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Building Inclusive Global Value Chains

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Executive Summary

- This article considers the economic dimension of inclusiveness, which is pivotal for fair distribution of benefits within and between countries, and, accordingly, for global sustainable development.The author makes some suggestions on how global governance mechanisms can support developing economies in attaining their respective share of benefits from globalized trade and investments.

Antonio Guterres, UN Secretary-General, during his WEF speech in January 2019, addressed the causes for resentment of multilateralism and proposed ways to rebuild trust in multilateral cooperation. Guterres suggests that we live in transition to the multipolar world and currently experience unclear power structures, as major powers have dysfunctional relations, while middle-sized powers are gaining more influence. Today's world is characterized by high level of convergence of politics, economy and technology. These interdependencies are more complex than ever, challenging the capacity of existing national and international governance structures to provide adequate and timely response, thus adding to the lack of confidence in multilateralism. The UN Secretary-General concludes that solution is in committed and effective collaboration within the entire family of international organizations and between these organizations, national governments and non-state actors, to deliver inclusive multilateralism, where no one is left behind.

The history suggests that fundamental technological shifts deepen divide between economies, and change the balance in the power of nations, notably the first industrial revolution with the introduction of the steam and waterpower at the end of 18th century. Technological breakthroughs, if lack inclusiveness, may lead to inequality rise within nations and between nations, fueling frustration of disengaged citizens and elevating risks of conflicts. How to ensure that significant number of countries not classified as developed economies and hosting most of the world's population, attain a fair place in the global economic distribution system and how global governance can support this?

Positioning developing economies for the future of production

WEF and A.T. Kearney in their report "Readiness for the Future of Production" examine 100 countries for their structure of production and its drivers. Only 25 countries are ready to benefit from the Fourth Industrial Revolution and already account for over 75% of global manufacturing value added. These leading 25 countries are best fit to attain even larger share in the future. Disturbingly, 90% of countries from Latin America, the Middle East, Africa and Eurasia are classified as nascent, given limited scope and complexity of their production base and risk of disruption from the Fourth Industrial Revolution. The authors of the report recommend nascent economies invest in their drivers of production, such as human capital, trade and investment, innovation and

institutional capacity. Obviously, the challenge with this recommendation lies in its implementation, given the limited technological and financial resources of countries classified as nascent.

The importance of economic inclusiveness of developing countries

Economic sustainability of developing nations during technological disruptions is vital on the national and sub-national levels as weak local private sector impedes wealth generation and distribution. This contributes to polarization of societies, to risks of conflicts and to proliferation of marginalized ideologies.

On the international level, inadequate participation of developing economies in global wealth distribution creates tensions between nations, gives rise to nationalistic movements and resentment to multilateral collaboration. This creates also threat to global security and entails the risk of substantial economic and social disruptions.

Consequently, it is imperative for developing economies to have a fair place in the global wealth distribution, relative to their demographic size and potential economic capacity. There should be no loosing countries due to technological disruptions. Instead, technological advancements should provide new ways of integrating developing economies into higher value-added opportunities. As examples we can mention the proliferation of mobile payment solutions in countries with poor landline telecom infrastructure, and the use of drones to deliver goods in locations with poor transport connections.

Integrating into global value chains

Obviously, higher level of economic development and technological adaptability requires countries to unlock their human capital by aligning skills with the future of production, enabling supportive institutions, physical and social infrastructure, so that nations develop their unique capabilities and integrate into global value chains through trade and investment. The key challenge is how to achieve such successful integration.

Multinational enterprises (MNEs) are the winners of globalization, owners of technologies and value chains. They often use tax and labor arbitrage to gain efficiencies. As technologies replace step by step human workers, labor costs as the only competitive advantage of developing economies will lose its attractiveness. Some developing markets may face the risk of expulsion from global value chains and de-industrialization. In other words, technological disruption can potentially move them backward. Therefore, developing economies should be competing on unique capabilities, not on labor costs. The objective is to attain and enhance such capabilities. Given the late stage of globalization, it is challenging for local businesses to tap into global networks through organic growth and gradual competence building. The feasible way of local business integration into higher value-added global chains is through collaboration with MNEs.

