CHAPTER 3: VALUE CHAINS AND THE DEVELOPMENT PATH

This chapter addresses how value chains o er o 3Nre49.1r:1 3o Ts:1 s14.422ATswO7i3422se

Speed and flexibility are crucial not only for the exchange of physical goods/services, but especially for information flows across countries within value chains. Adherence to international standards has become more important for the production of increasingly modular physical goods, as well as for the exchange of information across borders. Value chains crucially depend on seamless and uninterrupted information flows across companies and countries; ICT networks channel business information and data needed for the efficient co-ordination of activities across locations. A well-developed ICT infrastructure is therefore necessary to connect countries to the value chain activities of companies (OECD, 2013a: 161). Overall, reductions in effective transportation and communication costs can be seen as equivalent to trade liberalisation in reducing the costs of exchange and enhancing trade between countries (Globerman, 2011).

In addition to investments in "hard" transportation and communication infrastructure, the development of a "soft" infrastructure (*i.e.* facilitating policies, procedures and institutions) is at least as important for the integration of countries into value chains. Recent research has pointed to the quality of the institutional framework as a source of comparative advantage (Grossman and Helpman, 2005). Since value chains involve a large number of activities contracted between different companies, *i.e.* lead firms and independent suppliers, contract enforceability is crucial for the smooth functioning of value chains. Countries with better legal systems are indeed found to export more in more complex industries (Levchenko, 2007; Costinot, 2009). Moreover, tasks that require more complex contracts (*e.g.* R&D, design, branding) are more cheaply conducted in countries that have well-functioning contractual institutions (Acemoglu *et al.*, 2007). Countries characterised by bad governance and political instability have failed to attract foreign investors to export processing zones despite the fact that these dedicated zones promised to shelter investors from local rules (Cadot *et al.*, 2011).

Competitiveness in value chains is critically dependent upon efficient services inputs. Embedded services largely represent the "glue" between countries' infrastructure and companies' activities within the trade-investment-services nexus of value chains. Investments in logistics services (*i.e.* services and processes for moving goods from one country to another) are found to be strongly trade enhancing; examples are the organisation and management of international shipment operations, tracking and tracing, and the quality of transport and information technology infrastructures. High-quality logistics impact trade relatively more than less policy-dependent trade determinants such as distance and transport costs. A recent OECD study indicates that every extra day needed to ready goods for export and import reduces trade by around 4 percent (Korinek and Sourdin, 2011).

Last but not least, the supply capacity of domestic firms (often SMEs) is key to connect them better to value chains. Lead firms are attracted to "deep" markets in their search for independent suppliers in foreign markets: if the market is large, companies will have a better chance to find the appropriate match and in the case the supplier fails to deliver, alternative solutions are available (WTO, 2008).

