Why it is time for a "Global Value Chains for Least Developed Countries Initiative" *

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Abstract

A central message that came out of the 8th UNCTAD World Investment Forum was the urgent need for innovative solutions to facilitate the integration of least developed countries (LDCs) in the global trading system. In this article, I suggest that the international community should consider implementing a "Global Value Chains for LDCs Initiative" as an integral part of such a solution package. This initiative proposes to make the value added exports of LDCs exempt from duties throughout their entire journey along global value chains. I discuss the mechanisms through which this initiative enhances the attractiveness of integrating LDCs into global value chains. Furthermore, I elaborate on how it can foster the creation of new metrics related to Sustainable Development Goals, encouraging corporate engagement in incorporating LDCs in their supply chains. Overall, the initiative proposes new pathways through which the global trading system can boost the involvement of LDCs in the global economy.

Keywords: global value chains, least developed countries, sustainable development goals, trade costs, trade facilitation, value added trade

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1. Introduction

How can the international community promote fair and sustainable globalization that does not leave least developed countries (LDCs) behind? This was a key subtheme deliberated by members of the global investment and development community during the 8th UNCTAD World Investment Forum, held in Abu Dhabi from 16 to 20 October 2023. Discussions ranged from the need to support LDCs in their efforts to attract foreign direct investment (FDI) to the importance of debt relief to provide LDCs with the fiscal space for greater spending on clean energy, and the need to avoid that LDC countries become carbon havens. A recurring message during the discussions was that the status quo in terms of international business policies has proven ineffective for LDCs. Speakers underscored time and again that decisive action from the global community is imperative to foster innovative solutions that can facilitate sustainable transformation in LDCs. This is particularly critical as progress towards achieving the Sustainable Development Goals (SDGs) by 2030 has stalled and for some SDGs is regressing (United Nations, 2023). The gap in financing for the SDGs in all developing countries is now about $4 trillion per year – up from $2.5 trillion in 2015 when the Goals were adopted (UNCTAD, 2023a).

In this article, I propose that the international policy community consider the adoption of a "Global Value Chains for LDCs Initiative" as an integral part of an innovative solution package for LDCs. I illustrate how the initiative provides a novel approach to reducing the disproportionately high trade costs that LDCs face, which could boost their integration into the global economy. I also discuss how the initiative can incentivize multinational firms to engage more with LDCs through global value chains (GVCs). Finally, I propose several avenues for future research.

2. Trade costs in least developed countries

The plight of the world's 46 LDCs is one of the most pressing grand societal challenges that the world faces today. These countries, characterized by extreme poverty and vulnerability, are home to 880 million people, or about 12 percent of the world population (UNCTAD, 2023a). Owing to their disadvantaged status in the development process, they critically depend on support from the global community to enable them to overcome deep structural challenges, eradicate poverty, achieve the SDGs and enable their graduation from LDC status. The urgency to provide support was exacerbated by the COVID-19 pandemic, which has triggered the worst recession in 30 years for LDCs, pushing 15 million more people into extreme poverty, mainly in South Asia and sub-Saharan Africa (UNCTAD, 2023a).

A key obstacle hindering LDCs' development is the significant trade costs encountered by firms from these countries (de Melo and Wagner, 2016; OECD, 2015;

Pham and Sim, 2020). Trade costs capture all costs that are incurred to get a good to the final user, other than the cost of production itself (Anderson and Van Wincoop, 2004). They include the costs of getting products *to the border*, which relate to the quality of a country’s hard infrastructure, access to trade finance and the availability of logistics services; the costs that are incurred *at the border*, which include policy barriers such as tariffs and non-tariff measures, costs related to procedural delays and costs associated with the use of different currencies; and the costs *behind the border*, which include international transportation costs (both freight and time), legal and regulatory costs, and local distribution costs (wholesale and retail). In LDCs, trade costs are disproportionately higher than in other countries. They amount to the equivalent of a 300 per cent ad valorem tariff on international trade (WTO, 2015). In other words, for every $1.00 spent on manufacturing a product in an LDC, an additional $3.00 is incurred as trade costs. These trade costs are more than twice as high as in developed countries, where the same product would face an extra cost of only $1.34, a difference which substantially reduces the opportunity of LDC firms to participate in global trade.

The high trade costs not only prevent LDC firms from engaging with international markets but also reduce LDCs’ export diversity, often confining them to the export of volatile commodities (Mora and Olabisi, 2023). This exacerbates the exposure of LDCs to economic and natural shocks, including climate-related threats and geopolitical turbulence, which is of particular concern as these countries have inadequate resources to cope with such challenges. Notably, this situation is particularly acute for small island developing States, which account for 10 of the 46 LDCs.

