

Global Value Chains and Changes in Global Production Structures and Trade

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One of the most significant features of the recent global economic crisis has been the collapse in trade, where the drop in trade volumes was more dramatic than the drop in GDP. Milberg and Winkler (2010) note that this rapid and persistent collapse, which is well documented, has been more severe than trade collapses experienced in the past, including during the Great Depression. They show, for example, that the decline in U.S. goods imports in the fourth quarter of 2008 and the first two quarters of 2009 was greater than the decline in U.S. GDP, and the drop in the ratio of imports to GDP over that period represented by far the greatest three quarter decline in imports, both absolutely and relative to GDP, since 1980 at least. This was true, to a lesser extent, of the EU as well and also at a global level.

The dramatic extent of the trade collapse was apparent also because for a long period before the crisis broke, trade had been growing faster than growth in output at a global level. One of the features that emerged in the period from the mid-1980s, when trade liberalization became generalized across the board in developing countries, was that the share of low and middle income countries in world exports rose substantially, from 16% in goods and 13% in services in 1986 to more than 30% and 20% respectively in goods and services in 2007. Developing countries as a whole became more dependent on export revenues than before, with the share of exports in GDP of LMICs going up from less than 10% in the 1980s to more than 40% by 2007.

Another factor that marked out the trade collapse during the recent crisis was the synchronization of the collapse across countries, reflecting the degree to which real market and financial market shocks tended to get transmitted at great speed through the system. What this pointed to was not just the rise in the degree of world trade in relation to overall economic activity or the degree to which trade integration of countries has happened but the specific nature of internationalization of production structures, largely through the operations of Global Value Chains. The operations of these GVCs have led to significant structural changes in international trade and production, leading to the need to review the theory as well as the policy implications of both.

Global Value Chains, around which a substantial literature exists, represent the significant unit of organization of international production, where 'lead firms', largely MNCs, coordinate production across international borders through extensive networks of suppliers spread across large numbers of countries. This has resulted in a significant change in the structure of international trade, leading to a domination of what have been referred to as the 'trade in tasks', i. e., trade is no longer characteristically in goods, but in particular production segments (cut-make-trim (CMT) vs design-brand-market) of a production chain. The 'trade in tasks', empirically measured in terms of trade in intermediate goods, reflects this phenomenon, and the gains seen by low and middle income countries in trade involvement are clearly seen here, with their share being more than 35% of world intermediate good trade in the latter half of the 2000s.

However, over time, deverticalised production by MNCs is not reflected merely in trade in intermediates, with lead firms assembling components acquired from different locations, but also involves offshoring and outsourcing of final goods, produced by suppliers in developing countries. In a large number of industries, ranging from 'buyer-driven' labour-intensive ones to 'producer-driven' ones where control lay more substantially in production involvement by lead firms, such lead firms are increasingly focusing on design, branding and marketing, where entry is relatively difficult and maximum rents are generated within the chain. Thus, in manufacturing, this is not confined to garments and shoes, but includes sectors like IT hardware and automobiles. Apple, for instance, concentrates on product design, architecture and operating systems, leaving even detailed design of components to its network of suppliers. Similarly, the large automobile companies concentrate on design and assembly, leaving whole sub-assemblies to be designed and supplied by the various component manufacturers.

The GVC form of production organization and associated trade patterns have also reduced the extent of intra-firm trade, which was seen to have been a major feature of globalised trading patterns. As a result of the structural disintegration of production involving lead firms and large numbers of ostensibly independent suppliers from other countries, inter-firm trade, or seemingly arms-length transactions, is again a growing segment in international trade, although intra-firm trade tends to be the dominant, though relatively constant segment in absolute terms.

Why should we be concerned with the specific organizational form of the GVC, given that internationalization of production or in fact, the deverticalisation of production processes under the control of MNCs is not new? What follows below is a brief presentation of the argument that within the forms of production at an international level, we are witnessing,

through the organization of production of GVCs, specific forms of rent extraction and surplus maximization that occur through a combination of deverticalisation or disintegration and centralization on the other that have specific and long-lasting implications for developing countries.

First, given that developing countries have had decentralized structures of production organization in many sectors, this is considered a specific advantage that they possess and a major factor governing their incorporation into global value chains, which creates pressures to link up to GVCs even if it might not be necessary for growth in those sectors. It is argued that such incorporation allows for upgrading within the value chain and this is a sure path to economic development. For example, even in sectors where there are large and viable domestic markets, enterprises have got incorporated into value chains catering to the global market in the desire and the promise to upgrade. Evidence shows that more and more developing countries are entering manufacturing, mostly at low ends of the value chain. However, the evidence on systematic upgrading by firms in developing countries and within that, an upgrading that allows them access to a higher share of rents and even more, a retaining of those higher rents, is scanty. Thus, even with final product manufacturing capacities, the concentration of profits at the level of coordination, design, branding and marketing leaves developing country firms in a scramble to locate themselves at various points in the chain that involve only marginal upgrading of positions.

Second, as a result of this contractual incorporation into GVCs that represents the dominant form of market access, there has been a drying up of sources of independent access to foreign markets that cheap labour-intensive production allowed to small scale firms in developing countries. Such access, which came close to arms length and independent transactions in the case of several industrial clusters in developing countries, for example, also allowed for overcoming risks associated with production for volatile international markets by diversifying into domestic markets when necessary.

Third, given that disintegration of production across space allows for the utilization of segmentation in labour markets to keep labour costs at a minimum, the evidence points to a proliferation of practices in the labour market that allow for this and in fact, seek out such practices. So even in instances where there has been a move up the value chain or 'economic upgrading' for a firm or an industry, the evidence on 'social downgrading' or lowering of the conditions of labour and employment is extensive. The pervasive use of informal labour, the extension of informalised practices in production and employment to the formal sector, the use

of discriminatory criteria based on race, caste, gender and ethnicity in production for global markets signify this social downgrading.

Fourth, in theoretical terms, the dichotomy that was observed between the 'low road ' and the 'high road' to flexible production that was recorded as the crucial policy choice for developing countries as they linked up to international markets, is challenged as increasingly it is possible to upgrade conditions of production for value chains even as low road conditions are maintained in labour markets and there is pressure for labour downgrading from the high to the low ends of the chain. Countries, industries and firms thus get engaged in the race to come up with innovations in organizational and employment practices that allow for the exploitation of this 'absolute advantage' in labour costs.

Fifth, the structure of production that is tailored to the international market and for GVCs, tends to get emulated in domestic markets as well, with the same vulnerabilities and flexibilities. This is true in sectors that are export oriented as well as those that are not. This is seen in managerial practices, in reorientation of marketing setups for handloom and handicraft production and in the changes in labour markets.

Finally, the combination of deverticalisation and centralization that is seen in GVCs, involving a multitude of actual organizational forms and strategies, challenges a fundamental theoretical dichotomy between markets and hierarchies in determining industrial organizational forms.