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Review of Strategies and Policies for Participation in Global Value Chains

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Abstract

This article reiterates the importance of understanding and addressing the strategic inquiries and potential responses in the context of global value chain (GVC) participation. Policymakers must address these crucial matters to engage in GVCs effectively. Governments aspiring to participate in GVCs must focus on determining which tasks to prioritise and exploring various forms of GVC governance. The challenges and opportunities of establishing top-notch GVC connections and fostering a favourable environment for foreign assets are significant for countries looking to integrate into GVCs. While navigating power dynamics and supply chain risks, these efforts can attract suitable foreign investors, enhance market connectivity, and develop high-quality infrastructure and services, all of which can lead to significant economic growth and development. The potential benefits of GVC participation are vast, and by understanding and addressing the strategic inquiries and possible responses, policymakers can take control of the situation and pave the way for a prosperous future.

Task-based GVC Participation

Entering Global Value Chains (GVCs) involves addressing two vital strategic questions regarding tasks performed and governance structure. The first question encompasses sub-questions on GVC participation, task identification, and associated risks. It is crucial to avoid basing strategies solely on sector-based frameworks. A shift towards task-centred development strategies is not just a suggestion but a compelling approach, emphasising specialisation in tasks of comparative advantage for optimal development. With a strong emphasis on functional upgrading, this approach must also consider product and inter-sector upgrading through skills, capital, and process enhancements to align with the task-based development strategies observed in higher-income countries. This approach is not just a theoretical concept but a practical necessity for countries aiming to thrive in GVCs (Farole & Winkler, 2014).

Before exploring the tasks and risks within Global Value Chains (GVCs), it is essential to understand the two approaches to GVC participation: attracting foreign investors and facilitating domestic firms' access to GVCs. Attracting foreign investors, which involves seeking foreign direct investment (FDI), is primarily driven by the need for growth stimulation due to insufficient domestic capital. This can be done through various means, such as tax incentives, infrastructure development, and streamlined regulatory processes. As a less risky source of private capital than other financial flows, FDI can significantly enhance productivity through technology transfer and other advantages. This highlights the potential for significant economic growth and development by attracting foreign investors and providing policymakers with hope and determination. (Farole & Winkler, 2014; Dimelis, 2002; Takii, 2005; Crespo & Fontoura, 2007; Toth & Semjen, 1999). Foreign investors can also help internationalise domestic firms, setting international standards and providing access to global networks, which benefits local suppliers and increases productivity. On the other hand, facilitating domestic firms' access to GVCs involves creating an enabling environment for local businesses to participate in GVCs. This can be done through capacity building, providing access to finance, and promoting innovation and entrepreneurship (Farole & Winkler, 2014; United Nations Conference on Trade and Development, 2011).

Domestic firms can engage in Global Value Chains (GVCs) through methods beyond linking with foreign-owned subsidiaries, including exporting inputs, producing final goods with imported materials, and utilising contract manufacturers for large retailers. Contract manufacturers, a form of non-equity investment mode, involve multinational firms controlling operations in partnership with domestic firms, offering potential benefits and spillovers for development. Governance in GVCs is primarily determined by lead firms rather than public policy, though countries may implement supportive measures to capitalise on GVC opportunities (UNCTD, 2011).

Identification of GVC Tasks

Identifying tasks for which a country has a comparative advantage can be challenging due to limited task-specific production and trade data in low- and middle-income countries. Researchers can use a combination of approaches with varying data requirements to pinpoint sectors, value chains, and specific activities to guide a country's entry into Global Value Chains (GVCs). One approach involves leveraging existing expertise by expanding production within

the same sector or value chain, as seen in Kenya's entry into the horticulture GVC. Another strategy involves identifying sectors where a country is inactive, focusing on optimal export sectors and value chains to maximise domestic value added and diversification potential. Economic proximity concepts can aid in understanding the challenges associated with transitioning to new industries and tasks (Taglioni & Winkler, 2016).

Step 1 involves identifying sectors with the highest RCA based on value-added export data instead of gross export data. For instance, Malaysia exhibits an RCA greater than one in four manufacturing sectors, including electrical and optical equipment, machinery and equipment, chemicals, and wood products. However, the value-added RCA for electrical and optical equipment is slightly lower, highlighting a crucial difference. Step 2 entails analysing the upstream and downstream output of a GVC product using network analysis on input-output tables, which can reveal a country's specialisation in value chains. Despite potential bias due to technological differences, the need for comparable data globally justifies using detailed U.S. input-output tables. The method involves identifying the position of the export product within the production network, main buyers and suppliers, assessing countries as suppliers, and mapping out the value chain. Applying this approach to Malaysia's computer storage devices market shows its peripheral position in the production network, with China emerging as a key competitor and buyer, shaping GVC strategies. Step 3 involves identifying tasks within a sector that contribute the most to domestic value added or have growth potential. The availability of skilled workers and capital stock influences task dependency. Countries should focus on tasks that align with their labour and capital endowments to maximise domestic value added. Obtaining information on task value added is challenging (Gereffi et al., 2001; Gereffi & Fernandez-Stark, 2010), but methods like input-output tables and firm-level data analysis can help, though they have limitations (Del Prete & Rungi, 2017; Antràs & Chor, 2013). Analysing tasks within sectors can be done through various sources like industry associations, ministries, and academic centres, using methodologies that combine strategic analysis and cluster management tools (Christensen & Kempinsky, 2004). These tools should be complementary to the analyses suggested in this article.