There are concerns that several policies and initiatives related to supply chain sustainability may further increase trade costs for LDC firms, marginalizing them even more in the global trading system. Due diligence legislation for supply chain sustainability, such as the European Union’s Corporate Sustainability Due Diligence Directive and the Commonwealth’s Modern Slavery Act, aims to promote responsible business practices by requiring multinational firms to identify, prevent, mitigate and account for adverse impacts on human rights and the environment along their GVCs (Van Assche and Brandl, 2021). Yet concern exists that extensive due diligence obligations could reduce the involvement of LDCs in GVCs as their suppliers struggle to comply with imposed sustainability standards that are costly to meet. Climate regulations such as the European Union’s Cross-Border Adjustment Mechanism raise similar concerns (Pilato and Van Assche, forthcoming). That policy attempts to curtail carbon leakage by imposing a tariff on the carbon emitted during the production of carbon-intensive goods that are imported into the European Union. Simulations by UNCTAD suggest that such a policy would further marginalize LDCs that specialize in intermediate goods used by carbon-intensive industries (UNCTAD, 2023b).

3. Previous trade-cost reduction initiatives

Broad consensus exists among trade and development scholars that the international community should do more to reduce the trade costs of LDCs. However, there is disagreement on how to best achieve this (Flentø and Ponte, 2017).

The principal support measure that the international community has adopted to reduce LDC trade costs is the granting of duty-free and quota-free (DFQF) market access to their merchandise exports (Gnangnon and Priyadarshi, 2017). The 2005 World Trade Organization (WTO) Hong Kong Ministerial Conference was an important milestone in this regard. At that time, all developed countries had provided DFQF market access for 97–100 per cent of products imported from LDCs. Since then, a growing number of developing countries have followed suit. This preferential treatment has been accompanied by increasingly transparent methods of calculating the rules of origin. Several studies have found that the provision of DFQF access has substantially strengthened LDC exports (Gnangnon and Priyadarshi, 2017; Ito and Aoyagi, 2019).

A second mechanism to reduce LDC trade costs has been trade facilitation, which seeks to simplify, modernize and harmonize export and import processes at borders. The 2017 Trade Facilitation Agreement has been a critical accord, even though LDCs have found it complicated to implement because of their capacity constraints. In this respect, the Global Alliance for Trade Facilitation has been an important organization that has worked towards providing more technical assistance to improve administrative efficiency and encourage digitization at the border in LDCs. These actions can cut bureaucratic red tape and increase transparency to make it easier and cheaper for LDC firms to trade their goods. The Organisation for Economic Co-operation for Development predicted that trade facilitation can reduce trade costs by 10 per cent in advanced economies, 13.2 per cent in upper-middle-income countries, 15.5 per cent in lower-middle-income ones and 14.5 per cent in low-income ones (Moïsé and Sorescu, 2013). Nonetheless, Kurul (2023) did not find evidence that improved border efficiency in LDCs promotes their export diversity.

A third mechanism to reduce LDC trade costs has been the promotion of investment in infrastructural capacity. Often related to "Aid for Trade", this includes building more efficient ports, better roads, more modern airports and superior electricity grids to support international trade (Gnangnon, 2018; Suwa-Eisenmann and Verdier, 2007). This approach requires significant investment funding, which LDCs lack and which the international community provides in too limited amounts.

Despite significant efforts to lower trade costs through these three mechanisms, the incorporation of LDCs into the global economy has remained stubbornly limited. From 2011 to 2020, the share of LDCs in global exports declined from

0.95 per cent to 0.91 cent, far from the doubling of the share that the United Nations had envisioned in its Istanbul Program of Action (WTO, 2022). For this reason, there is growing demand for alternative approaches to foster the inclusion of LDCs in the global trading system. These policies should not only address the disproportionately high trade costs that LDCs face but also strive to make them an essential component of endeavours aimed at building a more sustainable global economy.

4. The Global Value Chains for Least Developed Countries Initiative

In the fall of 2021, I collaborated with Gary Gereffi (Duke University) and Stephanie Barrientos (University of Manchester) to endorse an alternative solution for lowering trade costs and making LDCs a central part of the agenda for a sustainable future. This approach, which had been initially proposed by Antimiani and Cernat (2021), was called "Global Value Chains for Least Developed Countries". We presented the initiative in an open letter addressed to Dr. Ngozi Okonjo-Iweala, Director-General of the WTO, and H.E. Mr. Ahmad Makaila, Ambassador of Chad and LDC Coordinator, in the hope that the members of the WTO would consider it at its 12th Ministerial Meeting. The letter received endorsement from 38 leading experts in the field of international trade and development across the globe. In May of 2023, Lucian Cernat and I presented the initiative at a WTO event co-hosted by Finland and Djibouti entitled "Global Value Chains for Least Developed Countries: Enhancing the Participation of LDCs in Global Supply Chains and Unlocking their Trade-Led Development Potential."

