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CAPACITY BUILDING WORKSHOP TRADE AND TRADE POLICY ANALYSIS FOR THE POST COVID-19 RECOVERY

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10:00 - 11:15 AM BKK TIME (UTC+7)

THURSDAY 9 DECEMBER 2021
09:30 AM - 15:45 PM BKK TIME (UTC+7)

FRIDAY 10 DECEMBER 2021
13:30 - 15:15 PM BKK TIME (UTC+7)

VIRTUAL MEETING, MS TEAMS

GVCs and Policy Issues

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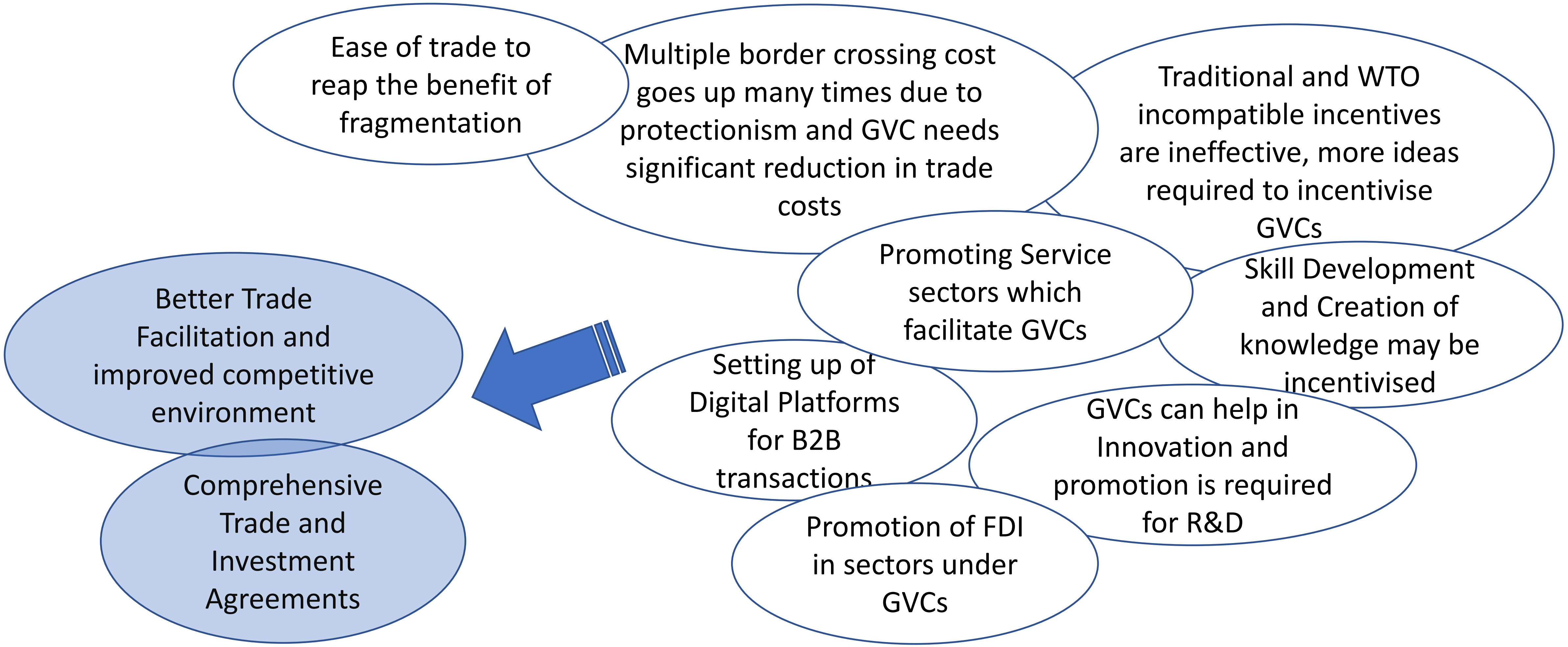
GVCs: Direct and Indirect Policy Connection



Trade Policy Implications of GVCs

Developments and trends observed in trade	Remarks
1. The Extent of Fragmentation	a) It highlights the need for countries wanting to reap the gains from value chain participation. b) This necessitates the requirement of ease in trade by the firms.
2. Protectionism leads to higher cumulative costs	a) Policies that restrict access to foreign intermediate goods and services have a detrimental impact on a country's position in regional and global supply chains. b) Tariffs and NTMs can add up to a significant level of cost by affecting production and investment at all stages of a value chain.
3. Issues with Traditional Policy Instruments	Traditional Policy instruments in the form of taxes, subsidies or which are not WTO-compliant are problematic in a GVC environment, where trade integration is paramount.
4. Multiple border crossings emphasize need for Trade Facilitation	Easy border crossing can fasten the movement of parts and components improving production efficiency
5. Competitiveness of Services is the Key	GVCs without well-functioning transport, logistics, finance, communication, and other business and professional services to move goods and coordinate production along the value chain, will not work.

