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Plenary on Item 9:
Investment for development: Global Value Chains and Development

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Division on Investment and Enterprise, UNCTAD

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Statement by
Mr. James Zhan
Director, Division on Investment and Enterprise, UNCTAD

Geneva, 18 September, 2013

Trade and Development Board Item 9. Investment for Sustainable Development: Global Value Chains and Development

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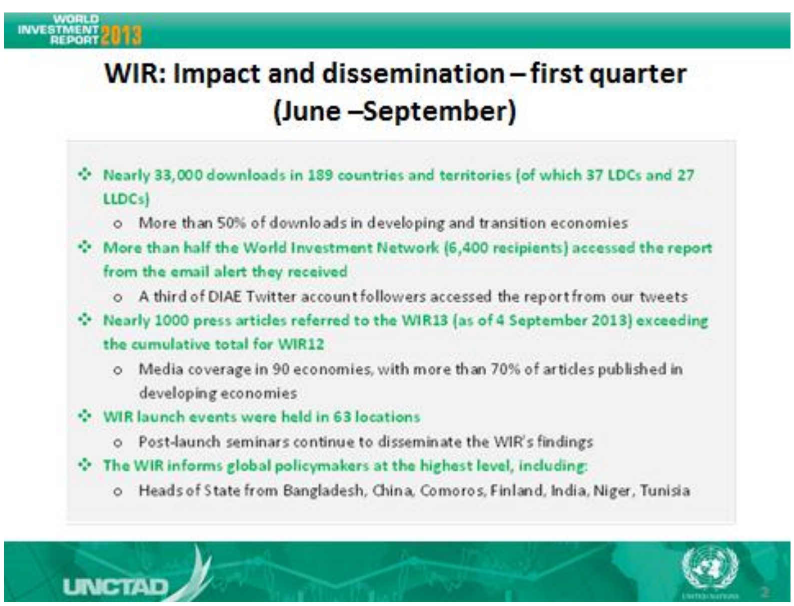
Excellencies,
Distinguished delegates,
Ladies and Gentlemen,

I would like to echo the Deputy Secretary-General's words, that it is an honour to welcome this distinguished panel to the TDB, and to present the topic of this year's session on investment for sustainable development to the panel and all delegates here today.

My remarks will largely be based on the analysis in chapter IV of this year's *World Investment Report* (WIR) which focused on global value chains and development. I will also supplement my remarks with some feedback we have received from our stakeholders since the report's publication which will hopefully feed into our deliberations today and provide some questions for our panel and delegates to address.



Before going into the substance of the report, I would like to take this opportunity to share with you some of the latest information on the impact and dissemination of this year's WIR. We gather statistics on a systematic basis to support results-based management in the Division, to assess the impact of the WIR, and to ensure that it meets the needs of our target stakeholders in the international investment community. This year's report compares favourably to previous years:

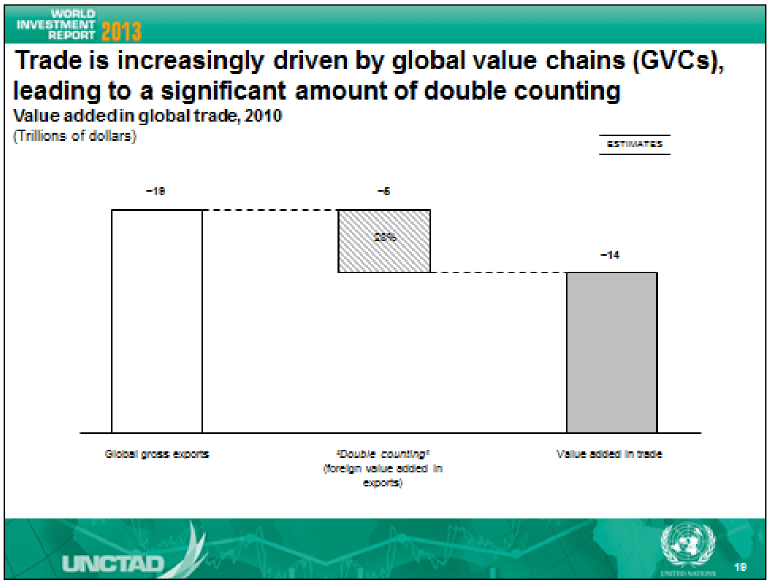
- The latest cumulative downloads reached 33,000 in September.
- The report was downloaded in 189 countries, including 37 LDCs and 27 LLDCs. Just over half of all downloads were in developing and transition economies.
- Our own dissemination network proved to be highly successful with almost two thirds of World Investment Network members accessing the report from the email alert they received. Moreover, a third of our Twitter followers accessed the report from our tweets.
- In the press, the WIR was reported in almost a 1000 articles globally, of which 70 per cent were in developing and transition economies.
- This year, we launched the WIR in over 60 locations globally in developing, transition and developed countries.
- And lastly, the WIR as a product has been solicited by policymakers at the highest levels, and has informed several heads of state and been quoted and/or used by them.

