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Least-Developed Countries in a World of Global Value Chains: Are WTO Trade Negotiations Helping?

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Summary. — Nimble trade and industrial policy is essential for Least-Developed Countries (LDCs) to thrive in a world of global value chains (GVCs). "Adaptive states" in LDCs need to create and exploit policy space in national decision-making, build specific production capabilities to participate and meaningfully capture value in GVCs, and handle policy stretches arising from factors and actors they cannot control. In this article, we show that the outcomes of recent multilateral trade negotiations will facilitate these processes only partially. The World Trade Organization's (WTO) Bali and Nairobi Ministerial Declarations have been commonly portrayed as relative victories for developing countries, but they have not provided sufficient steps forward for LDCs. While the WTO Trade Facilitation Agreement can help integration into GVCs by enabling freer imports and exports, supportive industrial policies are also needed to guide investment in the direction that allows for flexible specialization and domestic value addition—these options are severely limited in the current WTO regime. The legally binding commitments made in Nairobi on rules of origin are also a positive step, but must be linked to the yet unmet duty-free and quota-free commitments. We conclude by arguing that a future agenda for LDCs should focus on supply-side constraints, as well as on allowing nimble industrial and trade policies that can facilitate meaningful participation in some GVCs—and non-participation in others that are more detrimental to broad-based development.

Key words — global value chains, LDCs, WTO negotiations, trade and industrial policy, adaptive state

1. INTRODUCTION

Nimble trade and industrial policies are essential for Least-Developed Countries (LDCs) to thrive in a world of global value chains (GVCs).[1] "Adaptive states" (Whittaker, Sturgeon, & Song, 2014; Whittaker, Zhu, Sturgeon, Tsai, & Okita, 2010) in LDCs need to create and exploit policy space in national decision-making, build specific production capabilities to participate and meaningfully capture value in GVCs. Adaptive states also need to handle policy stretches arising from factors and actors that they cannot control. In this article, we examine whether the outcomes of recent World Trade Organization (WTO) trade negotiations include the tools that can promote meaningful LDC participation in GVCs. While there is general consensus in the trade and development literature that trade negotiations should aim at reducing the costs of trade, especially for developing countries and LDCs, there is wide disagreement on how this should be achieved (McCulloch, Winters, & Cirera, 2001; Rodrik, 2001; Stiglitz & Charlton, 2005; Wilkinson & Scott, 2013). WTO negotiations traditionally focused on reducing tariffs and quotas. But tackling non-tariff measures, regulatory policies and the domestic costs of trading has increasingly come under attention (Anderson & Wincoop, 2004; Arvis, Duval, Shepherd, & Utoktham, 2013; Hoekman & Nicita, 2011), together with the possibility of allowing "development defense" in dispute settlement cases related to the use of proactive industrial policy (Hoekman & Olarreaga, 2007).

Many of the perspectives on LDC participation in multilateral trade negotiations focus broadly on how other WTO members should eliminate detrimental policies, agree to multilateral rules that promote development, and deliver the necessary aid for LDCs to live up to their commitments (Hoekman & Kostecki, 2009; Narlikar, 2003, 2006; Wade, 2003). While valid as a point of departure, we push this analytical agenda further by linking the combined outcome of the recent WTO Ministerial Conferences in Bali (MC9) and Nairobi (MC10) to what GVC research suggests is needed to facilitate fruitful LDC participation in the global economy.

In the rest of this article, we first introduce the arguments behind GVC analysis, along with a brief coverage of key debates on trade in value added, the "adaptive state", and nimble trade and industrial policy. Next, we examine the origins and content of the WTO MC9 and MC10 agreements, followed by a more detailed examination of two sets of issues in these agreements that are particularly relevant for LDC participation in GVCs: trade facilitation, and duty-free and quota-free (DFQF) measures and related rules of origin. We conclude by arguing that a future development agenda for LDCs should include a bounded use of supportive trade and industrial policy that can facilitate flexible specialization, domestic value addition, inclusive and sustainable participation in some GVCs, and non-participation in others that are more detrimental to broad-based development.

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2. GLOBAL VALUE CHAINS, THE ADAPTIVE STATE, AND TRADE AND INDUSTRIAL POLICY IN LDCS

Global value chain (GVC) analysis has brought three key observations to long-standing discussions of the role of trade in development: (1) some of the key international trade dynamics arise in the interactions not between countries, but between and within firms (often transnational); these firms either add value sequentially or trade intermediate products that are used to assemble final products for end-markets (Kaplinsky & Morris, 2016; Ponte & Sturgeon, 2014); thus, policy based on traditional trade statistics overlooks where value is added to products, which is vital to ascertain which countries draw which benefits (Cattaneo, Gereffi, & Staritz, 2010; Elms & Low, 2013; OECD, 2013, 2015; UNCTAD, 2013); (2) a global economy organized in GVCs implies that countries need to find new ways to participate, add value and specialize; this requires an *adaptive state*, which acts with agility and is able to tackle simultaneous societal problems and needs that create "policy stretch" (Whittaker *et al.*, 2010, 2014); and (3) trade and industrial policies should be tackled in combination and with a high degree of flexibility (OECD, WTO, & World Bank, 2014; Taglioni & Winkler, 2016). In the rest of this section, we explore these three sets of issues in turn.