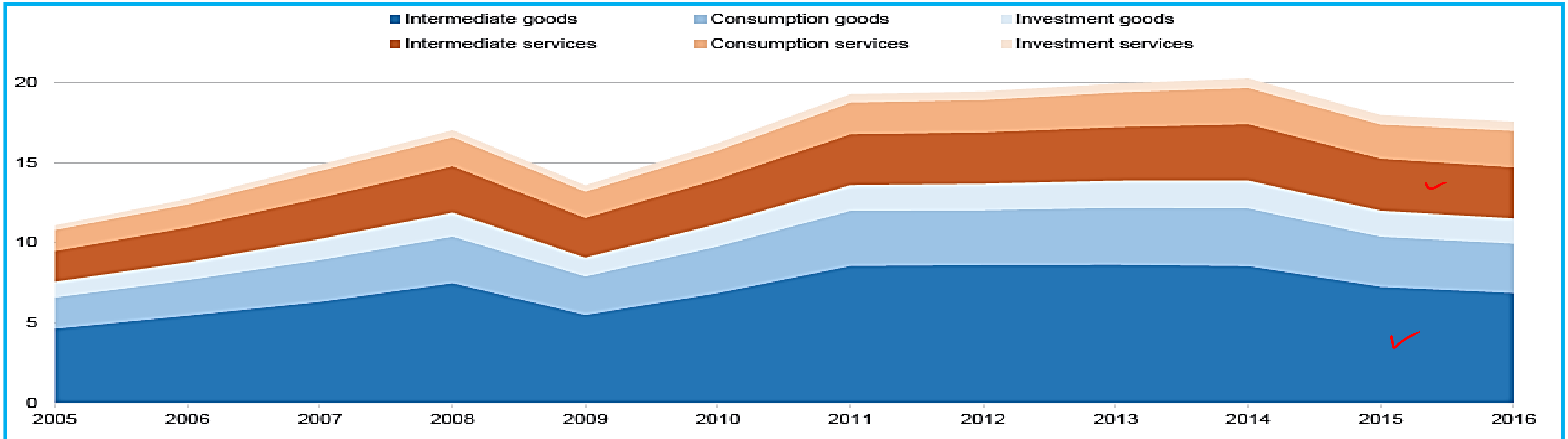
Trade Policy Implications of GVCs

Developments and trends observed in trade	Remarks
6. GVCs becoming Knowledge-intensive	The role of intangible capital in strengthening the value chain is gaining tremendous importance leading to higher export potentiality.
7. Trade and Investment	a) Investment decisions of MNEs impact on patterns of value added trade in GVCs. Countries with a higher presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs. b) Investment in GVCs can generate development benefits, but these are not automatic: policies matter
8. Comprehensive trade agreements grow global markets	GVCs strengthen the economic case for advancing negotiations at the multilateral level, as barriers between third countries upstream or downstream matter as much as barriers put in place by direct trade partners.
9. Complementary Policies	Investments in people are particularly important for engagement and upgrading in GVCs: education and skills training are key ingredients.
10. Platforms & GVCs	With the help of network effect and the ability to generate data, a new value chain is building in strengthening GVC through B2B and direct business purchases.

Extent of Fragmentation

More Trade in Intermediate Goods & Services

Decomposition of world gross exports, USD trillion (2005-2016)



Source: TiVA database 2018

- Today, 70 percent of international trade consists of a range of transactions in which services, raw materials, parts, and components are traded across countries in GVCs before being combined into final goods and sent to consumers all over the world.

Trade Policy needs complementary policy on manufacturing and services to promote GVCs

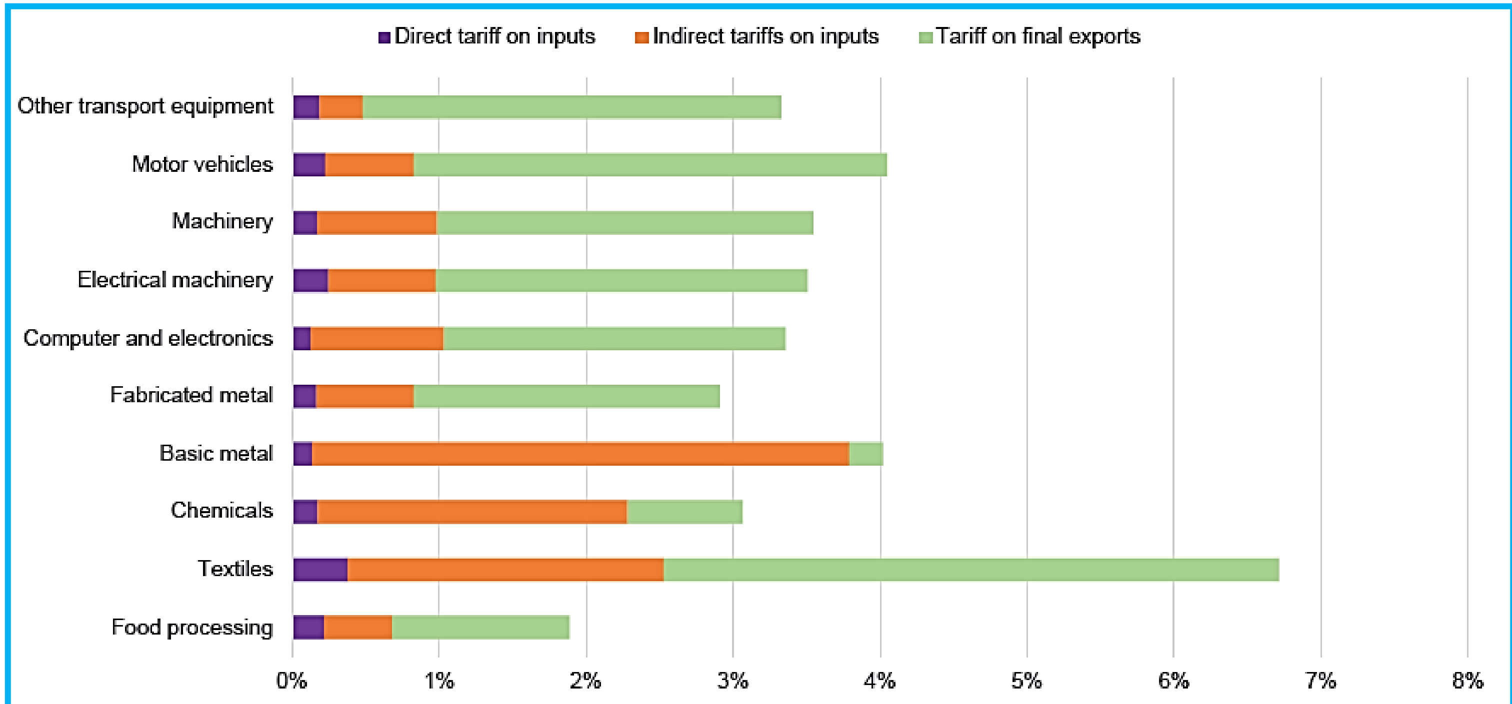
GVCs have spread beyond simple manufacturing. Both structure and pattern have changed.

Protectionism resulting in higher cumulative costs

Protectionism Charging Higher Cost

- Small tariffs applied repeatedly throughout the value chain can add up to large expenses for businesses. Higher the fragmentation higher will be the cost due to multiple border crossing
- When direct tariffs on imported inputs and various indirect tariffs from upstream inputs are added to the tariff on the end product (shown in Figure), the average ad valorem tariffs in some industries become much higher.
- The cumulative effect of trade barriers also applies to non-tariff measures of any kind. Quality and safety standards are very crucial in the operation of GVCs.

Average ad valorem tariffs along the value chain, selected industries, 2015



Source: TiVA database 2018 and TRAINS. Based on applied and preferential tariffs.

Countries engaged in value chain can have sector specific discussion to ease the trade of components and services

High tariffs & NTMs can prevent developing countries from upgrading to higher value-added segments of the value chain, potentially locking them into lower-value, limited-processing activities

Protectionism Charging Higher Cost

- Even currency interventions aimed at creating a competitive advantage for exporters lose relevance, as any export advantage gained from a cheaper currency is at least partially eroded by the cost of more expensive imported inputs.
- In many parts of the world, tariffs and other forms of trade protectionism have seen a resurgence over the last few years, fuelled in part by tensions between the United States and China.
- US, China trade war costs global value chains 3-5 years of growth, (UNDP, 2021).
- Restrictive trade policies during the Covid-19 pandemic have also amplified shocks as producing countries restricted exports.
- The supply troubles come as the cost of shipping goods across the globe is skyrocketing, threatening to boost consumer prices and compounding concerns.
- Trade policy uncertainty in some cases has made firms reluctant to invest in supply chains, resulting in long-lasting disruptions in global investment and production.
- However, GVCs will remain at the core of economic recovery in the Asia-Pacific region even as global manufacturers consider moving production closer to home, (UNDP, 2021).