Based on Michael E. Porter's concepts (Porter, 1980, 1985, 1990, 1998), the strategic analysis methodology involves evaluating competitive advantages, industry trends, strategic positioning, and value chains within Global Value Chains (GVCs). This analysis emphasises the international dimension of production and demand, requiring market analysis, technology assessment, end-market segmentation, and a multidimensional approach to policy intervention

to recommend attainable strategic options. By focusing on tasks and change processes, this methodology can help high-income countries face job and business challenges from lower-cost competitors.

GVC Risks

Global Value Chain (GVC) integration brings economic advantages and risks to countries, particularly concerning sourcing and selling. While governments have limited control over these risks since firms' decisions drive GVC participation, policymakers play a crucial role in managing and mitigating these risks. This underscores the importance of their role and the potential for them to make a significant impact. (Ferrantino & Taglioni, 2014). Seller's risks involve demand shocks and downstream risks in the value chain. Demand shocks can occur due to changes in consumer preferences, economic downturns, or geopolitical events. Downstream risks refer to the potential disruption of the value chain by a downstream partner, such as a manufacturer or retailer, which can affect the entire chain (Alessandria et al., 2010; Gereffi & Frederick, 2010; Kolasa et al., 2010; Milberg & Winkler, 2010). On the other hand, buyer's risks relate to supply shocks from unforeseen events among upstream suppliers. Natural disasters, political instability, or changes in trade policies can cause supply shocks. Risks are amplified in GVCs, especially for complex products like automobiles with parts from various countries, increasing exposure to potential hazards. Practitioners must be aware of these risks and plan accordingly. By underlining the role of policymakers in managing GVC risks, they can feel responsible and proactive in their approach, ensuring the best outcomes for their countries.

A seller's exposure to end-market risks has long been discussed. Concentration in a sector, firm, or geography can lead to high volatility in value-added and sharp GDP readjustments during a crisis. In contrast, a diversified production portfolio can result in more stable export revenues, with independent price dynamics across different products, firms, or locations. However, suppliers in Global Value Chains (GVCs) face more significant risks due to their specialised inputs, dependency on lead firms, and challenges finding alternative buyers. During economic crises, GVCs tend to adjust to demand changes quickly, transferring risks to suppliers, which was evident during the 2008 crisis impacting apparel suppliers in LMICs. Changes in lead firms' strategies and management pose significant dangers to value chains, particularly for high-tech and small-medium businesses in Thailand reliant on Japanese companies like Nikon

and Yazaki, who are shifting production to neighbouring countries to attract foreign investment, highlighting the growing importance and risks associated with regional transport links.

Buyers face novel risks related to upstream supply shocks, such as natural disasters and changes in suppliers' strategies, which increase their dependence on upstream inputs. Events like the 2011 flooding in Thailand and the Tohoku disaster in Japan expose the vulnerability of Global Value Chains to such risks, significantly impacting industries like automotive products, computers, and consumer electronics. Additionally, changes in upstream supplier strategies within GVCs can threaten existing downstream suppliers by offering bundled tasks at competitive costs, affecting the overall structure of the supply chain (O. Cattaneo et al., 2013; Escaith & Gonguet, 2011; IMF. Research Dept., 2011).

GVC Governance

Global Value Chains (GVCs) have evolved, leading to a variety of lead firm supplier relationships beyond the traditional "make" or "buy" dichotomy (Antràs, 2017; Antràs et al., 2024; Antràs & Helpman, 2004; Pol Antras et al., 2022; Milberg & Winkler, 2013). The type of governance (O. Cattaneo et al., 2013) between lead firms and suppliers is crucial, with five potential structures identified: market, modular, relational, captive, and hierarchy (Gereffi et al., 2005). Market governance involves straightforward transactions with minimal buyer input, relying on price as the central mechanism. On the other hand, modular governance is seen in industries like autos and electronics, where suppliers take responsibility for process technology, and interactions are more complex due to the high volume of information exchanged. In relational governance, buyers and sellers share knowledge and frequent interactions, relying on complex information that fosters trust and mutual reliance. Despite mutual dependence, lead firms still maintain some control over suppliers, who often provide differentiated products based on unique attributes. Switching partners in relational chains is challenging due to the time it takes to establish such links. Ethical leadership is crucial to ensure fair treatment of suppliers and equitable market prices. In hierarchical governance, lead firms with captive structures wield significant power, leading to thick ties and high switching costs for both parties. Vertical integration characterises hierarchical governance, with lead firms developing and manufacturing products in-house to control complex products or when competent suppliers are scarce.