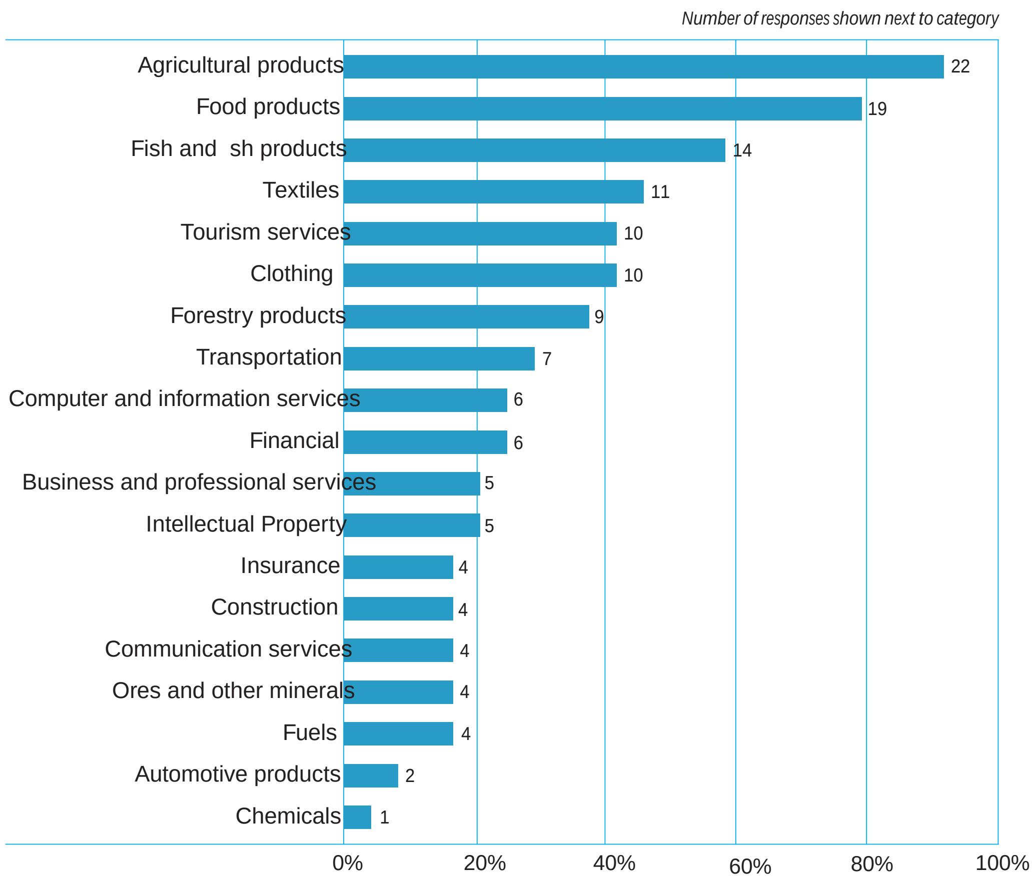
Capturing the gains

Connecting to value chains is a first step towards economic development, but the principal objective of partner countries remains to capture more of the value-added in each chain. Indeed, the link between participation in value chains and development still is questioned (Ismail, 2013) and while participation in value chains can bring benefits, it also presents risks.

Maximising the benefits

Not all value chains increase the transfers of skill and technology from lead firms to local suppliers in developing countries. Staritz *et al.* (2011) analysed the role of value chains in socio-economic upgrading and observed that the literature often focused on the economic rather than social dimensions of upgrading (*i.e.* improved working

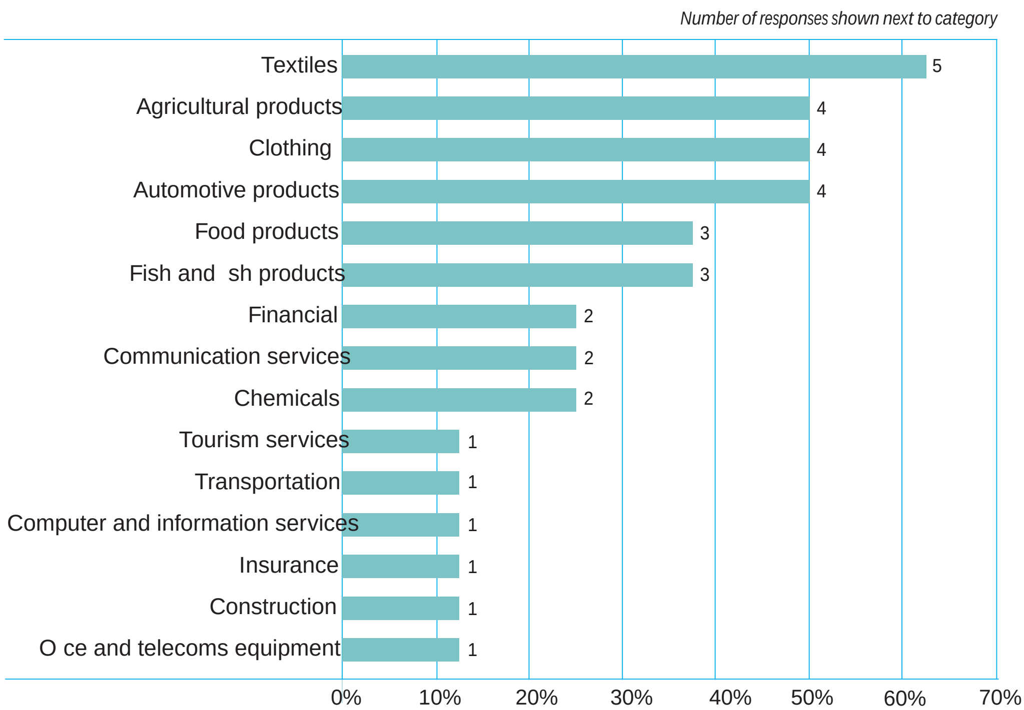
and in Tonga to control fruit ies, as well as in Indonesia to improve dairy livestock. Several projects were nanced by donors to aid producers in meeting quality standards in their home and other export markets. Examples include



Source: OECD/WTO Questionnaire 2013, *www.aid4trade.org*.