GVCs will remain at the core of economic recovery (UNDP). Hyper specialisation and distribution of tasks ensure this

Issues in the application of traditional policy instruments

Limiting the use of “traditional” distortionary instruments

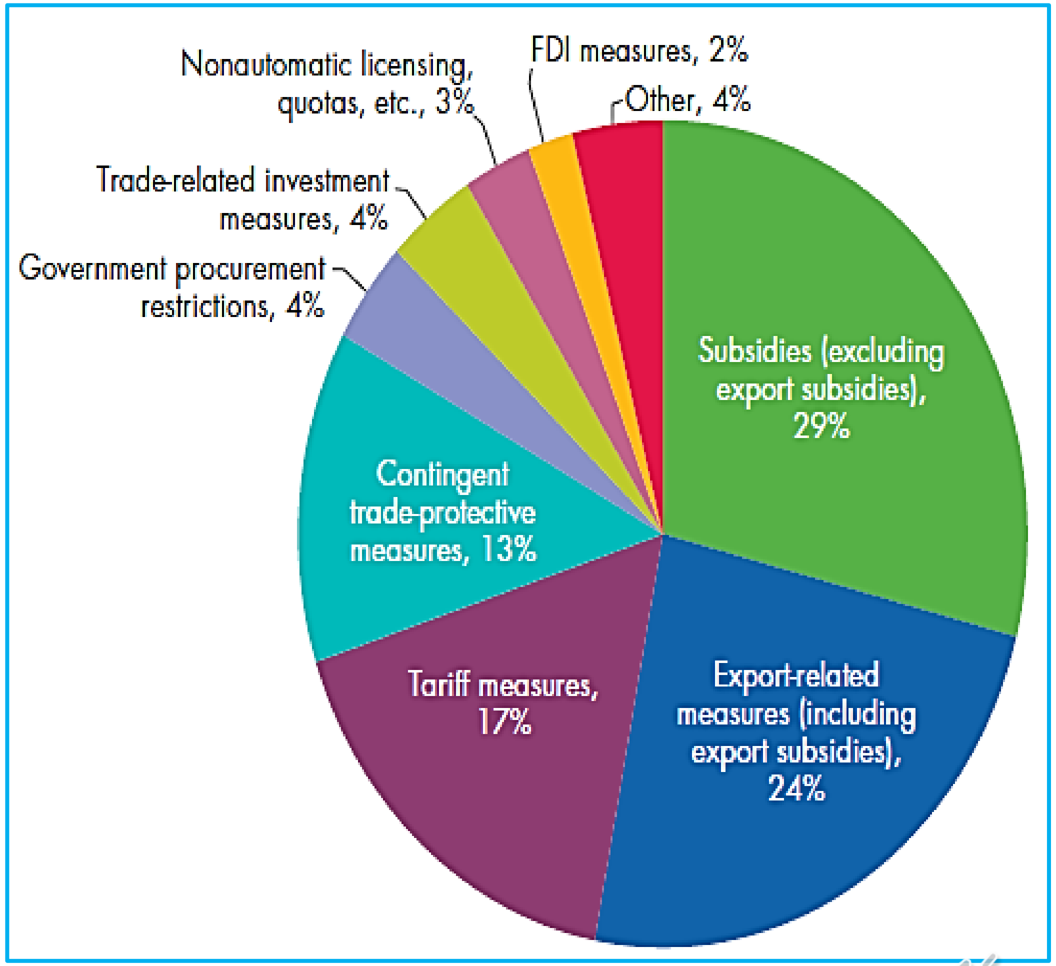
- Traditional incentives such as tax breaks, subsidies, etc help to overcome a market failure (such as information asymmetries), address a coordination failure (such as requirements for complementary investments in supply chains), or help capture an externality (such as technology spill overs).
- However, many of them are WTO incompatible and also these instruments often have proven ineffective or have created distortions by contributing to rent seeking and misallocation of capital.
- This might distort natural development of GVC. For example, rent seeking in transport sector may increase the cost and can neutralise the benefits of incentives.
- Hence, competitive environment along with WTO compatible incentives (promoting, skill, R&D, improving overall trade facilitation) can accentuate GVC driven benefits

GVC can flourish and provide desired benefits when accompanied with improved competitive environment and enabling policies

Limiting the use of "traditional" distortionary instruments

- By the end of 2018, 218 instances of **countervailing duties** had been notified to the WTO and were currently in force.
- Of these, 162 were applied either to metals and metal products or to chemicals, rubber, and plastics and products thereof, suggesting that trade in those sectors is particularly distorted by subsidies.
- **Local content policies** have been similarly problematic.
- Many countries employ local content requirements either as conditions for foreign investments or as requirements by foreign investors—to develop **backward linkages.**
- In the absence of quality local suppliers, however, such requirements can backfire, restricting investment.
- In many natural resource sectors policy makers may focus on developing **forward linkages**— and **raising domestic value added**—by encouraging requiring local processing on the imported components