At the same time, MNEs are highly selective in determining their host countries for investment, which makes developing economies compete in providing better terms for MNEs establishment on their territories. Moreover, MNEs might expect higher rate of returns on their investments due to perceived instability in macroeconomic, social or political environment. As such, the power of MNEs in negotiations with developing states, especially those of smaller market size, is growing. To support developing economies in attaining stable and strategic flows of foreign direct investments (FDIs), global supportive mechanisms are needed to mitigate or co-share risks for MNEs and provide best possible conditions for host states.

The role of multilateral organizations in the future of trade and development

The extensive family of international organizations in trade and development, including WTO, UNCTAD, ITC, ECOSOC with Bretton Wood Institutions, to mention a few, need to align their agenda to position developing economies for the future. It is vital to propose nation states not only FDI attraction and export promotion frameworks, but also specific tools to adapt to the future of production by identifying and enabling unique core competencies of the nation, unlocking and upskilling its human capital. The objective is to align vast supply of global capital with financing and capacity building needs in developing economies, in sustainable and profitable models, so that these economies move up the value chain instead of stagnating at its bottom.

Such models will require careful customization, with respect to national political, social and cultural traditions. Therefore, how to advance the objective of moving up in the global value chain and attain a larger share of global wealth is a central question of policy reforms on the national level. Key actors should be the States with their government, local private sector and civil society. On the international level, global governance mechanisms should play a role of

supportive facilitator, providing expertise and mobilizing financial flows.

Currently there is a general public perception that private platforms like WEF or informal governance systems like G20 lead in setting the global economic agenda. The significance and complexity of inequality between and within nations gives global economic governance institutions the opportunity to try to resolve this issue by taking a lead, in partnership with national states, MNEs and NGOs.

Governance mechanisms to incentivize MNEs for enabling local businesses

MNEs and local entrepreneurs share common interests and interdependencies, such as sustainable supply chains, growth and wealth of customer base, peaceful and inclusive societies. At the same time, MNEs may wish to capitalize on efficiencies and deficiencies of developing markets, by gaining excessive profits and not contributing their fair share to the society through relative portion of taxes, decent labor conditions, careful treatment of environment and respect to local social institutions.

Therefore, attraction of FDI and enablement export flows for developing economies should align with strategic priorities of the State and be conditional upon MNEs relevance to the national sustainable development. Obviously, strategic FDI brings value to communities not only through financial flows, but rather through building supportive entrepreneurship ecosystem, raising sophistication and technological adaptability of the domestic market, and upskilling human capital. The States and civil society should champion meaningful and fair collaboration of MNEs with local businesses, through relevant regulations and incentives.

However, some MNEs are more powerful than many developing states, based on their global financial, operational and technological capabilities and influencing power. Thus, global governance mechanisms are vital for enabling MNEs meaningful contribution to developing economies, relative to the size of benefits derived by MNEs through their operations in these economies.

OECD BEPS initiative is a prominent example of international governance to enable transparency and fairness of international taxation. Over decades, countries steadily lowered corporate tax rates and provided incentive schemes to attract international businesses. Average statutory corporate tax rate in OECD countries (where the majority of MNEs are headquartered) dropped from 43% (in 1981) to 22% (in 2017). Thus, tax burden shifted from taxing capital to taxing labor. This substantial decline enabled MNEs to generate sizable additional profits and expand their powers, while leaving public tax revenues constrained. Moreover, some MNEs optimize their taxation through various schemes to reduce tax burden further. Long-expected OECD BEPS initiative introduces country by country reporting to determine relevant level of taxation of MNE in each of its location worldwide, taking into consideration points of sale, employment and assets placement. This should result in more equitable tax base across countries and tax revenues proportionate to MNEs benefits from respective economy.

