

Trade and Investment

Fostering the Sustainability of Global Value Chains (GVCs)

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Abstract

The world economy is increasingly embedded in Global Value Chains (GVCs). Meanwhile, although the rising significance of GVCs increases the importance of removing both export and import restrictions, the willingness of nations to cooperate in that regard is at an ebb, noticeably regarding Deep Preferential Trade Arrangements (PTAs), something which needs to be addressed by policy-making.

Our main proposals are to (i) measure and set targets for the manifold contribution of GVCs to the global economy, (ii) commit to standards for the mitigation of economic disruption and sudden change, and (iii) set up a Global Pact for Sustainable Trade that sets a social and environmental agenda for the three other policy proposals, underlining the significance of the globally agreed 2030 Agenda for Sustainable Development.

Challenge

Global cooperation fostering economic integration is currently under challenge. The last two decades have seen important changes in the dominant modes of global economic integration. Broad multilateral deals, after having reached a high point with the conclusion of the Uruguay round of GATT talks, in which 123 nations participated, which was followed by the establishment of the World Trade Organization (WTO), have effectively stalled. This multilateral and “horizontal mode” of economic integration under the auspices of the WTO has been since superseded by one where bilateral or regional partnerships account for the bulk of trade negotiations. More recently, some so-called megaregional negotiations (such as TPP and TTIP) have tried to move on a much deeper agenda of

economic integration and homogenization agreements – a strategy that is currently facing significant resistance. Meanwhile, global economic integration has continued throughout many economic activities, with many companies having spread their production chains across wider and more diverse geographical areas. By now, Global Value Chains (GVCs) are considered essential for international trade (UNCTAD 2013, Taglioni and Winter 2016). The significance of trade in parts and components relative to that of trade in final goods has been increasing steadily and trade in intermediates now accounts for almost two-thirds of global trade (IMF 2013, UNCTAD, 2016). According to the International Labour Organization (ILO), the greater part of international trade already takes place in the context of a Global Value Chain (GVC).

This background presents us with a general challenge, which is not unique to the policy debates regarding GVCs but whose importance extends beyond production networks, and a specific challenge, which is to map some common goals of global sustainable development – including the globally agreed Sustainable Development Goals (SDGs), which was endorsed by the G20 and its 2030 Action Agenda – into the framework of GVCs.

The general challenge is to propose policies that promote global economic integration, emphasizing a vision of “trade policy as global public good” (see also the T20 policy brief on trade and investment policy). As such, instances of GVCs should not be seen as static entities, but rather seen as the mechanism through which both trade and development can be fostered.

The specific challenge is to propose policies that further common goals for global sustainable development, in line with the 2030 Agenda, through the world economy’s GVCs. We group these goals in three clusters: (a) economic growth and material well-being (see also e.g. SDG8); (b) global economic governance, international economic coordination and trade agreements (see also SDG 17); and (c) social and environmental sustainability (e.g. see SDGs e.g. 1, 2, 12, 13).

These challenges take place in an international context that exhibits a willingness to cooperate across borders, particularly on policies which target wide, abstract goals and might require, in turn, short-term sacrifices to achieve long-term benefits for all.

For these reasons, policy proposals designed to have a reasonable chance of success must “start small” – that is, to focus on specific actions that particular entities (whether governments, multilateral institutions or private actors) can take to address particular problems with a view to the broad challenges to policy we have discussed in this section. This is, of course, the universal challenge of policy-making: to transform a complex, nuanced understanding of the world into a roadmap for improving it.

Proposal

(A) The transformation of the global economy towards sustainability: From grand visions to practical policies.

“Sustainability” is a broad concept that refers, roughly speaking, to the long-term viability of ongoing and proposed processes. Traditionally, it came up in policy debates in cases where it was clear that “business as usual” practices were insufficient to ensure it, as is especially salient with environmental challenges (e.g. preserving biodiversity and combating man-made climate change).

However, we should not understand “sustainability” narrowly to be a mere code word for environmental responsibility. We should, instead, aim higher: focus on turning long-term scenarios, in

which global economic and social development within the planetary boundaries (WBGU 2014), environmental protection and cultural harmony, material prosperity, human well-being and freedom from fear are all present and inequalities are being tackled. This is, indeed, already the mainstream vision of sustainable development as enshrined, for example, in the globally agreed 2030 Agenda for Sustainable Development and its 17 SDGs. The G20 put the spotlight on it in the 2030 Action Agenda adopted at the Hangzhou Summit in 2016.