Distortionary trade policy instruments worldwide



Source-WDR, 2020. Data are from November 2018

Ease through Trade Facilitation

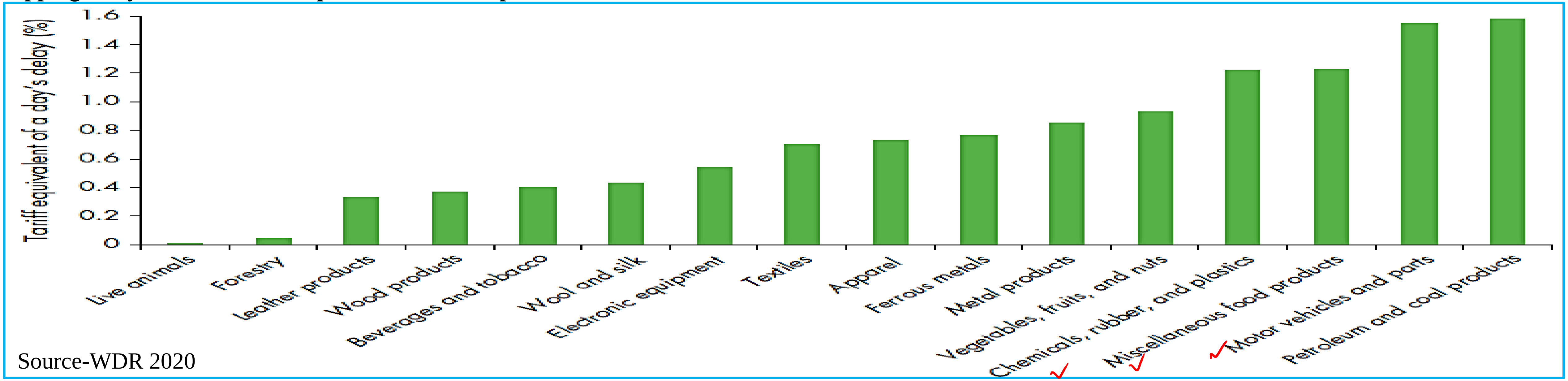
Emphasis on Trade Facilitation

- Global supply chain increases interdependence and a mid-way link failure affect the entire chain. Hence, it is important to **invest on trade facilitation** and ensure smooth transaction across the border.
- Lean inventory, faster turnaround, effective internal logistics, quick border clearances, less paperwork etc are essential for GVC to flourish
- It is projected that bringing supply chain-related trade costs associated with border administration, transportation, and communications infrastructure halfway to global best practise would result in global GDP gain up to six times greater than eliminating all tariffs, (WEF, 2013).
- Delays due to shipping and border procedures have a negative effect on trade comparable to that of tariffs.
- The time costs in trade are significant for products with complex value chains such as motor vehicles; perishable products such as fruits and vegetables; and textiles and apparel, both of which involve complex GVCs and changes in fashion that reduce their shelf life.

Trade Facilitation policy must take into account emerging GVCs in which domestic companies are involved and, special arrangements may be done to improve the parameters related to time, cost and reliability. Paperless trade must be promoted

Emphasis on Trade Facilitation

Shipping delays matter more for products with complex value chains



Source-WDR 2020

Note: The tariff equivalent on the y-axis is measured as the percentage of an ad valorem tariff economically equivalent to a day's delay in shipping. For example, a day's delay in moving chemicals, rubber, and plastics is equivalent in economic terms to imposing a 1.2 percent tariff on imports of the same goods.

- Poor, remote, landlocked countries suffer from lack of international shipping and air cargo services and thereby experience increase in trade cost. This is a big negative for GVC development. Although many such countries can become hub for downstream activities.
- There is a need to rebalance and repurpose trade infrastructure to support the environment needed for value chain–oriented sectors (such as food and nutrition value chain in Pacific Islands).

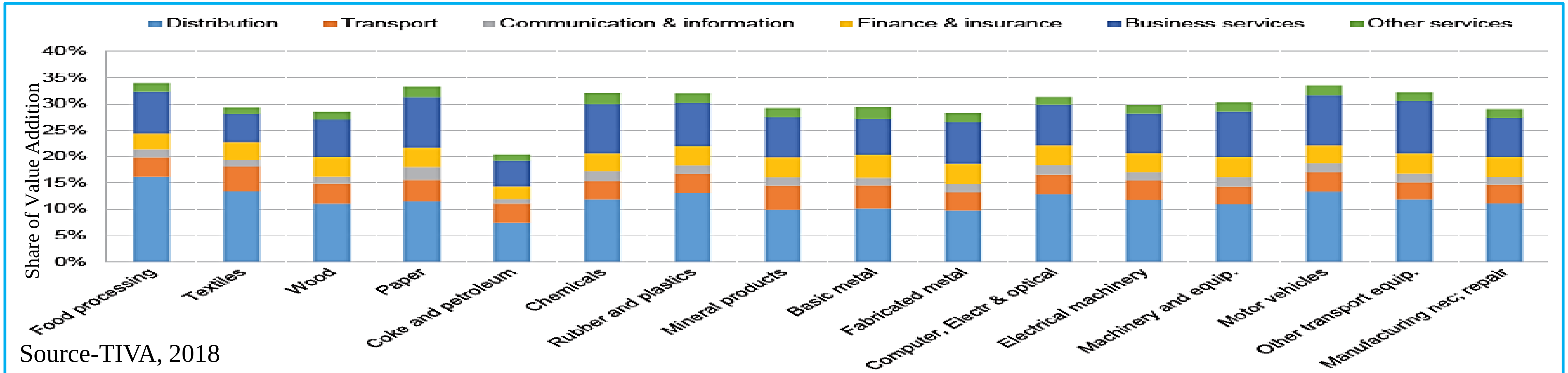
Services Competitiveness

Services are key for Competitiveness

- Global production networks rely on the logistics chain, requiring efficient network infrastructure and complementary services.
- Trade flows in value-added terms reveal that transport, logistics, finance, communication, and other business and professional services play a significant role in exports of goods.
- As shown in Figure, the value created by services as intermediate inputs account for 30-35% of the total value-added in manufacturing exports. More efficient service sectors enhance the competitiveness of manufacturing firms.

Services-led development, relying on globalization and digitization, can become the main development path for low and middle-income countries. As developing countries which are typically well-endowed with low-cost labour are witnessing manufacturing becoming increasingly capital-intensive.

