Are Global Value Chains (GVCs) relevant to Africa? A synthesis of the 2020 World Bank Global Value Chain Report

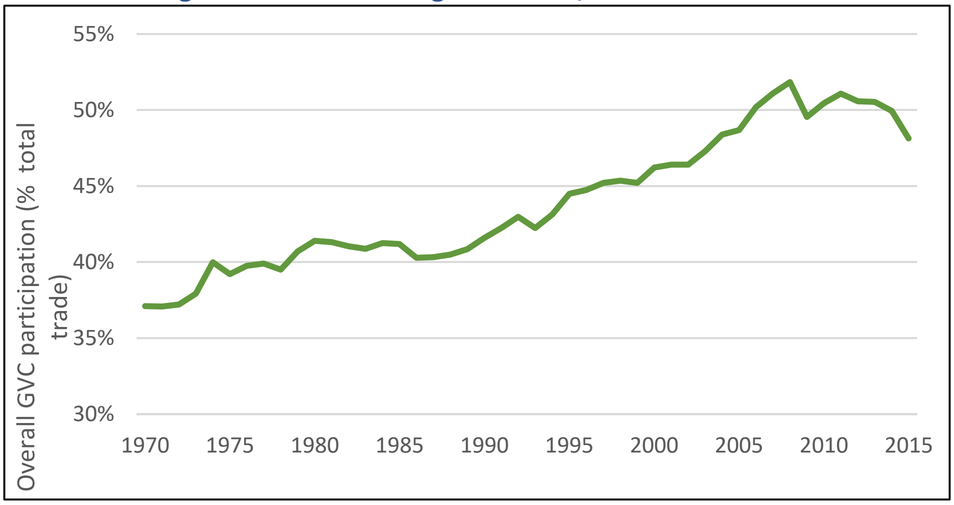
June 2020
Kevin Rombo

What are the Global Value Chains (GVCs)?

The World Bank (2020) report defines value chains as a series of stages, activities[1] and processes needed to bring a product from conception through the intermediary stage of production to delivery to the final consumers. When aggregated at a global scale, such activities become what is commonly known as global value chains (GVC). GVCs, as a share of world trade, rose steadily from 37% in 1970 to 51% in 2008 (see Figure **1**), with more evidence showing that GVCs provided new opportunities for developing countries. The main catalysts for such a steady rise in GVCs were rapid globalisation driven by technological innovations, efficient telecommunications, computer integrated manufacturing, and a fall in transport costs that have altogether facilitated smooth cross border trade.

Patterns in global trade changed dramatically post 2008/09 financial crisis with a decline in cross border production-sharing activities and increase in trade protectionism amid slow recovery. Growth in trade declined occasioned by low output growth in Europe, USA and China and non-responsiveness of trade growth to income. Figure **1** also shows a downward trend in the growth of GVCs post-2008. The World Bank (2020) report attributes two critical reasons to the GVCs decline: the adverse effects of 2007-08 financial crisis and the peak of the maturity circle of GVCs growth. The current COVID-19 pandemic that first suppressed production in China has transmitted its adverse supply shocks to the rest of the world, further disrupting GVCs and slowing down world trade.

