage the strategic links between production for global or regional value chains and domestic demand. Trade policy can play a strategic role in this context. In accordance with international agreements, domestic markets in final goods can be protected and reserved for domestic firms to build capacity and allow learning by doing along infant industry lines (hence restricting FDI firms to supply local markets, for example, through certain special economic zones or industrial parks). Moreover, government procurement can still be a powerful tool for supporting such a strategy and should be preserved. This should, however, be combined with capacity-building measures and a clear goal to start exporting within a sensible time frame, as this will force firms to increase productivity and competitiveness and obtain access to modern production processes, technology and standards. Ethiopia is a good example of this: its industrial policies towards priority export sectors strategically link policy incentives that encourage exports and at the same time protect the domestic market.[34]

V. Issues for discussion

30. Participants may wish to discuss the following issues:

(a) What can countries do to foster inclusive growth and development of domestic productive capacities when lacklustre international trade does not offer possibilities for export-led growth?

(b) What is the best way to put in practice the concept of developmental regionalism?

(c) Do global value chains change the development framework so that active industrial policy is no longer relevant for developing countries?

[33] UNCTAD, 2007, *Trade and Development Report, 2007: Regional Cooperation for Development* (United Nations publication, Sales No. E.07.II.D.11, New York and Geneva).

[34] C Staritz, L Plank and M Morris, 2016, *Global Value Chains, Industrial Policy and Sustainable Development: Ethiopia's Apparel Export Sector* (International Centre for Trade and Sustainable Development, Geneva).

(d) What conditions would enable regional value chains to become an engine of growth and structural transformation in a process of regional integration?

(e) What lessons in regional productive integration may be learned from the experiences of Southern Africa?