Services shares of value added in manufacturing trade, all countries, 2016



Source-TIVA, 2018

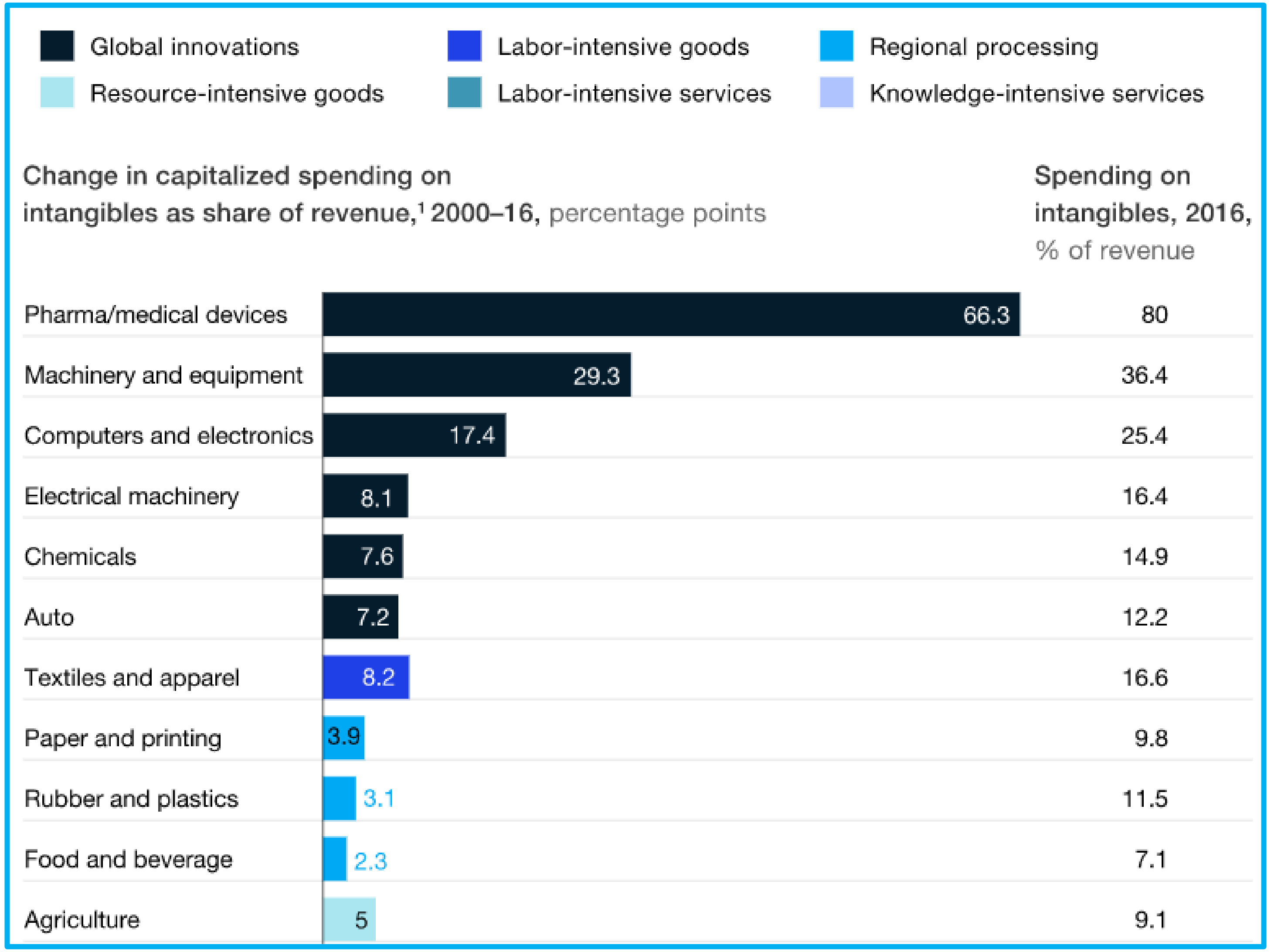
Services are key for Competitiveness

- National decisions to open markets to certain types of services trade are critical for GVCs. Among those types are third-party logistics providers and express delivery services.
- In addition, much of the innovation in value chains takes place at the downstream end, through retailers.
- Thus policies that restrict the entry of large retailers (either domestic or foreign) can have a negative impact on efforts to exploit the full efficiencies of GVCs.
- Also, services play a crucial role not only for their own sector but also in the production of non-services sectors, a process defined as the “servicification” of an economy. More focus on engineering services, design services, etc.
- The upstream position of many highly traded services, with the exception of tourism, implies that the trade in services is mainly trade in intermediates and can therefore also be seen as trade in global services value chains.
- The “production” process of certain services allows for fragmentation similar to goods. This enables countries to join services GVCs just as they joined goods GVCs.

Two countries where these strategies are working well are India and the Philippines. Both are now among the leading countries for offshore business services worldwide because of their low costs, human capital availability, and attractive business environments for services sectors

Knowledge-intensive GVCs

GVCs growing more Knowledge-intensive



- Upstream operations like R&D and design, as well as downstream activities like distribution, marketing, and after-sales services, are strengthening value generation in various value chains.
- This trend is pronounced in pharmaceuticals and consumer electronics, which have seen the rise of “virtual manufacturing” companies that focus on developing goods and outsource actual production to contract manufacturers.
- Intangible assets that multinational companies send to their affiliates around the world—including software, branding, design, operational processes, and other intellectual property developed at headquarters—represent tremendous value.

Source- McKinney Global Institute Analysis, 2020

GVCs growing more Knowledge-intensive

- The growing emphasis on knowledge and intangibles favours countries with **highly skilled labour** forces, strong innovation and R&D capabilities, and **robust intellectual property protections**.
- More knowledge → More Innovation → More Productivity & better quality products
- Furthermore, when a foreign firm and a local supplier are part of the same supply chain, they need to interact and **coordinate to guarantee the chain functions smoothly**. That facilitates the transfer of tacit knowledge, potentially increasing domestic innovative capabilities.
- Foreign affiliates of MNCs generate positive local spill overs, especially to their suppliers. These positive effects depend on **absorptive capacity of local firms**, further relying on human capital, own R&D investment, and broad institutional capabilities.

Enabling policy is required to equip the labour force to adopt the new technology and be part of the innovation process