In other words, there is already a wide debate on the conceptual issues, as well as tentative agendas and consensus further encoding this broader, systemic vision. And as a clearer vision of sustainable development comes into focus, policy researchers and policy-makers become responsible for handling all these issues in their full systemic complexity, including all relevant trade-offs and synergies.

This, of course, is already a “policy-making philosophy” rather than policy-making itself: concrete, actionable policy-making tends to be incremental, narrow in scope and mediated by the adjacent problems of politics. Nevertheless, when we are challenged to target the grand problem of Sustainable Development, we need to be aware of its wide scope and holistic nature: Even if we intend to start by attacking little pieces of it, eventually we have to be more ambitious:

The overall aim has to be to promote transformative policies that foster the transformation of the global economy towards sustainability. A transformation of the global economy is also required in light of the Paris Agreement and the need to decarbonize our economies until 2070 in order to fight dangerous climate change by holding the increase in global average temperature to “well below 2°C” compared to pre-industrial levels. The G20, as a central global player, needs to stick to its commitment to implement the 2030 Agenda and the Paris Agreement, thereby seizing the opportunities this entails (see WBGU 2016) and enabling the transformation of the global economy towards sustainability.

(B) Promoting economic integration and trade as a global public good – improving the measuring and tracking of GVC to better harness their potential for economic development.

Looking at the global economy through the lens of GVCs underlines how multi-faceted international trade is and how many opportunities the rising significance of such value chains entail – and how important it is to foster awareness of these potentials and make use of them. “Trade” itself ceases to be a macroeconomic monolith. While old trade debates did not foreground the distinction between intra-firm and inter-trade firm, it is now clear that these are distinct phenomena reflecting different economic dynamics, regulatory environments and social effects.

More generally, the current policy landscape is far from being smooth across sectors and industries, even when we emphasize a long-run view of open trade and predictable policy. For example, multilateral negotiations must continue to pay attention to the distinction between trade-in-goods and trade-in-services (already a classical problem) and, most recently, in digital goods (see also the T20 Task Force on the digital economy).

Nevertheless, the rising significance of GVCs should not be recast as a new background for national interests, industrial privileges or development “strategies”. To the contrary, we should continue to emphasize the basics: trade and economic integrations as drivers of specialization, productivity growth and material well-being for all parties involved.

Moreover, it is key to underline that the rise of GVCs increases the importance of imports that are required as intermediates for many export products, and that can lead to a positive transfer of

technology and knowledge. Empirical data shows that growth can actually be import-driven (e.g. Awokuse 2008) and imports have a bearing on the magnitude of the growth effects that are triggered by exports (Riezman et al. 1996). Taking account of the importance of GVCs in today's global economy thereby undercuts the conventional mercantilist goal of generating foreign-trade surpluses by promoting exports and minimizing imports.

GVCs offer tremendous economic potential. GVCs are especially key for developing countries since GVCs enable the use of intermediate products from abroad and take over the part of the production process that suits it best without having to build an entire industry. Integration in international production networks is thus regarded a promising growth strategy. While GVCs thus entail great opportunities, their significance could be more adequately taken into account by policy-makers in order to harness their potential for economic integration and fostering economic development. While in the recent past, new data on GVCs has become available, the data basis for measuring the effects of GVCs should be further improved. Moreover, a stronger focus by the G20 on GVC data and metrics and targets to track the role of GVCs provides many untapped potentials. For example, GVCs imply that a significant amount of goods crosses borders more than once. In 2010, more than 25% of global gross exports were double-counted (UNCTAD 2013). In a world of GVCs, gross exports are therefore no longer sufficient for studying trade patterns as they mask the underlying structure and overstate export performance through multiple counting in the official statistics (Bruhn 2014).

Against this background, our proposal for the general challenge of promoting economic integration is to better define metrics and targets for Global Value Chains as contributors to global development through open and fair trade. The G20 should work towards improving the measuring and tracking of GVC and their effects to better harness their potential for economic development. We reference this elsewhere in this document as **Policy 1**.

There is at least one important precedent for this in the context of carbon reduction targets in the context of the UNFCCC. This experience has shown that setting and committing to targets – even when the policy mechanisms are unclear and goalposts are frequently missed – is a powerful tool for focusing efforts that would have been otherwise diffuse, as well for raising general awareness. The Millennium Development Goals (MDGs), the predecessor of the 2030 Agenda and the 17 SDGs it entails, also illustrates the great potential of such an approach. At the same time, the new global goals, the SDGs, while underlining the potential of international trade, do not include targets on GVCs. In light of this missed opportunity, the G20 should consider introducing relevant targets.