The report therefore meets an important need in the global investment community for information and analysis on investment and investment-related policymaking.

Ladies and Gentlemen,

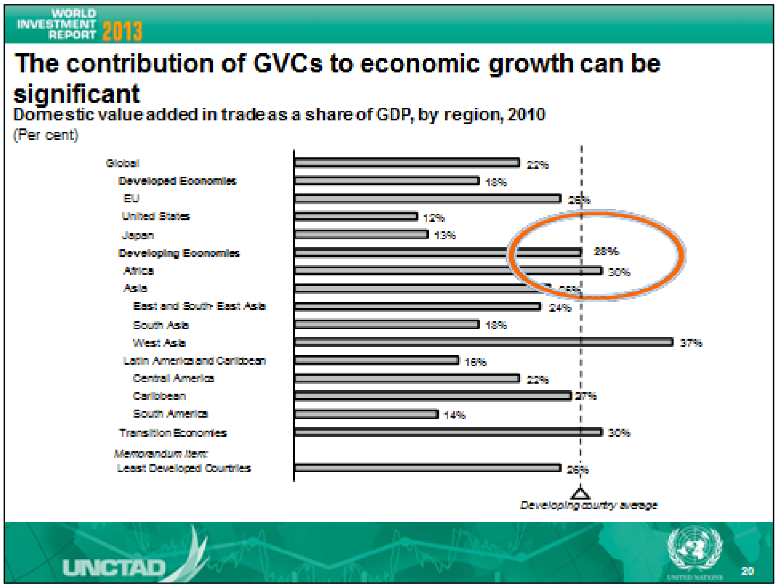
This year's report provides an in-depth analysis, strategic development options and practical advice for policymakers and others on how to maximize the benefits and minimize the risks associated with global value chains. This is essential to ensure more inclusive growth and sustainable development.

Today’s global economy is characterized by global value chains (GVCs), in which intermediate goods and services are traded in fragmented and internationally dispersed production processes.

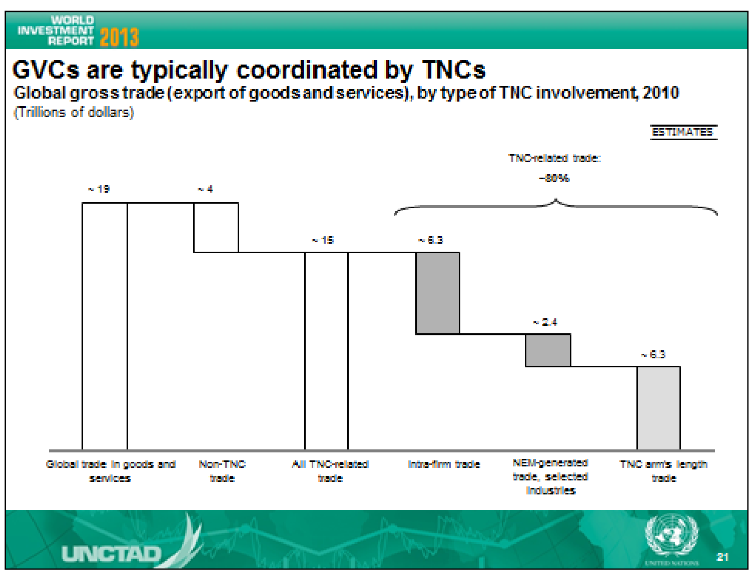


GVCs lead to a significant amount of double counting in trade, because intermediate goods and services may cross borders several times before final consumption. Raw material extracted in one country may be exported first to an affiliate in a second country for processing, then exported again to a manufacturing plant in a third country, which may then export the manufactured product to a fourth for final consumption. The value of the raw material counts only once as a GDP contribution in the original country but is counted several times in world exports.

