# *Executive summary*

Today, “what you do” (the activities a firm or country is involved in) matters more for growth and employment than “what you sell” (the final product). Global value chains (GVCs) allow firms and economies to “do” the part of the process they are best at, using intermediate goods and services from elsewhere without having to develop a whole industry. They affect countries’ competitiveness and patterns of trade and investment, offer potential for development in less developed countries, but also imply risks.

Old-style support policies that ignore the interconnected nature of production in GVCs and the need for international competition and openness may result in protectionism, but success in international markets depends as much on the capacity to import high-quality inputs as on the capacity to export. The growing interconnectedness of economies creates important opportunities but also new policy challenges.

## *Competitiveness*

Competitiveness in GVCs requires strengthening factors of production that are “sticky” and unlikely to cross national borders. This implies investment in human capital and skills and high-quality infrastructure, and encouraging strong industry-university linkages and other tacit knowledge. The quality of institutions and government are also important.

Outsourcing and offshoring enhance competitiveness by providing access to cheaper, more differentiated, and better quality inputs. Manufacturing remains a core activity in GVCs, although services are also a source of much value creation. Governments in advanced economies can help anchor production and value creation by supporting investment in skills and advanced manufacturing technologies, including in traditional industries, and through policies that strengthen networks and co-operation.

As small and medium-sized enterprises (SMEs) play an important role in niche areas of GVCs and contribute to the exports of larger firms, governments can encourage the development of SMEs’ linkages with international firms by fostering their ability to innovate and facilitating their adoption of product standards.

## *Trade*

Trade-facilitating measures, such as fast and efficient port and custom procedures, permit the smooth operation of value chains. In most economies, around a third of intermediate imports end up in exports. In GVCs, tariffs and other import barriers are therefore effectively a tax on exports. Export restrictions can also impede the efficient functioning of GVCs and raise costs. The negative effects of trade protection are compounded when parts and components cross borders many times.

GVCs strengthen the economic case for advancing multilateral trade negotiations, as barriers between third countries upstream or downstream matter as much as barriers in direct trading partners and are best addressed together. Convergence of standards and certification requirements and mutual recognition agreements can also alleviate burdens on exporting firms.

While abolishing tariffs is a starting point for creating new trade opportunities, GVCs also require efficient services and the possibility to move people, capital and technology across borders. Services already account for over half of value creation in GVCs in many OECD countries and over 30% in China. Regulatory reforms and liberalisation of trade and investment in services are essential to enhance competition and increase the productivity and quality of services.

### *Investment*

Investment policies need to focus more closely on activities in GVCs than on industries because success in GVCs depends on the promotion and facilitation of both inward and outward investment. Given the important role of multinational enterprises (MNEs) in GVCs, lowering investment barriers is an efficient way for a country to participate. Moreover, by inhibiting the efficient functioning of GVCs, impediments to cross-border investment can have significant negative welfare impacts.

Governments should work together to ensure that the multilateral investment system continues to support growth. A regime built on thousands of bilateral and regional investment agreements does not adequately reflect the interconnected nature of economies in GVCs. Multilateral co-operation and co-ordination are needed to maintain the open and predictable international investment climate that has supported international investment in GVCs. Governments should not engage in incentive wars to attract high-value stages of a GVC.

### *Development*

Through access to networks, global markets, capital, knowledge and technology, integration in a GVC can be a first step to economic development. Developing economies can enter GVCs by opening their markets to trade and foreign direct investment and strengthening domestic capabilities to engage in international trade. They need to strengthen their business environment, support investment in knowledge assets such as R&D and design, and foster the development of economic competencies such as skills and management.

Since GVCs involve activities contracted within and between MNEs and independent suppliers, the ability to enforce contracts is crucial. Countries with sound legal systems tend to export more in more complex industries, and tasks that require more complex contracts are more easily carried out in countries with well-functioning contractual institutions.

Many low-income countries remain excluded from GVCs, owing to their location, lack of natural resources, lack of infrastructure, or business environment. These constraints can sometimes be overcome through capacity building, but this may be difficult for the poorest developing economies, which would benefit from donor support through “aid for trade” initiatives.

### *Adjustment and risks*

Participation in GVCs inevitably entails adjustment costs, as some activities grow and others decline, and as these are relocated across countries. Policy needs to facilitate the adjustment process through labour market and social policies and through investment in education and skills. Structural policies also help strengthen the economy's flexibility and resilience.

Given the broad welfare implications of GVCs, governments, enterprises and other stakeholders need to remain mindful of their respective roles and responsibilities for governance. The prominence of large MNEs, including some state-owned enterprises, in GVCs raises some policy concerns, for example about the effects on competition and markets further downstream.

While the growing interconnectedness of economies is a source of resilience it can also lead to contagion if events in part of the GVC feed through the system. While firms have the first responsibility to address such risks, a multi-stakeholder approach, involving governments, should support information sharing and capability building. Greater international co-operation can help reconcile national policies with the global nature of economic activity.

Informed policies require good data and analysis. Work is needed to measure the role of investment in GVCs, and the impacts of GVCs on employment, skills and incomes.

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