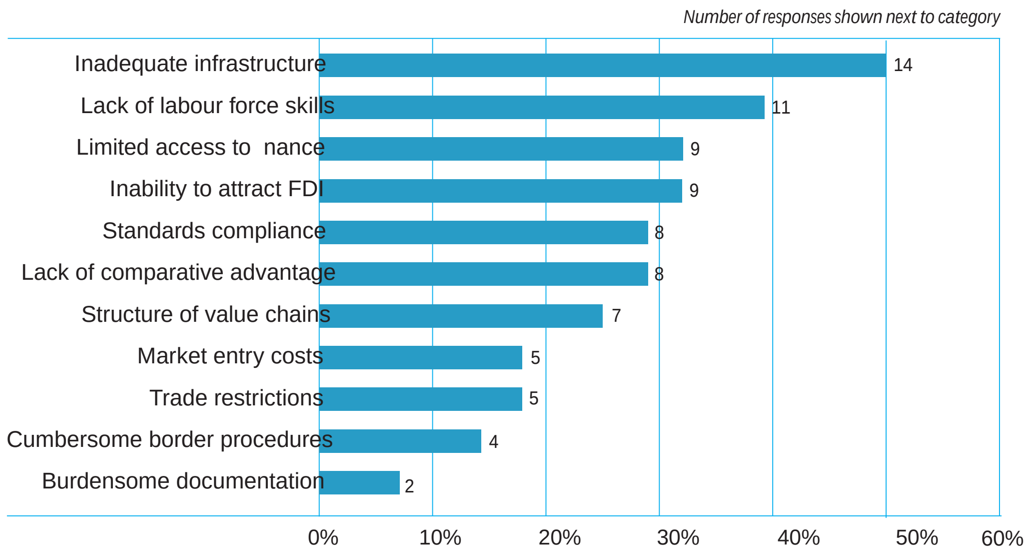
Through its Sustainable Economic Growth Strategy, which guides aid-for-trade activities, Canada is actively supporting a number of e orts to strengthen access to global value chains. These e orts have primarily focused on agribusiness value chains in Bangladesh, Ukraine and Viet Nam, and in the extractive sector value chains, most notably in Peru. Value chain development has been a strategic priority for Denmark since 2010, while New Zealand•s Aid for Trade focus is on helping the Paci c Islands to engage in value chains and to encourage greater access to the New Zealand market. Germany•s priority is to improve integration into regional and international value chains and strengthen compliance with social and environmental standards (BMZ, 2011:6). Germany also helps SMEs and small-scale farms to improve their exports and marketing capabilities, so as to use value chains at the micro level to achieve higher levels of value added.

Enabling SMEs in developing countries to export, which is a core objective of the International Trade Centre (ITC),



Source: OECD/WTO Questionnaire 2013 *www.aid4trade.org*.

Fashion Initiative). ITC also provides training that speci cally targets supply-chain management and participation in international value chains, and explores further areas of co-operation with lead rms to improve developing countries• supply chain management and to better connect women-led SMEs to value chains.[5] As public-private dialogue is a critical ingredient for developing domestic value chains in de