Figure 1: GVC share in global trade, 1970-2015



Source: World Development Report 2020

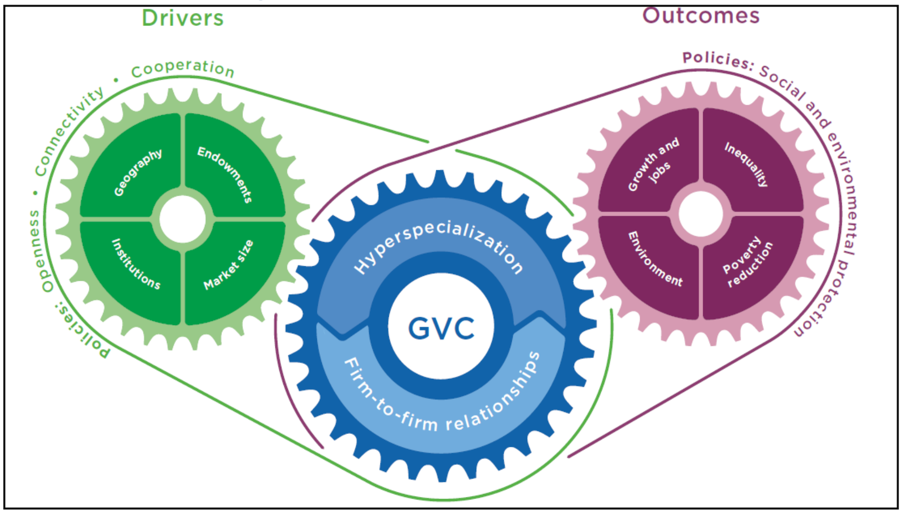
[1] Ranging from research and development(R&D), product design, sourcing of primary products, production of intermediate products, final assembly of the product, packaging, branding and marketing of the product are unbundled and dispersed such that parts and components that make up the final product are produced by various firms in different countries across the world through effective inter-firm networks and coordination (Gereffi and Fernandez-Stark, 2011; Evenett, et al., 2009). The unbundling of production across countries comes with the cross-border movement of investments, technological know-how and human capital (World Bank, 2017; Taglion and Winkler, 2016).

Empirical evidence indicates that GVCs have the potential to boost countries' productivity, create employment and improve economic outcomes . GVCs can support industrialisation by increasing value-added capabilities in agriculture, manufacturing and services sectors and by enhancing the capabilities needed to produce and export goods through new skill acquisition, adoption of innovative technologies, specialisation in core tasks and access to imported inputs from multinational corporations (MNCs). Exporting through GVCs participation has been touted as a faster route to industrialisation for developing countries, allowing them access to global markets.

How do GVCs work?

The key drivers to GVCs functionality are factor endowments, market size, geography, and institutions. These need supporting policies that can attract investments inflows to remedy capital scarcity, technology, and management skills transfer to be effective. For enabling access to international markets and a variety of inputs, trade liberalisation is also essential. Efficient infrastructure-transport and communication are critical to mitigating geographical barriers (World Bank (2020) with supporting policies and regulatory framework that attract investments, as illustrated in Figure **2**. Finally, for GVCs to thrive and benefit countries, sound and effective macroeconomic policies are critical (Pahl and Timmer, 2019).

Figure 2: Drivers and outcomes from GVCs



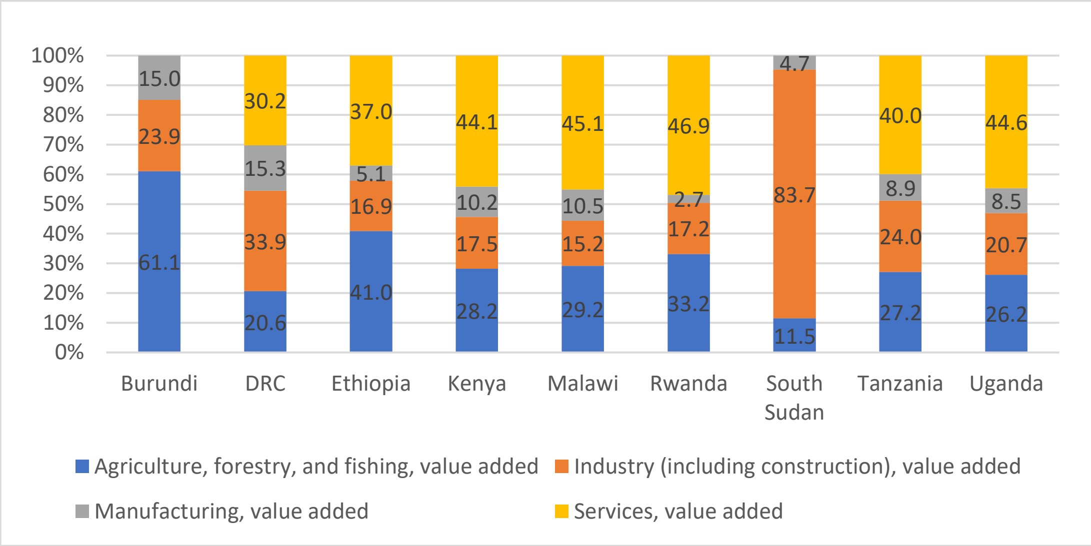
Source: World Development Report 2020

Benefits of Participating in GVCs

Firstly**,** until recent global trends such as trade wars, climate change and COVID-19, GVCs drove ***economic growth*** in both developing and developed countries. China is a success story from emerging and developing economies having reaped productivity, efficiency, and economic growth gains of GVCs integration. Developing countries effectively participating in GVCs can boost their economic growth through trade, investments and knowledge flows that can increase the productivity of local firms, access to markets, adoption of innovative technologies and better jobs (World Bank, 2017).