Trade & Investment

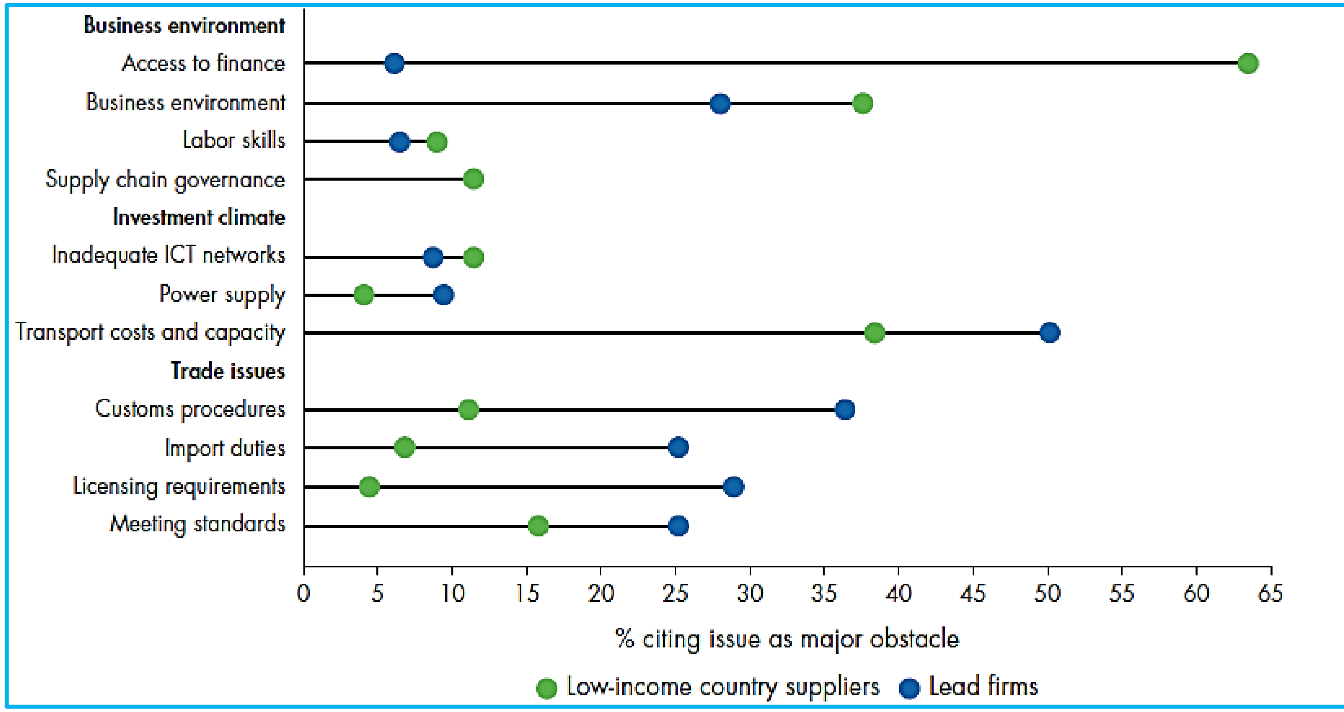
Trade and Investment

- In developing countries, foreign capital is especially important for GVC integration.
- Foreign investors bring with them the technology, managerial expertise, and established market relationships needed for GVC integration.
- Facilitating FDI for GVCs requires **effective coordination of investment**, **trade, and domestic regulatory policies**.
- Political stability, **investor protection**, and a **business-friendly regulatory environment** are especially important in attracting FDI.
- FDI is not homogenous. Investors with different motives consider different factors in their decision to invest
- Also, **countries with stronger IP protections** tend to attract more FDI and receive more technology flows through licensing and royalties.
- Governments can play a role in providing the information needed to bring local SMEs together with FDI through supplier linkage programs

Trade and Investment

- **Lack of financing** is one of the main obstacles to GVC participation among suppliers in developing economies
- Governments can help **deepen domestic supply chain** relationships through broad reforms of their country's investment climate.
- This is particularly critical for domestic investors, who may not be in a position to benefit from targeted investment incentives or SEZ programs that are available to large foreign investors.
- Governments also play a central role in **building a local absorptive capacity.**
- Research shows that **direct technical assistance** from lead firms—either through formal linkage programs or as part of the normal firm-client relationship—is one of the biggest sources of spill overs to local suppliers.
- For local SMEs to absorb spill overs from GVC participation, ongoing investments are required in technology, process improvements, and training.

Lack of financing impedes many low-income country suppliers from entering or upgrading in GVCs



Source: Cusolito, Safadi, and Taglioni 2016.

Trade agreements helping GVCs

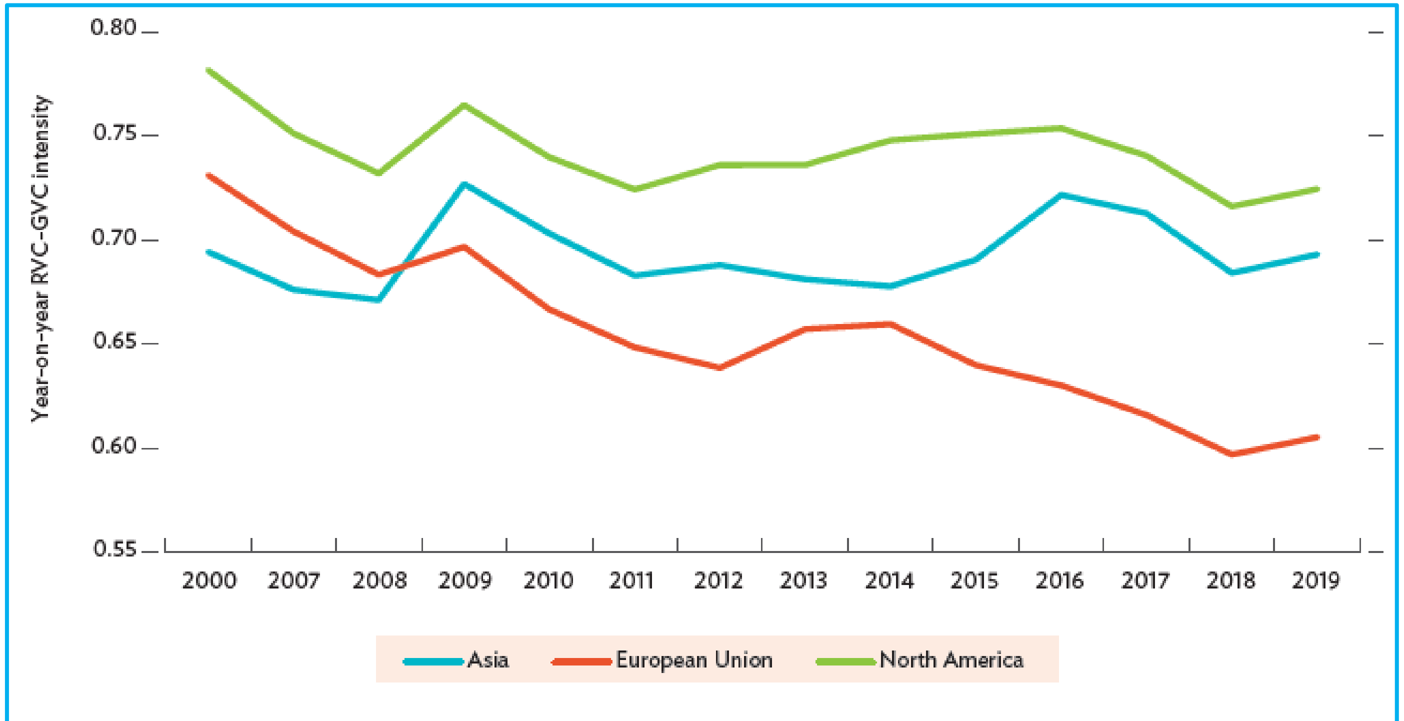
Trade Agreements Growing Value chains

- Trade agreements (TA) have significantly reduced the extent of tariff escalation in high-income countries. Governments can exploit the opportunities created by different TAs, particularly when they offer duty-free market access, to catalyse GVC entry.
- TA should cover as many dimensions of GVCs as possible, from **customs barriers to rules of origin to trade facilitation to services**. This will lead to—a stronger case to move from **reciprocal "concessions**" to unilateral responses.
- GVCs strengthen the economic case for advancing negotiations at the multilateral level, as barriers between third countries upstream or downstream matter as much as barriers put in place by direct trade partners and are best addressed together.
- TAs of the future should be careful to avoid the pitfalls of distorting firms' choices and losing the connection with the rest of the value chain.
- More liberal rules of origin, would make TAs more GVC-friendly and increase their impact on firms' productivity.