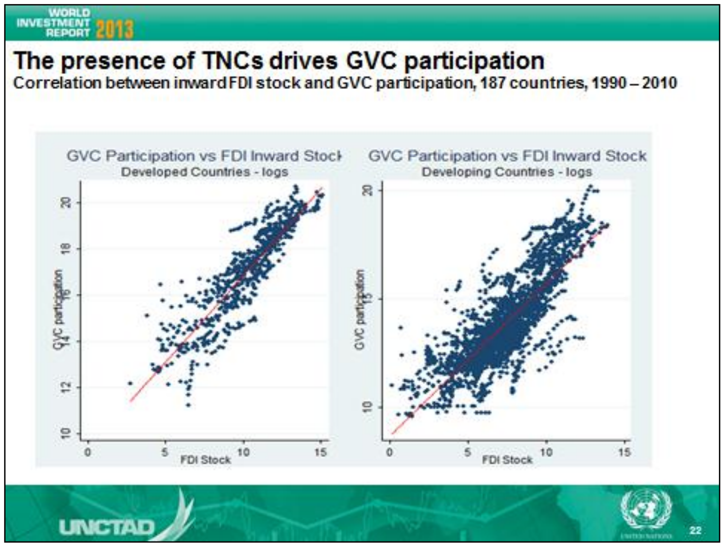
Today, some 28 per cent of gross exports consist of value added that is first imported by countries only to be incorporated in products or services that are then exported again. Some $5 trillion of the $19 trillion in global gross exports (in 2010 figures) is double counted.



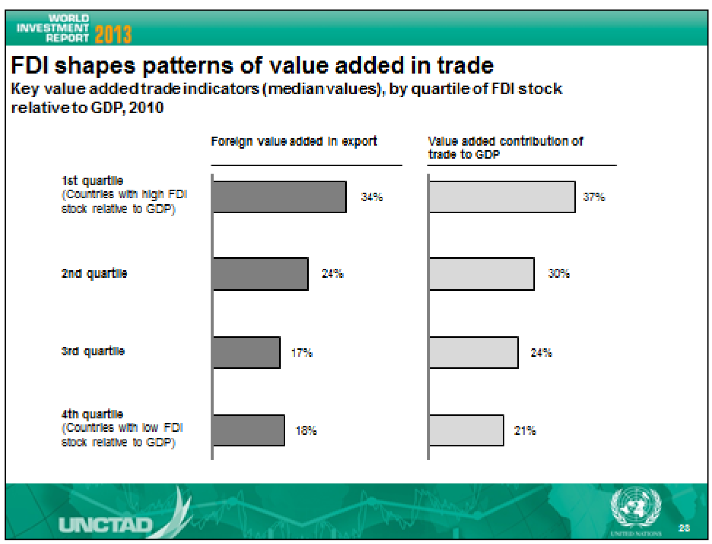
The contribution of GVCs to economic growth can be significant. In developing countries, value added trade contributes nearly 30 per cent to countries' GDP on average, as compared with 18 per cent in developed countries. And there is a positive correlation between participation in GVCs and growth rates of GDP per capita. GVCs have a direct economic impact on value added, jobs and income.



GVCs are typically coordinated by TNCs, with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers. TNC-coordinated GVCs account for some 80 per cent of global trade.

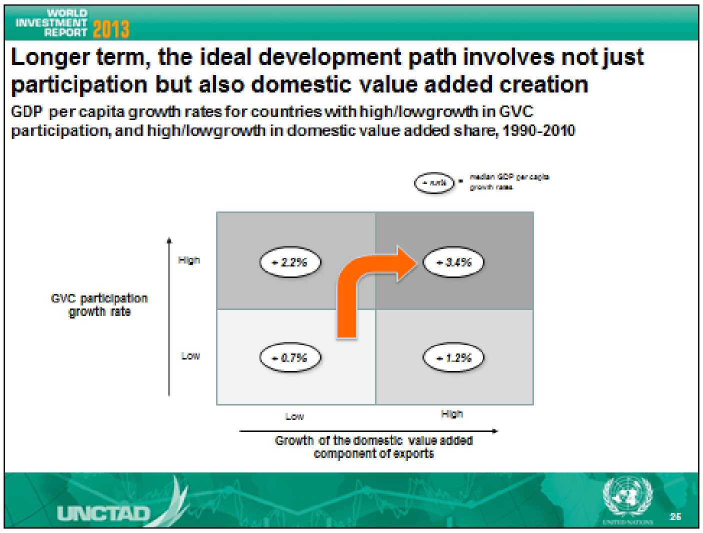


As a result of the role of TNCs in global trade, foreign direct investment, or FDI, is closely linked with countries' GVC participation. The correlation between FDI stock in countries and their GVC participation rates is strongly positive, and increasingly so over time, especially in the poorest countries, indicating that FDI may be an important avenue for developing countries to gain access to GVCs and grow their participation.