Secondly, GVCs also have the potential for value addition which can be measured using value-added to gross exports. Figure **3** depicts the value-added to gross exports by sectors for nine selected economies in East Africa. The decomposition provides insights on the sectors in which if value addition occurred, there would be meaningful benefits for the countries concerned. The share of value-added in agriculture, forestry and fishing stands at 61.1% and 41% for Burundi and Ethiopia respectively which are higher than those for DRC, Kenya, Malawi, Rwanda, SSD, Uganda and Tanzania. The high value-added in agriculture for Ethiopia relates to the special economic zones that process textiles and leather used as local inputs to produce shoes and garments in the country or exported for production in other countries.

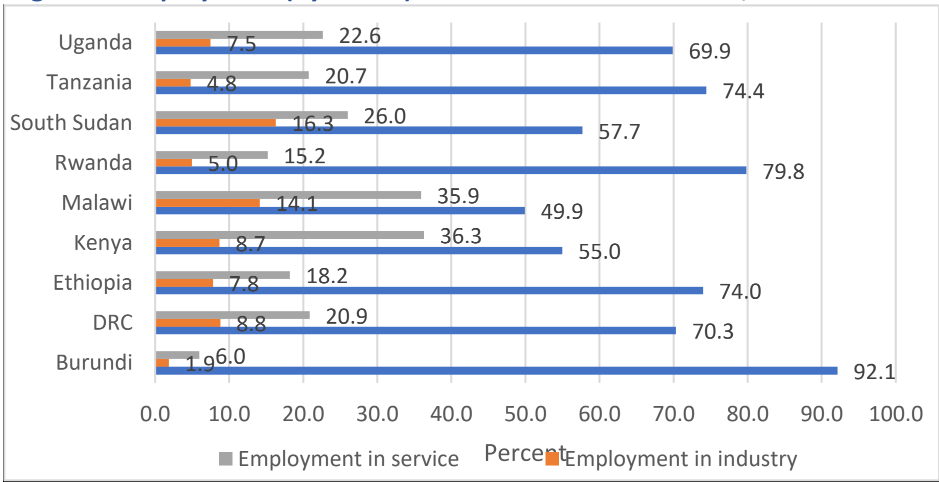
Figure 3: Sectoral value-added to gross exports for selected Africa Counties, 1995-2015



Source: Constructed using data from the IMF Direction of Trade Statistics Database

The share of value-added in the mining, construction, and extractive sectors for South Sudan is 83% as its economy is heavily reliant on oil exploration and exportation while for DRC it is at 23% on account of extensive mining of gold, cobalt, and other minerals. Value addition in these countries is mainly at the elementary level after extraction, and where processing occurs MNCs dominate. Countries rich in mineral resources (e.g. DRC and South Sudan) can pursue GVC participation that makes use of their mineral resource base to upgrade to intermediate value addition with substantial benefits to workers, local firms, and their economies. The little share of value addition in manufacturing across selected African countries is an attestation of their little integration into the production GVCs. Service value added is substantial for countries of Kenya (44%), Malawi (45%), Rwanda (47%), Tanzania (40%) and Uganda (45%) and an indication of the vital role of services trade in economies. Overall from the decomposition in Figure **3**, African countries stand to benefit more by participating in agricultural and natural resource-related GVCs with meaningful opportunities to upgrade to intermediate and even advanced value-added centred around its resource endowments.