Trade Agreements Growing Value chains

- In recent times value chains are becoming more regional and less global.
- Until recently, long-haul trade crisscrossing oceans was becoming more prevalent as transportation and communication costs fell.
- The share of trade in goods between countries within the same region (as opposed to trade between more far-flung buyers and sellers) declined from 51 percent in 2000 to 45 percent in 2012.
- That trend has begun to reverse in recent years.
- The intraregional share of global goods trade has increased by 2.7 % since 2013, partially reflecting the rise of emerging-market consumption.
- This development is most noticeable for Asia and the EU-28 countries.

Ratio of Regional and Global Value Chain Participation Rates in Asia, European Union, and North America, 2000–2019



EU = European Union, GVC = global value chain, RVC = regional value chain.
Note: RVC–GVC intensity is the ratio of RVC and GVC participation rates. North America comprises Canada, Mexico, and the United States.
Source: Figure 2.11 in Asian Development Bank. 2021. *Asian Economic Integration Report 2020/2021: Making Digital Platforms Work for Asia and the Pacific.* Manila.

- **Regionalization is most apparent in global innovations value chains, given their need to closely integrate many suppliers for just-in-time sequencing.**
- **This trend could accelerate in other value chains as well, as automation reduces the importance of labour costs and increases the importance of speed to market in company decisions about where to produce goods**

Complimentary Policies: A comprehensive approach

Complementary Policies: Towards more Inclusive Growth and Employment

- Not all economies are equally prepared for the changes that firms and workers have to face in GVCs.
- The process of GVC-induced growth can entail **reallocation of workers** to more productive activities and some **workers may experience unemployment** or may see their real wage decline.
- Facilitating the adjustment process is crucial and requires **well-designed social policies** and a **well-functioning labour market**. Effective re-employment services and training programmes can help dislocated workers take advantage of new job opportunities.
- Also, developing sector-specific skills is the need of the time. In many developing counties, **lack of skills in technical and managerial positions** is a binding constraint to upgrading in value chains.
- **Targeted workforce development** strategies can bridge these gaps, ideally linking lead firms and local institutions, including universities and vocational and technical centers.
- Few countries actively help GVC investors identify skilled labour. For example, the Chengdu Hi-tech Industrial Development Zone gives priority to talent recruitment, assisting companies in the zone with their recruitment efforts both within China and abroad.
- Penang Skills Development Centre in Malaysia, illustrate how governments, in coordination with the private sector, can build strongly territorialized capabilities through an industry or cluster-led skills development initiative.

Specialised suppliers, labour market pooling and knowledge spill over are the benefits from investing on human capital

Complementary policies: Improving firm capability

- Developing **management and firm capabilities** to capture and generate productivity and profitability is needed.
- Governments can support firm upgrading and boost firm productivity by correcting market failures, including encouraging firms to improve their managerial practices and build relationships with buyers.
- The ability of firms to **effectively match the needs of foreign buyers**—a core requirement of participating in GVCs—requires a combination of good management and actively accumulating demand.
- **Strengthening innovation systems**—the capacity of national and regional innovation systems also needs to expand.
- The range of technical, engineering, and managerial skills to sustain complex manufacturing, much less innovation-intensive GVCs, is substantial.
- Although innovation **systems—universities, government, firms, and specialized research institutions**—vary in their configurations and role, the desired outputs of an innovation system's capabilities are similar.
- Whatever forms such systems take, **knowledge must flow among firms, government, and universities**.
- Another Policy—Considering special economic zones (SEZs) as a possible shortcut to GVC participation. Their advantage lies in well-built infrastructure, friendly customs regime, streamlined regulatory and administrative regime and relaxed fiscal regime.

Platform economy & GVCs

Digital Platforms and GVCs

- The new digital economy is based around platforms—search systems such as Google, marketplaces such as Alibaba, and application platforms such as Android, among many others (ADB 2021; Evans 2011; Kenney and Zysman 2016; OECD 2019).
- The COVID-19 pandemic has strengthened the digital economy and the role of digital platforms as the global economy became increasingly virtual because of physical distancing measures (ADB 2021; OECD 2021).
- The internet also makes it easier to find and target niche demand opportunities, and has created the phenomenon of "**born global**" firms, with small enterprises able to export their products from initiation (Wong and Merrilees 2012).
- Platforms also create "**network effects**," meaning the more users a platform has the more valuable those users find the platform (Evans 2016).
- Digital platforms can provide valuable network effects for MSMEs that help them increase their access to more consumers and provide more sourcing options.
- These platforms are also one of the primary ways for MSMEs to **get into international markets** since they can reduce trade barriers and lower costs (Morais and Ferreira 2020; OECD 2018).
- Digital platforms affect GVCs through B2B e-commerce and direct purchases through business websites.

Digital Platforms and GVCs

- The statistics on cross-border e-commerce are scarce, especially for B2B transactions (UNCTAD 2016), but a link between trade facilitated by digital platforms, especially for e-commerce marketplaces, and GVCs exists.
- Many researchers have linked e-commerce with GVCs.
- Some **new value chains** have also developed in tandem with these e-commerce transactions; these are "infomediary" value chains related to the data generated from a transaction conducted over a digital platform (Kang, Bacate, and Ramizo 2020).
- Data collected about a user, whether for accessing a website to view, say, a research paper or someone's shopping habits in an online store, allow firms to **generate new value from the data** either by selling it to other firms or using it for their own marketing.
- The participation of MSMEs with an already developed digital platform enables **to skip investing their own resources** to create something similar from the ground up (OECD 2021).
- Digital technologies have also created a whole new GVC governance structure—**internet-driven GVCs**—that bring in the digital platform itself as an intermediary actor along with sellers or providers (supply side) and buyers or clients (demand side) (Gereffi 2001a and 2001b; ADB 2021).

