
ISSUE BRIEF

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#10

Cluster 5: New approaches to growth and development

Global value chains for an inclusive and sustainable future

The establishment of the Global Commission on the Future of Work in August 2017 marked the start of the second phase of ILO's Future of Work Centenary initiative. The six thematic clusters provide a basis for further deliberations of the Global Commission. They focus on the main issues that need to be considered if the future of work is to be one that provides security, equality and prosperity. A series of Issue Briefs are prepared under each of the proposed clusters. These are intended to stimulate discussion on a select number of issues under the different themes. The thematic clusters are not necessarily related to the structure of the final report.

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Introduction

Increasing production in global value chains (GVCs) has transformed the world economy in the last three decades. GVCs have been an engine of growth and a significant driver of job creation, especially in the developing world. At the same time, questions have been raised as to whether participation in GVCs will continue to be a viable development strategy for inclusive growth and decent work in the future.

Production taking place in GVCs is complex and refers both to foreign direct investment by multinational enterprises in their off-shore subsidiaries and, most significantly, to outsourced production where global brands and retailers coordinate production without owning facilities. This is particularly striking in labour-intensive industries, where “manufacturers without factories” are responsible for the high-value activities (conception, design and branding of the product) while outsourcing the low value added manufacturing segments to producers typically based in developing countries. This has created challenges for industrial, employment and development policies.

The 2016 International Labour Conference debated at length the issue of decent work in global supply chains.¹ This Issue Brief focuses on the implications that participation in GVCs holds for prospects of inclusive and sustainable development. It considers future trends, including technological change and shifting consumer demand as these affect the configuration of GVCs. It then examines the types of policies that are needed to ensure that participation in GVCs contributes to economic and social development for workers, enterprises and economies.

Key findings

Technological change is expected to have a large impact on the international division of labour (see Issue Brief No. 6). However, the implications for employment, distribution and inclusion remain an open question. Participation in GVCs can be a driver of industrialization and development, facilitating structural transformation, the transfer of technology and the adoption of new production practices (ILO, 2016a; Lopez-Acevedo and Robertson, 2016).

What impact will technological change have on the international division of labour?

Technological change, including increased digitalization, automation, the use of robotics and 3D printing, poses important questions for future production in GVCs and their role in generating and sustaining employment in both developed and developing countries. There are different accounts of the potential impact that technological change is likely to have on production in GVCs.

¹ <http://www.ilo.org/ilc/ILCSessions/105/committees/supply-chains/lang--en/index.htm>.

With the introduction of new technology, including robotics and automation, labour costs become less relevant to production and offshoring less attractive. This may lead to a possible restructuring of GVCs and a reshoring of global production back towards industrialized economies (De Backer and Flaig, 2017; see also Issue Brief No. 6). This has the potential to displace large number of workers in developing countries, particularly in labour-intensive industries such as apparel and footwear and electronics assembly, industries which have served as important entry points for developing countries into global markets.

The introduction of new technologies in traditionally labour-intensive production may also have a gendered impact on employment. Women workers are typically employed in lower-skilled occupations, and as these become more technology-intensive, they also tend to become less feminized. As a result, potential job losses resulting from technological change may have a disproportionate impact on women (Kucera and Tejani, 2014).

Rising labour costs in producer countries could also drive the reshoring of production to high-income countries. However, initial estimates show that the effect of these rising labour costs is likely to be negligible (De Backer and Flaig, 2017), as wage increases are typically compensated to some extent by productivity increases. Moreover, especially for labour-intensive industries, rising labour costs in one producer location may lead to a geographical shift of production towards a lower labour cost frontier country.

While a large number of jobs, especially in light manufacturing, may feasibly be replaced by machines (Chang, Rynhart and Huynh, 2016), it may not make economic sense to do so, due to the high capital investment needed at the onset, and the continuing comparative advantage in terms of low labour costs of developing countries. Thus, economic factors may prove to be more important for robot deployment than the technical possibilities of automating workers' tasks (UNCTAD, 2017). As a result, the organization of production through offshoring to low labour cost locations is likely to continue. This is particularly relevant in sectors such as apparel, where technology has yet to provide an answer to the specific labour intensity of the production process (Kucera, forthcoming).

Significant technological bottlenecks remain and it will still be necessary to demonstrate that the use of new automation technologies will be as profitable, if not more, than conventional alternatives for production. In business process outsourcing, particularly in the case of call centres, consumers continue to prefer human-to-human interaction over interactive voice response (IVR) technology. Thus in services, consumer preferences and operational costs will continue to determine the degree to which services are automated (ILO, forthcoming).

There is little evidence of significant reshoring of production at present (Cohen et al., 2016; De Backer et al., 2016; UNCTAD, 2016). However, technological change is proceeding apace in both robotics and 3D printing, with significant new developments announced each year. Thus, even though we may not yet have witnessed significant reshoring, the arguments for reshoring are compelling. These include the potential for reduced transport costs and delivery times, less surplus inventory sold at discounts as production becomes more just-in-time, closer proximity to designers, improved product quality, reduced corporate social responsibility risk and improved brand image. The influence of fast-fashion has been important in this regard, with business models, in Europe at least, increasingly being based on production in low-cost regions within the European Union as well as nearby countries like Morocco and Turkey.