Figure 4: Employment (by sector) in selected Africa Counties, 1995-2015



Source: Constructed using IMF direction of Trade Statistics Data

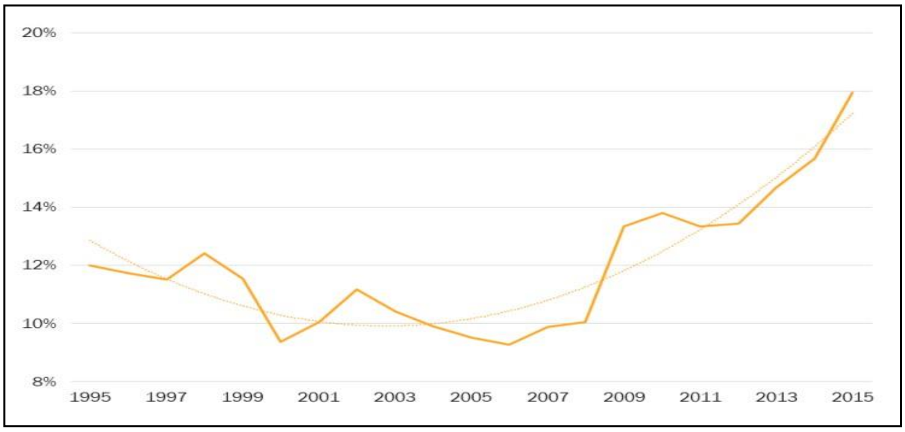
Thirdly, integration into GVCs also has the potential to create jobs. The impact on job creation can have a profound effect in the developing world, especially Africa, where GVCs gains have been dismal. Value addition attached to GVCs has the potential to generate employment for many African countries where agriculture is the backbone of most economies. ***Figure 4*** shows the shares of jobs in the agricultural sector in Africa, indicating that GVCs, if well adapted and implemented, have the potential to improve employment in both the service and industry sectors.

Global *versus* Regional Value Chains: Which way for African countries?

Developing countries that have traditionally exported raw agricultural and mineral products can participate in global production chain through value addition without having to set up industries that produce a full product and benefit from rapid productivity gains, employment and improved incomes and reduced poverty levels. In Africa, countries participate in GVCs mostly through apparel, food, horticulture, and automotive industries as small actors finding themselves locked in low-value tasks at the beginning of the value chain with the inability to upgrade or diversify hence inhibiting their integration and economic convergence. For instance, Ethiopia and Kenya have integrated mainly in agribusiness, Tanzania in transport and tourism while Botswana, the Democratic Republic of Congo, and Nigeria in exports of oil and other natural resources.

Despite the benefits of GVCs integration, trade costs can be an impediment that may hinder or prevent developing countries already in GVC from achieving sustained benefits (World Bank, 2017). Non-tariff trade costs tend to be higher than import tariffs as product move across borders to various stages of production. The impediments to trade are equivalent to ad valorem tax at a specific rate. The additional costs—such as weak transportation links, inefficient customs clearance, bureaucracy, and red tape—tend to impede trade (Dollar, 2017). Undoubtedly, countries with very high trade costs are not able to participate in GVCs, and any exports are thus likely to be traditional goods, mostly raw agricultural and unprocessed mineral commodities. High trade costs coupled with recent global trends such as trade wars, climate change and COVID-19 have exposed the extent to which GVCs can be beneficial to countries. However, such limitations do not offset the GVCs role completely, creating a policy dilemma for African policymakers to strike a healthy balance between GVCs and regional value chains (RVCs).

Figure 5: Intra-African trade trends, 1995-2015



Source: Mold and Mveyange (2020)

Mold and Mveyange (2020) assert that countries in East Africa have found it challenging to integrate into the GVCs due to the low value of raw materials, textiles, and horticultural products they produce. The reasons for their low participation in GVCs range from those related to internal policies that affect production efficiency to external dynamics, e.g. excessively demanding phytosanitary standards on their products, suspension of preferential market access and harsh rules of origin that undermine the value of preferential market access. Inter-African trade had also been on the rise from 12 per cent in 1995 to 18 per cent in 2015 (Figure **5**) presenting a unique opportunity for African countries to strengthen regional trade and hence consider RVCs favourably.

With the COVID-19 crisis shrinking global trade and disrupting GVCs, African countries can find it even harder to join, participate and reap substantial benefits from GVCs. There are potentials for African countries to benefit from regional trade by strengthening regional and local (country-specific) value chains for instance through the African Continental Free Trade Area (AfCFTA) that aims to create a unified continental market that promotes trade and prosperity in Africa. The AfCFTA presents enormous opportunities for African countries to integrate, trade, create jobs (especially in sectors predominant with female labour) and boost economic growth. UNECA and TMEA (2020) report show that the long-term impact of the AfCFTA leads to higher national and multinational investments, the emergence of regional value chains (RVCs) and more resilient economies. Among many others, these reasons make a strong case for a renewed policy interest in RVCs in Africa.