(a) *Trade in value added*

Measuring gross trade flows does not provide clear indications of *where* value is added. It also provides a distorted view of bilateral trade balances, as intermediate products imported from other countries are incorporated in gross export values. For example, an iPhone that ships from China to the US is usually treated in trade statistics as causing a negative trade balance of $169 for the US. But when value added is measured at each stage of production, a much more nuanced picture emerges – with China adding only $6.5 of value per iPhone, Korea adding $80 and Germany $16 (Gereffi, 2014; Xing & Detert, 2010). Under the proposition that what counts is trade in value-added, GVC analysis challenges the classic liberal views on global imbalances and market access, and on the effects trade has on employment, the environment and competitiveness (Elms & Low, 2013; Taglioni & Winkler, 2016).

A value-added focus on trade also entails that upgrading no longer requires a country to have capabilities within all aspects of production. The patterns of specialization apparent today show that countries can focus on the production of intermediary goods, a simpler task than creating beginning-to-end production systems (Cattaneo *et al.*, 2010; Ponte & Sturgeon, 2014). But while trade in intermediary goods is larger than trade in finished goods (Sturgeon & Memedovic, 2011), opportunities for trade in intermediary services (what is referred to as "trade in tasks" in some of the GVC literature) are not clear, as they are more difficult to measure. It should also be recognized that involvement in intermediary good production is currently concentrated in industrialized and emerging economies, with many LDCs still operating largely in sequential value addition to natural resources (Kaplinsky & Morris, 2016; Taglioni & Winkler, 2016).

The global "unbundling" of production highlighted in the GVC literature suggests three important aspects for how LDCs can be better integrated in global trade: (a) they can attempt to tap into the production of specific intermediary goods in a value chain; (b) they can raise their competitiveness by building capacity for their firms, not only to join GVCs and remain part of them, but also to capture more value and increase domestic content in time; and (c) given that key parts of GVCs operate regionally, LDCs without sufficient capacities of their own should seek regional integration (Gibbon & Ponte, 2005; Sturgeon & Memedovic, 2011).

(b) *The adaptive state*

Contemporary development processes are constantly changing, becoming more "compressed" and occurring along different paths than in the past (Whittaker *et al.*, 2010). While Asian late-developers started their development process in the so-called industrial era, the global economy is now organized as a collection of GVCs. This prompts countries to find new ways to participate, add value and specialize. In this context, Whittaker *et al.* (2010) question a development strategy based on emulation (Reinert, 2007, 2009). This is also because accession to the WTO limits the usefulness of previously available options—which were discussed under the rubric of the "developmental state" (see, among many others, Amsden; 2001; Dosi, 1988; Woo-Cumings, 1999; Wade, 2003; Rodrik, 2005). The question is not simply one of emulating earlier institutional and technological innovations, but one of finding ways of "fitting in" contemporary GVCs (Whittaker *et al.*, 2014).

Whittaker *et al.* (2014) highlight that timing matters, and that learning and upgrading now occur in a different context. In order to best benefit from the opportunities for development provided by GVCs, states (including in LDCs) must remain active in promoting engagement, but must do so in an agile manner. This requires an *adaptive state*, which is similar to the developmental state in taking initiative, but acts according to the changed environment of GVCs. It is not just agility that the state needs, but also the ability to tackle simultaneous societal problems and needs, in the context where powerful actors do not operate within a national jurisdiction (Whittaker *et al.*, 2014). While state-society linkages in late development theory were based on connections to—and power over—business elites, most if not all LDCs lack power over major corporations nowadays.

In contrast to the developmental state, which focused on designing and coordinating industrial development within its national borders, the adaptive state can facilitate the possibility of technological upgrading and learning through participation in GVCs. Furthermore, state engagement with GVCs must be understood in the context of leveraging the learning processes that are associated with the now blurred and simultaneous stages of development (Whittaker *et al.*, 2014). Importantly, the required agility of the adaptive state faces other external limitations that were not present in earlier periods. The narrowing policy space derived from membership in the WTO (Gallagher, 2005; Hoekman, 2005; Natsuda & Thoburn, 2014), for example, continues to curtail independent state action in addressing the simultaneous challenges of economic, social, and human development, despite the special provisions for LDCs. In attempting to meet numerous challenges simultaneously, states inevitably engage in "policy stretching" (Whittaker *et al.*, 2010), which thins their already limited capacity.

(c) *Nimble trade and industrial policy*

GVC analysis allows us to go beyond a simplistic distinction between trade liberalization and protectionism. The reality of a myriad of transactions, actors, processes, and tasks that is involved in GVC participation presents policy makers in LDCs with a more complex picture that requires precise,