The initiative proposes a new approach to boosting the inclusion of LDCs in the global trading system through the logic of GVCs. Under it, WTO members would complement their existing DFQF scheme based on "direct" LDC exports with a multilateral scheme that would extend a proportional duty-free treatment to the LDC value added that is embodied in exports across the globe. Hence, the value added exports of LDCs would remain duty-free throughout their journey along global and regional value chains, thus fitting the "Made in the World" logic that the WTO has been advocating for the past decade. The scheme can rely on existing customs procedures and documentation (e.g. certificates of origin) that LDCs use to benefit from DFQF schemes, thus limiting the need for new administrative requirements.

The logic of the initiative can be illustrated with a practical example. In Chad, raw cotton is a leading export product. Under the current DFQF scheme, direct exports from Chad face little to no tariffs or quotas to virtually any country around the globe. But if a Turkish textile company uses the raw cotton to make a men's dress shirt and then exports it to Canada, it will at that time face an 18 per cent tariff,

which applies to the value added made in both Chad and Türkiye. This trade barrier reduces the demand not only for Turkish dress shirts but also for Chadian raw cotton. Under the initiative, the local content value of Chadian cotton exports would be deducted from the dutiable value of Turkish shirts, boosting exports of both Turkish shirts and Chadian cotton. More generally, the initiative would provide a sizeable incentive for downstream producers around the globe to consider LDC export products more carefully.

It is important to point out that the initiative has the potential to boost export diversification into more sophisticated industries. What it does is reduce the trade costs for all LDC exports, but the drop is disproportionately large for those products that have longer GVCs, in which LDC products cross borders more times before reaching the final consumer (Yi, 2003). The GVCs for LDCs Initiative would thus stimulate LDC exports in manufacturing industries that tend to have longer value chains.

Antimiani and Cernat (2021) have used computational general equilibrium modelling to analyze the aggregate effect of the initiative on LDC trade. They estimate that the initiative will increase the value added embodied in LDC exports by more than $5 billion on an annual basis, with textiles, metal products and other primary goods showing the biggest gains. On average, LDCs would see their domestic value added content in exports increase by 2 per cent and move away from excessive specialization in agrifood production towards the supply of intermediate inputs for a wide range of manufacturing industries.

In addition to lowering trade costs, the initiative has the potential to mitigate the negative exclusionary effects of recent climate and sustainability policies on LDCs. Specifically, it can be designed as a means to boost corporate engagement to enhance the involvement of LDCs in GVCs. This can be complemented with the development of transparent and traceable indicators related to LDC involvement that multinational firms can use to demonstrate their engagement with the SDGs. Goal 1, for example, aims to eradicate poverty in all forms. Multinational firms can highlight their commitment in this respect by tracing their use of LDC exporters and workers in their GVCs.

New digital tools such as blockchain technology can help governments and multinational firms to implement the initiative and achieve related SDG metrics. In a recent article, Cernat (2023) discusses how digital certificates can facilitate LDC trade in organic products along complex supply chains by including relevant information that enhances the traceability of products. Thus, new technologies can help ensure that the initiative does not generate excessive administrative hurdles.

5. Conclusion

The Global Value Chains for Least Developed Countries Initiative proposes new pathways through which the global trading system and multinational enterprises can boost the involvement of LDCs in the global economy. We would like to encourage the research community to reflect on the factors that can strengthen these pathways. One question is the role that more liberal rules of origin can play in stimulating LDC exports. Instead of making the value added exports of LDCs duty-free along their GVCs, for example, developed countries could consider making all imports DFQF, regardless of the country of origin, if a minimum percentage of value added has been created in LDCs. Another question is how to ensure that the initiative fosters substantive economic, social and environmental upgrading in LDCs, especially if combined with multinational firm measures to promote social and environmental standards throughout their GVCs. A third question is how the initiative can be structured to promote high-quality investment into LDCs, in the process strengthening the trade-investment-development nexus.

Overall, the initiative is in line with the idea of re-globalization championed by WTO Director-General Ngozi Okonjo-Iweala, which emphasizes the importance of integrating LDCs in GVCs. We strongly encourage the international community to consider the ideas presented in this article as part of a larger package of innovative solutions to facilitate a sustainable transformation in LDCs.

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