More should be done, though, in bringing transparency and fairness to supply and labor chains. In particular, international organizations can provide a more coherent approach to support channeling investment and trade flows with measurable and quantifiable impact on sustainable development of the State, for instance by assessing the impact against SDGs in a particular country. The tangible help will come from assisting States in identifying their competitive advantages for global or regional investment and trade and linking their industrial policies with SDGs. The focus should be given on key sectors with multiplying effect that would generate higher value activity, advanced skills jobs and scale the nation's unique capabilities, followed by mobilizing finance through anchor multinational investors who would enable local entrepreneurship.

UNCTAD estimates that an investment of 3.9 trillion USD is needed on average each year from 2015 to 2030 to fully meet 17 SDGs in developing countries alone. Only 36% (1.4 trillion USD) of this amount is met by current public investment plans. The remaining 2.5 trillion per year represents a gap that can potentially be addressed through MNEs direct investment flows, international development institutions, sovereign wealth funds, pension funds, high-net worth individual funds.

The key role of international organizations is to provide facilitations to align supply and demand in flow of impactful finance, capacity building for state's policies and institutions. It is vital to incentivize global private sector for long-term sustainable investment, given that MNEs are both contributors to and beneficiaries of developing economies inclusive growth. However, the work of international organizations should not focus only on policies and collaboration with states and institutions. Enterprise level work is essential to help build their resilience at the bottom of the value chains, especially those of SMEs and make them rise through the chains.

The ongoing COVID-19 pandemic demonstrates how fragile global value chains could be, with most burden from disruption taken by those at the bottom. WTO expects global trade to fall between 13% and 32% in

2020. WTO suggests that lessons learnt from COVID-19 could contribute to a further growth of e-commerce, and could help narrow digital divide between countries and support small businesses by engaging them in online trade.

Conclusion

Unequal power relations in global value chains fuels resentment to globalization and multilateralism in general.

The solution lies in comprehensive collaboration between international organizations in the UN family, informal international platforms like G20, NGOs and the private sector, which are a vital component of the mechanism for economic advancement of developing economies, given that MNEs de-facto own global value chains.

The world needs to bridge the inequality gap between nations and within nations. The challenge is magnificent. International organizations are best positioned to propose enhanced global economic governance, given their legitimacy, neutrality, accumulated expertise, capabilities and networks.

Regulations with respect to transparency of supply chains are needed on both national and international levels, as well as global coordinated mechanisms are required to support developing economies to advance their positioning in global value chains. This requires not only policy level solutions but practical work on the level of enterprises by elevating their competencies to claim a bigger share of value. E-commerce has been a growing trend over the past decade, and COVID-19 pandemic accelerated it, thus providing more opportunities to advance in value chains through digital channels.

Further reading

- Guterres A., speech at the World Economic Forum, 24 January 2019 https://www.weforum.org/agenda/2019/01/these-are-the-global-priorities-and-risks-for-the-future-according-to-antonio-guterres/

- World Economic Forum, A.T. Kearney "Readiness for the Future of Production" (2018)

- UNCTAD – promoting investment in SDGs, Investment advisory series, Series A, Number 8

- United Nations Publication - Transnational Corporations - investment and development, Volume 25, 2018, Number 2. Special issue on investment and international taxation. Does tax drive the headquarters locations of the world's biggest companies? Sharing the corporate tax base: equitable taxing of multinationals and the choice of formulary apportionment

- WTO, E-commerce, trade and the COVID-19 pandemic, 4 May 2020, Information note

About the author

Natalya Kozlenkova is a practitioner with expertise in the areas of multi-stakeholder partnerships, investment promotion and facilitation, private sector enablement and sustainability programs. Currently works as a consultant with an international organization in Geneva. She served on the Foreign Investors Council Investment Policy working group in Kazakhstan and on the OECD Eurasia competitiveness working group. She is graduated from the Said Business School, University of Oxford, and holding a postgraduate degree in Global Business as well as a postgraduate Master in European and International Governance (MEIG Programme) from the University of Geneva.

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