Global Value Chain (GVC) governance can shift over time depending on industry evolution, with varying governance patterns within chain links. Distinctions can be made between buyer-driven and producer-driven value chains based on the leading firm's nature in the chain (Gereffi, 1994). Buyer-driven GVCs are common in consumer products like apparel, driven by retailers focusing on design and marketing. At the same time, producer-driven GVCs are prevalent in industries like automobiles, led by multinational producing firms. The governance structure in GVCs is crucial as it determines power relations and dictates resource allocation within the chain, with different degrees of power asymmetries across various industries (Hertenstein, 2021; Milberg & Winkler, 2013; Scherrer, 2022). Country policies to attract Foreign Direct Investment (FDI) are influenced by the potential for knowledge or productivity spillovers, with evidence suggesting positive backward spillovers on local suppliers from multinationals (Behera, 2015; Dogan et al., 2017; Du et al., 2012; Ebghaei & Akkoyunlu Wigley, 2018; Havranek & Irsova, 2011; Jinji et al., 2022; Le & Pomfret, 2011; Marcin, 2008; Sari, 2019).

International buyer characteristics, such as motives, global production strategies, technology intensity, and the duration of supplier relations, can influence potential spillovers in Global Value Chains (GVCs), similar to how foreign investor characteristics mediate Foreign Direct Investment (FDI) spillover potential. Host country characteristics and institutions, including labour availability, quality, learning infrastructure, innovation, trade policy, and the movement of goods and services, also significantly facilitate spillovers through domestic firms' involvement in international trade within GVCs (Milberg & Winkler, 2013; Taglioni & Winkler, 2016).

Policy Option 1: GVC Links

Lead firms strategically make decisions, so governments should do the same when evaluating policies to optimise global value chains (GVCs) and enhance the business climate for foreign assets. Countries can enter GVCs by supporting domestic firms or attracting foreign investment to access technology and know-how, as seen in Costa Rica and Thailand. Establishing competitive spaces like export processing zones (EPZs) can jumpstart GVC participation by providing favourable conditions for businesses, although their impact on development outcomes varies according to empirical research (Milberg & Winkler, 2013; Taglioni & Winkler, 2016).

EPZs are designated areas within a country to lure export-oriented companies through tax breaks, tariff exemptions, and regulatory benefits. Incentives for EPZs typically involve tax exemptions, duty waivers on imports, relaxed foreign exchange controls, and enhanced infrastructure. Despite their significant contributions to national exports in many lower-income countries, EPZs need help integrating with the broader economy due to their initial focus on attracting foreign firms over domestic ones. EPZs face resistance due to the dominance of foreign firms that have established relationships with foreign input producers. Many foreign firms in EPZs rely on imported inputs or require established foreign input suppliers to enter the zones. Studies show minimal backward links from EPZ firms to domestic orders, leading to terms-of-trade weakness in LMIC manufacturing exports. EPZs allowing duty-free imports of material inputs put non-EPZ domestic firms at a cost disadvantage, as the share of inputs purchased from domestic suppliers remains low in many countries (Aggarwal, 2005; Engman et al., 2007; Farole & Akinci, 2011; Kusago & Tzannatos, 1998).

EPZs and competitive spaces pose a unique challenge in attracting foreign investors. Governments should focus on broader, nationwide measures to establish a sustainable investment attraction strategy. Policymakers must consider various factors, especially those targeting FDI, when designing investment promotion measures. Countries entering GVCs can attract foreign investors by assessing their nature, motivations, technology contribution, and potential spillovers. Designing public policy to attract FDI and NEMs should prioritise creating an attractive investment climate and considering the nature and motivations of potential investors to maximise spillover benefits. Assessing technology contributions during Foreign Direct Investment (FDI) evaluation involves determining the possible absorption of investor technologies in the economy. Efforts should target global suppliers beyond original equipment manufacturers to promote spillovers effectively. Avoid diluting spillover benefits by offering excessive incentives to attract FDI and New Emerging Markets. Recognise the importance of both foreign and domestic investors in delivering spillovers to ensure unbiased investment policies that support mutual interaction. Facilitating joint ventures (JVs) can enhance technology transfer, particularly for low-income countries, but coercion should be avoided. A light-handed industrial policy can help overcome challenges in low-income countries by strategically addressing market failures and coordinating externalities (Becattini, 2017; Farole & Winkler, 2014; Porter, 1990).

