The Potential of ACP Countries to Participate in Global and Regional Value Chains:

A Mapping of Issues and Challenges

Executive Summary

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Executive Summary

International trade has changed dramatically since the 1980s. Due to enormous reductions in transportation and communications costs, and world-wide liberalization of trade in goods and – to a lesser extent – services, production processes have been fragmented and value chains have gone global. These global value chains (GVCs) have led tofirms increasingly offshoring and outsourcing jobs and tasks, involving both goods and services. International competition no longer takes place only between industries and firms in different countries, but increasingly between workers and their skills. Countries no longer specialize exclusively in goods and services, but more and more in tasks.

Theseactivities occur primarily between developed countries,but also between developed countries and certain developing or emerging economies. African, Caribbean and Pacific countries (ACP), the focus of this paper, are only integrated in GVCs to a very limited extent. When looking at the group of ACP countries, their huge heterogeneity in terms of geographical characteristics and economic development is immediately apparent. Furthermore, their generally small economic scales, and prevalence of small-scale producers and suppliers, means that plugging into existing value chains coordinated by large, first-tier multinational corporations (MNCs),is rather difficult.

For ACP countries, it seems appropriate to aim at attracting second and third-tier firms, not necessarily first-tier firms. In the target country, these firms choose local suppliers according to criteria such as reputation, quality and the speed of response. Meeting these criteria is especially important for local suppliers in developing countries that wish to plug into GVCs.However, there are some challenges for ACP countries to enter the world economy.

The *first* category of challenges is general market access and a country's openness to FDI. *Second*, infrastructural services play a key role. These services include transportation, telecommunication, finance and insurance, and energy. Their quality and efficiency determine the business and trade environments, and company performance.*Third*, the business and trade environment is crucially influenced by the country's institutional framework. This comprises the existence of the rule of law, of property rights, a proper health system, education and innovation policies, a transparent tax environment as well as administrative capacity. *Fourth*, the efficiency of border processes, customs practices and domestic regulations influencethe country's trading. *Fifth*, and different to 20th century globalization, the workforce is relevant. Whereas in the past, FDI in developing countries was driven either by trade barriers (tariff jumping) or cheap labor, today much more emphasis is laid upon the education and productivity of workers. *Sixth*, MNCs are also the main standard setters in terms of ecological and social requirements; an issue of special concerntolow-income countries and their prevalent small-scale producers and suppliers.Finally, from the perspective of ACP countries, ethnic and/or cultural links between producers and customers

may play a role. By the same token, participating in GVCs may well be positively driven by ethnic links to other participants and particularly lead firms in GVCs and or RVCs.

Given these challenges, it is necessary tolook at the relevance of regional value chains (RVCs) in contrast to GVCs. Integration at the regional level amongst less demanding partners may offer a viable stepping-stone into subsequent integration into GVCs. These RVCs may become relevant since some of the countries under consideration are very weakly integrated into the world economy. Their local firms and workers can benefit from globalization if they integrate into value chains regionally. Thus, regional attempts to integrate markets may be instrumental for the inclusion of ACP countries into GVCs.

The general idea of regional integrationsuggests that the reduction of barriers to regional trade enhances the division of labor between neighboring countries. This promotes economic efficiency, but also dynamic gains. It may be considered to form regional *growth poles*, i.e. areas or industries, which show a particularly dynamic development and thereby create spillovers for other regions. A successful form of regional cooperation in South East Asia has been the concept of *growth triangles*. The concept aims at forming a sub-region foreconomic growth by linking adjacent areas of countries with different factor endowments and sources of comparative advantages.Another approach focuses on *'development corridors'*, which may be enhanced with the help of official development assistance.Finally, there is the more traditional route of trade integration through *preferential trade arrangements*.

In order to analyze the preparedness and challenges the ACP countries face for plugging into GVC/RVCs, we first group them according to their current degree of integration in the world economy. Accordingly, three groups emerge: globally, regionally and weakly integrated ACP countries. On the basis of this distinction, a subsequent data analysis is conducted which compares both the countries' performances regarding basic trade enabling requirements for value chain participation, and business sophistication requirements for upgrading within value chains. In order to have a general benchmark for the assessment of the performance of the ACP countries we use a set of 8 non-ACP countries (Singapore, Hong Kong, Costa Rica, China, India, Mexico, Vietnam and Iceland).

For the consideration of basic trade enabling requirements, market access conditions, infrastructure quality and the institutional framework are considered. While generally restricted market access is mainly an issue for the weakly integrated ACP countries, globally and regionally integrated countries record major restrictions on trade in professional services, which can be especially detrimental in light of intended upgrading measures. Considerable drawbacks for all of the ACP countries exist when it comes to infrastructure development and logistics performance (see *Graph 7*). Except for the overall high corruption problem that the majority of the ACP countries face, the quality of the institutional framework differs. Countries of the globally as well as some members of the regionally integrated groups record relatively sound institutional settings, especially when it comes to the granting of property rights. However, the remaining ACP countries face major challenges in this area (see *Annexes 12-14*). The need for an improved institutional framework is especially pressing in the case of weakly integrated countries.The analysis of business sophistication comprises sophistication and innovation capacities and higher workforce development (see *Annexes 16-19*). Evidently, all the ACP countries face major challenges in this area. Improved quality of higher education and enhanced innovation capacities are of special relevance for the globally and regionally integrated countries as business sophistication strongly promotes intended upgrading within existing value chains.

While the analysisreveals some patterns, it also exposed many differences. Therefore, it is neither possible nor desirable to come up with detailed policy proposals for the whole ACP group. However, there is a primary lesson. All measures to enhance integration into GVCs heavily depend on the institutional quality and governance structure in a country. Corruption, poorly defined property rights, weak rule of law and the like, render all measures directed at human capital formation, infrastructure investments, and trade facilitation ineffective. Next, and as agreed by many observers, we stress that infrastructure is a decisive bottleneck to development in many ACP countries. Furthermore, the workforce has to be fit for the requirements of GVCs, which implies a solid knowledge and skill base (stocks) and – more important – the ability to adjust to new challenges (flows). Therefore, education plays a decisive role.Crucially, where skills are not available domestically foreigners can be harnessed to fill the gap, and in the process train locals.Finally, even though market access did not emerge as a major constraint, it is our opinion that governments should minimize political barriers to trade. This includes tariffs, subsidies and other non-tariff barriers.

The classification of the ACP countries according to their current degree of global integration, as applied in this paper, is indicative for basic mutual challenges each group of integration faces. Striving for upgrading opportunities, the basic challenge of the highly integrated ACP countries is increased business sophistication and innovation capacities. For the group of regionally integrated countries, ongoing expansion and improvement of basic infrastructural and institutional requirements is necessary. Finally, the group of weakly integrated countries faces for the most part basic challenges of infrastructure development and improvement of the institutional settingsin order to facilitatevalue chain participation and to ensure adequate responsiveness to stimuli by surrounding growth poles.

A final warning about the abilities of governments to actively create business or growth poles through inward-looking industrial policies is warranted. It is rarely successful and regularly attracts rent-seeking and corruption. With a clear commitment to concentrate on horizontal measures such as described above, governments may be able to resist the rent-seeking sirens and reduce corruption.