At the same time, we should be wary of reducing the problem to a single “proxy” measurement that currently represents the real issues but may cease to do so in the future. Moreover, we should be appreciative of Goodhart's law, which tells us that focusing solely on metrics may cause them to lose value as representations of the underlying phenomena.

As such, it is necessary to develop multiple metrics that address different facets of the problem (some of which are given by our specific challenges, specified in this document's next subsection) in such a way that they cannot be easily manipulated or directly addressed in a form that fails to engage the underlying issues.

Moreover, it is necessary to agree on targets for each of the metrics that include dates (time trajectories), stakeholders (groups that stand to benefit and are able to exert pressure, whether within nations or at the level of national states) and responsible parties (actors which are in a position to influence outcomes towards the targets, even if indirectly). There should be a balance between variables focusing on economic performance with others concerned with social issues and environmental impact. Among all possible actors that could implement this policy, G20 is uniquely apt

to do so in an effective manner, given both the diversity of its member countries and the relatively focused nature of its actions and decision-making processes.

(C) Economic growth and material well-being in the context of GVCs- Improving social sustainability in GVCs, enabling people to cope with sudden change.

We include, in the two-fold expression of “economic growth and material well-being” a variety of economic goals that have to do with growth and economic development in a narrow sense (e.g. as measured by GDP, unemployment and median incomes) and its broader consequences, which should encompass quality of life in its full range, from eradication of preventable diseases to universal internet access, among many other things.

It is our understanding that economic development in the narrow sense is a fundamental precondition for the improvement of material well-being in the wider meaning. At the same time, focusing on growth only is not enough to eliminate imbalances and injustices that block the way towards material well-being. This, too, is a mainstream view, and has had the attention of policy-makers throughout the introduction of the Human Development Index and the adoption of the SDGs. At the same time, development is the generalized problem of economic policy, and cannot be tackled by trade policy alone. However, trade policy affects it, both in the narrow and wide sense, through mechanisms that are not unaffected by the growing role of GVCs. Global value chains offer great opportunities, especially to developing countries, as indicated above. For example, economic integration by inclusion in GVCs has a unique potential for technological diffusion. This is most clear if we compare it with traditional, simplified theories of how developing countries can integrate into the global economy. On the one hand, “export-led” growth has been claimed to induce premature specialization, particularly in low-complexity activities. On the other, “import substitution” often leads nations to spend precious decades reinventing the wheel. If, instead, participation in complex value chains is emphasized, nations (through its concrete actors, such as workers, managers, investors, scientists and politicians) find themselves embedded in the production of high-value goods, even if they focus on low-complexity stages at the beginning.

While GVCs thus offer great potential for economic development, they are highly competitive, and there is no guarantee that the benefits that accrue to developing countries will always be sustainable. Moreover, in GVCs, goods are imported, processed or assembled and then re-exported, so in many cases only a small share of the total export volume actually reflects value added in the country itself – while adding value is what boosts a country’s gross domestic product and its economic development. Without developing countries being successful in upgrading their GVCs, there is also a risk to get stuck in the so-called middle-income-track.

Moreover, the presence of complex, high-value economic chains can lead to short-term externalities that need to be kept in the foreground, both for reasons of equitableness and because political opposition presents a continual challenge to the actual sustainability of GVCs. First, there can be significant economic disruption coming from the intensified interaction with a world economy that is perpetually growing in complexity and sophistication. Second, such disruption may affect disproportionately social groups that already face an inequitable treatment or have a fragile economic stance as it is.

Since GVCs are highly competitive, and there is no guarantee that the benefits that accrue to developing countries will always be sustainable. There should be policies in place that help developing countries integrate in GVCs and upgrade their value chains and policies in all countries that deal with disruptive change in GVCs.

Given this scenario, our proposal is to set a gold standard for the mitigation of economic disruption in the context of international trade. The G20 should work towards enabling people to cope with sudden change in the context of international trade. We note that international institutions have an important role in setting global norms/policy guidelines standards ranging from gender equality to fiscal responsibility, and their role here could be very fruitful. This is referred elsewhere in this document as **Policy 2**.

We propose, as a general orientation, that governments should help individuals to understand and cope with sudden change and develop resilience skills. In due time, a firm definition of “sudden change” should be developed, leading in turn to firmer global norms/policy guidelines on the responsibility of governments and, in turn, of corporations, in this area.

In its first iterations, these global norms/policy guidelines should focus on specific types of economic disruption. While a number of policies in that regard exist in different parts of the world, there is still substantial room for upscaling and improvement. A great example is set by Sweden’s policy of retraining workers to deal with the disappearance of jobs in their areas of specialization, helping them navigate the changes without putting themselves and their families at risk.