Conclusions

The significant benefits of participating in GVCs are twofold. Firstly, countries with differences in comparative advantage can benefit from participating in GVCs through efficiency gains in the division of labour, boosting specialisation and overcoming domestic demand and supply constraints. Secondly, access to high quality-low cost intermediate inputs form the basis for productivity growth also tied to economies of scale arising from exporting to the world market. However, several challenges still exist, especially for Africa:

i) Unequal distributions of the gains from GVCs participation especially for the large MNCs that dominate GVCs around the globe
ii) The need to adapt and recalibrate economies to become knowledge-intensive. For some countries and sectors, firms have access to technologies, processes, and tasks but have limited opportunities to innovate, upgrade, and diversify.
iii) The evolution of GVCs has magnified tax avoidance challenges with the growth of intangibles and digital service delivery. MNCs and their fragmentation of production through affiliates also lead to more significant intra-firm trade and more opportunities for tax avoidance resulting in substantial tax losses for developing countries.

Policy Implications

While dismissing the importance of GVCs is difficult, burgeoning evidence seems to suggest waning prominence of GVCs and lower appetite, especially in Africa. With declining trends after the 2007-08 financial crisis and increasingly worrisome trade wars, climate change and now COVID-19, GVCs do not seem to offer the promising potentials for Africa's renewed and strategic impetus for structural reform, industrialisation, job creation and broader economic development. Instead, RVCs appear to more suited to help Africa achieve its intended goals by boosting intra-African trade and support the development of local and regional supply chains. The new dawn offers essential lessons for formulating and implementing the relevant policy levers:

i) Improving efficiencies at the borders and ports as well harmonisation of tariffs and elimination of Non-Tariff Barriers, e.g. lengthy customs procedures to make RVCs more effective and efficient
ii) Attracting investments that support value addition relevant for Africa resource endowments (e.g., agriculture and minerals value chains)

iii) Enactment of supporting policies in areas of trade policy, logistics, trade facilitation, business regulation, investment, taxation, industrialisation, standards, and labour markets that promote RVCs participation.

iv) Development of necessary infrastructure-roads, railways, ports, ICT, electricity-that support trade, commerce, and linkages to RVCs.

References

1. United Nations Economic Commission for Africa and TradeMark East Africa (2020). Creating A Unified Regional Market: Towards the Implementation of the African Continental Free Trade Area in East Africa, Nairobi, Kenya.
2. World Bank (2020). *World Development Report 2020: Trading for Development in the Age of Global Value Chains.* Washington, DC: World Bank.
3. Mold, Andrew and Mveyange, Anthony (2020). Trade in uncertain times: Prioritising regional over global value chains to accelerate economic development in East Africa. Brookings, New York
4. Pahl, Stefan and Timmer, Marcel P (2019) Do Global Value Chains Enhance Economic Upgrading? A Long View, The Journal of Development Studies.
5. International Bank for Reconstruction and Development/The World Bank (2017). Global Value Chain Development Report 2017. Washington DC, USA
6. Dollar, David (2017). Global value chains provide new opportunities for developing countries. Brookings, New York
7. Gereffi, Gary and Fernandez-Stark, Karina (2016). Global Value Chain Analysis: A Primer. A Primer, Second Edition, The Duke Center on Globalization, Governance & Competitiveness
8. Taglioni, Daria; Winkler, Deborah (2016). Making Global Value Chains Work for Development. Trade and Development series; Washington, DC: World Bank.
9. Evenett, Simon J., Bernard Hoekman, and Olivier Cattaneo, eds(2009). Effective Crisis Response and Openness: Implications for the Trading System. London: Centre for Economic Policy Research (CEPR) and the World Bank.

Data sources

1. IMF's direction of trade statistics available at https://data.imf.org/?sk=9D6028D4-F14A-464C-A2F2-59B2CD424B85&sId=1390030341854

2. World Bank World Integrated Solution(WITS) data available at https://wits.worldbank.org/analyticaldata/evad/Country/VNM/Year/1997