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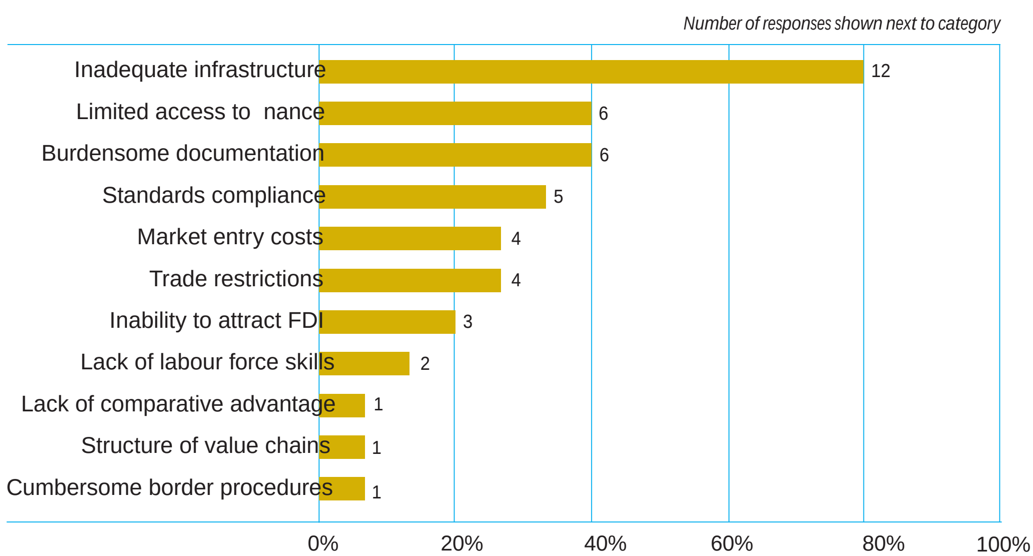
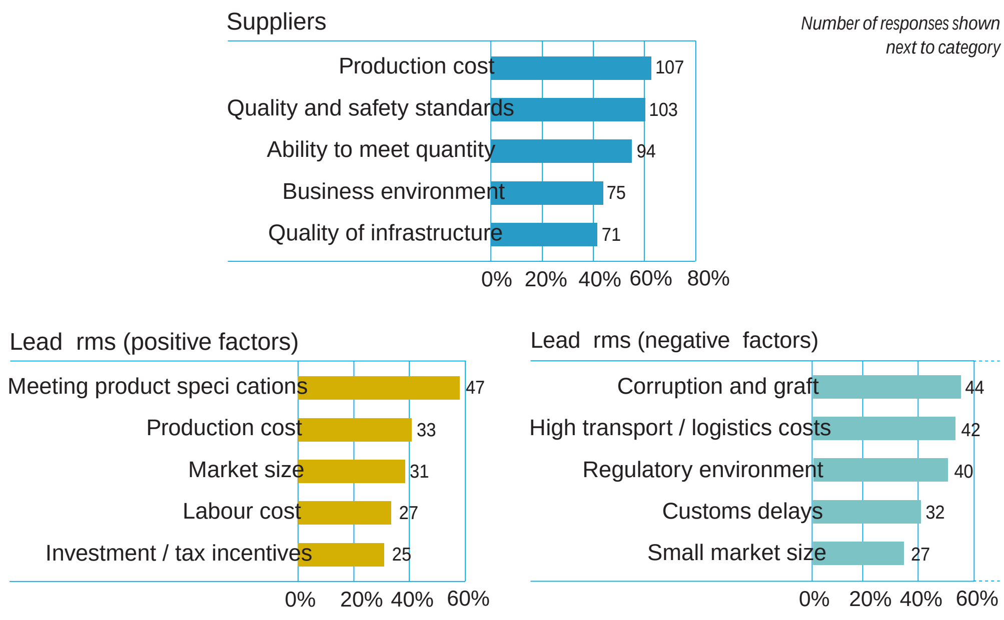


Source: OECD/WTO Questionnaire 2013 *www.aid4trade.org*.

Another major constraint highlighted by partner countries and bilateral and multilateral donors, and to a lesser extent by providers of South-South trade-related co-operation, is meeting and certifying the technical, health and safety stand3nance

Among lead rms across all ve sectors customs procedures ranked high as a particular obstacle in bringing



Source: OECD/WTO Questionnaire 2013 *www.aid4trade.org*.

skills/productivity (38 percent). Lead rms consider a developing country attractive for sourcing and investment opportunities, in the context of value chains development, if it is able to consistently meet product speci cations (58 percent), has low production and labour costs (41 percent and 33 percent, respectively), has a large domestic market (38 percent) and o ers attractive investment or tax incentives (31 percent).

Other factors include con dence in the regulatory environment (27 percent), labour skills (26 percent), the depth of local goods and services (26 percent), market openness and participation to trade agreements (25 percent each), language (25 percent), market proximity (21 percent), and short order completion times (16 percent). A country will be unattractive if it is subject to corruption and graft (53 percent) and has high transport and logistics costs (51 percent), a weak business and regulatory environment (48 percent), customs delays (38 percent), a small market size with low purchasing power (33 percent), and low labour skills (27 percent).