Governments can assist both domestic and international potential buyers and suppliers find suitable trade partners and technology by creating online directories containing detailed firm

profiles, sector expertise, and certification information. Meeting specific quality, legal, labour, health, safety, and environmental standards is essential for local suppliers to become suppliers to lead firms like Walmart, which has responsible sourcing requirements. Tools such as Standard Maps by the International Trade Centre can provide verified information on voluntary standards. At the same time, government e-tools can aid domestic companies in commercialising intellectual property or establishing licensing agreements, as seen in Morocco's Horizon 2015 program. In the context of Global Value Chains (GVCs), enhancing a country's ability to participate relies on promoting imports to access top-quality inputs, with examples like JETRO in Japan establishing import promotion facilities in the 1990s. The effectiveness of a country's logistics infrastructure in connecting to global markets is influenced by geography and policies, such as infrastructure investment, regulatory practices, and trade facilitation efforts. Improving international connectivity through various means, like tightening links within GVCs, securing input/output flows, and reducing trade barriers, can significantly benefit countries, especially Lower- and Middle-Income Countries (LMICs), facing transport cost challenges in GVC participation (*OECD*, 2011; Pietrobelli, 2008).

The drivers behind offshore outsourcing go beyond cutting labour costs, encompassing factors like predictability, reliability, and timeliness, which are crucial for global value chains. Delays in exporting can result in significant tariffs for time-sensitive products (Hummels et al., 2007), hindering countries like Sub-Saharan Africa from participating fully in the electronics value chain (Jean-François Arvis et al., 2010; Christ & Ferrantino, 2011). The World Bank introduced the concept of logistics performance to assist policymakers in reforming the sector, emphasising the importance of trade infrastructure, trade procedures, and logistics services in enhancing a country's connectivity to international markets through various policy interventions (Jean-François Arvis et al., 2010, 2007; Jean-François Arvis et al., 2023, 2014, 2016, 2024). Policies addressing obstacles at the border should focus on traditional trade barriers and customs efficiency (O. Cattaneo et al., 2013), especially within Global Value Chains (GVCs). GVCs expand the importance of addressing both export and import barriers, with high tariffs hindering efficiency in value chains, making it crucial for countries at intermediate production stages to have lower tariffs (*OECD*, 2012). Implementing a national single-window system to simplify border procedures requires strong government support, political will, stakeholder engagement, and institutional reform across multiple government agencies (Dessus et al., 2013).

The policy aims to enhance domestic markets' connectivity by focusing on logistics, transport, and telecommunications, particularly for goods transport and offshoring services via ICTs. The efficiency of importer logistics plays a significant role in parts and components trade, impacting lead firms' location decisions (Saslavsky & Shepherd, 2014). ICTs have revolutionised Global Value Chains by facilitating the transfer of design specifications and enabling cross-border service exports, benefiting LMICs, though challenges remain for the poorest nations. The liberalisation of services sectors in LMICs, driven by privatisation, competition, and independent regulation, has attracted substantial FDI by transitioning from protectionist policies to foreign company ownership (O. Cattaneo et al., 2013; *OECD*, 2012).

Policy Option 2: GVC Climate

Cost competitiveness is crucial for countries aiming to attract foreign tangible and intangible assets and remain competitive in the global value chains. While low wages may initially help countries enter global value chains, various factors such as production costs, labour costs, transportation, and tax incentives influence lead firms' decisions to invest in or source production from low- and middle-income countries. A strong business climate is vital to avoid excessive costs resulting from inadequate infrastructure, lack of competition in services, administrative burdens, stringent labour laws, political instability, or corruption. Instead of solely focusing on low wages, countries should strive for higher labour productivity and wages to maintain cost competitiveness amidst improving living standards (Mayneris et al., 2014). They should leverage investment and tax incentives to boost productivity, skill development, and technological empowerment (O. Cattaneo et al., 2013).

Improving the drivers of investment, particularly in protecting foreign assets, significantly impacts a country's appeal to foreign investors (*World Bank*, 2014). Protecting assets involves safeguarding firm-specific technology and know-how, with some elements being defensible through intellectual property laws. However, other aspects, like business models and production processes, remain unprotected. In global production networks, incomplete contracts (Rodrik, 2000) arise due to various factors influencing firms' decisions on location and boundaries (P. Antras, 2014; Antràs & Yeaple, 2014). Metrics like political stability, governance, and corruption levels influence firms' choices to engage in Global Value Chains (GVCs). Entry into Global Value Chains (GVCs) via foreign investment necessitates the smooth movement of production factors. Obstacles to foreign direct investment (FDI) can

result in a country's exclusion from significant GVCs or limit its participation in specific governance forms. Ensuring contract stability, engaging in international arbitration, and enhancing domestic value chains are crucial for a country's integration into GVCs (*OECD-WTO*, 2013; *OECD*, 2014).

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