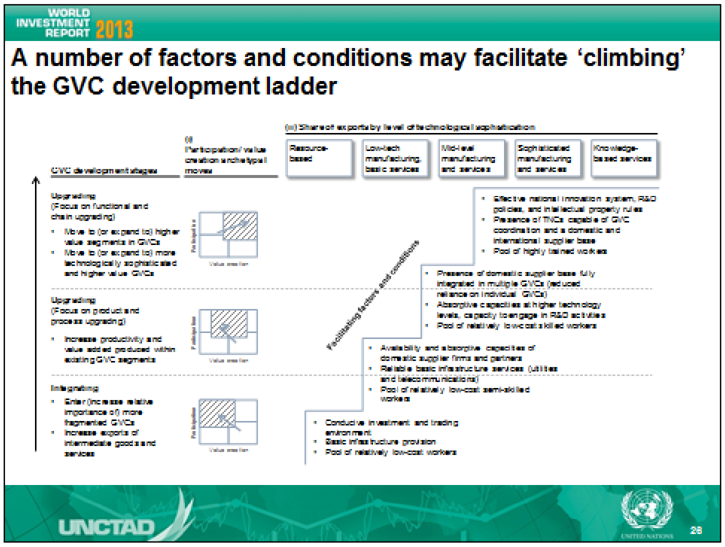
Patterns of value added trade in GVCs are shaped to a significant extent by the investment decisions of TNCs. Ranking countries by the ratio of FDI stock over GDP and grouping them in quartiles shows that the group of countries with most FDI relative to the size of their economies tend to have:

1. higher foreign value added in their exports (foreign affiliates of TNCs producing for exports tend to use value added produced by other parts of the TNC production network); and
2. a higher relative share in global value trade compared their share in global exports.



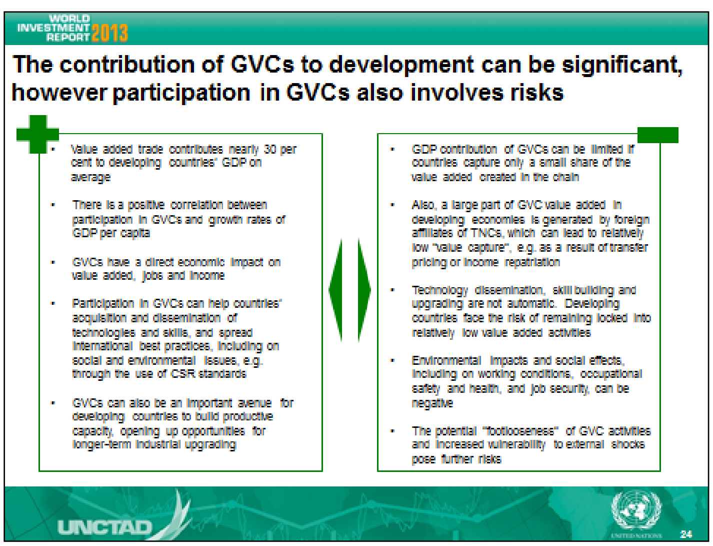
Most developing countries have seen increasing participation in GVCs over the past 20 years (moving from the lower to the higher end of the matrix shown here), almost invariably at the cost of a higher share of foreign value added in exports, at least initially.

As is clear from the matrix, which shows the highest rate of per capita GDP growth in the top right quadrant, the optimal policy outcome is higher GVC participation combined with or followed by higher domestic value added creation (i.e. moving not just upwards but also towards the right).



Climbing the GVC development ladder implies not only increasing GVC participation and increasing domestic value added in exports. It also means moving into activities that can provide more development value added and increasing participation in more sophisticated GVCs, from resource-based activities, to low-, medium- and high tech activities, to knowledge-based activities such as design, innovation, R&D, marketing and branding. In other words, climbing the ladder means moving up and to the right of the chart presented here.

At each step along the GVC development ladder – defined by opportunities to *increase participation* and to *upgrade* along GVCs – there are a number of facilitating factors and conditions that countries need to put in place, which are discussed in-depth in the Report.