Should reshoring become a significant trend, developing countries will be faced with a new set of challenges, including the need to strengthen skills policies so that workers are employable in other activities, and to increase aggregate demand to offset the resultant decline in foreign direct investment. A significant challenge will be whether and how low-income countries will be able to improve their working conditions in the face of competition not just from other low-income countries, but also from robotics in high-income countries. Low-income countries may also need to consider reorienting production towards markets in middle-income countries in their own regions, thus addressing concerns about transport costs and delivery times that motivate reshoring. Some technological advancements may also create new opportunities, by easing communications across locations through email, sensors, electronic data collection, and creating online collaborative spaces (World Bank, 2016).

Will participation in global value chains remain a viable development strategy in the future?

Enterprises, as well as countries, can benefit from participation in GVCs through spill-overs in skills, learning and know-how, and improvements in work processes and technology. Participation in GVCs offers opportunities for developing countries to participate in global markets, enabling them to diversify exports. They can be an important vector for inclusive growth. At the same time, research shows that in GVCs where competition is high and price-driven, returns for suppliers are likely to be low and/or decrease over time. There is a risk that the entry of new low-wage producers will precipitate a downward spiral of competition, in which increases in exports produce ever-diminishing returns (Kaplinsky, 1998; UNCTAD, 2013).² Under this scenario, the potential social gains that arise from an increase in exports will be more than offset by lower prices.

For participation in GVCs to contribute to development and decent work, suppliers need to upgrade and move into higher value added activities, thus increasing the benefits or profits derived from participation in them (Gereffi, 2005). They might do this by shifting into value added manufacturing products that demand a higher price (e.g. moving from agricultural exports into frozen foods and canning in the food industry), or acquiring new functions (e.g. design and marketing competencies). Making this shift may be difficult when markets for higher value added products are dominated by a few large companies (Schmitz and Knorringa, 1999).

From a development policy perspective, efforts to forge an inclusive growth path through participation in the global market are likely to require a mix of national policies aimed at entering GVCs, expanding and strengthening participation by moving into higher value added production, and ensuring that this contributes to sustainable long-term development (Taglioni and Winkler, 2016). This policy mix includes investment promotion measures, strengthened customs, transport and telecommunications infrastructure, focus on skills development including through vocational training, industrial policies aimed at product and task diversification and competition policy (Cattaneo et al., 2013). An effective regulatory framework for labour standards and the monitoring of compliance is also important to ensure that social and economic development go hand in hand (see Issue Brief No. 11). To ensure that producer firms and countries can move up the value chain, a strong link needs to be fostered between enterprises participating in GVCs and the local economy, for example through backward and forward linkages with domestic firms, and through the diffusion of knowledge, technology and know-how from

² Bhagwati (1958) theorized that a rapid increase in exports of labour-intensive products involves a potential risk that the terms of trade decline to such an extent that the benefits of any increased volume of exports may be more than offset by losses due to lower export prices, giving rise to "immiserizing growth".

foreign investors. Local content requirements can also stimulate the use of domestically produced renewable energy and thus domestic job creation in the green economy.

However, conditions that facilitate diffusion, learning and upgrading in GVCs are not always present. For example, upgrading processes present considerable challenges in terms of skills gaps in the domestic economy, intellectual property rights and global brands' concerns that suppliers are encroaching on their core competencies (such as marketing and product development) (Schmitz and Knorringa, 1999).

The degree to which participation in GVCs represents a viable path for sustainable development and the structural transformation of the economy raises the question as to whether there is sufficient international policy space for the adoption of industrial policies that might foster linkages with the local economy. Developed and developing countries deployed a range of industrial policies in the past to accelerate their own industrial development, often with considerable sophistication, as in the case of East Asian economies such as Japan, Republic of Korea, Singapore and Taiwan, China. Local content requirements can stimulate the use of domestically produced renewable energy and thus domestic job creation in the green economy. Today, multilateral trade agreements as well as many bilateral and regional trade and investment agreements might constrain the capacity of developing countries to use these policies in supporting economic development (UNCTAD, 2014).

These complex challenges raise a more fundamental question: what will the future path of industrialization and development be for developing countries? Traditional paths to development which rely heavily on export-oriented manufacturing are being questioned, as developing countries find it increasingly difficult to participate in manufacturing-led development (Hallward-Driemeier and Nayyar, 2017). In addition, the job creation capacity of manufacturing has been weakened in recent years and many developing countries are showing signs of “premature deindustrialization” (Fontagné and Harrison, 2017). The current projection suggests that their manufacturing employment share is unlikely to increase and the development path and process of structural transformation is likely to be very different to that taken by developed countries in the past (ILO, 2018). While some are cautious about this prospect, other experts are calling for new approaches to development which place emphasis on the service sector. For instance, Rodrik (2017) argues that the manufacturing-centred model should be replaced by “massive economy-wide investments in human capital and institutions” with particular focus on comprehensive reforms “targeting productivity growth in all services” (pp. 92–93).

Some considerations

The introduction of new technology will change the configuration of sourcing patterns in GVCs and is expected to have a significant impact on jobs in developed and developing economies alike. Participation in GVCs in the future may not bring the “development dividends” that it has delivered in the past. This poses significant questions:

- What policies are needed so that developing economies can harness the potential brought about by digitalization and technological change?
- What policy mix is needed to ensure that participation in GVCs contributes to sustainable development? What industrial and development policies can be used at the national level to support entrepreneurship and enable technology spill-overs and skill development, strengthening backward linkages to domestic economies in producer countries?
- What can be done to ensure that there is sufficient international policy space for the types of industrial policies that can facilitate sustainable development?



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