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26-27 October 2017

Harnessing GVC participation for inclusive and sustainable industrial development

Paper submitted by

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Harnessing GVC participation for inclusive and sustainable industrial development

Adnan Seric
Department of Policy, Research and Statistics & UNIDO Institute for Capacity Building
27 October 2017
In brief

UNIDO is the specialized agency of the United Nations that promotes industrial development for poverty reduction, inclusive globalization and environmental sustainability.

Lima declaration (??): to promote and accelerate inclusive and sustainable industrial development (ISID) in developing countries and economies in transition.
Outline

1. Can countries develop through GVC participation and FDI?

2. Which policy options do countries have?
What is the role of FDI in shaping global development efforts?

“Private business activity, investment, and innovation are major drivers of productivity, inclusive economic growth, and job creation. [...] Foreign direct investment (FDI), along with a stable international financial system, are vital complements to national development efforts. Nonetheless, we note that there are investment gaps in key sectors for sustainable development. FDI is concentrated in a few sectors in many developing countries and often bypasses countries most in need, and international capital flows are often short-term oriented.”
What is the role of TNCs in shaping value added trade patterns?

Global trade (exports of goods and services), by type, 2010, $ Trillions

- Global trade in goods and services: ~19
- Non-TNC trade: ~4
- All trade under governance of TNCs: ~15
- Intra-firm trade: ~6.3
- NEM-generated trade: ~2.4
- TNC arm's length trade: ~6.3

Total TNC-governed trade: ~80%

Source: UNCTAD estimates; based on WIR13; BEA; EFIGE.
VIENNA INVESTMENT CONFERENCE 2016

QUALITY FDI, GROWTH AND DEVELOPMENT

14-15 September 2016
VIC Conference Room C, C Building (2nd floor)

G20 INSIGHTS

POLICY AREA:
Trade and Investment

How to attract Quality FDI?
Theodore Moran (Georgetown University)
Heiner Götting (Kiel Institute for the World Economy)
Adnan Seri (UNIDO)
Christiane Krüger-Boden (Kiel Institute for the World Economy)

www.g20-insights.org

VIENNA INVESTMENT CONFERENCE
Quality FDI and Supply-Chains in Manufacturing
Overcoming Obstacles and Supporting Development
How can countries develop through GVC participation and FDI?

- **Economic upgrading in GVCs:**
  - Higher value-added production in the form of product, functional, and inter-sectoral upgrading via better skills and know-how, capital and technology, and processes
  
  Goerg and Seric (2016) in a cross-section of 20 countries in Africa find evidence for GVC participation (via FDI linkages) leading to product and process upgrading in domestic firms. MNE- and Government support often crucial!

- **Social & Environmental upgrading in GVCs:**
  - Measurable aspects of worker well-being (employment, wages, and working conditions) and enabling rights (right to bargain, freedom of association, nondiscrimination, etc.).

  Higher labor and social standards in GVCs result in small-scale worker, labor-intensive, and higher-skill upgrading (Barrientos, Gereffi, and Rossi 2011).

  - The global trade landscape is trending toward more climate-friendly international standards and mandatory sustainability reporting regimes.
Targeting foreign investors and strengthening absorptive capacity to benefit from FDI spillovers

Host country conditions
- Labor market regulation
- Access to finance
- STI infrastructure
- Trade, investment, and industrial policy
- Governance

Foreign firm characteristics
- Ownership structure
- Investment motive
- Global production and sourcing strategy
- Technology intensity
- FDI origin
- Entry mode
- Length of presence

Transmission channel
- Supply chains
  - Demand effect
  - Assistance effect
  - Diffusion effect
- Labour turnover
- Market restructuring

Domestic firm characteristics
- Technology gap
- R&D capability
- Human capital
- Scale
- Firm location
- Trade patterns (exporter)
- Sector dynamics
- Competition
- Type of ownership

FDI spillover potential

Absorptive capacity

Spillovers
Which policy options do countries have?