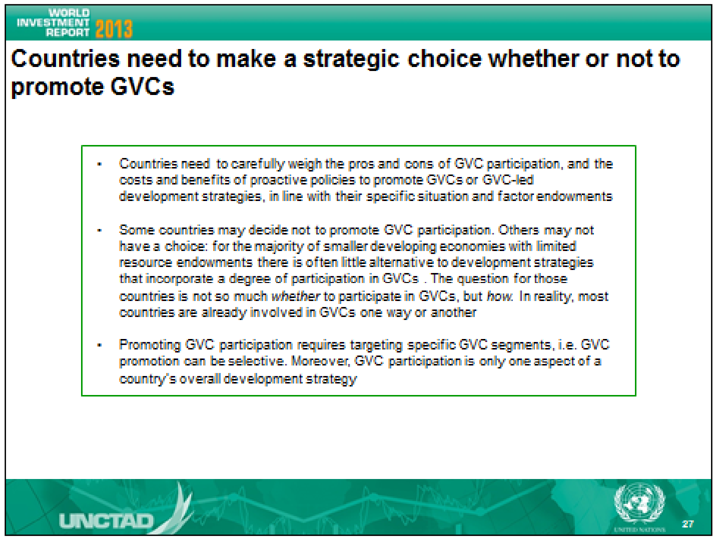


So far I have discussed the contribution of GVCs to development, which can be significant. GVCs have a direct economic impact on value added, jobs and income. They can also be an important avenue for developing countries to build productive capacity, including through technology dissemination and skill building, thus opening up opportunities for longer-term industrial upgrading.

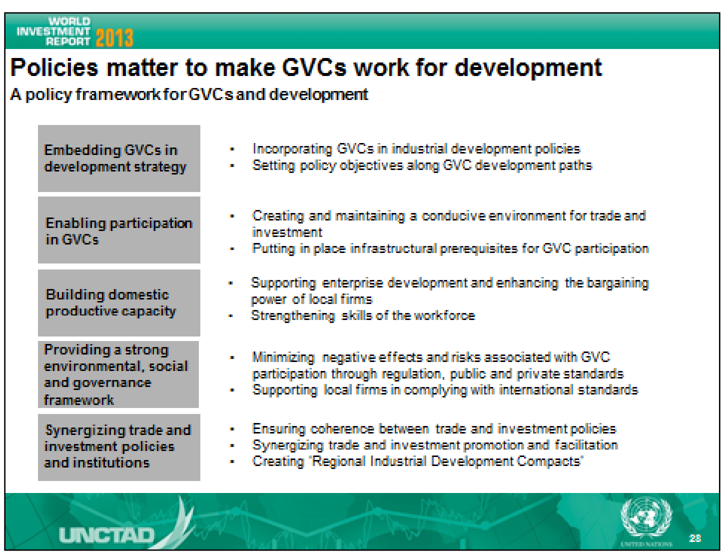
However participation in GVCs also involves a number of risks:

- The GDP contribution of GVCs can be limited if countries capture only a small share of the value added created in the chain.
- A large part of GVC value added in developing economies is generated by 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.
- And the potential "footlooseness" of GVC activities and increased vulnerability to external shocks pose further risks.

Thus, sound policies are needed to maximize the benefits and minimize the risks associated with GVCs.



First of all, countries need to make a strategic choice on whether or not to promote GVCs. They 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 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 one aspect of a country's overall development strategy.



Second, policies are needed to make GVCs work for development. If countries decide to actively promote GVC participation, policymakers should first determine where their countries' trade profiles and industrial capabilities stand and then evaluate realistic GVC development paths.

Gaining access to GVCs and realizing upgrading opportunities requires a structured approach that includes

- embedding GVCs in industrial development policies (e.g. targeting GVC tasks and activities);
- enabling GVC growth by creating a conducive environment for trade and investment and by putting in place infrastructural prerequisites; and
- building productive capacities in local firms and skills in the local workforce.

To mitigate the risks involved in GVC participation, these efforts should take place within a strong environmental, social and governance framework, with strengthened regulation and enforcement and capacity-building support to local firms for compliance.