Resilience & Rebalancing of GVCs

Rebalancing in GVCs

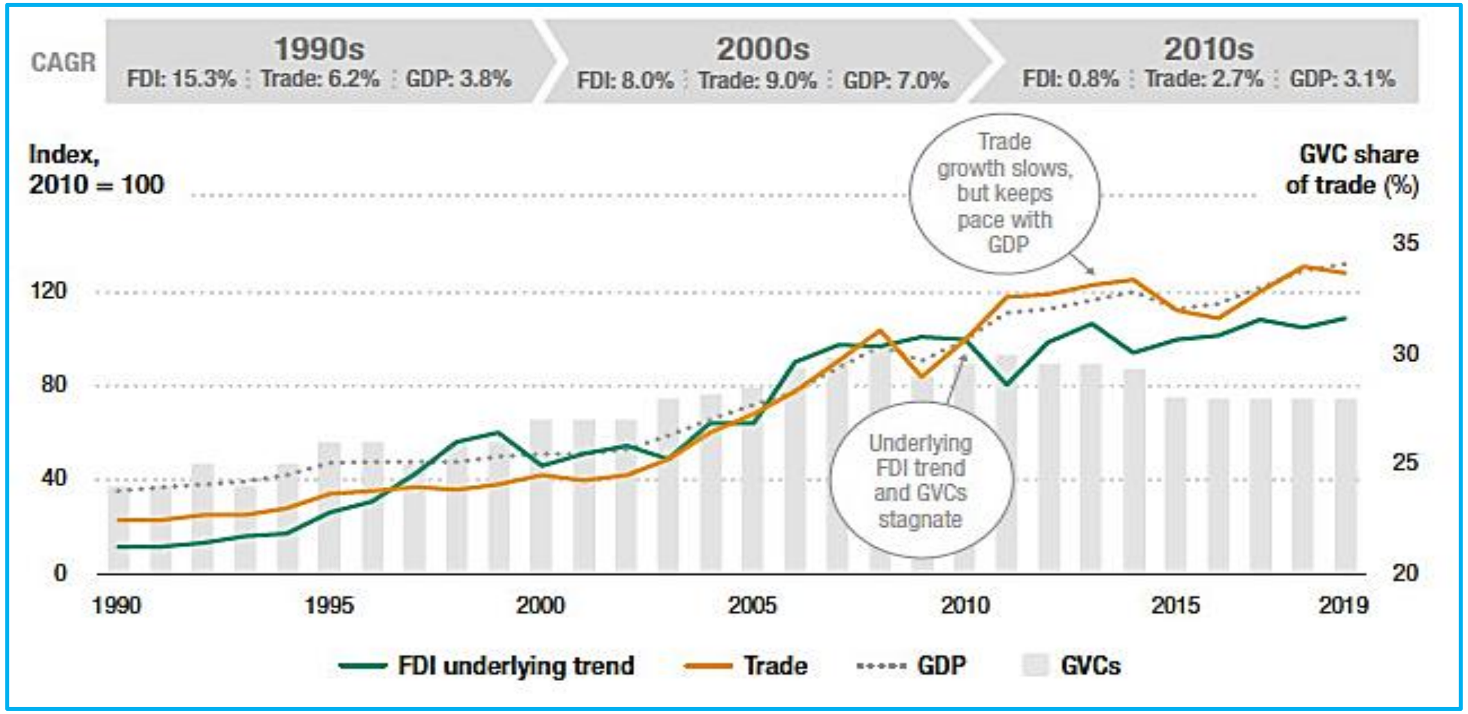
- Intricate supplier networks that span the globe can deliver with great efficiency, but they may contain **hidden vulnerabilities**.
- Shocks that affect global production are growing more frequent and more severe—The adoption of discriminatory trade interventions outpaced liberalisations, despite the increase in new trade-liberalising measures or the lifting of some emergency trade restrictions during the period.
- Value chains are exposed to different **types of shocks** based on their geographic footprint, factors of production—Those with the highest trade intensity and export concentration in a few countries are more exposed than others.
- They include some of the highest-value and most sought-after industries, such as communication equipment, computers and electronics, and semiconductors and components.
- Many labour-intensive value chains, such as apparel, are highly exposed to pandemics, heat stress, and flood risk. In contrast, food & beverage and fabricated metals have lower average exposure to shocks because they are among the least traded and most regionally oriented value chains.
- **Operational choices** can heighten or lessen vulnerability to shocks—Practices such as just-in-time production, **sourcing from a single supplier**, and **relying on customized inputs with few substitutes amplify the disruption of external shocks** and lengthen companies' recovery times.
- Geographic concentration in supply networks can also be a vulnerability.
- The interconnected nature of value chains **limits the economic case for making large-scale changes in their physical location**

The Long-Term Trend of International Production

Pandemic magnifies existing challenges-Flows of cross-border investment in physical productive assets stopped growing in the 2010s, the growth of trade slowed down and GVC trade declined.

The trends observed so far:

1. Shorter and less fragmented value chains.
2. More concentrated value added.
3. A shift from global to regional and sub-regional value chains.
4. Downward pressure on global efficiency-seeking FDI in favour of regional market
5. Downward pressure on global trade in intermediate goods, less on trade in final products.
6. Continued growth and fragmentation in services value chains.



Source-WIR2020

Resilience in GVCs

- Building supply chain resilience can take many forms **beyond relocating production**.
- This includes **strengthening risk management capabilities** and **improving transparency**; building redundancy in supplier and transportation networks; holding more inventory; reducing product complexity; creating the capacity to flex production across sites; and **improving the financial and operational capacity to respond to shocks and recover quickly from them**.
- For e.g. China has become a particularly attractive investment destination and trading partner for neighbouring economies over the years, especially the Association of Southeast Asian Nations (ASEAN). It has also focused on building international economic relationships within its own '**neighbourhood**',
- A shift in investment promotion strategies towards **infrastructure and services** is necessary.
- For the past three decades international production and the promotion of export-oriented manufacturing investment has been the pillar of development and industrialisation strategies of most developing countries.
- Investment geared towards exploiting factors of production, resources and low cost labour will remain important, but the pool of such investment is shrinking.
- A degree of rebalancing towards growth based on domestic and regional demand and on services, as well as the green and blue economy, will be the new path forward

Resilience in GVCs

- Internet-driven GVCs are **diminishing the importance of physical stores and retailers**, a trend that has been magnified by the COVID-19 pandemic.
- Internet-driven value chains have also adding important new dimensions, **including the two-sided market** where customers can directly contribute their feedback to sellers or manufacturers, thereby influencing future product development and output (Evans 2011).
- This has significant implications for the labour-market space.
- Internet-based virtual intermediaries **replacing physical intermediaries**, such as brick and mortar stores, the displacement of clerks, and other face-to-face service providers, is accelerating—and entailing a remarkable shift within the spectrum of demand for services jobs.
- Internet-based virtual intermediaries have developed whole new value chains, such as the **data-driven value chain** for the generation, processing, and sale of data products (Curry et al. 2014).
- COVID-19 pandemic has both **expanded e-commerce** and underscored the fragility of some supply chains.
- This has revealed the need for diversity to accelerate resilience, which may prompt the reconfiguration of the GVC landscape, including **near-shoring, regionalization, and reshoring**.
- The **role of digital platforms** due to their inherent interplay with sourcing, production, marketing, distribution, and service networks will likely continue to be crucial for shaping GVCs in the future.

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