(D) Address the specific challenge: Fostering the social and environmental sustainability of GVCs – A Global Pact for Sustainable Trade.

The discussion on sustainability in Global Value Chains addresses issues of equitable economic growth and material well-being in inextricable conjunction with the social and environmental implications of global trade, production and consumption. There is already an active debate on how globalization relates to the key social as well as environmental challenges of our time, including the rising inequalities, the preservation of biodiversity and the mitigation of rapid man-made climate change. There has also been significant policy action in this segment, including in the context of the 2030 Agenda and the Paris Agreement.

Globalization presents significant questions regarding the equitableness of adverse outcomes in environmental degradation and climate change in particular. It has been argued, for example, that current non-industrial nations are facing the negative outcomes of industrialization of first world nations while having reaped none of its benefits. Another issue is that some nations and populations are both uniquely exposed to the effects of climate change (for example, in small islands or low shorelines) and uniquely unprepared for the major disruption that it could cause.

These issues have, in the past few decades, been extensively discussed within the major international institutions and multi-stakeholder forums, and have been the target of a few specific high-level public officials summits, especially during the Germany G7-presidency in 2015. Despite this history, current political trends point towards a low willingness¹ for international cooperation, which needs to be taken into account when designing policy.

In this context, the emergence of Global Value Chains as a major mode of economic integration presents a great opportunity to integrate non-state actors such as businesses and to enact environmental responsibility policies. Sustainability becomes also a global task for businesses. Indeed, many corporations already have extensive corporate strategies to implement risk based due diligence procedure for CSR and Sustainability programs in global value chains.

¹ *Adriana Neligan has had a particularly lengthy contribution towards this topic.*

Much more, however, can be done in a coordinated fashion. Multi-stakeholder initiatives of civil society and private sector actors² have, in the past, assumed some of this coordinating role by issuing environmental responsibility certifications of companies and products, which are fully optional (i.e. not legally mandated) but nevertheless influential.

Standards and the associated labels offer great opportunities for strengthening the social and environmental sustainability of GVCs, for example by fostering consumer awareness and more transparency along GVCs and thus promoting more sustainable consumption and production patterns. Standards compliance can also be a business opportunity, as it can open up new market opportunities in high-value ethical/organic markets. Moreover, environmental standards can help to reduce resource and energy use and thus contribute to cutting costs.

At the same time, standards entail challenges. The work of these initiatives in establishing so-called Voluntary Sustainability Standards is often done in a fractional, issue-oriented fashion. There is thus debate about underlying methodologies, the harmonization of standards, and their transparency. Moreover, sustainability standards often do not have the impacts that consumers hope for, i.e. protecting the environment and improving livelihoods and working conditions for local producers (in the global South). For instance, certification can be costly and the higher price that the end-consumer pays does in many cases not reach the other end of the value chain. An additional challenge relates to costs this involves for producers and the market access implications it may have, especially for smaller producers (Brandi 2016). Moreover, market coverage of such products is still too low in order to have market-wide “transformative” impacts. Questions of cost/benefit sharing yet have to be overcome within and across voluntary standards systems. Economic actors have focused both on furthering environmental as well as social issues, especially regarding the implementation of certain standards in the context of social sustainability, promoting labor rights, living wages, decent working conditions and environmental protection in global supply chains has become central in the application of internationally recognized standards, principles and commitments.

In line with the UN Guiding Principles on Business and Human Rights, OECD Guidelines for Multinational Enterprises, ILO core standards, the EU Communications on CSR and the SDG’s, companies are expected to express their social responsibility by preventing human-rights abuses, accepting and creating remedy mechanisms, complying with work and safety regulations, paying living wages, considering consumer interests and issues of sustainable development. Our proposal is to bring this process of governmental regulations strategies to govern responsibility in complex GVCs in different countries to the global stage, possibly with the participation of the major international institutions, government, business, especially SME’s, and other non-state actors. This would take the form of a Global Pact for Sustainable Trade, which would set minimum standards for environmental protection as well as for labor conditions and human rights protection. We reference this elsewhere in this document as **Policy 3**.

There is already some relevant precedent with private actors and governments being pressured by international institutions into action (ranging from law-making to corporate hiring) in the field of Gender Equality. In several G20 countries, national multi-stakeholder coordination platforms on Voluntary Sustainability Standards are currently taking shape pro-actively, supported by national governments and the UN Forum on Sustainability Standards (UNFSS). The G20 should further promote these initiatives as well as the UNFSS.

² *There are also certification schemes established by brands themselves, as well as public (and public-private) initiatives for voluntary standards and certification.*

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