Finally, UNCTAD proposes three specific initiatives:

1. *Synergistic trade and development policies and institutions.* Trade and investment policies often work in silos. In the context of GVCs they can have unintended and counterproductive reciprocal effects. To avoid this, policymakers – where necessary, with the help of international organizations – should carefully review those policy instruments that simultaneously affect investment and trade in GVCs; i.e. trade measures affecting investment and investment measures affecting trade. Furthermore, at the institutional level, the trade and investment links in GVCs call for closer coordination and collaboration between trade and investment promotion agencies.
2. *Sustainable export processing zones (EPZs)*. Sustainability is becoming an important factor for attracting GVC activities. EPZs have become significant GVC hubs by offering benefits to TNCs and suppliers in GVCs. They could also offer – in addition to or in lieu of some existing benefits – expanded support services for corporate social responsibility (CSR) efforts to become catalysts for CSR implementation. Policymakers could consider setting up relevant services, including technical assistance for certification and reporting, support on occupational safety and health

issues, and recycling or alternative energy facilities, transforming EPZs into centres of excellence for sustainable business. International organizations can help through the establishment of benchmarks, exchanges of best practices and capacity-building programmes.

3. *"Regional industrial development compacts"* [SEE NEXT SLIDE]

The relevance of regional value chains shows the potential impact of evolving regional trade and investment agreements towards "Regional Industrial Development Compacts". Such Compacts could focus on liberalization and facilitation of trade and investment and establish joint investment promotion mechanisms and institutions. They could extend to other policy areas important for enabling GVC development, such as the harmonization of regulatory standards and consolidation of private standards on environmental, social and governance issues. And they could aim to create cross-border industrial clusters through joint investments in GVC-enabling infrastructure and productive capacity building. Establishing such compacts implies working in partnership – between governments in the region to harmonize trade and investment regulations and jointly promotion trade and investment, between governments and international organizations for technical assistance and capacity-building, and between the public and private sectors for investment in regional value chain infrastructure and productive capacity.

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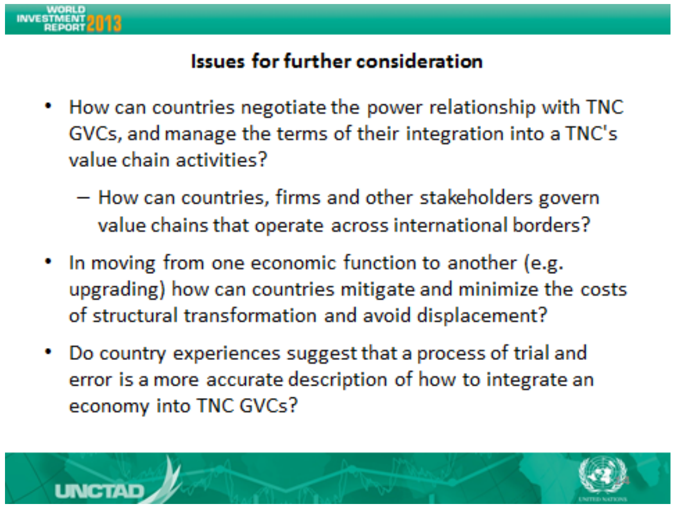

Finally, since publishing the WIR in June, we have organised several seminars and outreach activities that have helped further the discussion on GVCs and international investment. These have provided us with some valuable feedback, including issues and ideas for consideration and further work. I would like to broach some of these with you, especially to kick of the debate this afternoon. I think it would also be useful if we can try to address these issues and hear reactions from the panel and delegates who may be able to provide examples from their own country experiences.

1) GVCs are about a power relationship, and countries cannot easily dictate the terms of their integration into a TNC's value chain activities. It also follows from this point that countries face the problem of how to govern TNCs and GVCs that operate across international borders. TNCs' own governance standards and CSR policies are one side of the coin, and have had some success, but what role is there for government regulation to ensure good governance and environmental and social practices, especially beyond first tier contractors in a GVC? This area needs 'fleshing out' in terms of concrete policies.

2) In pursuing economic and social upgrading along TNC GVCs - switching from a low value function to a high value one - countries risk displacing economic activity, including jobs. This is a well-documented cost of structural transformation inherent in the process of development, but how can we mitigate and minimize such costs and avoid displacement?

3) Countries cannot easily choose a development path whereby they decide autonomously which GVC to integrate into; country experiences suggest that a process of trial and error is a more accurate description of how to integrate an economy into TNC GVCs. With that in mind, how can countries use the analysis in the WIR to steer their policy choices and maintain some sort of sovereignty over the process?

I hope very much that we may be able to address some or all of these points in our discussions today, not only from panel members, but equally from contributions from the floor.

Thank you.