Asked about the support needed to join and move up value chains, developing country suppliers indicated that they seek as a priority better access to nance (59 percent of the answers), incentives for investment (57 percent), better market access (56 percent), investment in infrastructure (46 percent), internationally recognised standards (38 percent), and labour training schemes (36 percent). This largely mirrors the wishes expressed by lead rms, which point to better market access (52 percent), investment in infrastructure (46 percent), better public-private dialogue with national authorities (44 percent), trade facilitation measures (42 percent), better standards infrastructure and certi cation capacity (37 percent), and support to improve the business environment (36 percent).

Among the 160 developing country suppliers that responded 70 percent bene tted from a government initiative, 50 percent from a development agency initiative, and 20 percent from a foreign company initiative. For those rms that bene tted from support, the main impact has been better export market intelligence (46 percent of the responses), geographical and product export diversi cation (46 percent exported to new markets and 25 percent exported

Textiles and apparel

Tourism

Tourist arrivals surpassed 1 billion for the rst time in 2012. Despite occasional shocks, international tourist arrivals have enjoyed virtually uninterrupted growth … from 277 million in 1980 to 528 million in 1995, and 1.035 billion in 2012. Developing countries are playing an increasingly prominent role in this expanding sector. Tourism is one of the top three exports for the majority of developing countries. It is the lead export for at least 11 LDCs and an important sector of economic activity in all LDCs that have managed to or are about to graduate out of LDC status.

The tourism sector is contributing to economic growth in developing countries and o ers signi cant further potential. Tourism is employment intensive and has linkages to many other parts of the economy. It contributes directly to poverty reduction … notably among women. This has been recognised by policy makers both at the national and international level. Development strategies in LDCs and other low income countries often highlight the tourism sector and its important potential to stimulate growth and poverty reduction. The majority of LDC Diagnostic Trade Integration Studies highlight tourism as a priority sector for growth and exports.

This section examines tourism value chains and the role of developing country rms within this global sector. It focuses on identifying bottlenecks that impede developing country rms from connecting to tourism value chains or that make it di cult for developing countries to reap bene ts from tourism. It focuses on the 113 responses received from lead rms and developing country tourism operators across 46 countries collected through a joint OECD-WTO-UNWTO monitoring survey, conducted in collaboration with the International Chamber of Commerce (ICC), the International Trade Centre (ITC) and Grow Africa. In total, 23 lead rms replied from 17 countries (including from 6 developing countries) and 83 developing country operators from 34 countries. Among the lead rms, three respondents had a turnover in excess of USD 1 billion per annum. The survey results (Figure 3.11) highlight that:

- The quality of the general business environment and access to nance play a crucial role when it comes to allowing suppliers in low and middle income countries to operate e ectively and to connect to global value chains. This is in line with ndings in relevant empirical literature and with anecdotal evidence.
- Labour skills are another crucial determinant for the success of suppliers of services in the tourism sector. Although this determinant has received less attention in previous literature, the role of skills does not come as a surprise given the frequency and importance of personal contacts between service providers and clients in the tourism sector.
- Openness to imports, security and a smoothly functioning visa scheme are other elements that are crucial for the tourism sector to engage in a strong and sustainable growth path.
- The availability and quality of infrastructure plays a key role in the development of the tourism sector because of its role in bringing tourists to the country and in allowing them to travel through the country.

In order to maximise spill-over e ects of the toCs6 cs .d e   ve

Source: OECD/WTO Questionnaire 2013,

Partner countries consistently see domestic and foreign private investment, as well a1se.3(l)0(a1 ,7i)141a0 ade

partnerships can incentivise and leverage such investments. Besides facilitating infrastructure investments, policy makers and regulators face the challenge of increasing competition in access to undersea cables so that lower access prices will accelerate the proliferation of broadband.

ICT is an enabler of economic and social development for firms and households. Internet and mobile phones have allowed the rise of e-commerce. E-commerce provides entrepreneurs with improved access to domestic and foreign markets and allows for new types of services such as mobile money. However, developing countries still face significant challenges regarding e-commerce such as lack of internet access, insecure payments systems, lack of digital literacy or inadequate distribution networks, and customs procedures for the shipping of goods sold online.

Figure 3.15 Reasons for lead rms to better connect developing country suppliers to their value chains
(percentage of responses)

Figure 3.16 Lead rms• assessment of the impact of activities to connect developing

CONCLUSIONS

Value chains create opportunities for economic growth in developing countries. The analysis of agri-food,

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