Focus area: How to enter GVCs?
Policy objective: FDI and domestic firm participation in GVC
Key questions:
- Which tasks?
- Which forms of governance?
Policy options:
- Creating GVC linkages
- Creating the right business environment for investment

Focus area: How to strengthen presence in GVC?
Policy objective: Economic upgrading and densification
Key questions:
- What are the transmission channels?
- Which type of economic upgrading?
Policy options:
- Strengthening GVC linkages
- Strengthening absorptive capacity

Focus area: How to achieve ISID via participation in GVC?
Policy objective: Social/ environmental upgrading
Key questions:
- Which type of social upgrading?
- What are the benefits from environmental regulation?
Policy options:
- Developing world-class skills
- “Greening” the value chain
Which policy options do countries have?

<table>
<thead>
<tr>
<th>Policy domain</th>
<th>Instruments</th>
<th>Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market-based</td>
<td>Import tariffs, duty drawbacks, tax credits, investment/FDI incentives</td>
<td>Procurement policy, export market information/trade fairs, linkage programmes, FDI country marketing, one-stop shops, investment promotion agencies</td>
</tr>
<tr>
<td>Product market</td>
<td>Wage tax credits/subsidies, training grants</td>
<td>Training institutes, skills councils</td>
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<td>Labour market</td>
<td></td>
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<tr>
<td>Capital market</td>
<td>Interest rate subsidies, directed credit, loan guarantees, tax incentives for venture capital</td>
<td>Development Bank lending, loan guarantees, financial regulation, venture capital</td>
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<tr>
<td>Land market</td>
<td>Subsidized rental</td>
<td>EPZs/SEZs, factory shells, infrastructure, legislative change, incubator programmes</td>
</tr>
<tr>
<td>Technology</td>
<td>R&amp;D subsidies, grants</td>
<td>Technology transfer support, technology extension programme, Public-private research consortia, public research institutes, funding of basic research</td>
</tr>
</tbody>
</table>

Source: UNIDO IDR (2016)
Policy options in the context of SSA

**Focus area**

- **How to enter GVCs?**

**Policy objective**

- FDI and domestic firm participation in GVC

**Policy options**

- Creating GVC linkages
- Creating the right business environment for investment

- Jump-starting entry via IZ/EPZ/SEZ or other spatial policies
- Strengthening IPAs and going after “quality” investors
- Matchmaking domestic firms with foreign partners and technology
- Connecting to international markets
UNIDO’s PCP approach as platform for policy coordination, implementation and learning

Pilot countries: Ethiopia, Senegal, Peru and Kyrgyzstan
a.seric@unido.org
Quality FDI: investment that contributes to broad-based **inclusive and sustainable** development within the host economy

- Creates *decent and value-adding jobs*

- Enhances the *skill base* of host economies

- Facilitates transfer of *technology, knowledge and know-how*

- Boosts *competitiveness* of domestic firms (e.g. access to markets)

- Operates in a *socially and environmentally responsible* manner
Dearth of information

Growing but limited literature

Large body of evidence

- Diversification
- Sophistication
- Gender
- Geographic dispersion
- Vertical integration
- Jobs
- Skills
- SME Linkages
- Domestic investment
- Wages
- Productivity
Classification of industrial policy

- Three types of industrial policy relating to different stages of industrialization: early, middle and late stage

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Early stage</th>
<th>Middle stage</th>
<th>Late stage</th>
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</thead>
<tbody>
<tr>
<td>Agriculture and some low-technology, labor-intensive manufacturers</td>
<td>Medium-technology and labor-intensive high-technology manufacturers</td>
<td>High-technology manufactures, Knowledge-based</td>
<td></td>
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</tbody>
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<table>
<thead>
<tr>
<th>Key objectives of Industrial policy</th>
<th>Early stage</th>
<th>Middle stage</th>
<th>Late stage</th>
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<tbody>
<tr>
<td>Diversification from primary goods exports into simple manufactures, Attraction of FDI, Encourage new start-up firms</td>
<td>Promotion of higher-value-added medium and high technology, Upgrading of local firms within GVCs, International marketing of local brands</td>
<td>Supporting firms in use and creation of new technologies, Provide education and science infrastructure</td>
<td></td>
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</tbody>
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<tr>
<th>Main form of intervention</th>
<th>Early stage</th>
<th>Middle stage</th>
<th>Late stage</th>
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<tr>
<td>Direct public provision</td>
<td>Market-based and direct public provision</td>
<td>Market-based</td>
<td></td>
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Source: Weiss (UNIDO working paper, 2015)